

HSBC HOLDINGS PLC
Form 20-F
February 28, 2014
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As filed with the Securities and Exchange Commission on February 28, 2014.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

Or

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

For the fiscal year ended December 31, 2013

Or

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

Or

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

Date of event requiring this shell company report _____

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

Commission file number: 001-14930

HSBC Holdings plc

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(Exact name of Registrant as specified in its charter)

<p>N/A (Translation of Registrant's name into English)</p>	<p>United Kingdom (Jurisdiction of incorporation or organisation)</p>
	<p>8 Canada Square</p> <p>London E14 5HQ</p> <p>United Kingdom</p>
	<p>(Address of principal executive offices)</p> <p>Russell C Picot</p> <p>8 Canada Square</p> <p>London E14 5HQ</p> <p>United Kingdom</p> <p>Tel +44 (0) 20 7991 8888</p> <p>Fax +44 (0) 20 7992 4880</p>
	<p>(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)</p>

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

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

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6.5% Subordinated Notes 2037	New York Stock Exchange
6.8% Subordinated Notes Due 2038	New York Stock Exchange
6.100% Senior Unsecured Notes due 2042	New York Stock Exchange
8.125% Perpetual Subordinated Capital Securities	New York Stock Exchange

Exchangeable at the Issuer's Option into Non-

Cumulative Dollar Preference Shares	
8.00% Perpetual Subordinated Capital Securities	New York Stock Exchange

Exchangeable at the Issuer's Option into Non-

Cumulative Dollar Preference Shares, Series 2
 Securities registered or to be registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

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

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

Ordinary Shares, nominal value US\$0.50 each	18,830,007,039
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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>
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Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP <input type="checkbox"/>	International Financial Reporting Standards as issued by the International Accounting Standards Board <input type="checkbox"/>	Other <input type="checkbox"/>
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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.

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 p No

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

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HSBC HOLDINGS PLC

Annual Report and Accounts 2013

Certain defined terms

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

Financial statements

The consolidated financial statements of *HSBC* and the separate financial statements of *HSBC Holdings* have been prepared in accordance with International Financial Reporting Standards (*IFRSs*) as issued by the International Accounting Standards Board (*IASB*) and as endorsed by the European Union (*EU*). *EU*-endorsed *IFRSs* could differ from *IFRSs* as issued by the *IASB* if, at any point in time, new or amended *IFRSs* were not to be endorsed by the *EU*. At 31 December 2013, there were no unendorsed standards effective for the year ended 31 December 2013 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 2013 are prepared in accordance with *IFRSs* as issued by the *IASB*.

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

When reference to *underlying* is made in tables or commentaries, the comparative information has been expressed at constant currency (see page 47), the impact of fair value movements in respect of credit spread changes on *HSBC*'s own debt has been eliminated and the effects of acquisitions, disposals and dilutions have been adjusted as reconciled on page 50. *Underlying return on risk-weighted assets (RoRWA)* is defined and reconciled on page 71.

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HSBC HOLDINGS PLC

Strategic Report

Who we are

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

Customers:

54 million

Served by:

254,000 employees

Through four global businesses:

Retail Banking and Wealth Management

Commercial Banking

Global Banking and Markets

Global Private Banking

Located in:

75 countries and territories

Across six geographical regions:

Europe

Hong Kong

Rest of Asia-Pacific

Middle East and North Africa

North America

Latin America

Offices:

Over 6,300

Global headquarters:

London

Market capitalisation:

US\$207 billion

Listed on stock exchanges in:

London

Hong Kong

New York

Paris

Bermuda

Shareholders:

216,000 in 131 countries and territories

Cover images: internationalisation of the renminbi

The images show the views from HSBC's head offices in Shanghai, Hong Kong and London – the three cities that are key to the development of China's currency, the renminbi (RMB). The growth of the RMB is set to be a defining theme of the 21st century. HSBC has RMB capabilities in over 50 countries and territories worldwide, where our customers can count on an expert service.

Our purpose

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

Our strategic priorities

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

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

grow the business and dividends;

implement Global Standards; and

streamline processes and procedures.

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

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

How we measure performance

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

Rewarding performance

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

For further information on HSBC Values, see page 25.

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Strategic Report (continued)

Highlights of 2013

- Ø Profit before tax was up 9% to US\$22.6bn on a reported basis. Underlying profit before tax was up 41% to US\$21.6bn.

- Ø Considerable progress in delivering on strategic priorities including the disposal or closure of a further 20 businesses and non-core investments announced in 2013, helping make HSBC easier to manage and control.
- Ø Reinforced HSBC's position as one of the best-capitalised banks in the world. Based on our current understanding of capital rules, we remain well-placed to meet expected future capital requirements.

- Ø Dividends to shareholders increased to US\$9.2bn as capital strength creates capacity for organic growth and allows us to increase the dividends paid.

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

For footnotes, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Cautionary statement regarding forward-looking statements

The *Annual Report and Accounts 2013* contains certain forward-looking statements with respect to HSBC's financial condition, results of operations, capital position and business.

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

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

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

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

Group Chairman's Statement

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

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

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

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

Performance in 2013

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

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

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

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

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

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

Once again in 2013, the British Government increased the rate of the bank levy imposed on the consolidated balance sheets of UK domiciled banks and expanded the scope of the levy. This increased the cost to HSBC in 2013 by US\$321 million, taking the levy for the year to US\$904 million, of which US\$484 million related to non-UK banking activity. The impact of the levy represented US\$0.05 per share

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HSBC HOLDINGS PLC

Strategic Report (continued)

which would otherwise have been available for distribution to shareholders or retained to strengthen the capital base or support incremental growth.

Global Standards and regulatory change

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

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

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

Responding to heightened standards

Sustainable success in banking is founded upon meeting the expectations of society. Fundamentally, this means delivering transparent and fair outcomes to our customers. It also means avoiding any perception of self-interest by ensuring there is a proper division of value between providers and consumers of financial products and services. While regulatory changes seek to address the framework supporting these outcomes, responsibility and accountability rest with the industry itself, and ultimately with the management and boards of individual institutions. We understand this and strive to be seen as proactively responsive to rising expectations. We made good progress in 2013 in this regard. In particular, we redesigned the compensation frameworks in Retail

Banking and Wealth Management around the customer, so that from the start of 2014 we have removed the link between financial reward opportunity and product sales for substantially all of our staff in our retail and wealth businesses. We have also stepped up the Board's governance oversight over conduct and behavioural issues, and I deal with this later.

Board changes

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

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

In his time on the Board, in addition to his measured contributions to Board discussions, John has brought a wealth of business and financial experience and expertise to the Group Audit Committee, which latterly he chaired, and to the Group Risk and Remuneration Committees. In

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these roles he has taken on a considerable workload and critical responsibilities throughout periods of significant economic and market uncertainty and major regulatory change. Upon his retirement it is proposed that John will be succeeded in his role as Chair of the Group Audit Committee by Renato Fassbind.

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

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

Governance changes

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

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

Looking forward

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

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

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

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

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

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

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

detail of that strategy.

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

D J Flint, *Group Chairman*

24 February 2014

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HSBC HOLDINGS PLC

Strategic Report (continued)

Group Chief Executive's Review

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

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

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

We have transformed the way that we run the business, exerting pressure on costs and making it easier to manage and control. We have installed consistent business models, reshaped global businesses and global functions, and removed layers of management to give staff greater responsibility, improve decision making and remove bureaucracy. The number of full-time equivalent employees has been reduced from 295,000 at the start of 2011 to

254,000 at the end of 2013, primarily through disposals and our cost-reduction programmes. We achieved an additional US\$1.5bn of sustainable cost savings bringing our total annualised sustainable cost savings to US\$4.9bn since 2011. This comfortably exceeded our target of US\$2.5-3.5bn and provides good momentum into 2014. On a constant currency basis and excluding UK customer redress and restructuring costs, operating expenses in 2013 were broadly flat compared to 2010. This demonstrates the impact of our sustainable cost savings and business disposals in broadly offsetting cost increases, which came primarily from inflationary pressures, the UK bank levy and investment in risk and compliance, as well as business initiatives.

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

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

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

Performance

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

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

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

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

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

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

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

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

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

Strategy next phase

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

thus reduce the impact of our portfolio of legacy businesses.

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

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

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

Outlook

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

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

S T Gulliver, *Group Chief Executive*

24 February 2014

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HSBC HOLDINGS PLC

Strategic Report (continued)**Value creation and long-term sustainability**

<u>How we create value</u>	9	Through our principal activities – making payments, holding savings, providing finance and managing risks – we play a central role in society and in the economic system. Our target is to build and maintain a business which is sustainable in the long term.
<u>Long-term sustainability</u>	10	
<u>Our strategy</u>	11	
<u>Our strategic priorities</u>	12	

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

How we create value

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

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

We also offer additional financial products and services including broking, asset management, financial advisory, life insurance, corporate finance, securities services and alternative investments. We make markets in financial assets so that investors have confidence in efficient pricing and the availability of buyers and sellers. We provide these products for clients ranging from governments to large and mid-market corporates, small and medium-sized enterprises, high net worth individuals and retail customers. We help customers raise financing from

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external investors in debt and equity capital markets. We create liquidity and price transparency in these securities allowing investors to buy and sell them on the secondary market. We exchange national currencies, helping international trade.

Value creation

Our main products and services are described in more detail on page 79.

Our operating income is primarily derived from:

net interest income interest income we earn on customer loans and advances and on our surplus funds, less interest expense we pay on interest-bearing customer accounts and debt securities in issue;

net fee income fee income we earn from the provision of financial services and products to customers less fees we pay; and

net trading income income from client driven trading activities primarily conducted in Markets, including Foreign Exchange, Credit, Rates and Equities trading.

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

using forward foreign currency contracts to hedge their income from export sales or costs of imported materials;

using an inflation swap to hedge future inflation-linked liabilities, for example, for pension payments;

transforming variable payments of debt interest into fixed rate payments, or vice versa; or

providing investors with hedges against movements in markets or particular stocks.

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

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

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

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

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

Long-term sustainability

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

profitable.

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

Our strategy

Long-term trends

Our strategy is aligned to two long-term trends:

The world economy is becoming ever more connected, with growth in world trade and cross-border capital flows continuing to outstrip growth in average gross domestic product. Over the next decade we expect 35 markets to generate 90% of world trade growth with a similar degree of concentration in cross-border capital flows.

Of the world's top 30 economies, we expect those of Asia-Pacific, Latin America, the Middle East and Africa to have increased by around four-fold in size by 2050, benefiting from demographics and urbanisation. By this time they will be larger than those of Europe and North America combined. By 2050, we expect 18 of the 30 largest economies will be from Asia-Pacific, Latin America or the Middle East and Africa.

Competitive advantages

What matters in this environment are:

having an international network and global product capabilities to capture international trade and movements in capital; and

being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest. HSBC's competitive advantages come from:

our meaningful presence in and long-term commitment to our key strategic markets;
our strong ability to add to our capital base while also providing competitive rewards to our staff and good returns to our shareholders;

our stable funding base, with about US\$1.5 trillion of customer accounts of which 73% has been advanced to customers;

our business network, which covers over 90% of global trade and capital flows; and

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our local balance sheet strength and trading capabilities in the most relevant financial hubs.
A two-part strategy

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

A network of businesses connecting the world. HSBC is well positioned to capture growing international trade and capital flows. Our global reach and range of services place us in a strong position to serve clients as they grow from small enterprises into large multi-nationals through our Commercial Banking and Global Banking & Markets businesses.

Wealth management and retail with local scale. We will capture opportunities arising from social mobility and wealth creation in our priority growth markets across Asia-Pacific, Latin America and the Middle East, through our Premier proposition and Global Private Banking business. We will invest in full scale retail businesses only in markets where we can achieve profitable scale, namely in our home markets of the United Kingdom and Hong Kong.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Our strategic priorities

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

Grow

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

Implement

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

Streamline

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

Strategic priority 1

Grow the business and dividends

<u>Business model</u>	13	Our targets are to:
<u>Operating model</u>	14	
<u>Financial performance</u>	16	1. grow risk-weighted assets (RWA s) in line with our organic investment criteria;
		2. progressively grow dividends and introduce share buy-backs as appropriate; and
		3. reduce the effect of legacy and non-strategic activities on our profit before tax and RWAs.

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

Business model

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

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

The UK and Hong Kong are our home markets, and a further 20 countries form our priority growth markets (see table below). These 22 markets accounted for over 90% of our profit before tax in 2013, and are the primary focus of capital deployment. Network markets are markets with strong international relevance which serve to

complement our international spread, operating mainly through Commercial Banking and Global Banking and Markets. Our combination of home, priority growth and network markets covers around 85-90% of all international trade and financial flows.

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

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

HSBC's market

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HSBC HOLDINGS PLC

Strategic Report (continued)

Operating model

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

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

Holding company

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

Under authority delegated by the Board of HSBC Holdings, the Group Management Board (GMB) is responsible for the management and day-to-day running of the Group, within the risk

appetite set by the Board. GMB works to ensure that there are sufficient cash resources to pay dividends to shareholders, interest to bondholders, expenses and taxes.

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

Matrix management structure

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

For details of our principal subsidiaries see Note 24 on the Financial Statements. A simplified Group structure chart is provided on page 570.

Matrix management structure

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HSBC HOLDINGS PLC

Strategic Report (continued)

Global businesses

Our four global businesses are Retail Banking and Wealth Management (RBWM), Commercial Banking (CMB), Global Banking and Markets (GB&M) and Global Private Banking (GPB). They are responsible for developing, implementing and managing their business propositions consistently across the Group, focusing on profitability and efficiency. They set their strategies

within the parameters of the Group strategy in liaison with the geographical regions, are responsible for issuing planning guidance regarding their businesses, are accountable for their profit and loss performance, and manage their headcount.

The main business activities of our global business are summarised below, and their products and services on page 79.

Main business activities by global business and reported revenue⁵ in 2013

For footnotes, see page 46.

Investment criteria

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

Decisions over where to invest additional resources have three components:

Strategic – we will only invest in businesses aligned to our strategy, mostly in our 22 home and priority growth markets and in target businesses and clients;

Financial – the investment must be value accretive for the Group, and must meet minimum returns, revenue and cost hurdles; and

Risk – the investment must be consistent with our risk appetite.

Using the six filters in decision-making

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HSBC HOLDINGS PLC

Strategic Report (continued)**Financial performance**

Performance reflected underlying momentum in areas of targeted investment

Reported results

	2013	2012	2011
	US\$m	US\$m	US\$m
Net interest income	35,539	37,672	40,662
Net fee income	16,434	16,430	17,160
Other income	12,672	14,228	14,458
Net operating income⁵	64,645	68,330	72,280
LICs ¹²	(5,849)	(8,311)	(12,127)
Net operating income	58,796	60,019	60,153
Total operating expenses	(38,556)	(42,927)	(41,545)
Operating profit	20,240	17,092	18,608
Income from associates ¹³	2,325	3,557	3,264
Profit before tax	22,565	20,649	21,872

For footnotes, see page 46.

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

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

Underlying performance

For further information on non-GAAP financial measures, see page 47.

From reported results to underlying performance

To arrive at underlying performance,

we adjust for the year-on-year effects of foreign currency translation;

we eliminate the fair value movements on our long-term debt attributable to credit spread (own credit spread) where the net result of such movements will be zero upon maturity of the debt; and

we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates and businesses, by eliminating the gain or loss on disposal in the year incurred and removing the operating profit or loss of the acquired and disposed of businesses from all years presented. Reconciliations of our reported results to an underlying basis are provided in the Form 20-F filed with the Securities and Exchange Commission which is available on www.hsbc.com.

Underlying profit before tax
(US\$bn)

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

Earnings per share
(US\$)

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

The following commentary is on an underlying basis.

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

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

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

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

Underlying LICs were US\$1.9bn or 25% lower than in 2012, primarily in North America where the decline was, in part, due to improvements in housing market conditions, reduced lending balances from continued portfolio run-off and loan sales, and lower levels of new impaired loans and delinquency in the CML portfolio. LICs were also lower in

Europe, mainly in GB&M and CMB, and in the Middle East and North Africa, which benefited from an overall improvement in the loan portfolio. By contrast, LICs were higher in Latin America, particularly in Mexico from specific impairments in CMB relating to homebuilders due to a change in the public housing policy and higher collective impairments in RBWM. In Brazil, although credit quality improved following the modification of credit strategies in previous periods to mitigate rising delinquency rates, LICs increased, reflecting impairment model changes and assumption revisions for restructured loan account portfolios in RBWM and CMB, and higher specific impairments in CMB.

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

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

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

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

For more details of the Group's financial performance, see page 51.

Balance sheet strength

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

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

For further information on the Balance Sheet, see page 65, and on the Group's liquidity and funding, see page 213.

Total assets

Post-tax return on average total assets

(US\$bn)

(%)

Loans and advances to

Customer accounts¹⁴

Ratio of customer advances to customer

customers¹⁴ (US\$bn)

(US\$bn)

deposits (%)

For footnote, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)**Capital strength**

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

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

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

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

Leverage ratio

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

Estimated leverage ratio

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

For further details of the leverage ratio, see page 312.

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

For further information on the Group's capital and our risk-weighted assets, see page 298.

Core tier 1 ratio¹

Total capital ratio

Common equity tier 1 ratio¹⁵

(%)

(%)

(%)

For footnotes, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Meeting our targets

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

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

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

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

Progressively grow dividends and introduce share buy-backs as appropriate

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

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

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

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

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

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

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

Risk-weighted assets (US\$bn)

Return on risk-weighted assets (%)

Dividend payout ratio (%)

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Strategic Report (continued)

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

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

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

Brand value

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

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

Brand value (US\$bn)

In addition to the Brand Finance measure, we have reviewed our performance in two other rating agency evaluations that receive substantial public

coverage. In the Brand Z Most Valuable Global Brand tables published in the *Financial Times* in May 2013, we achieved first place in the International Banks peer grouping with a valuation of US\$24bn (up 24% from 2012). The *Interbrand* Annual Best Global Brands report, published in September 2013, showed HSBC as the top ranked banking brand with a valuation of US\$12bn (up 7% from 2012) and in second place when all financial services brands are considered.

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

Economic contribution

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

HSBC has adopted the UK Code of Practice for the Taxation of Banks and seeks to apply the spirit as well as the letter of the law in all the territories in which we operate. In January 2013, the Global Standards Steering Meeting of the GMB agreed terms of a new Global Standard on tax transparency to ensure that HSBC's banking services are not associated with any arrangements that are known or suspected to be designed to

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facilitate tax evasion by a customer.

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

HSBC's net tax paid

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

For footnote, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)*Distribution of economic benefits*

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

Pro-forma post-tax profit allocation¹⁷

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

*For footnote, see page 46.***Market capitalisation and total shareholder return**

US\$0.50 ordinary shares in issue	Market capitalisation	Closing market price		
		London	Hong Kong	American Depository Share ¹⁸
18,830m	US\$207bn	£6.62	HK\$84.15	US\$55.13
		2012: £6.47	2012: HK\$81.30	
2012: 18,476m	2012: US\$194bn	2011: £4.91	2011: HK\$59.00	2012: US\$53.07

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2011: 17,868m

2011: US\$136bn

2011: US\$38.10

	Over 1 year	Total shareholder return¹⁹ Over 3 years	Over 5 years
To 31 December 2013	107	118	144
Benchmarks:			
FTSE 100 ¹	119	128	183
MSCI World ²	127	141	207
MSCI Bank ³	125	132	186

For footnotes, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Strategic priority 2

Implement Global Standards

<u>HSBC Values</u>	25	Our target is to make significant progress in implementing Global Standards for the benefit of HSBC and the financial system as a whole.
<u>Governance</u>	25	
<u>Employees</u>	27	

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

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

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

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

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

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

We see the implementation of Global Standards

as a source of competitive advantage. Global Standards allow us to:

strengthen our response to the ongoing threat of financial crime;

make consistent and therefore simplify the ways by which we monitor and enforce high standards at HSBC;

strengthen policies and processes that govern how we do business and with whom; and

ensure that we consistently apply our HSBC Values.

Implementing Global Standards

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

Governance framework

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

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

The process of embedding Global Standards and the supporting controls and capabilities that allow the business to identify and mitigate financial crime

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HSBC HOLDINGS PLC

Strategic Report (continued)

risk is underway and will continue in 2014 and beyond. The implementation programme is focused on the following four areas:

data readiness: creating a complete, cleansed data set to improve our understanding of the customer base and facilitate our financial crime risk assessment. This will provide the basis for transaction monitoring and assist capacity planning to improve the quality and efficiency of our KYC activities.

customer due diligence: strengthening the rigour with which we research and evaluate our customers and affiliates to better understand them and their activities; improving KYC profiling through enhanced due diligence, customer identification, screening and financial crime risk scoring; tightening our controls around tax transparency and bearer shares and putting a global customer selection and exit policy in place.

financial crime compliance: building HSBC's Financial Crime Compliance organisation with the right people and capabilities to support the business; developing global policies for anti-money laundering (AML), sanctions and anti-bribery and corruption and enhancing the monitoring, screening and testing that will allow us to manage financial crime risk more effectively; and designing a new, annual HSBC-wide risk assessment to better understand the financial crime risk we carry in the business and determine the best approach to managing it.

financial intelligence: establishing a new global network of Financial Intelligence Units that use cutting edge technology to identify and investigate significant cases, trends and strategic issues related to financial crime risks.
Changes in day-to-day activities

Risk appetite

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

Enterprise-wide risk assessment

We completed enterprise-wide assessments of our

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

Incentives

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

Organisation

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

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

The Monitor

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

Michael Cherkasky began his work as the Monitor on 22 July 2013, charged with evaluating and reporting upon the effectiveness of the Group s internal controls, policies and procedures as they relate to ongoing compliance with applicable AML, sanctions, terrorist financing and proliferation financing obligations, over a five-year period.

The Monitor s work is proceeding as anticipated, consistent with the timelines and requirements set forth in the relevant agreements.

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

HSBC Values

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

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

HSBC Values

Be dependable and do the right thing

stand firm for what is right, deliver on commitments, be resilient and trustworthy;

take personal accountability, be decisive, use judgement and common sense, empower others.

Be open to different ideas and cultures

communicate openly, honestly and transparently, value challenge, learn from mistakes;

listen, treat people fairly, be inclusive, value different perspectives.

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

build connections, be externally focused, collaborate across boundaries;

care about individuals and their progress, show respect, be supportive and responsive.

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

Business principles

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

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

business responsibly and consistently adhere to HSBC Values.

Business principles

Financial strength maintain capital strength and liquidity

Risk-management be enterprising and commercial, understand and be accountable for the impact of our actions, take prudent decisions

Speed be fast and responsive, make principles-led decisions

Performance-focus drive leading, competitive levels of performance, act with urgency and intensity, prioritise, simplify

Efficiency focus on cost discipline and process efficiency

Quality pursue excellence

Customer-focus provide outstanding customer experience

Integrated align the Group and break down silos

Sustainability take a long-term outlook, understand impact of actions on stakeholders, brand and reputation

Governance

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

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

Role of the Board and Committees

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

GMB executive committees

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

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Strategic Report (continued)

The committee structure and governance framework of the HSBC Holdings Board

For footnotes, see page 46.

The terms of reference of the principal non-executive Board committees are available at [www.hsbc.com/ boardcommittees](http://www.hsbc.com/boardcommittees).

For further details on Group corporate governance, see page 329.

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Strategic Report (continued)

Employees

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

We aim to attract, retain and motivate the very best people, and our remuneration policy supports this endeavour.

We actively manage succession planning by defining the capabilities we need and complementing this by identifying talented individuals and ensuring they are provided with appropriate career and development opportunities to fulfil their potential in HSBC.

We provide training and development opportunities to enable employees to acquire the technical and leadership skills needed to enhance their careers.

We are committed to a diverse and inclusive culture reflective of our customer base.

We encourage employees to engage in the local communities in which they work.

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

Profile of leadership

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

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

Employment proposition

HSBC Values

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

Employee development

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

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

Employee engagement

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

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

The overall engagement score in 2013 was 68%, which was four points ahead of the financial services industry norm and eight points behind the best-in-

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Strategic Report (continued)

class benchmark. Strong scores were registered in risk awareness (81% and nine points above best-in-class), leadership capability (67%) and living the HSBC Values (77%). Employee development significantly improved from six points below best-in-class in 2011 to three points above in 2013. Aspects that require attention included pride and advocacy, which were 12 and 13 points, respectively, below best-in-class norms and had fallen from 2011 levels.

Succession planning

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

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

Diversity and inclusion

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

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

of Group People/Diversity Committees. We have over 55 employee network groups representing gender, ethnicity, age, sexuality, disability, religion, culture, working parents, health and community volunteering. These groups are instrumental in driving an inclusive culture and maintaining effective dialogue between management and employees.

Gender balance

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

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

Gender balance

Male	Female	Total
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Executive Directors	3		3
Non-executive Directors	9	4	13
Directors	12	4	16
Senior employees	6,339	1,867	8,206
Other employees	118,981	135,714	254,695
Total	125,331	137,585	262,916

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

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

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

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Unconscious bias

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

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

Health, welfare and safety

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

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

Whistleblowing

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

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

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

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Strategic Report (continued)

Strategic priority 3

Streamline processes and procedures

<u>Operational performance</u>	34	Our aim is to achieve a cost efficiency ratio in the mid 50 s.
<u>Customers</u>	31	
<u>Environmental, social and community obligations</u>	34	

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

Operational performance

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

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

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

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

Sustainable savings 2011 to 2013

US\$bn

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

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

people and structure we implemented an 8x8 reporting structure, moved to a global operating model, and defined and introduced target business models across all global businesses and functions;

software development we improved software development productivity and shifted the mix of employees towards lower-cost locations;

process optimisation we improved the efficiency of our operational activities such as contact centres (including offshoring), trade and payments services; and

corporate real estate we rationalised our property portfolio by leasing and launching facilities management initiatives.

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

propositions, and sales channels;

processes and servicing channels, including production management, multi-channel servicing, operational processes and the locations of activities; and

infrastructure, including real estate, technology, supplier management and global functions.

Streamlining will be achieved through a combination of simplifying and globalising our processes, products, systems and operations.

Simplifying involves identifying inefficiencies or excessive complexity and redesigning or rationalising processes to make them easier to understand and manage and more efficient. *Globalising* involves developing standard global processes and implementing them around the Group with minimal local variations.

Cost efficiency ratio

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

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Strategic Report (continued)

Customers

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

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

Customer service and satisfaction

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

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

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

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

We have conducted over 2,500 interviews with our Corporate Banking customers and over 6,000 interviews in our Business Banking customers. These interviews allow us to build an overall score

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

Retail Banking and Wealth Management

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

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

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

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

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

We have undertaken a full review of all our products in RBWM, and are standardising our offering across all categories. Products are assessed on grounds of fairness and transparency before being approved. For example, in the UK, we made money management easier by simplifying automated teller machine (ATM) withdrawals, we improved our branch infrastructure to enable customers to reset their telephone security at the branches and we

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updated our on-line avatar, Ask Olivia, so that customers can easily get online answers to questions about error codes on their secure key. In Vietnam, an SMS Alert message will now be sent to a customer's registered mobile phone number as soon as they complete a credit card transaction, preventing fraud and helping to protect our credit cardholders.

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

Interacting with customers

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

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

Supporting home ownership

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

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

award for Best Bank Mortgage Provider for the fifth year running.

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

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

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

Supporting customers in financial difficulty

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

Across Europe, frontline specialists were trained to offer an income and expenditure review for customers who are likely to face difficulty in making repayments to HSBC in the near future. We also eliminated certain current account charges in the UK (unpaid transaction fees). We

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updated our restructure and payment programme suites in the Middle East and Mexico while collaborating with charities, associations and government loan relief programmes in the US, Canada and France. In the Philippines, we offer a General Restructuring Facility as a restructuring programme for both non-delinquent and delinquent customers, and responded to Typhoon Haiyan with targeted payment holidays to credit card customers affected by the catastrophe. In Australia, we offered hardship relief on mortgage repayments to customers affected by bushfires in New South Wales.

Commercial Banking

Supporting small and medium-sized entities

To help our customers find the right financial solutions to succeed in the global economy, we launched a series of funds to support SMEs that trade or aspire to trade internationally. We launched SME funds in the UK, France and Mexico in the first

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half of 2013 and in the US and Canada in the second half of the year. The latter two were of US\$1bn each. We also launched our fourth SME fund in the UAE of AED1bn (US\$272m) for international trade customers.

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

Interacting with customers

In 2013, our CEP undertook over 10,000 customer interviews in 15 of CMB's priority markets. The programme gives customers the opportunity to share their views, and demonstrates that HSBC is listening and actively working to improve our ability to support customers with global operations.

We are enhancing our customers' account opening experience, enabling it to take place anytime anywhere, provided we can fulfil regulatory and Group KYC requirements. At the end of 2013, we launched a multi-channel business account opening tool in the UK for customers who wish to open accounts using online channels or call centres without visiting a branch.

In Hong Kong, in the fourth quarter of 2013, we made *iPads* available in Business Banking centres to enable customers to register for internet banking at the time of account opening.

We are expanding the servicing and transaction options available on our international online platform, HSBCnet, to better cater for the requirements of businesses of different sizes and needs. In addition to our payments and cash management HSBCnet package, which is available in all markets, we launched domestic and international HSBCnet packages in our top 12 markets during 2013.

Relationship managers now update and validate customer information through regular routine discussions.

Significant training is being provided for staff, including around the use of tools to help them support customers in completing required customer due diligence information.

New renminbi products and services

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

offer an automated foreign currency cross-border sweeping structure in mainland China to help multinationals optimise the use of internal funding by consolidating their liquidity positions onshore and offshore;

pilot foreign currency cross-border netting in mainland China, enabling multinationals to offset foreign currency payables and receivables between Chinese subsidiaries and netting centres overseas. The product allows companies to reduce inter-company transactions while lowering processing costs and currency risk exposure; and

implement a tailor-made renminbi cross-border centralised payments and collections settlement product in mainland China. This eliminates foreign exchange exposure and optimises working capital management for companies.

For further information on the products and services we offer, see page 79.

Client selection

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

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

Our risk profile is described on page 134.

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Environmental, social and community obligations

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

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

Human rights

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

Our sustainability risk framework

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

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

Our approach to managing sustainability risk is described on page 297.

Climate business

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

Our sustainable operations strategy

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

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

To incorporate all of the operations over which we have financial (management) control, the

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

Carbon dioxide emissions in tonnes

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

Carbon dioxide emissions in tonnes per FTE

	2013	2012
Total	3.43	3.61
From energy	2.91	3.09
From travel	0.52	0.52

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

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

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

Our 10-point sustainable operations strategy

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

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

Community investment

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

Youth education

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

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

Staff volunteering

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

HSBC Water Programme

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

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Risk overview

<u>Risk and our strategic priorities</u>	36	Our risk profile is underpinned by our core philosophy of maintaining a strong balance sheet and liquidity position, and capital strength.
<u>Risk in 2013</u>	36	
<u>Top and emerging risks</u>	37	
<u>How we manage risk</u>	39	
<u>How risk affects our performance</u>	41	

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

Risk and our strategic priorities

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

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

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

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

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around US\$90bn in risk-weighted assets to date.

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

Risk in 2013

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

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

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

we repositioned certain portfolios through our six filters process (see page 15) and our focus on certain products or customer segments;

we made our client selection filters more robust in managing the risk of financial crime; and

we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite. The diversification of our lending portfolio across global businesses and regions, together with our broad range of products, ensured that we were not overly dependent on a limited number of countries or markets to generate income and growth.

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

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

For footnotes, see page 46.

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Risks incurred in our business activities

Our principal banking risks are credit risk, liquidity and funding risks, market risk, operational risk, compliance risk, fiduciary risk, reputational risk pension risk and sustainability risk. We also incur insurance risk. The chart below provides a

high level guide to how our business activities are reflected in our risk measures and in the Group's balance sheet. The third-party assets and liabilities indicate the contribution each business makes to the balance sheet, while RWAs illustrate the relative size of the risks incurred in respect of each business.

For a description of our principal risks, see page 136.

Exposure to risks arising from the business activities of global businesses

For footnote, see page 46.

For further information on credit risk, see page 150; capital and risk-weighted assets, see page 298; market risk, including value at risk, see page 230; and operational risk see page 244.

Top and emerging risks

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

The ongoing assessment of our top and emerging risks is informed by a comprehensive suite of risk factors (see page 135) which may result in our risk appetite being revised.

During 2013, senior management paid particular attention to a number of top and emerging risks. These risks, as at 31 December 2013, are tabulated below.

We made a number of changes to our top and emerging risks to reflect revised assessment of their effect on HSBC during 2013. Threats to the global economy from a disorderly exit from quantitative easing, which emerged as a risk during the first half of 2013 following announcements

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that monetary stimuli may be scaled back, receded during the second half of the year. This followed announcements by central banks on the likely pace and scale of tapering together with an acceleration of economic growth in the US and UK.

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Top and emerging risks /

<p>Macroeconomic and geopolitical risks</p>	<p>Macro-prudential, regulatory and legal risks to our business model</p>	<p>Risks related to our business operation, governance and internal control systems</p>
<p>Emerging markets slowdown</p>	<p>Regulatory developments affecting our business model and Group profitability</p>	<p>Heightened execution risk</p>
<p>Growth decelerated in a number of emerging markets during 2013. Any contraction in trade and capital flows would affect both emerging and developed economies.</p>	<p>Governments and regulators in numerous jurisdictions continue to develop policy which may impose new requirements, including in the areas of capital and liquidity management and business structure.</p>	<p>Regulatory demands, a challenging external environment, the level of internal transformation and risks arising from business and portfolio disposals may affect our ability to execute our strategy.</p>
<p>Increased geopolitical risk</p>	<p>Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand</p>	<p>Internet crime and fraud and Information security risk</p>
<p>Our operations are exposed to risks arising from political instability and civil unrest in a number of countries, which may have a wider effect on regional stability and regional and global economies.</p>	<p>Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime.</p>	<p>Our businesses face a range of operational risks, including those arising from internet crime and fraud and cyber attacks affecting the security of Group and customer information.</p> <p>Data management</p>
	<p>In December 2012, HSBC entered into agreements with US and UK authorities in relation to investigations regarding past inadequate compliance with AML and sanctions laws and we continue to be subject to other regulatory proceedings, the outcome of which is difficult to predict. There is a risk that we fail to meet agreed deadlines or are found to have material gaps in our plans or the implementation progress compared with that required by the DPAs and other orders.</p>	<p>New regulatory requirements necessitate more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis.</p>

Dispute risk

HSBC is party to legal proceedings arising out of its normal business operations which could give rise to potential financial loss and significant reputational damage.

Model risk

Regulatory requirements relating to models and assumptions in areas such as capital calculations and stress testing could potentially result in an increased and more volatile capital requirement.

Heightened execution risk was also assessed as a top risk to reflect the external and internal challenges to delivering our strategy at the same time

as implementing the changes necessitated by regulatory change and the implementation of Global Standards.

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

For a detailed account of these risks see page 141 and for a summary of our risk factors, see page 135.

How we manage risk

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

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

Running risk like a business

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

making systems compatible (for example, in Global Risk and Global Finance) so a complete picture of our risks is obtained;

streamlining data production and re-engineering processes to create time to spend on risk management; and

understanding the detail behind our risks and costs.

Organisation and structure

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

Our risk governance framework, of which our risk appetite framework is a significant element, ensures the appropriate oversight of and accountability for the effective management of risk, including financial crime risk, at Group, regional and

global business levels. Similar arrangements are in place in our major operating subsidiaries.

The Group Risk Committee is responsible for advising the Board on high-level risk related matters and risk governance.

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

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

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

Three lines of defence

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

First line every employee is responsible for the risks that are part of their day to day jobs. The first line of defence ensures that all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment.

Second line global functions, such as Global Risk, Global Finance and Global Human Resources form the second line of defence. They have similar responsibilities to the first line of defence for the processes and activities they own. In addition, they are responsible for setting policy and for providing oversight and challenge of the activities conducted by the first line.

Third line Internal Audit forms the third line of defence, providing independent assurance to senior management and the Board over the design and operation of HSBC's risk management, governance and internal control processes.

For details of our operational risk management framework, see page 244.

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People

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

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

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

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

Risk management processes and procedures

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

risk identification;

risk appetite;

mapping our risk profile; and

stress testing and scenario analysis.

Risk identification

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

Risk appetite

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

operating plan and plays an important role in our six filters process.

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

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

guides underlying business activity, ensuring it is aligned to risk appetite statements;

informs risk-adjusted remuneration;

enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and

promptly identifies business decisions needed to mitigate risk.

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

Key risk appetite metrics

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

For footnotes, see page 46.

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

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

Our six filters are described on page 15.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Mapping our risk profile

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

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

For a summary of our banking and insurance risks, see page 136.

Stress testing and scenario analysis

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

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

For further information on our stress-testing and scenario analyses, see page 139.

How risk affects our performance

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

The execution of our strategy, including the exit from non-strategic markets, the sale of businesses and non-core investments, the repositioning of our portfolios and implementation of revised client selection filters, together with an improvement in market conditions, led to a modest improvement in

credit metrics in our retail portfolios during 2013, while our wholesale portfolios remained stable.

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

Operational losses declined significantly compared with 2012, although remained above historical trend. The decrease reflected the non-recurrence of fines and penalties paid in 2012 as part of the settlement of investigations into past inadequate compliance with AML and sanctions laws. Provisions related to UK customer redress, principally payment protection insurance and interest rate protection products, also

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declined. There are many factors which could affect these estimated liabilities and there remains a high degree of uncertainty as to the eventual cost of redress for these matters.

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations. We recognise a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. Our provisions for legal proceedings and regulatory matters and for customer remediation at 31 December 2013 totalled US\$4.2bn. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made.

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

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

Provisions for legal proceedings and regulatory matters and for customer remediation are disclosed in Note 31 on the Financial Statements on page 526.

For details of operational losses, see page 246.

For details of our critical accounting policies, see page 72.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Rewarding performance

<u>Employee remuneration</u>	42	Our remuneration strategy rewards commercial success and compliance with our risk management framework.
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The quality of our people and their long-term commitment to the Group are fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a long-term career with HSBC, and who will perform their role in the long-term interests of shareholders.

Employee remuneration

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

fixed pay;

benefits;

annual incentive; and

the Group Performance Share Plan (GPSP).

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

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

Industry changes and key challenges

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

significant number of our material risk takers are based outside the EU.

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

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

Variable pay pool determination

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

Variable pay pool

	Group 2013 US\$m	2012 US\$m
Variable pay pool total	3,920	3,689
as a percentage of underlying profit	15%	17%
percentage of pool deferred ²⁸	18%	17%

For footnote, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Funding

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

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

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

For the Directors Remuneration Report for the 2012, 2013 and target split, see page 394.

Relative importance of spend on pay

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

Directors remuneration

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

Executive Directors

	Douglas Flint		Stuart Gulliver		Iain Mackay	
	2013	2012	2013	2012	2013	2012
	£000	£000	£000	£000	£000	£000
Fixed pay						
Base salary	1,500	1,500	1,250	1,250	700	700
Pension	750	750	625	625	350	350

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	2,250	2,250	1,875	1,875	1,050	1,050
Benefits	48	64	591	642	33	36
Variable pay						
Annual incentive			1,833	780	1,074	539
GPSP			3,667	3,000	2,148	1,400
			5,500	3,780	3,222	1,939
Notional return on deferred cash	27	12			7	3
Non-taxable benefits	102	98	67	65	53	50
Total single figure of remuneration	2,427	2,424	8,033	6,362	4,365	3,078
<i>Addendum</i>						
Annual incentive with performance conditions ³⁰				1,170		809
Total single figure of remuneration and annual incentive with performance conditions	2,427	2,424	8,033	7,533	4,365	3,887
<i>For footnote, see page 46.</i>						

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Strategic Report (continued)

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

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

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

For full details of Directors remuneration, see page 389.

Variable pay performance for 2013

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

For footnote, see page 46.

Remuneration policy going forward

In order to deal with the challenges of CRD IV we have introduced changes to our remuneration structure for executive Directors in 2014 as summarised in the table below, subject to

shareholders approval at the 2014 AGM. If approved, the policy is intended to apply for three years to the conclusion of the AGM in 2017.

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For full details of the remuneration policy for executive Directors, see page 381.

Changes in remuneration policy for 2014

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

For footnote, see page 46.

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

External reporting

The required remuneration disclosures for Directors and highest paid employees in the Group are made in the Directors Remuneration Report on page 378. Remuneration disclosures for Code Staff can be found in the *Pillar 3 Disclosures 2013*.

On behalf of the Board 24 February 2014

D J Flint, *Group Chairman*

HSBC Holdings plc

Registered number 617987

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HSBC HOLDINGS PLC

Strategic Report (continued)**Footnotes to Strategic Report**

- 1 *A Basel II measure, of core tier 1 capital expressed as percentage of total risk-weighted assets.*
- 2 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*
- 3 *Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year. The third interim dividend for 2012 of US\$0.09 was paid on 12 December 2012. The fourth interim dividend for 2012 of US\$0.18 was paid on 8 May 2013. First, second and third interim dividends for 2013, each of US\$0.10 per ordinary share, were paid on 11 July 2013, 9 October 2013 and 11 December 2013, respectively. Note 10 on the Financial Statements provides more information on the dividends declared in 2013. On 24 February 2014 the Directors declared a fourth interim dividend for 2013 of US\$0.19 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 30 April 2014 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 22 April 2014, with a scrip dividend alternative. The reserves available for distribution at 31 December 2013 were US\$49,339m. Quarterly dividends of US\$15.5 per 6.2% non-cumulative Series A US dollar preference share, equivalent to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A US dollar preference share, were paid on 16 September 2013, 17 June 2013, 15 March 2013 and 16 December 2013. Quarterly coupons of US\$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2013, 15 April 2013, 15 July 2013 and 15 October 2013. Quarterly coupons of US\$0.5 per security were paid with respect to 8% capital securities on 15 March 2013, 17 June 2013, 16 September 2013 and 16 December 2013.*
- 4 *The return on average ordinary shareholders' equity is defined as profit attributable to ordinary shareholders of the parent company divided by average ordinary shareholders' equity.*
- 5 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.*
- 6 *Intermediation of securities, funds and insurance products, including Securities Services in GB&M.*
- 7 *Merger and acquisition, event and project financing, and co-investments in GPB.*
- 8 *Including Foreign Exchange, Rates, Credit and Equities.*
- 9 *Including portfolio management.*
- 10 *Including private trust and estate planning (for financial and non-financial assets).*
- 11 *Including hedge funds, real estate and private equity.*
- 12 *Loan impairment charges and other credit risk provisions.*
- 13 *Share of profit in associates and joint ventures.*
- 14 *In 2013, GB&M changed the way it manages repo and reverse repo activities in the Credit and Rates businesses as set out on page 68 of the Financial Review. This led to an increase in the amount of reverse repo and repo agreements classified as Loans and advances to customers at amortised cost and Customer accounts at amortised cost in the balance sheet, respectively.*
- 15 *A Basel III measure, of common equity tier 1 capital expressed as percentage of total risk exposure amount.*
- 16 *UK bank levy paid reflects the payments made to the tax authorities during the calendar year and may differ from the recognition of liabilities charged to the income statement.*
- 17 *Excludes movements in the fair value of own debt and before variable pay distributions. See Directors' Remuneration Report page 378.*
- 18 *Each American Depositary Share represents five ordinary shares.*
- 19 *Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.*
- 20 *The Financial Times Stock Exchange 100 Index, The Morgan Stanley Capital International World Index and The Morgan Stanley Capital International World Bank Index.*
- 21 *Established on 17 January 2014.*
- 22 *Established on 22 November 2013.*
- 23 *The HSBC UK entity shown comprises five legal entities; HSBC Bank plc (including all overseas branches), and SPEs consolidated by HSBC Bank plc for Financial Statement purposes), Marks and Spencer Financial Services Limited, HSBC Private Bank (UK) Ltd, HFC Bank Ltd and HSBC Trust Company (UK) Limited, managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the UK PRA.*
- 24 *The Hongkong and Shanghai Banking Corporation represents the bank in Hong Kong including all overseas branches. Each branch is monitored and controlled for liquidity and funding risk purposes as a standalone operating entity.*
- 25 *The HSBC USA principal entity shown represents the HSBC USA Inc consolidated group; predominantly HSBC USA Inc and HSBC Bank USA, NA. The HSBC USA Inc consolidated group is managed as a single operating entity.*
- 26 *The sum of balances presented does not agree to consolidated amounts because inter-company eliminations are not presented here.*

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- 27 *Targets for 2014 to 2016 were announced at our Investor Update on 15 May 2013.*
- 28 *The percentage of variable pay deferred for the Code Staff population was 64%.*
- 29 *Dividends per ordinary share in respect of that year. For 2013, this includes the first, second and third interim dividends paid in 2013 of US\$5.6bn (gross of scrip) and a fourth interim dividend of US\$3.6bn.*
- 30 *60% of the 2012 annual incentive for Stuart Gulliver and Iain Mackay disclosed in the 2012 Directors Remuneration Report was deferred for five years. The vesting of these awards is subject to a service condition and satisfactory completion of the DPA. The DPA condition ends on the fifth anniversary of the award date unless the DPA is extended or otherwise continues beyond that date, in which case the awards will vest on the date on which the DPA expires and otherwise ceases to operate.*
- 31 *In its meeting of 15 January 2014, the Group Remuneration Committee used its discretion to reduce overall variable pay by £1.25m (equivalent to 18.5% of the total annual incentive and GPSP). This adjustment was considered appropriate in the context of overall Group-wide year-over-year profitability and incentive pool funding, Group-wide risk and compliance, market remuneration benchmarks and the remuneration recommendations for the Group CEO's direct reports.*
- 32 *Maximum award potentials for fixed pay allowances and variable pay awards are based on obtaining shareholder approval to increase the maximum variable pay award as a percentage of fixed pay under CRD IV from 100% to 200% at the Annual General Meeting on 23 May 2014. If shareholder approval is not obtained the maximum fixed pay allowance payable for each executive Director under the policy will be the difference between (i) 50% of maximum total remuneration of the executive Director under this policy as shown in the Remuneration scenarios chart on page 389 and (ii) the aggregate of the base salary and cash allowance in lieu of pension for that executive Director. Maximum variable pay award levels will be revised to 100% of fixed pay and the maximum annual incentive and GPSP awards will accordingly be reduced to 1/3 and 2/3 of this amount (i.e. 33% and 67% of fixed pay, respectively). The requested increase in the cap to 200% would enable us to minimise the increase in fixed remuneration costs and so help to maintain greater flexibility on total pay.*

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Use of non-GAAP financial measures

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Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements starting on page 416. In measuring our performance, the financial measures that we use include those which have been derived from our reported results in

order to eliminate factors which distort year-on-year comparisons. These are considered non-GAAP financial measures. Non-GAAP financial measures that we use throughout our Financial Review and are described below. Other non-GAAP financial measures are described and reconciled to the closest reported financial measure when used.

Constant currency

The constant currency measure adjusts for the year-on-year effects of foreign currency translation differences by comparing reported results for 2013 with reported results for 2012 retranslated at 2013 exchange rates. Except where stated otherwise, commentaries are on a constant currency basis, as reconciled in the table below.

The foreign currency translation differences reflect the movements of the US dollar against most major currencies during 2013.

We exclude the translation differences because we consider the like-for-like basis of constant currency financial measures more appropriately reflects changes due to operating performance.

Constant currency

Constant currency comparatives for 2012 referred to in the commentaries are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

the income statements for 2012 at the average rates of exchange for 2013; and

the balance sheet at 31 December 2012 at the prevailing rates of exchange on 31 December 2013.

Constant currency comparatives for 2011 referred to in the 2012 commentaries are computed on the same basis, by applying average rates of exchange for 2012 to the 2011 income and rates of exchange on 31 December 2012 to the balance sheet at 31 December 2011.

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

Underlying performance

To arrive at underlying performance:

we adjust for the year-on-year effects of foreign currency translation;

we eliminate the fair value movements on our long-term debt attributable to credit spread (own credit spread) where the net result of such movements will be zero upon maturity of the debt. This does not include fair value

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changes due to own credit risk in respect of trading liabilities or derivative liabilities; and

we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses. For acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses, we eliminate the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and remove the operating profit or loss of the acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses from all the years presented so we can view results on a like-for-like basis. For example, if a disposal was made in the current year, any gain

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax*

	2013 compared with 2012				
	2012 as reported US\$m	Currency translation adjustment ¹ US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Constant currency change ² %
HSBC					
Net interest income	37,672	(682)	36,990	35,539	(6)
Net fee income	16,430	(203)	16,227	16,434	1
Net trading income	7,091	(164)	6,927	8,690	23
Own credit spread ³	(5,215)	12	(5,203)	(1,246)	76
Other income/(expense) from financial instruments designated at fair value	2,989	(53)	2,936	2,014	(33)
Net income/(expense) from financial instruments designated at fair value	(2,226)	(41)	(2,267)	768	
Gains on disposal of US branch network, US cards business and Ping An	7,024		7,024		(100)
Gains less losses from financial investments	1,189	(17)	1,172	2,012	69
Net earned insurance premiums	13,044	(118)	12,926	11,940	(8)
Other operating income (including dividend income)	2,321	(200)	2,121	2,954	27
Total operating income	82,545	(1,425)	81,120	78,337	(5)
Net insurance claims incurred and movement in liabilities to policyholders	(14,215)	96	(14,119)	(13,692)	(4)
Net operating income⁴	68,330	(1,329)	67,001	64,645	(5)
Loan impairment charges and other credit risk provisions	(8,311)	201	(8,110)	(5,849)	30
Net operating income	60,019	(1,128)	58,891	58,796	(2)
Operating expenses	(42,927)	683	(42,244)	(38,556)	10
Operating profit	17,092	(445)	16,647	20,240	18
Share of profit in associates and joint ventures	3,557	45	3,602	2,325	(35)
Profit before tax	20,649	(400)	20,249	22,565	9
By global business					
Retail Banking and Wealth Management	9,575	(26)	9,549	6,649	(31)
Commercial Banking	8,535	(96)	8,439	8,441	(1)
Global Banking and Markets	8,520	(147)	8,373	9,441	11
Global Private Banking	1,009	(16)	993	193	(81)
Other	(6,990)	(115)	(7,105)	(2,159)	69
Profit before tax	20,649	(400)	20,249	22,565	9

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By geographical region

Europe	(3,414)	65	(3,349)	1,825		
Hong Kong	7,582	(1)	7,581	8,089	7	7
Rest of Asia-Pacific	10,448	(227)	10,221	7,764	(26)	(24)
Middle East and North Africa	1,350	(36)	1,314	1,694	25	29
North America	2,299	(28)	2,271	1,221	(47)	(46)
Latin America	2,384	(173)	2,211	1,972	(17)	(11)
Profit before tax	20,649	(400)	20,249	22,565	9	11

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

or loss on disposal, any associated gain or loss on reclassification or impairment recognised and the results of the disposed-of business would be removed from the results of the current year and the previous year as if the disposed-of business did not exist in those years. Disposal of investments other than those included in the above definition do not lead to underlying adjustments.

We use underlying performance to explain year-on-year changes when the effect of fair value movements on own debt, acquisitions, disposals or dilution is significant because we consider that this basis more appropriately reflects operating performance.

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

Disposal gains/(losses) affecting underlying performance

	Date	Disposal gain/(loss) US\$m
HSBC Bank Canada's disposal of HSBC Securities (Canada) Inc.'s full service retail brokerage business	Jan 2012	83
The Hongkong and Shanghai Banking Corporation Limited's disposal of RBWM operations in Thailand	Mar 2012	108
HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology and Services (USA) Inc.'s disposal of US Card and Retail Services business ⁵	May 2012	3,148
HSBC Bank USA, N.A.'s disposal of 138 non-strategic branches	May 2012	661
HSBC Argentina Holdings S.A.'s disposal of its non-life insurance manufacturing subsidiary	May 2012	102
The Hongkong and Shanghai Banking Corporation Limited's disposal of its private banking business in Japan	Jun 2012	67
The Hongkong and Shanghai Banking Corporation Limited's disposal of its shareholding in a property company in the Philippines ⁶	Jun 2012	130
Hang Seng Bank Limited's disposal of its non-life insurance manufacturing subsidiary	Jul 2012	46
HSBC Bank USA, N.A.'s disposal of 57 non-strategic branches	Aug 2012	203
HSBC Asia Holdings B.V.'s investment loss on a subsidiary	Aug 2012	(85)
HSBC Bank plc's disposal of HSBC Securities SA	Aug 2012	(11)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Credit Zft	Aug 2012	(2)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Insurance (Ireland) Limited	Oct 2012	(12)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Reinsurance Limited	Oct 2012	7
HSBC Private Bank (UK) Limited's disposal of Property Vision Holdings Limited	Oct 2012	(1)
HSBC Investment Bank Holdings Limited's disposal of its stake in Havas Havalimanlari Yer Hizmetleri Yatirim Holding Anonim Sirketi ⁶	Oct 2012	18
HSBC Insurance (Asia) Limited's disposal of its non-life insurance portfolios	Nov 2012	117
HSBC Bank plc's disposal of HSBC Shipping Services Limited	Nov 2012	(2)
HSBC Bank (Panama) S.A.'s disposal of its operations in Costa Rica, El Salvador and Honduras	Dec 2012	(62)
HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation Limited's disposal of their shares in Ping An Insurance (Group) Company of China, Ltd (Ping An)	Dec 2012	3,012
The Hongkong and Shanghai Banking Corporation Limited's disposal of its shareholding in Global Payments Asia-Pacific Limited ⁵	Dec 2012	212
Reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties ⁵	Jan 2013	1,089
HSBC Insurance (Asia-Pacific) Holdings Limited's disposal of its shareholding in Bao Viet Holdings	Mar 2013	104
Household Insurance Group Holding company's disposal of its insurance manufacturing business	Mar 2013	(99)
HSBC Seguros, S.A. de C.V., Grupo Financiero HSBC's disposal of its property and Casualty Insurance business in Mexico	Apr 2013	20

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HSBC Bank plc's disposal of its shareholding in HSBC (Hellas) Mutual Funds Management S.A.	Apr 2013	(7)
HSBC Insurance (Asia-Pacific) Holdings Limited disposal of its shareholding in Hana HSBC Life Insurance Company Limited ⁵	May 2013	28
HSBC Bank plc's disposal of HSBC Assurances IARD	May 2013	(4)
The Hongkong and Shanghai Banking Corporation Limited's disposal of HSBC Life (International) Limited's Taiwan branch operations ⁶	June 2013	(36)
HSBC Markets (USA) Inc.'s disposal of its subsidiary, Rutland Plastic Technologies	Aug 2013	17
HSBC Insurance (Singapore) Pte Ltd's disposal of its Employee Benefits Insurance business in Singapore	Aug 2013	(8)
HSBC Investment Bank Holdings plc's disposal of its investment in associate FIP Colorado	Aug 2013	(5)
HSBC Investment Bank Holdings plc group's disposal of its investment in subsidiary, Viking Sea Tech	Aug 2013	54
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Panama) S.A.	Oct 2013	1,107
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Peru) S.A.	Nov 2013	(18)
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Paraguay) S.A.	Nov 2013	(21)
Reclassification loss in respect of our holding in Yantai Bank Co., Limited following an increase in its registered share capital ⁵	Dec 2013	(38)

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)

Acquisition gains/(losses) affecting underlying performance⁶

	Date	Fair value gain on acquisition US\$m
Gain on the merger of Oman International Bank S.A.O.G. and the Omani operations of HSBC Bank Middle East Limited	Jun 2012	3
Gain on the acquisition of the onshore retail and commercial banking business of Lloyds Banking Group in the UAE by HSBC Bank Middle East Limited	Oct 2012	18

For footnote, see page 132.

The following table reconciles selected items for 2013 and 2012 to an underlying basis. Equivalent tables are provided for each of our global businesses

and geographical segments in the Form 20-F filed with the Securities and Exchange Commission (SEC), which is available on www.hsbc.com.

Reconciliation of reported and underlying items

	2013 US\$m	2012 US\$m	Change ² %
Net interest income			
Reported	35,539	37,672	(6)
Currency translation adjustment ¹	(273)	(682)	
Acquisitions, disposals and dilutions		(2,015)	
Underlying	35,266	34,975	1
Other operating income			
Reported	2,632	2,100	25
Currency translation adjustment ¹	(2,234)	(811)	
Acquisitions, disposals and dilutions			
Underlying	398	1,094	(64)
Revenue⁴			
Reported	64,645	68,330	(5)
Currency translation adjustment ¹		(1,341)	
Own credit spread ³	1,246	5,215	
Acquisitions, disposals and dilutions	(2,596)	(10,607)	
Underlying	63,295	61,597	3
Loan impairment charges and other credit risk provisions			

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Reported	(5,849)	(8,311)	30
Currency translation adjustment ¹		201	
Acquisitions, disposals and dilutions	32	376	
Underlying	(5,817)	(7,734)	25
Total operating expenses			
Reported	(38,556)	(42,927)	10
Currency translation adjustment ¹		683	
Acquisitions, disposals and dilutions	353	1,490	
Underlying	(38,203)	(40,754)	6
Underlying cost efficiency ratio	60.4%	66.2%	
Share of profit in associates and joint ventures			
Reported	2,325	3,557	(35)
Currency translation adjustment ¹		45	
Acquisitions, disposals and dilutions	(14)	(1,425)	
Underlying	2,311	2,177	6
Profit before tax			
Reported	22,565	20,649	9
Currency translation adjustment ¹		(412)	
Own credit spread ³	1,246	5,215	
Acquisitions, disposals and dilutions	(2,225)	(10,166)	
Underlying	21,586	15,286	41
<i>For footnotes, see page 132.</i>			

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Report of the Directors: Financial Review (continued)**Consolidated income statement***Five-year summary consolidated income statement*

	2013	2012	2011	2010	2009
	US\$m	US\$m	US\$m	US\$m	US\$m
Net interest income	35,539	37,672	40,662	39,441	40,730
Net fee income	16,434	16,430	17,160	17,355	17,664
Net trading income	8,690	7,091	6,506	7,210	9,863
Net income/(expense) from financial instruments designated at fair value	768	(2,226)	3,439	1,220	(3,531)
Gains less losses from financial investments	2,012	1,189	907	968	520
Dividend income	322	221	149	112	126
Net earned insurance premiums	11,940	13,044	12,872	11,146	10,471
Gains on disposal of US branch network, US cards business and Ping An		7,024			
Other operating income	2,632	2,100	1,766	2,562	2,788
Total operating income	78,337	82,545	83,461	80,014	78,631
Net insurance claims incurred and movement in liabilities to policyholders	(13,692)	(14,215)	(11,181)	(11,767)	(12,450)
Net operating income before loan impairment charges and other credit risk provisions	64,645	68,330	72,280	68,247	66,181
Loan impairment charges and other credit risk provisions	(5,849)	(8,311)	(12,127)	(14,039)	(26,488)
Net operating income	58,796	60,019	60,153	54,208	39,693
Total operating expenses	(38,556)	(42,927)	(41,545)	(37,688)	(34,395)
Operating profit	20,240	17,092	18,608	16,520	5,298
Share of profit in associates and joint ventures	2,325	3,557	3,264	2,517	1,781
Profit before tax	22,565	20,649	21,872	19,037	7,079
Tax expense	(4,765)	(5,315)	(3,928)	(4,846)	(385)
Profit for the year	17,800	15,334	17,944	14,191	6,694
Profit attributable to shareholders of the parent company	16,204	14,027	16,797	13,159	5,834
Profit attributable to non-controlling interests	1,596	1,307	1,147	1,032	860

Five-year financial information

	US\$	US\$	US\$	US\$	US\$
Basic earnings per share ⁸	0.84	0.74	0.92	0.73	0.34
Diluted earnings per share ⁸	0.84	0.74	0.91	0.72	0.34
Dividends per ordinary share ⁹	0.48	0.41	0.39	0.34	0.34

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	%	%	%	%	%
Dividend payout ratio ¹⁰	57.1	55.4	42.4	46.6	100.0
Post-tax return on average total assets	0.7	0.6	0.6	0.6	0.3
Return on average ordinary shareholders' equity	9.2	8.4	10.9	9.5	5.1
Average foreign exchange translation rates to US\$:					
US\$1: £	0.639	0.631	0.624	0.648	0.641
US\$1:	0.753	0.778	0.719	0.755	0.719

For footnotes, see page 132.

Unless stated otherwise, all tables in the *Annual Report and Accounts 2013* are presented on a reported basis.

For a summary of our financial performance in 2013, see page 16.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Notable revenue items by geographical region*

	Rest of						
	Hong	Asia-		North	Latin		
Europe	Kong	Pacific	MENA	America	America	Total	
US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
2013							
Net gain on completion of Ping An disposal ¹¹		553				553	
2012							
Ping An contingent forward sale contract ¹¹		(553)				(553)	

Notable revenue items by global business

	Retail	Global				
	Banking	Banking	Global	Private		
	and	Commercial	Markets	Banking	Other	Total
	Wealth	Banking	US\$m	US\$m	US\$m	US\$m
Management	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
2013						
Net gain on completion of Ping An disposal ¹¹					553	553
2012						
Ping An contingent forward sale contract ¹¹					(553)	(553)

*For footnote, see page 132.**Notable cost items by geographical region*

	Rest of						
	Hong	Asia-		North	Latin		
Europe	Kong	Pacific	MENA	America	America	Total	
US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
2013							
Restructuring and other related costs	217	6	81	3	100	76	483
UK customer redress programmes	1,235						1,235
2012							

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Restructuring and other related costs	299	31	131	27	221	167	876
UK customer redress programmes	2,338						2,338
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws	375				1,546		1,921
2011							
Restructuring and other related costs	404	68	45	31	236	338	1,122
UK customer redress programmes	898						898

Notable cost items by global business

	Retail		Global			
	Banking		Banking			
	and Wealth		and			
	Management	Commercial	Markets	Global	Other	Total
	US\$m	Banking	US\$m	Private	US\$m	US\$m
	US\$m	US\$m	US\$m	Banking	US\$m	US\$m
2013						
Restructuring and other related costs	165	32	15	74	197	483
UK customer redress programmes	953	148	134			1,235
2012						
Restructuring and other related costs	266	62	63	58	427	876
UK customer redress programmes	1,751	258	331	(2)		2,338
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws					1,921	1,921
2011						
Restructuring and other related costs	405	122	158	38	399	1,122
UK customer redress programmes	875	23				898

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Report of the Directors: Financial Review (continued)**Group performance by income and expense item****Net interest income**

	2013	2012	2011
	US\$m	US\$m	US\$m
Interest income	51,192	56,702	63,005
Interest expense	(15,653)	(19,030)	(22,343)
Net interest income ¹²	35,539	37,672	40,662
Average interest-earning assets	1,669,368	1,625,068	1,622,658
Gross interest yield ¹³	3.07%	3.49%	3.88%
Less: cost of funds	(1.10%)	(1.36%)	(1.56%)
Net interest spread ¹⁴	1.97%	2.13%	2.32%
Net interest margin ¹⁵	2.13%	2.32%	2.51%

Summary of interest income by type of asset

	2013			2012			2011		
	Average	Interest	Yield	Average	Interest	Yield	Average	Interest	Yield
	balance	income		balance	income		balance	income	
	US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Short-term funds and loans and advances to banks	301,267	3,655	1.21	275,979	4,307	1.56	261,749	5,860	2.24
Loans and advances to customers	946,756	38,720	4.09	934,656	41,043	4.39	945,288	45,250	4.79
Financial investments	393,309	8,002	2.03	387,329	9,078	2.34	384,059	10,229	2.66
Other interest-earning assets	28,036	815	2.91	27,104	2,274	8.39	31,562	1,666	5.28
Total interest-earning assets	1,669,368	51,192	3.07	1,625,068	56,702	3.49	1,622,658	63,005	3.88
Trading assets and financial assets designated at fair value ^{16,17}	354,817	5,763	1.62	368,406	6,931	1.88	410,038	8,671	2.11
Impairment provisions	(15,954)			(17,421)			(18,738)		
Non-interest-earning assets	683,785			730,901			752,965		
Total assets and interest income	2,692,016	56,955	2.12	2,706,954	63,633	2.35	2,766,923	71,676	2.59

Summary of interest expense by type of liability and equity

2013	2012	2011
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	Average balance	Interest expense	Cost %	Average balance	Interest expense	Cost %	Average balance	Interest expense	Cost %
	US\$m	US\$m		US\$m	US\$m		US\$m	US\$m	
Deposits by banks ¹⁸	86,882	691	0.80	92,803	1,160	1.25	106,099	1,591	1.50
Financial liabilities designated at fair value own debt issued ¹⁹	72,333	967	1.34	75,016	1,325	1.77	73,635	1,313	1.78
Customer accounts ²⁰	1,104,644	9,063	0.82	1,052,812	10,878	1.03	1,058,326	13,456	1.27
Debt securities in issue	150,976	4,182	2.77	161,348	4,755	2.95	181,482	5,260	2.90
Other interest-bearing liabilities	11,345	750	6.61	19,275	912	4.73	14,024	723	5.16
Total interest-bearing liabilities	1,426,180	15,653	1.10	1,401,254	19,030	1.36	1,433,566	22,343	1.56
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)	301,353	3,027	1.00	318,883	3,445	1.08	355,345	4,564	1.28
Non-interest bearing current accounts	184,370			177,085			162,369		
Total equity and other non-interest bearing liabilities	780,113			809,732			815,643		
Total equity and liabilities	2,692,016	18,680	0.69	2,706,954	22,475	0.83	2,766,923	26,907	0.97

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

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

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

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

Interest income

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

Interest income in Balance Sheet Management also decreased. Yields on financial investments and cash placed with banks and central banks declined as

the proceeds from maturities and sales of available-for-sale debt securities were invested at prevailing rates, which were lower. This was partly offset by growth in customer deposits leading to an overall increase in the size of the Balance Sheet Management portfolio.

Interest expense

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

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

Repos and reverse repos

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

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

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Report of the Directors: Financial Review (continued)**Net fee income**

	2013	2012	2011
	US\$m	US\$m	US\$m
Account services	3,581	3,563	3,670
Funds under management	2,673	2,561	2,753
Cards	2,455	3,030	3,955
Credit facilities	1,907	1,761	1,749
Broking income	1,388	1,350	1,711
Imports/exports	1,157	1,196	1,103
Unit trusts	891	739	657
Underwriting	866	739	578
Remittances	849	819	770
Global custody	698	737	751
Insurance	551	696	1,052
Other	2,957	2,958	2,748
Fee income	19,973	20,149	21,497
Less: fee expense	(3,539)	(3,719)	(4,337)
Net fee income	16,434	16,430	17,160

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

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

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

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

Net trading income

	2013	2012	2011
	US\$m	US\$m	US\$m
Trading activities	6,921	5,249	4,873

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Ping An contingent forward sale contract ¹¹	(682)	(553)	
Net interest income on trading activities	2,047	2,683	3,223
Loss on termination of hedges	(194)		
Other trading income – hedge ineffectiveness:			
on cash flow hedges	22	35	26
on fair value hedges	65	(27)	(224)
Non-qualifying hedges ²¹	511	(296)	(1,392)
Net trading income ²²	8,690	7,091	6,506

For footnotes, see page 132.

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

The rise in net income from trading activities was due in part to lower adverse foreign exchange movements on assets held as economic hedges

of foreign currency debt designated at fair value. These adverse movements offset favourable foreign exchange movements on the foreign currency debt which are reported in Net expense from financial instruments designated at fair value. In addition, we made foreign exchange gains of US\$442m on sterling debt issued by HSBC Holdings. We also recorded a favourable debit valuation adjustment (DVA) of US\$105m on derivative contracts, compared with a net reported charge of US\$385m in

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

2012, as a result of a change in estimation methodology in respect of credit valuation adjustments (CVA s) of US\$903m and a DVA of US\$518m, to reflect evolving market practices.

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

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

liquidity intervention. Revenue in 2013 was also affected by uncertainty regarding the tapering of quantitative easing in the US.

During 2013, we reported adverse fair value movements of US\$682m compared with US\$553m in 2012 on the contingent forward sale contract relating to Ping An in Rest of Asia-Pacific (see Note 25 on the Financial Statements).

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

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

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

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

	2013	2012	2011
	US\$m	US\$m	US\$m
Net income/(expense) arising from:			
financial assets held to meet liabilities under insurance and investment contracts	3,170	2,980	(933)
liabilities to customers under investment contracts	(1,237)	(996)	231
HSBC s long-term debt issued and related derivatives	(1,228)	(4,327)	4,161
Change in own credit spread on long-term debt	(1,246)	(5,215)	3,933
Other changes in fair value ²³	18	888	228
other instruments designated at fair value and related derivatives	63	117	(20)

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Net income/(expense) from financial instruments designated at fair value
For footnote, see page 132.

768

(2,226)

3,439

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Report of the Directors: Financial Review (continued)

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

	2013	2012	2011
	US\$m	US\$m	US\$m
Financial assets designated at fair value at 31 December	38,430	33,582	30,856
Financial liabilities designated at fair value at 31 December	89,084	87,720	85,724
Including:			
Financial assets held to meet liabilities under:			
insurance contracts and investment contracts with DP ²	10,717	8,376	7,221
unit-linked insurance and other insurance and investment contracts	25,423	23,655	20,033
Long-term debt issues designated at fair value	75,278	74,768	73,808

For footnote, see page 132.

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

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

We reported net income from financial instruments designated at fair value of US\$768m in 2013 compared with a net expense of US\$2.2bn in 2012. This included credit spread-related movements in the fair value of our own long-term debt, on which we experienced adverse fair value movements of US\$1.2bn in 2013 compared with US\$5.2bn in 2012. Adverse fair value

movements were less extensive in 2013 than in 2012 as HSBC spreads tightened significantly in Europe and North America, having widened during 2011.

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

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

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investment contracts with discretionary participation features (DPF), where the corresponding movement in liabilities to customers is recorded under Net insurance claims incurred and movement in liabilities to policyholders .

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

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Report of the Directors: Financial Review (continued)**Gains less losses from financial investments**

	2013	2012	2011
	US\$m	US\$m	US\$m
Net gains/(losses) from disposal of:			
debt securities	491	781	712
Ping An equity securities classified as available-for-sale ¹	1,235		
other equity securities	462	823	360
other financial investments	(1)	5	12
	2,187	1,609	1,084
Impairment of available-for-sale equity securities	(175)	(420)	(177)
Gains less losses from financial investments	2,012	1,189	907

For footnote, see page 132.

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

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

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

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

Net earned insurance premiums

	2013	2012	2011
	US\$m	US\$m	US\$m
Gross insurance premium income	12,398	13,602	13,338
Reinsurance premiums	(458)	(558)	(466)
Net earned insurance premiums	11,940	13,044	12,872

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

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

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

In Latin America, net earned premiums decreased in Brazil due to lower sales of unit-linked

pension products, primarily as a result of changes to the distribution channel. In addition, the sale of the non-life business in Argentina in 2012 contributed to the decrease.

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

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

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Report of the Directors: Financial Review (continued)**Gains on disposal of US branch network, US cards business and Ping An**

	2013	2012	2011
	US\$m	US\$m	US\$m
Gains on disposal of US branch network	-	864	
Gains on disposal of US cards business	-	3,148	
Gains on disposal of Ping An ¹¹	-	3,012	
	-	7,024	

For footnote, see page 132.

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

In May 2012, HSBC USA Inc., HSBC Finance and HSBC Technology and Services (USA) Inc. sold their US Card and Retail Services business, realising a gain on sale of US\$3.1bn.

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

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

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

Other operating income

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	2013	2012	2011
	US\$m	US\$m	US\$m
Rent received	155	210	217
Gains/(losses) recognised on assets held for sale	(729)	485	55
Gains on investment properties	113	72	118
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	178	187	57
Gains arising from dilution of interest in Industrial Bank and other associates and joint ventures	1,051		208
Gain on disposal of HSBC Bank (Panama) S.A.	1,107		
Change in present value of in-force long-term insurance business	525	737	726
Other	232	409	385
Other operating income	2,632	2,100	1,766

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

	2013	2012	2011
	US\$m	US\$m	US\$m
Value of new business	924	1,027	943
Expected return	(505)	(420)	(428)
Assumption changes and experience variances	88	69	(30)
Other adjustments	18	61	241
Change in present value of in-force long-term insurance business	525	737	726

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Report of the Directors: Financial Review (continued)

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

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

On an underlying basis, which excludes the net gains above, the results of disposed of operations and the effects of foreign currency translation, other operating income decreased. This was driven by losses totalling US\$424m on the sales of our CML non-real estate personal loan portfolio and several tranches of real estate secured loans, and a loss of US\$279m following the write-off of goodwill relating to our GPB business in Monaco. In addition,

we recognised a loss of US\$146m on the sale of the HFC Bank UK secured loan portfolio in RBWM in Europe. These factors were partly offset by higher disposal and revaluation gains on investment properties in Hong Kong.

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

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

Net insurance claims incurred and movement in liabilities to policyholders

	2013	2012	2011
	US\$m	US\$m	US\$m
Insurance claims incurred and movement in liabilities to policyholders:			
gross	13,948	14,529	11,631
reinsurers share	(256)	(314)	(450)
net	13,692	14,215	11,181

For footnote, see page 132.

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

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

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This reduction was partly offset by increases in reserves attributable to increased renewal premiums in Hong Kong and higher investment returns on the

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

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

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Report of the Directors: Financial Review (continued)**Loan impairment charges and other credit risk provisions**

	2013	2012	2011
	US\$m	US\$m	US\$m
Loan impairment charges			
New allowances net of allowance releases	7,344	9,306	12,931
Recoveries of amounts previously written off	(1,296)	(1,146)	(1,426)
	6,048	8,160	11,505
Individually assessed allowances	2,320	2,139	1,915
Collectively assessed allowances	3,728	6,021	9,590
Impairment/(releases of impairment allowances) on available-for-sale debt securities	(211)	99	631
Other credit risk provisions/(recoveries)	12	52	(9)
Loan impairment charges and other credit risk provisions	5,849	8,311	12,127
	%	%	%
Impairment charges on loans and advances to customers as a percentage of average gross loans and advances to customers	0.6	0.9	1.2

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

The percentage of impairment charges to average gross loans and advances reduced to 0.6% at 31 December 2013 from 0.9% at 31 December 2012.

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

The fall in collectively assessed charges largely arose in North America, in part due to improvements in housing market conditions. In addition, the decrease reflected lower lending balances, reduced new impaired loans and lower delinquency levels in the CML portfolio. This was partially offset by increases in Latin America, principally in Mexico due to higher collective impairments in RBWM. In Brazil, improvements in credit quality were broadly offset by higher charges from model changes and assumption revisions for restructured loan portfolios in RBWM and Business Banking in CMB.

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

the loan portfolio compared with charges in 2012. In Europe, higher provisions in GB&M were broadly offset by decreases in CMB, mainly in the UK and Greece.

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

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

In **Europe**, LICs decreased by 20% to US\$1.5bn. In the UK, GB&M reported net releases of credit risk provisions on available-for-sale asset-backed securities (ABS s), compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, there were lower loan impairment charges in CMB due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from

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debt sales. In other countries in Europe, lower individually assessed impairment provisions in Greece were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM and a rise in Spain, where the challenging economic conditions continued to affect the market.

In the **Middle East and North Africa**, LICs reflected a net release of US\$42m compared with a charge of US\$282m in 2012. We recorded provision releases, mainly in GB&M, for a small number of UAE-related exposures, reflecting an overall improvement in the loan portfolio compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB, and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

In **Rest of Asia-Pacific**, LICs decreased by US\$63m as 2012 included a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M. These factors were partly offset by an increase in individually assessed impairments in GB&M and CMB in a number of countries across the region.

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

LICs in **Hong Kong** were US\$63m higher due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, although these remained low. This was partly offset by collective provision releases in CMB from lower historical loss rates and individual impairment releases in GB&M.

Operating expenses

	2013	2012	2011
	US\$m	US\$m	US\$m
By expense category			
Employee compensation and benefits	19,196	20,491	21,166
Premises and equipment (excluding depreciation and impairment)	4,183	4,326	4,503
General and administrative expenses	12,882	15,657	12,956
Administrative expenses	36,261	40,474	38,625
Depreciation and impairment of property, plant and equipment	1,364	1,484	1,570
Amortisation and impairment of intangible assets	931	969	1,350
Operating expenses	38,556	42,927	41,545

Staff numbers (full-time equivalents)

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Geographical regions	2013	At 31 December	
		2012	2011
Europe	68,334	70,061	74,892
Hong Kong	28,367	27,742	28,984
Rest of Asia-Pacific	85,334	85,024	91,051
Middle East and North Africa	8,618	8,765	8,373
North America	20,871	22,443	30,981
Latin America	42,542	46,556	54,035
	254,066	260,591	288,316

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

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

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a charge for additional estimated redress for possible mis-selling in previous years of payment protection insurance (PPI) policies of US\$756m (US\$1.7bn in 2012);

US\$261m in respect of interest rate protection products (US\$586m in 2012); and

US\$149m in respect of wealth management products.

The provision for the UK customer redress programmes at 31 December 2013 is US\$2.1bn. The business disposals, primarily the disposal of the CRS business and the non-strategic branches in the US in 2012, resulted in a lower cost base in 2013.

Excluding the above, expenses were US\$808m higher than in 2012. The UK bank levy charge of US\$904m in 2013 increased compared with US\$571m in 2012, mainly due to an increase in its rate. In addition, operating expenses in both years included adjustments relating to the prior year charge for the UK bank levy (2013: US\$12m adverse adjustment; 2012: US\$99m favourable adjustment).

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

During 2013:

we increased our investment in digital and wealth management capabilities in RBWM;

in CMB we continued our ongoing expansion into the large corporate market in the US; and

increased investment spend on regulatory requirements particularly through the Global Standards programme.

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

These cost increases were in part offset by further sustainable cost savings of US\$1.5bn from our ongoing organisational effectiveness programmes. In addition, we recorded an accounting gain of US\$430m from changes in delivering ill-health benefits to certain employees in the UK (see Note 7 on the Financial Statements).

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

*Cost efficiency ratios*²⁶

	2013	2012	2011
	%	%	%
HSBC	59.6	62.8	57.5
Geographical regions			
Europe	84.0	108.4	70.4
Hong Kong	38.2	39.0	44.5
Rest of Asia-Pacific	47.1	42.7	54.2
Middle East and North Africa	51.5	48.0	44.5
North America	72.9	60.8	55.7
Latin America	56.1	58.7	63.3
Global businesses			
Retail Banking and Wealth Management	64.5	58.4	63.2
Commercial Banking	43.1	45.9	46.3
Global Banking and Markets	51.9	54.2	57.0
Global Private Banking	91.4	67.6	68.8

For footnote, see page 132.

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Report of the Directors: Financial Review (continued)**Share of profit in associates and joint ventures**

	2013	2012	2011
	US\$m	US\$m	US\$m
Associates			
Bank of Communications Co., Limited	1,878	1,670	1,370
Ping An Insurance (Group) Company of China, Ltd		763	946
Industrial Bank Co., Limited		670	471
The Saudi British Bank	403	346	308
Other	5	72	126
Share of profit in associates	2,286	3,521	3,221
Share of profit in joint ventures	39	36	43
Share of profit in associates and joint ventures	2,325	3,557	3,264

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

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

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

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

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

Tax expense**2013**

2012

2011

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	US\$m	US\$m	US\$m
Profit before tax	22,565	20,649	21,872
Tax expense	(4,765)	(5,315)	(3,928)
Profit after tax	17,800	15,334	17,944
Effective tax rate	21.1%	25.7%	18.0%

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

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

The tax expense decreased by US\$0.6bn to US\$4.8bn despite a US\$2.0bn increase in accounting profit before tax, due to the combination of benefits noted above and because the 2012 tax expense included the non-tax deductible effect of fines and penalties paid as part of the settlement of

investigations into past inadequate compliance with anti-money laundering and sanction laws.

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

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

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Report of the Directors: Financial Review (continued)**2012 compared with 2011***Reconciliation of reported and constant currency profit before tax*

	2011 as reported US\$m	2012 compared with 2011				
		Currency translation adjustment ¹ US\$m	at 2012 exchange rates US\$m	2012 as reported US\$m	Reported change ² %	Constant currency change ² %
HSBC						
Net interest income	40,662	(1,151)	39,511	37,672	(7)	(5)
Net fee income	17,160	(436)	16,724	16,430	(4)	(2)
Own credit spread ³	3,933	(35)	3,898	(5,215)		
Gains on disposal of US branch network, US cards business and Ping An				7,024		
Other income ⁷	10,525	(446)	10,079	12,419	18	23
Net operating income ⁴	72,280	(2,068)	70,212	68,330	(5)	(3)
Loan impairment charges and other credit risk provisions	(12,127)	277	(11,850)	(8,311)	31	30
Net operating income	60,153	(1,791)	58,362	60,019		3
Operating expenses	(41,545)	1,273	(40,272)	(42,927)	(3)	(7)
Operating profit	18,608	(518)	18,090	17,092	(8)	(6)
Share of profit in associates and joint ventures	3,264	55	3,319	3,557	9	7
Profit before tax	21,872	(463)	21,409	20,649	(6)	(4)
By global business						
Retail Banking and Wealth Management	4,270	(71)	4,199	9,575	124	128
Commercial Banking	7,947	(180)	7,767	8,535	7	10
Global Banking and Markets	7,049	(200)	6,849	8,520	21	24
Global Private Banking	944	(8)	936	1,009	7	8
Other	1,662	(4)	1,658	(6,990)		
Profit before tax	21,872	(463)	21,409	20,649	(6)	(4)
By geographical region						
Europe	4,671	(130)	4,541	(3,414)		
Hong Kong	5,823	20	5,843	7,582	30	30
Rest of Asia-Pacific	7,471	(79)	7,392	10,448	40	41
Middle East and North Africa	1,492	(7)	1,485	1,350	(10)	(9)
North America	100	(14)	86	2,299	2,199	2,573
Latin America	2,315	(253)	2,062	2,384	3	16
Profit before tax	21,872	(463)	21,409	20,649	(6)	(4)

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	2012	2011	Change ²
	US\$m	US\$m	%
Revenue ⁴			
Reported	68,330	72,280	(5)
Currency translation adjustment ¹		(2,033)	
Own credit spread ³	5,215	(3,933)	
Acquisitions, disposals and dilutions	(10,048)	(6,976)	
Underlying	63,497	59,338	7
Loan impairment charges and other credit risk provisions			
Reported	(8,311)	(12,127)	31
Currency translation adjustment ¹		277	
Acquisitions, disposals and dilutions	338	1,619	
Underlying	(7,973)	(10,231)	22
Operating expenses			
Reported	(42,927)	(41,545)	(3)
Currency translation adjustment ¹		1,273	
Acquisitions, disposals and dilutions	1,004	2,666	
Underlying	(41,923)	(37,606)	(11)
Underlying cost efficiency ratio	66.0%	63.4%	
Profit before tax			
Reported	20,649	21,872	(6)
Currency translation adjustment ¹		(428)	
Own credit spread ³	5,215	(3,933)	
Acquisitions, disposals and dilutions	(9,479)	(3,650)	
Underlying	16,385	13,861	18
By global business			
Retail Banking and Wealth Management	4,001	871	359
Commercial Banking	7,941	7,691	3
Global Banking and Markets	8,371	6,735	24
Global Private Banking	954	945	1
Other	(4,882)	(2,381)	(105)
Underlying profit before tax	16,385	13,861	18
By geographical region			
Europe	699	1,629	(57)
Hong Kong	7,162	5,761	24
Rest of Asia-Pacific	6,403	6,249	2
Middle East and North Africa	1,380	1,417	(3)
North America	(1,499)	(3,076)	51
Latin America	2,240	1,881	19
Underlying profit before tax	16,385	13,861	18

For footnotes, see page 132.

Consolidated income statement

Reported profit before tax of US\$20.6bn in 2012 was US\$1.2bn, or 6%, lower than in 2011. This was primarily due to adverse fair value movements on own debt attributable to credit spreads of US\$5.2bn, compared with favourable movements of US\$3.9bn in 2011. The variance was partially offset by US\$7.5bn of gains (net of losses) on disposals, in particular in respect of the US Card and Retail Services business and our associate, Ping An. Our remaining shareholding in Ping An has been

reclassified as a financial investment, the sale of which was completed on 6 February 2013.

We expect disposal of the Card and Retail Services business in North America and of our associate shares in Ping An in Rest of Asia-Pacific to have a significant impact on our profits in each of these regions for the foreseeable future. In addition, future profits in Rest of Asia-Pacific are expected to be affected by the dilution of our shareholding in Industrial Bank Co. Limited (Industrial Bank), following its issue of additional share capital to third parties on 7 January 2013. Our shareholding in

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Industrial Bank has now been classified as a financial investment.

On an underlying basis, profit before tax rose by 18%, primarily due to higher net operating income before loan impairment charges and other credit risk provisions (revenue) and lower loan impairment charges and other credit risk provisions, which were partially offset by an increase in operating expenses. The latter was primarily driven by fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws of US\$1.9bn, and a higher provision for UK customer redress programmes of US\$1.4bn.

The following commentary is on an underlying basis, except where otherwise stated.

Revenue of US\$63.5bn was US\$4.2bn, or 7%, higher than in 2011, primarily due to lower adverse movements on non-qualifying hedges which accounted for US\$1.1bn of the increase, and revenue growth in GB&M and CMB.

Revenue growth in GB&M mainly reflected higher Rates and Credit income, notably in Europe, as spreads tightened and investor sentiment improved following stimuli by central banks globally.

In CMB, revenue growth primarily reflected increased net interest income as a result of average balance sheet growth. Customer loans and advances grew in all regions, with over half this growth coming from our faster-growing regions of Hong Kong, Rest of Asia-Pacific and Latin America, driven by trade-related lending. In Europe, lending balances increased, notably in the UK, despite muted demand for credit. Customer deposits also rose as we continued to attract deposits through our Payments and Cash Management products.

Revenue growth in RBWM reflected increased insurance income, mainly in Hong Kong and Latin America, which benefited from higher investment returns and increased sales of life insurance products. In addition, net interest income grew, mainly in Hong Kong and Latin America, reflecting higher average lending and deposit balances. These factors were partially offset by the continued run-off of our Consumer and Mortgage Lending (CML) portfolio in the US.

Loan impairment charges and other credit risk provisions were US\$2.3bn lower than in 2011. This primarily reflected a decrease in North America, mainly due to the continued decline in lending balances and lower delinquency rates in the CML portfolio. In addition, in Europe there were lower credit risk provisions on available-for-sale asset-

backed securities (ABS s) driven by an improvement in underlying asset prices, and lower loan impairment charges in RBWM, most notably in the UK, as delinquency rates improved across both unsecured and secured lending portfolios. These factors were partially offset by increased loan impairment charges and other credit risk provisions in Latin America, particularly in Brazil, which were primarily due to higher delinquency rates in RBWM and in Business Banking in CMB. In Rest of Asia-Pacific, there were also higher individually assessed loan impairments on a small number of customers in CMB.

Operating expenses were higher than in 2011, primarily from fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws of US\$1.9bn, as well as an increase in provisions relating to UK customer redress programmes of US\$1.4bn. In addition, in 2011 operating expenses included a credit of US\$570m relating to defined benefit pension obligations in the UK, which did not recur.

The charges for UK customer redress programmes include estimates in respect of possible mis-selling in previous years of payment protection insurance (PPI) policies of US\$1.7bn and interest rate protection products of US\$598m. The additional provision relating to PPI reflects our recent claims experience. The provision in relation to interest rate protection products reflects an estimate of possible customer redress requirements following an independent review carried out at the request of the Financial Services Authority (FSA). There are many factors which affect these estimated liabilities and there remains a high degree of uncertainty as to the eventual cost of redress for these matters.

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Operating expenses also increased due to inflationary pressures, for example, on wages and salaries, in certain of our Latin American and Asian markets. Other increases arose from investment in strategic initiatives including certain business expansion projects, enhanced processes and technology capabilities, and increased investment in regulatory and compliance infrastructure, primarily in the US. These factors were partly offset by US\$2.0bn of sustainable cost savings achieved across all regions, as we continued with our organisational effectiveness programmes during 2012. The number of full time equivalent staff numbers (FTEs) fell by more than 27,700, reflecting the planned net reduction of staff numbers across the Group from organisational effectiveness initiatives and business disposals.

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On a constant currency basis, *income from associates* increased, mainly driven by strong results in our mainland China associates. The contribution from Bank of Communications Co., Limited (BoCom) and Industrial Bank rose due to loan growth and higher fee income. These factors were partially offset by a decline in income from Ping An due to market valuation losses on equity securities held by their insurance business, reflecting volatile domestic equity markets.

The reported profit after tax was US\$2.6bn or 15% lower than in 2011, reflecting a decrease in taxable profits, and a higher tax charge in 2012. The increased tax charge included the effect of the non-tax deductible charge for fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws, together with the non-recognition of the tax benefit in respect of the accounting charge associated with negative fair value movements on own debt. The lower tax charge in 2011 included the benefit of US foreign tax credits. The effective tax rate in 2012 was 26% compared with 18% in 2011.

Group performance by income and expense item

Net interest income

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

Reported net interest income decreased by 7%. On a constant currency basis, it declined by 5%.

On an underlying basis, excluding net interest income earned by the businesses sold during 2012 from all periods presented (2012: US\$1.6bn; 2011: US\$4.8bn) and currency translation movements of US\$1.2bn, net interest income rose by 4%. This reflected strong balance sheet growth in Hong Kong and Rest of Asia-Pacific, together with a lower cost of funds in Latin America driven by a decline in interest rates in Brazil.

The decrease in both net interest spread and net interest margin compared with 2011 was attributable to significantly lower yields on customer lending and on our surplus liquidity, partly offset by a reduction in our cost of funds, notably on customer accounts.

Interest income was lower than in 2011. This was driven by lower interest income on customer lending, including loans classified within Assets held for sale, due in part to the loss of interest income from disposals during 2012, principally in the US. These disposals also led to a change in the composition of our lending book as the decline in higher yielding card balances was replaced by volume growth in relatively lower yielding products,

mainly residential mortgages and term lending, in Hong Kong, Rest of Asia-Pacific and Europe. Growth in average residential mortgage balances reflected the success of marketing campaigns and competitive pricing in the UK, the continued strength in the property market in Hong Kong and the expansion of our distribution network in Rest of Asia-Pacific. Average term lending balances increased in Hong Kong and Rest of Asia-Pacific as we capitalised on trade and capital flows, while the rise in Europe was in spite of muted demand for credit. As a result of the change in composition of the lending book, the gross yield on customer lending fell.

Revenue in Balance Sheet Management also decreased, principally in Europe as yield curves continued to flatten and liquidity arising from maturities and sales of available-for-sale debt securities was re-invested at lower prevailing rates. In addition, we placed a greater portion of our liquidity with central banks. This was partly offset by higher revenue in Rest of Asia-Pacific, notably mainland China, as strong customer deposit growth led to a rise in the size of the available-for-sale debt securities portfolio.

The decline in interest income was partly offset by lower interest expense, notably on customer accounts. This was driven by a reduction in the cost of funds on customer accounts in Latin America, notably in Brazil, and in Europe due to the downward movement in interest rates during the year, together with deposit repricing initiatives in the US and Europe. The reduction in average customer account balances due to the disposal of non-strategic branches in the US was largely offset by significant volume growth in other parts of the business, notably in Hong

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Kong, reflecting more conservative customer behaviour during the year in RBWM, and in Rest of Asia-Pacific, as a result of new mandates and deposit acquisition in Payments and Cash Management in CMB and GB&M.

Interest expense on deposits by banks decreased, mainly in Europe. This was due to lower placements by other financial institutions with HSBC, in part due to lower interest rates offered, together with a reduction in the cost of sale and repurchase (repo) funding as market rates fell. Lower average balances and interest rates in Brazil also contributed to the decline.

There was also a decrease in interest expense on debt securities issued by the Group, driven by a net reduction in average balances outstanding, mainly in North America and, to a lesser extent, in Europe. Funding requirements in the US fell as a result of the

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business disposals and continued reduction of the CML portfolio in run-off and, as a consequence, maturing debt was not replaced and some of the outstanding debt was repaid with the proceeds from the sales. In addition, maturing debt was not replaced in Europe. These decreases were partly offset by higher interest expense in Latin America, as a result of new debt issued, principally in 2011. The Group's cost of funds on debt securities rose as the new issuances in Latin America were at a higher effective interest rate than that paid in other parts of the Group. The replacement of short-term debt by the issuance of medium-term notes in Europe also contributed to the rise in the cost of funds of debt securities in issue.

Net interest income includes the expense of internally funding trading assets, while related revenue is reported in Net trading income. The internal cost of funding of these assets declined, reflecting the reduction in average trading assets during the year. In reporting our global business results, this cost is included within Net trading income.

Net fee income

Net fee income decreased by US\$730m on a reported basis, and by US\$294m on a constant currency basis.

On an underlying basis, which excludes the net fee income relating to the business disposals (2012: US\$401m and 2011:US\$1.41bn) and currency translation movements of US\$436m, net fee income rose by US\$726m, or 5%.

The reduction on a constant currency basis was primarily due to the sale of the Card and Retail Services business, which led to a reduction in cards and insurance fee income and fee expenses. As part of that transaction, we entered into a transition service agreement with the purchaser to support certain account servicing operations until they are integrated into the purchaser's infrastructure. We receive fees for providing these services, which are reported in Other fee income. The associated costs are reported in Operating expenses.

Broking income fell, most notably in Hong Kong and Europe, due to reduced transaction volumes reflecting investor sentiment. Income from funds under management (FuM) fell, mainly in Rest of Asia-Pacific, as customers invested in lower yielding products reflecting their lower risk appetite. Income from FuM was also lower in North America, due to the sale of the full service retail brokerage business in Canada. In Europe, the decline was mainly due to challenging market conditions in the latter half of 2011 which led to a fall in average

client assets in 2012 as well as net new money outflows and a fall in client numbers within GBP.

Partly offsetting these reductions was growth in underwriting fees as we actively captured increased client demand for debt capital financing in North America, Hong Kong and Europe in 2012, in part, reflecting the enhanced collaboration between CMB and GB&M. Trade-related income also increased, most notably in Europe and Hong Kong, reflecting increased transaction volumes as we capitalised on our global network to capture cross-border trade flows.

Fees from unit trusts also rose in Hong Kong, reflecting higher sales volumes.

Net trading income

Reported net trading income of US\$7.1bn was US\$585m higher than in 2011. On a constant currency basis, net trading income rose by US\$849m, driven by lower adverse fair value movements on non-qualifying hedges. Net income from trading activities rose in GB&M, but this was more than offset by lower net interest income on trading activities and adverse fair value movements on the contingent forward sale contract relating to Ping An.

There were lower adverse fair value movements on non-qualifying hedges. These hedges are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, nor could be, applied. They are principally cross-currency and interest

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rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings and floating rate debt issued by HSBC Finance Corporation (HSBC Finance). The size and direction of the changes in the fair value of non-qualifying hedges that are recognised in the income statement can be volatile from year-to-year, but do not alter the cash flows expected as part of the documented interest rate management strategy for both the instruments and the underlying economically hedged assets and liabilities if the derivative is held to maturity. In North America, there were lower adverse fair value movements on non-qualifying hedges as US long-term interest rates declined to a lesser extent than in 2011. There were also lower adverse fair value movements on non-qualifying hedges in Europe. This was driven by favourable fair value movements in HSBC Holdings, compared with adverse fair value movements in 2011, reflecting the less pronounced decline in long-term US interest rates relative to sterling and euro interest rates compared with 2011. This was partly offset by adverse movements in European operating entities as interest rates fell.

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During 2012, HSBC Finance terminated approximately US\$3.0bn of non-qualifying hedges. A further US\$2.4bn of non-qualifying hedges were terminated in January 2013 to better align our hedges with the overall interest rate position in HSBC Finance. The losses on these economic hedges reported in previous years were therefore crystallised.

Net income from trading activities increased compared with 2011, driven by a strong performance in GB&M. This was after taking into account a net charge of US\$385m in the fourth quarter of 2012 as a result of a change in estimation methodology in respect of credit valuation adjustments on derivative assets and debit valuation adjustments on derivative liabilities to reflect evolving market practices.

Rates revenue was significantly higher, notably in Europe, as spreads on government debt securities tightened and investor sentiment improved following stimuli by central banks. This was despite significant adverse fair value movements due to own credit spreads on structured liabilities as spreads tightened, compared with a gain reported in 2011, together with a credit valuation adjustment charge of US\$837m. The improvement in market sentiment also led to tighter spreads on corporate debt securities, resulting in strong growth in Credit revenue. Foreign Exchange revenue was broadly in line with 2011, as higher income resulting from enhanced collaboration between GB&M and CMB, and increased volumes from improvements in our electronic pricing and distribution capabilities, offset the effect of less volatile markets in 2012. These favourable movements were partly offset by a reduction in Equities trading revenue, reflecting a decline in market volumes together with adverse fair value movements on structured liabilities as own credit spreads tightened in 2012, compared with favourable movements in 2011.

These factors were partly offset by unfavourable fair value movements on assets held as economic hedges of foreign currency debt at fair value compared with favourable movements in 2011, due to movements in the underlying currencies. These offset favourable foreign exchange movements on foreign currency debt which are reported in Net expense from financial instruments designated at fair value .

Net interest income on trading activities also declined. This was driven by a significant reduction in average trading assets, notably holdings of debt securities in Europe, in the latter part of 2011 and the first quarter of 2012 as eurozone sovereign debt concerns dominated the market. In addition, yields fell as a result of both price appreciation in a low

interest rate environment and an increase in the proportion of the portfolio invested in relatively lower-yielding treasury bills and government debt securities. This was partly offset by a reduction in funding costs, reflecting both the decline in the size of the portfolio and the low rate environment.

There were also adverse fair value movements of US\$553m on the contingent forward sale contract relating to Ping An.

Net income from financial instruments designated at fair value

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

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

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We reported net expense from financial instruments designated at fair value of US\$2.2bn in 2012 compared with net income of US\$3.4bn in 2011. This included the credit spread-related movements in the fair value of our own long-term debt, on which we reported adverse fair value movements of US\$5.2bn in 2012 and favourable movements of US\$3.9bn in 2011. The adverse fair value movements arose in 2012 as credit spreads tightened in Europe and North America, having widened during 2011.

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Net income arising from financial assets held to meet liabilities under insurance and investment contracts reflected net investment gains in 2012 as global equity market conditions improved, compared with net investment losses in 2011. This predominantly affected the value of assets held to support unit-linked contracts in the UK and Hong Kong, insurance contracts with discretionary participation features (DPF) in Hong Kong, and investment contracts with DPF in France.

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

Within net income from financial instruments designated at fair value were favourable foreign exchange movements in 2012, compared with adverse movements in 2011, on foreign currency debt designated at fair value issued as part of our overall funding strategy. An offset from assets held as economic hedges was reported in Net trading income .

Gains less losses from financial investments

Gains less losses from financial investments increased by US\$282m on a reported basis and US\$310m on a constant currency basis.

The increase was driven by higher net gains from the disposal of available-for-sale equity securities, notably in Hong Kong as a result of the sale of our shares in four Indian banks. In addition, we reported a rise in disposal gains in Principal Investments in GB&M.

Higher gains were also reported on the disposal of available-for-sale government debt securities, principally in the UK as part of Balance Sheet

Management s structural interest rate risk management activities. This was partly offset by losses on the disposal of legacy assets in GB&M in the UK, together with the non-recurrence of gains in 2011 on the disposal of available-for-sale debt securities in our Insurance business in RBWM, also in Europe.

There were higher impairments of available-for-sale equity securities due to significant write-downs in 2012 on three holdings, two of which were in our direct investment business, which is in run-off.

Net earned insurance premiums

Net earned insurance premiums were broadly in line with 2011 on a reported basis. On a constant currency basis net earned premiums increased by 6%.

The rise in net earned premium income was driven by Hong Kong and Latin America. In Hong Kong, sales of insurance contracts increased, in particular deferred annuity products, as we widened our product offerings to fulfil customers long-term savings and retirement needs, supported by successful marketing campaigns. Renewal premiums from both unit-linked and insurance contracts with DPF also increased reflecting strong sales in previous years. The increase in net earned premiums in Latin America was due to higher sales of unit-linked and term life products in Brazil, reflecting customer appetite for life insurance products. It was partly offset by a decrease in net earned premiums following the sale of the general insurance business in Argentina in May 2012. In Europe, net earned premiums decreased, mainly on investment contracts with DPF in France, as a result of the uncertain economic and political environment in the election year and increased product competition. The non-renewal and transfer to third parties of certain contracts in our Irish business during 2011 also contributed to the decline. This was partly offset by a rise in net earned premiums in the UK due, in part, to the sale of a unit-linked insurance product through two new third party

platforms.

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

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

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

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to Capital One Financial Corporation, realising a gain on sale of US\$3.1bn.

In May 2012, HSBC Bank USA, N.A. (HSBC Bank USA) sold 138 out of 195 branches primarily in upstate New York to First Niagara Bank, realising a gain of US\$661m. In August 2012, it sold the remaining 57 branches to the same purchaser, realising a gain of US\$203m. In December 2012, HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation agreed to sell to indirect wholly-owned subsidiaries of Charoen Pokphand Group Company Limited their entire shareholdings in Ping An, representing 15.57% of the issued share capital of Ping An, in two tranches. The first tranche was completed on 7 December 2012. The completion of the second tranche took place on 6 February 2013. The disposal of this associate resulted in a gain of US\$3.0bn in 2012. Our remaining shareholding has been classified as a financial investment.

Other operating income

Reported other operating income of US\$2.1bn increased by 19% in 2012. On a constant currency basis, it rose by 25% as a result of business disposals during the year.

We continued to rationalise our portfolio in non-strategic markets, resulting in a number of gains and losses on disposal which are excluded from our underlying results. These included gains of US\$108m on the sale of our RBWM operations in Thailand, US\$130m on the sale of our shareholding in a property company in the Philippines, US\$163m on the sales of the HSBC and Hang Seng general insurance businesses in Hong Kong, US\$102m following the completion of the sale of our general insurance manufacturing business in Argentina, and US\$212m following the sale of our shares in Global Payments Asia-Pacific Ltd. The gains on disposal were partly offset by an investment loss on a subsidiary of US\$85m in the Middle East and North Africa and a loss of US\$62m on the sale of our operations in Costa Rica, Honduras and El Salvador.

Reported other operating income in 2011 included a gain of US\$181m arising from a dilution of our holding in Ping An following its issue of share capital to a third party and a gain of US\$83m from the sale of HSBC Afore S.A. de C.V. (HSBC Afore), our Mexican pension business.

On an underlying basis, excluding the gains and losses on disposal totalling US\$747m in 2012 and US\$354m in 2011, other operating income rose.

This was due to lower losses on foreclosed properties due to the reduction in foreclosure activity in the US, less deterioration in housing prices during 2012 and, in some markets, improvements in pricing compared with 2011 in the US.

The present value of in-force (PVIF) long-term insurance business asset was broadly in line with 2011. The value of new business from the sale of life insurance products, favourable investment returns, together with the recognition of a PVIF asset relating to the unit-linked pension products in Brazil contributed to a rise. In addition, there were lower adverse changes to non-economic assumptions, including mortality and lapse rates in Hong Kong and North America in 2012. These factors were substantially offset by adverse assumption changes in 2012, principally relating to the valuation of policyholder options and guarantees in Hong Kong, along with the non-recurrence of a gain of US\$237m (US\$243m as reported) recognised upon refinement of the PVIF asset in 2011.

The increase in other operating income was partly offset by losses recognised on the sale of syndicated loans in Europe and on the reclassification of certain businesses to held for sale in South America. In addition, a gain on sale and leaseback of branches in Mexico recognised in 2011 did not recur.

Net insurance claims incurred and movement in liabilities to policyholders

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Net insurance claims incurred and movement in liabilities to policyholders increased by 27% on a reported basis, and by 33% on a constant currency basis.

The increase in liabilities to policyholders largely resulted from gains in the fair value of the assets where the policyholders bear the investment risk, particularly in relation to unit-linked insurance contracts and investment and insurance contracts with DPF.

The higher investment returns were largely the result of positive equity market movements in 2012 compared with losses experienced during 2011 notably in Hong Kong, France and the UK. The gains or losses on the financial assets designated at fair value held to support these insurance and investment contract liabilities are reported in Net income from financial instruments designated at fair value .

The increase in liabilities to policyholders also reflected the increase in new business written, notably in Hong Kong and Brazil as explained under Net earned insurance premiums . This was partly

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offset by a lower increase in reserves in France attributable to the decline in net earned premiums, and a decrease in Argentina due to the sale of the general insurance business in May 2012.

Loan impairment charges and other credit risk provisions

Reported loan impairment charges and other credit risk provisions (LIC s) fell from US\$12bn to US\$8.3bn, a decrease of 31% compared with 2011. On an underlying basis they reduced from US\$10bn to US\$8.0bn.

On a constant currency basis, they declined by US\$3.5bn or 30% compared with 2011. Collectively assessed allowances were down by US\$3.3bn and credit risk provisions fell by US\$456m, partly offset by higher individually assessed impairment charges of US\$258m.

At 31 December 2012, the aggregate balance of customer loan impairment allowances was US\$16bn. This represented 2% of gross loans and advances to customers (net of reverse repos and settlement accounts) in line with 31 December 2011.

The fall in collectively assessed impairment allowances was most significant in RBWM in North America due to the continued reduction in the CML portfolios in run-off, and the sale of the Card and Retail Services business. In addition, lower loan impairment charges in Europe in RBWM were due to improved credit quality as we continued to pro-actively identify and monitor customers facing financial hardship and focused our lending growth on higher quality assets, notably in the UK. These factors were partly offset by higher loan impairment charges and other credit risk provisions in Latin America which were driven by increased delinquency rates in RBWM and CMB, mainly in Brazil.

Impairment of available-for-sale debt securities reduced, mainly in Europe, due to lower charges on available-for-sale ABSs and on Greek sovereign debt, partly offset by an increase in Rest of Asia-Pacific due to a charge on an available-for-sale debt security in GB&M.

Individually assessed impairment allowances increased by 14%, primarily in Europe in CMB, reflecting challenging economic conditions in the UK, Greece, Spain and Turkey. In addition, higher individually assessed impairments in Latin America mainly related to a single exposure in Brazil.

LICs declined in North America, primarily in the CML portfolio, as well as in Europe, Hong Kong and the Middle East and North Africa. The decrease was

partly offset by an increase in Latin America and Rest of Asia-Pacific.

In North America, LICs fell by 51% to US\$3.5bn. Within this, loan impairment charges fell by US\$1.3bn following the sale of the Card and Retail Services business. Loan impairment charges in our CML business in the US fell by 48% to US\$2.6bn, driven by lower lending balances, as we continued to run off the portfolio, and lower delinquency levels. Loan impairment charges continued to be adversely affected by delays in expected cash flows from mortgage loans due, in part, to delays in foreclosure processing, although the effects were less pronounced than in 2011. These decreases were partly offset by an adjustment made following a review completed in the fourth quarter of 2012 which concluded that the estimated average period of time from current status to write-off was ten months for real estate loans. In CMB and GB&M, loan impairment charges increased, mainly in Bermuda, due to individually assessed impairments on a small number of exposures.

In Europe, LICs decreased by 22% to US\$1.9bn. This was mainly in GB&M due to lower credit risk provisions on available-for-sale ABSs as a result of an improvement in underlying asset prices, as well as lower charges on Greek sovereign debt. This was partly offset by increased impairment charges on the legacy credit loans and receivables portfolio. In RBWM, loan impairment charges continued to decline, primarily in the UK, as we focused our lending growth on higher quality assets and continued to pro-actively identify and monitor customers facing financial hardship. As a result, delinquency rates improved across both the secured and unsecured lending portfolios. This was partly offset by an increase in impairments in Turkey due to strong growth in previous years in our RBWM customer loans and advances. In addition, there were higher

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individually assessed provisions in CMB across a range of sectors, reflecting increased stress on the financial status of certain customers in the challenging economic conditions in certain eurozone countries.

In Hong Kong, LICs fell by 53% to US\$74m, largely due to lower specific impairment charges in CMB and the non-recurrence of charges relating to available-for-sale Greek sovereign debt securities.

In the Middle East and North Africa, LICs decreased by US\$6m to US\$286m. Lower loan impairment charges in RBWM reflected repositioning of the book towards higher quality secured lending in previous years. This was largely

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offset by higher LICs recorded for a small number of large exposures in GB&M.

LICs in Latin America and Rest of Asia-Pacific increased compared with 2011. In Latin America, they increased by 29% to US\$2.1bn. This was mainly in Brazil, driven by increased delinquency rates in RBWM and CMB, particularly in the Business Banking portfolio reflecting lower economic growth in 2012. We took a number of steps to reposition the portfolios in RBWM and CMB including improving our collections capabilities, reducing third-party originations and lowering credit limits where appropriate. Loan impairment charges fell in Brazil during the second half of 2012, mainly due to lower collective portfolio provisions.

In Rest of Asia-Pacific, LICs increased by 64% to US\$436m, notably in CMB as a result of the impairment of a corporate exposure in Australia and a small number of corporate exposures in India, as well as a credit risk provision on an available-for-sale debt security in GB&M.

Operating expenses

Reported operating expenses of US\$42.9bn were US\$1.4bn or 3% higher than in 2011. On an underlying basis, costs increased by 11%.

On a constant currency basis, operating expenses in 2012 were US\$2.7bn or 7% higher than in 2011, primarily driven by fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanction laws of US\$1.9bn, of which US\$1.5bn was attributed to, and paid by, HNAH and its subsidiaries and US\$375m was paid by HSBC Holdings. Further provisions for the UK customer redress programmes of US\$2.3bn were raised during 2012 compared with a charge of US\$890m in 2011 (US\$898m as reported). This included a charge for additional estimated redress for possible mis-selling in previous years of PPI policies US\$1.7bn (2011: US\$713m) and interest rate protection products (US\$598m), which took the balance sheet provision for the UK customer redress programmes at 31 December 2012 to US\$2.2bn.

In 2011 we recorded a credit of US\$570m (US\$587m as reported) following a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred pensions which did not recur in 2012.

Costs also rose due to inflationary pressures in certain of our Latin American and Asian markets and increased investment costs in strategic initiatives,

including certain business expansion projects, and in enhanced processes and technology capabilities. We also increased investment in our regulatory and compliance infrastructure primarily in the US.

The above increases in costs were mitigated by strict cost control and the continued delivery of our organisational effectiveness programmes, which resulted in sustainable cost savings of US\$2.0bn. The number of employees (expressed in FTEs) at the end of the 2012 was 10% lower than at the end of 2011. This reflected the planned net reduction of staff numbers across the Group from organisational effectiveness initiatives and business disposals. In 2012, average FTEs fell by 7%.

Business disposals in 2011 and 2012 resulted in a lower cost base, most significantly from the sale of the Card and Retail Services business and the 195 branches in the US.

Restructuring and other related costs were US\$876m in 2012 compared with US\$1.1bn in 2011 (US\$1.1bn as reported).

Share of profit in associates and joint ventures

The reported share of profit in associates and joint ventures was US\$3.6bn, an increase of 9% compared with 2011. On a constant currency basis, it increased by 7%, driven by higher contributions from our associates in mainland China.

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Our share of profits from BoCom rose, as a result of loan growth and higher fee income from cards, management service and guarantees and commitments. This was partly offset by increased operating expenses reflecting investment in staff and technology, and higher loan impairment charges. Profits from Industrial Bank also increased, reflecting continued growth in lending balances and a rise in associated fee income, partly offset by higher operating expenses in line with business expansion, as well as increased loan impairment charges. On 7 January 2013, our holding in Industrial Bank was diluted following its issue of additional share capital to third parties. Our shareholding has now been classified as a financial investment.

Profits from The Saudi British Bank rose, driven by higher revenues reflecting strong balance sheet growth and lower costs resulting from effective control and monitoring.

Profits from Ping An were lower due to market valuation losses on equity securities held by their insurance business, reflecting volatile domestic equity markets, partly offset by increased income from the banking business reflecting the contribution of Ping An Bank (formerly Shenzhen Development

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Bank). On 5 December 2012, we agreed to sell our entire shareholding in Ping An and recognised a gain on the disposal of the associate. Our remaining shareholding has been classified as a financial investment.

Tax expense

The tax charge in 2012 was US\$1.4bn or 35% higher than in 2011 on a reported basis.

The higher tax charge in 2012 reflected the non-tax deductible effect of fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws, together with the non-recognition of the tax benefit in respect of the accounting charge associated with negative fair value movements on own debt. The lower tax charge in 2011 included the

benefit of US deferred tax recognised in 2011 in respect of foreign tax credits.

As a result of these factors, the reported effective tax rate for 2012 was 25.7 % compared with 18.0% for 2011.

In 2012, the tax paid by the Group was US\$9.3bn (2011: US\$8.0bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy included in the pre-tax profit and the timing of payments.

The Group also plays a major role as tax collector for governments in the jurisdictions in which we operate. In 2012, the Group collected US\$8.5bn (2011: US\$8.7bn).

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Report of the Directors: Financial Review (continued)**Consolidated balance sheet***Five-year summary consolidated balance sheet*

	2013	2012	At 31 December		2009
	US\$m	US\$m	2011	2010	US\$m
ASSETS					
Cash and balances at central banks	166,599	141,532	129,902	57,383	60,655
Trading assets	303,192	408,811	330,451	385,052	421,381
Financial assets designated at fair value	38,430	33,582	30,856	37,011	37,181
Derivatives	282,265	357,450	346,379	260,757	250,886
Loans and advances to banks	211,521	152,546	180,987	208,271	179,781
Loans and advances to customers ²⁷	1,080,304	997,623	940,429	958,366	896,231
Financial investments	425,925	421,101	400,044	400,755	369,158
Assets held for sale	4,050	19,269	39,558	1,991	3,118
Other assets	159,032	160,624	156,973	145,103	146,061
Total assets	2,671,318	2,692,538	2,555,579	2,454,689	2,364,452
LIABILITIES AND EQUITY					
Liabilities					
Deposits by banks	129,212	107,429	112,822	110,584	124,872
Customer accounts	1,482,812	1,340,014	1,253,925	1,227,725	1,159,034
Trading liabilities	207,025	304,563	265,192	300,703	268,130
Financial liabilities designated at fair value	89,084	87,720	85,724	88,133	80,092
Derivatives	274,284	358,886	345,380	258,665	247,646
Debt securities in issue	104,080	119,461	131,013	145,401	146,896
Liabilities under insurance contracts	74,181	68,195	61,259	58,609	53,707
Liabilities of disposal groups held for sale	2,804	5,018	22,200	86	3
Other liabilities	117,377	118,123	111,971	109,868	148,411
Total liabilities	2,480,859	2,509,409	2,389,486	2,299,774	2,228,791
Equity					
Total shareholders' equity	181,871	175,242	158,725	147,667	128,299
Non-controlling interests	8,588	7,887	7,368	7,248	7,362
Total equity	190,459	183,129	166,093	154,915	135,661
Total equity and liabilities	2,671,318	2,692,538	2,555,579	2,454,689	2,364,452
<i>Five-year selected financial information</i>					
Called up share capital	9,415	9,238	8,934	8,843	8,705
Capital resources ^{28,29}	194,009	180,806	170,334	167,555	155,729
Undated subordinated loan capital	2,777	2,778	2,779	2,781	2,785
Preferred securities and dated subordinated loan capital ³⁰	48,114	48,260	49,438	54,421	52,126

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Risk-weighted assets and capital ratios²⁸

Risk-weighted assets	1,092,653	1,123,943	1,209,514	1,103,113	1,133,168
	%	%	%	%	%
Core tier 1 ratio	13.6	12.3	10.1	10.5	9.4
Total capital ratio	17.8	16.1	14.1	15.2	13.7

Financial statistics

Loans and advances to customers as a percentage of customer accounts	72.9	74.4	75.0	78.1	77.3
Average total shareholders' equity to average total assets	6.55	6.16	5.64	5.53	4.72
Net asset value per ordinary share at year-end ³¹ (US\$)	9.27	9.09	8.48	7.94	7.17
Number of US\$0.50 ordinary shares in issue (millions)	18,830	18,476	17,868	17,686	17,408
Closing foreign exchange translation rates to US\$:					
US\$1: £	0.605	0.619	0.646	0.644	0.616
US\$1:	0.726	0.758	0.773	0.748	0.694

For footnotes, see page 132.

A more detailed consolidated balance sheet is contained in the Financial Statements on page 419.

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Report of the Directors: Financial Review (continued)**Movement in 2013**

Total reported assets were US\$2.7 trillion, 1% lower than at 31 December 2012, on both a reported and constant currency basis. Our balance sheet remains strong, with a ratio of customer advances to customer accounts of 72.9%.

During 2013, GB&M changed the way it manages repo and reverse repo activities. This led to an increase in 2013 in reverse repo agreements classified as Loans and advances to customers and Loans and advances to banks, and a decline in those included in Trading assets. Similarly, there was an increase in repo agreements classified in Deposits by banks and Customer accounts, with a decline in Trading liabilities. For further details of this change, see page 68.

Loans and advances to customers grew by more than US\$34.2bn in 2013, notably in term and trade-related lending to corporate and commercial customers. Customer accounts increased by over US\$56.3bn in 2013. These movements exclude reverse repo and repo transactions and the effect of currency movements.

The following commentary is on a constant currency basis.

Assets

Cash and balances at central banks increased by 17%, mainly in Europe, driven by the placement of surplus funds reflecting growth in deposits in excess of lending growth and, to a lesser extent, in North America.

Trading assets decreased by US\$110bn or 27%, driven by a fall in reverse repos, reflecting the change in the way GB&M manages these activities noted above. Excluding this, trading assets were broadly in line with December 2012 levels.

Financial assets designated at fair value increased by 16%, in part due to favourable market movements in our European insurance operations coupled with higher investments from premium income received during the year in our insurance businesses, notably in Europe and Hong Kong.

Derivative assets decreased by 22%. Upward movements in yield curves in major currencies led to a decline in the fair value of interest rate contracts, largely in Europe. In North America, declines in fair values of interest rate contracts reflected the increase in swap rates during the year and increased netting.

Loans and advances to banks rose by US\$61.4bn or 41%, including a US\$56.4bn increase in reverse repos reflecting the change in the way

GB&M manages these activities. Excluding this, there was a US\$5.0bn increase driven by higher placements with financial institutions in Hong Kong and Rest of Asia-Pacific.

Loans and advances to customers increased by US\$87.0bn or 9%, including a US\$52.8bn rise in reverse repo balances reflecting the change in the way GB&M manages these activities, which mainly affected balances in North America and the UK. We reclassified over US\$9.5bn of customer lending balances mainly relating to our operations in Panama and first lien mortgage portfolios in the US to Assets held for sale. These were subsequently disposed of in the second half of the year.

Excluding these factors, customer lending balances grew by US\$44.0bn as continued demand for financing led to a rise in term and trade-related lending to CMB and GB&M customers in Hong Kong and, to a lesser extent, in Rest of Asia-Pacific. Commercial real estate and other property-related lending also grew in Hong Kong and Rest of Asia-Pacific. Residential mortgages remained broadly in line with 2012. There was growth in Rest of Asia-Pacific and, to a lesser extent, in Hong Kong, although the rate of growth in Hong Kong fell in the second half of the year. We also continued to grow our portfolio in the UK, which reflected our competitive offering. These factors were broadly offset by the

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continued reduction in the US run-off portfolio. In addition, in the UK there was an increase in corporate overdraft balances, mainly in GB&M that did not meet the criteria for netting, with a corresponding rise in related customer accounts.

Financial investments were broadly in line with 2012 levels. We recorded net sales and maturities of available-for-sale government debt securities in North America. This was broadly offset by an increase in Hong Kong due to net new purchases, together with the re-classification of our shareholding in Industrial Bank.

Assets held for sale decreased by 79%, driven by the completion of the sales of our investment in Ping An and of the non-real estate personal lending portfolio in the US.

Liabilities

Deposits by banks rose by US\$21.4bn or 20% and included an increase of US\$30.5bn relating to repo balances, reflecting the change in the way GB&M manages these activities. Excluding this, balances fell in Europe and North America.

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Report of the Directors: Financial Review (continued)

Customer accounts increased by US\$148.6bn or 11%. This included a rise in repo funding of US\$92.3bn reflecting the change in the way GB&M manages these activities, which mainly affected balances in North America and the UK. In addition, we reclassified over US\$6.5bn of deposit balances, mainly relating to our operations in Panama, to Liabilities of disposal groups held for sale. These were subsequently disposed of in the second half of the year.

Excluding these factors, customer accounts increased by US\$63.4bn, driven by a rise in the UK in RBWM reflecting customers' continued preference for holding higher balances in readily-accessible current and savings accounts in the uncertain economic environment. This was coupled with higher balances in our Payments and Cash Management business in GB&M and CMB. Current accounts also grew in GB&M due to higher balances that did not meet the netting criteria and an increase in short-term deposits. In Hong Kong and Rest of Asia-Pacific, customer accounts rose, mainly in RBWM reflecting customer sentiment, but also in CMB reflecting deposit campaigns in the final quarter of the year. In North America, customer accounts grew, driven by higher balances in our CMB business although this was offset in part by a fall in RBWM, due to re-pricing.

Trading liabilities decreased by US\$102.1bn or 33% and included a fall of US\$114.3bn in repos reflecting the change in the way GB&M manages

these activities. Excluding this, trading liabilities increased by US\$12.2bn driven by increases in Europe, reflecting client demand and volumes.

Financial liabilities designated at fair value remained broadly unchanged during 2013.

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

Debt securities in issue fell by 12%. This was driven by a net redemption in debt securities in issue in Europe together with maturing debt that was not replaced in the US as funding requirements declined due to business disposals and the run-off of the CML portfolio. These factors were partly offset by an increase in Brazil as we substituted wholesale customer deposits for medium-term loan notes.

Liabilities under insurance contracts rose by 9% as a result of liabilities to policyholders established for new business, largely written in Hong Kong.

Liabilities of disposal groups held for sale decreased by US\$1.9bn, driven by the disposal of non-strategic businesses in Latin America and North America.

Equity

Total shareholders' equity rose by 4%, primarily driven by profits generated in the year, partly offset by dividends paid.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency assets and liabilities*

	31 December 2013 compared with 31 December 2012					
	31 Dec 12	Currency translation adjustment ³²	31 Dec 12 at 31 Dec 13 exchange rates	31 Dec 13	Reported	Constant
	as reported			as reported	change	change
	US\$m	US\$m	US\$m	US\$m	%	%
HSBC						
Cash and balances at central banks	141,532	565	142,097	166,599	18	17
Trading assets	408,811	4,379	413,190	303,192	(26)	(27)
Financial assets designated at fair value	33,582	(372)	33,210	38,430	14	16
Derivative assets	357,450	6,480	363,930	282,265	(21)	(22)
Loans and advances to banks	152,546	(2,420)	150,126	211,521	39	41
Loans and advances to customers	997,623	(4,367)	993,256	1,080,304	8	9
Financial investments	421,101	(3,132)	417,969	425,925	1	2
Assets held for sale	19,269	(303)	18,966	4,050	(79)	(79)
Other assets	160,624	3,215	163,839	159,032	(1)	(3)
Total assets	2,692,538	4,045	2,696,583	2,671,318	(1)	(1)
Deposits by banks	107,429	339	107,768	129,212	20	20
Customer accounts	1,340,014	(5,801)	1,334,213	1,482,812	11	11
Trading liabilities	304,563	4,605	309,168	207,025	(32)	(33)
Financial liabilities designated at fair value	87,720	1,155	88,875	89,084	2	-
Derivative liabilities	358,886	6,815	365,701	274,284	(24)	(25)
Debt securities in issue	119,461	(1,088)	118,373	104,080	(13)	(12)
Liabilities under insurance contracts	68,195	115	68,310	74,181	9	9
Liabilities of disposal groups held for sale	5,018	(280)	4,738	2,804	(44)	(41)
Other liabilities	118,123	(1,594)	116,529	117,377	-	1
Total liabilities	2,509,409	4,266	2,513,675	2,480,859	(1)	(1)
Total shareholders' equity	175,242	(463)	174,779	181,871	4	4
Non-controlling interests	7,887	(43)	7,844	8,588	9	9
Total equity	183,129	(506)	182,623	190,459	4	4
Total equity and liabilities	2,692,538	3,760	2,696,298	2,671,318	(1)	(1)

For footnote, see page 132.

In 2013, GB&M changed the way it manages repo and reverse repo activities in the Credit and Rates businesses, which were previously being managed in a trading environment. During the year, the repo and reverse repo business activities were organised into trading and non-trading portfolios, with separate risk management procedures. This resulted in an increase in the amount of reverse repos classified as Loans and advances to customers and Loans and advances to banks, and a decline in the amount classified as Trading assets at 31 December 2013, compared with previous year-ends. Similarly, at 31 December 2013 there was an increase in the amount of repos classified as Customer

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accounts and Deposits by banks , with a

decline in the amount classified as Trading liabilities , compared with previous year-ends. The increase in amortised cost balances and the decrease in trading balances primarily occurred in Europe and North America, specifically the UK and the US.

The impact of repos and reverse repos on the balance sheet is set out in the table below. The table also provides a combined view of customer lending and customer deposits which, by taking into account loans and advances to customers and customer account balances reported as held for sale, more accurately reflects the overall size of our lending and deposit books.

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Report of the Directors: Financial Review (continued)

Combined view of lending and deposits

	2013	2012	Change
	US\$m	US\$m	%
Customers – amortised cost			
Loans and advances to customers	1,080,304	997,623	8
loans and other receivables	992,089	962,972	3
reverse repos	88,215	34,651	155
Loans and advances to customers reported in Assets held for sale ⁶	1,703	6,124	(72)
Combined customer lending	1,082,007	1,003,747	8
Customer accounts	1,482,812	1,340,014	11
cash deposits and other accounts	1,361,297	1,311,396	4
repos	121,515	28,618	325
Customer accounts reported in Liabilities of disposal groups held for sale	2,187	2,990	(27)
Combined customer deposits	1,484,999	1,343,004	11
Banks – amortised cost			
Loans and advances to banks	211,521	152,546	39
loans and other receivables	120,046	117,085	3
reverse repos	91,475	35,461	158
Deposits by banks	129,212	107,429	20
cash deposits and other accounts	86,507	95,480	(9)
repos	42,705	11,949	257
Customers and banks – fair value			
Trading assets – reverse repos	10,120	118,681	(91)
loans and advances to customers	7,180	73,666	(90)
loans and advances to banks	2,940	45,015	(93)
Trading liabilities – repos	17,421	130,223	(87)
customer accounts	9,611	103,483	(91)
deposits by banks	7,810	26,740	(71)

For footnote, see page 132.

Financial investments

	At 31 December 2013			Equity	At 31 December 2012	
	Equity securities	Debt securities	Total		Equity securities	Debt securities
	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn
Balance Sheet Management		314.4	314.4		293.4	293.4
Insurance entities		46.4	46.4		43.4	43.4
Structured entities	0.1	22.6	22.7		24.7	24.7
Principal investments	2.7		2.7	2.9		2.9

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Other	6.3	33.4	39.7	2.9	53.8	56.7
	9.1	416.8	425.9	5.8	415.3	421.1

The table above analyses the Group's holdings of financial investments by business activity. Further information can be found in the following sections:

Balance Sheet Management (page 238) for a description of the activities and an analysis of third party assets in balance sheet management.

Risk management of insurance operations (page 249) includes an analysis of the financial investments within our insurance operations by the type of contractual liabilities that they back.

Structured entities (page 550) for further information about the nature of securities investment conduits in which the above financial investments are held.

Equity securities classified as available for sale (page 235) includes private equity holdings and other strategic investments.

Other represents financial investments held in certain locally managed treasury portfolios and other GB&M portfolios held for specific business activities.

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Report of the Directors: Financial Review (continued)**Average balance sheet****Average balance sheet and net interest income**

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

Average balances are based on daily averages for the principal areas of our banking activities with monthly or less frequent averages used elsewhere.

Balances and transactions with fellow subsidiaries are reported gross in the principal

commercial banking and consumer finance entities and the elimination entries are included within Other operations .

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

Assets

	2013			2012			2011		
	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %	Average balance US\$m	Interest income US\$m	Yield %
Summary									
Interest-earning assets measured at amortised cost (itemised below)	1,669,368	51,192	3.07	1,625,068	56,702	3.49	1,622,658	63,005	3.88
Trading assets and financial assets designated at fair value ^{55,56}	354,817	5,763	1.62	368,406	6,931	1.88	410,038	8,671	2.11
Impairment provisions	(15,954)			(17,421)			(18,738)		
Non-interest-earning assets	683,785			730,901			752,965		
Total assets and interest income	2,692,016	56,955	2.12	2,706,954	63,633	2.35	2,766,923	71,676	2.59
Average yield on all interest-earning assets			2.81			3.19			3.53

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Short-term funds and loans and advances to banks										
Europe	HSBC Bank	104,187	938	0.90	86,496	1,040	1.20	62,489	1,186	1.90
	HSBC Private Banking Holdings (Suisse)	15,400	10	0.06	2,072	9	0.43	1,886	14	0.74
	HSBC France	36,874	127	0.34	33,199	176	0.53	36,023	477	1.32
Hong Kong	Hang Seng Bank	16,496	251	1.52	16,396	283	1.73	17,761	334	1.88
	The Hongkong and Shanghai Banking Corporation	16,294	192	1.18	18,379	224	1.22	22,033	233	1.06
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	46,684	853	1.83	42,814	805	1.88	41,692	920	2.21
	HSBC Bank Malaysia	5,865	173	2.95	5,375	157	2.92	6,049	174	2.88
MENA	HSBC Bank Middle East	5,638	34	0.60	5,922	41	0.69	4,467	42	0.94
North America	HSBC Bank USA	25,105	87	0.35	23,768	106	0.45	27,495	97	0.35
	HSBC Bank Canada	3,174	30	0.95	1,677	17	1.01	2,886	23	0.80
Latin America	HSBC Mexico	2,979	114	3.83	3,053	119	3.90	3,383	130	3.84
	Brazilian operations ⁵⁷	11,076	788	7.11	14,610	1,155	7.91	18,954	2,036	10.74
	HSBC Bank Argentina	1,337	31	2.32	396	45	11.36	341	33	9.68
Other operations		10,158	27	0.27	21,822	130	0.60	16,290	161	0.99
		301,267	3,655	1.21	275,979	4,307	1.56	261,749	5,860	2.24

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		Average	2013 Interest		Average	2012 Interest		Average	2011 Interest	
		balance	income	Yield	balance	income	Yield	balance	income	Yield
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Loans and advances to customers										
Europe	HSBC Bank	306,065	10,686	3.49	289,586	10,596	3.66	299,775	10,225	3.41
	HSBC Private Banking Holdings (Suisse)	15,235	194	1.27	12,591	199	1.58	14,631	255	1.74
	HSBC France	67,062	1,670	2.49	69,021	1,713	2.48	75,033	2,087	2.78
	HSBC Finance	173	10	5.78	886	42	4.74	1,486	98	6.59
Hong Kong	Hang Seng Bank	72,537	2,179	3.00	64,907	1,895	2.92	63,198	1,569	2.48
	The Hongkong and Shanghai Banking Corporation	113,936	2,631	2.31	100,203	2,410	2.41	91,209	1,975	2.17
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	126,095	5,427	4.30	109,298	5,231	4.79	99,683	4,863	4.88
	HSBC Bank Malaysia	13,928	683	4.90	13,456	707	5.25	12,118	657	5.42
MENA	HSBC Bank Middle East	25,537	1,124	4.40	24,012	1,214	5.06	22,494	1,296	5.76
North America	HSBC Bank USA	58,177	1,786	3.07	59,806	1,742	2.91	67,817	3,226	4.76
	HSBC Finance	34,146	3,064	8.97	43,887	3,904	8.90	59,857	5,842	9.76
	HSBC Bank Canada	45,646	1,497	3.28	44,673	1,588	3.55	44,512	1,683	3.78
Latin America	HSBC Mexico	15,335	1,658	10.81	14,411	1,613	11.19	14,290	1,630	11.41
	Brazilian operations ⁵⁷	25,732	4,608	17.91	27,621	5,468	19.80	30,212	6,584	21.79
	HSBC Bank Argentina	3,615	799	22.10	3,644	718	19.70	3,320	524	15.78
Other operations		23,537	704	2.99	56,654	2,003	3.54	45,653	2,736	5.99
		946,756	38,720	4.09	934,656	41,043	4.39	945,288	45,250	4.79
Financial investments										
Europe	HSBC Bank	88,406	1,223	1.38	80,475	1,275	1.58	95,522	1,631	1.71
	HSBC Private Banking Holdings (Suisse)	13,509	183	1.35	5,722	107	1.87	13,521	247	1.83
	HSBC France	13,733	94	0.68	11,208	130	1.16	4,662	133	2.85
Hong Kong	Hang Seng Bank	31,502	601	1.91	29,319	590	2.01	26,095	596	2.28
	The Hongkong and Shanghai Banking Corporation	56,325	291	0.52	48,695	320	0.66	52,357	399	0.76
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	48,415	1,490	3.08	46,095	1,501	3.26	40,033	1,422	3.55
	HSBC Bank Malaysia	2,197	72	3.28	1,798	59	3.28	1,013	33	3.26
MENA	HSBC Bank Middle East	11,838	113	0.95	10,266	113	1.10	10,944	150	1.37
North America	HSBC Bank USA	56,302	884	1.57	61,510	1,092	1.78	50,357	1,250	2.48
	HSBC Finance				941	67	7.12	2,956	104	3.52
	HSBC Bank Canada	20,364	279	1.37	21,179	297	1.40	17,821	307	1.72
Latin America	HSBC Mexico	7,782	351	4.51	8,021	379	4.73	9,767	473	4.84
	Brazilian operations ⁵⁷	7,404	740	9.99	9,527	1,019	10.70	10,072	1,206	11.97
	HSBC Bank Argentina	451	71	15.74	701	96	13.69	651	99	15.21
Other operations		35,081	1,610	4.59	51,872	2,033	3.92	48,288	2,179	4.51
		393,309	8,002	2.03	387,329	9,078	2.34	384,059	10,229	2.66

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Assets (continued)*

		2013			2012			2011		
		Average	Interest		Average	Interest		Average	Interest	
		balance	income	Yield	balance	income	Yield	balance	income	Yield
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Other interest-earning assets										
Europe	HSBC Bank	73,607	64	0.09	119,175	153	0.13	53,394	101	0.19
	HSBC Private Banking									
	Holdings (Suisse)	7,441	69	0.93	14,461	189	1.31	19,568	262	1.34
	HSBC France	14,294	111	0.78	13,107	121	0.92	10,037	160	1.59
Hong Kong	Hang Seng Bank	2,088	14	0.67	1,003	9	0.90	854	9	1.05
	The Hongkong and									
	Shanghai Banking									
	Corporation	50,474	452	0.90	43,871	441	1.01	32,917	383	1.16
Rest of	The Hongkong and									
Asia-Pacific	Shanghai Banking									
	Corporation	11,895	46	0.39	15,320	40	0.26	15,414	53	0.34
	HSBC Bank Malaysia	456	2	0.44	553	4	0.72	578	8	1.38
MENA	HSBC Bank Middle East	1,888	87	4.61	1,914	72	3.76	698	22	3.15
North America	HSBC Bank USA	6,386	103	1.61	12,324	872	7.08	15,187	903	5.95
	HSBC Finance	6,821	19	0.28	7,723	656	8.49	6,014	671	11.16
	HSBC Bank Canada	1,691	42	2.48	2,340	69	2.95	3,109	59	1.90
Latin America	HSBC Mexico	265	6	2.26	614	39	6.35	383	27	7.05
	Brazilian operations ⁵⁷	2,394	107	4.47	1,338	100	7.47	2,031	54	2.66
	HSBC Bank Argentina	93			106	4	4	88		
Other operations		(151,757)	(307)		(206,745)	(495)		(128,710)	(1,046)	
		28,036	815	2.91	27,104	2,274	8.39	31,562	1,666	5.28
Total interest-earning assets										
Europe	HSBC Bank	572,265	12,911	2.26	575,732	13,064	2.27	511,180	13,143	2.57
	HSBC Private Banking									
	Holdings (Suisse)	51,585	456	0.88	34,846	504	1.45	49,606	778	1.57
	HSBC France	131,963	2,002	1.52	126,535	2,140	1.69	125,755	2,857	2.27
	HSBC Finance	173	10	5.78	889	42	4.72	1,486	98	6.59
Hong Kong	Hang Seng Bank	122,623	3,045	2.48	111,625	2,777	2.49	107,908	2,508	2.32
	The Hongkong and									
	Shanghai Banking									
	Corporation	237,029	3,566	1.50	211,148	3,395	1.61	198,516	2,990	1.51
Rest of	The Hongkong and									
Asia-Pacific	Shanghai Banking									
	Corporation	233,089	7,816	3.35	213,527	7,577	3.55	196,822	7,258	3.69
	HSBC Bank Malaysia	22,446	930	4.14	21,182	927	4.38	19,758	872	4.41
MENA	HSBC Bank Middle East	44,901	1,358	3.02	42,114	1,440	3.42	38,603	1,510	3.91
North America	HSBC Bank USA	145,970	2,860	1.96	157,408	3,812	2.42	160,856	5,476	3.40

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	HSBC Finance	40,967	3,083	7.53	54,342	4,627	8.51	68,827	6,617	9.61
	HSBC Bank Canada	70,875	1,848	2.61	69,869	1,971	2.82	68,328	2,072	3.03
Latin America	HSBC Mexico	26,361	2,129	8.08	26,099	2,150	8.24	27,823	2,260	8.12
	Brazilian operations ⁵⁷	46,606	6,243	13.40	53,096	7,742	14.58	61,269	9,880	16.13
	HSBC Bank Argentina	5,496	901	16.39	4,847	863	17.80	4,400	656	14.91
Other operations		(82,981)	2,034		(78,191)	3,671		(18,479)	4,030	
		1,669,368	51,192	3.07	1,625,068	56,702	3.49	1,622,658	63,005	3.88

For footnotes, see page 133a.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Equity and liabilities*

		2013			2012			2011		
		Average	Interest		Average	Interest		Average	Interest	
		balance	expense	Cost	balance	expense	Cost	balance	expense	Cost
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Summary										
Interest-bearing liabilities measured at amortised cost (itemised below)		1,426,180	15,653	1.10	1,401,254	19,030	1.36	1,433,566	22,343	1.56
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)		301,353	3,027	1.00	318,883	3,445	1.08	355,345	4,564	1.28
Non-interest bearing current accounts		184,370			177,085			162,369		
Total equity and other non-interest bearing liabilities		780,113			809,732			815,643		
Total equity and liabilities		2,692,016	18,680	0.69	2,706,954	22,475	0.83	2,766,923	26,907	0.97
Average cost on all interest-bearing liabilities				1.08			1.31			1.50
Deposits by banks⁵⁸										
Europe	HSBC Bank	29,394	209	0.71	27,738	435	1.57	33,764	529	1.57
	HSBC Private Banking Holdings (Suisse)	379	1	0.26	657	2	0.30	874	2	0.23
	HSBC France	20,081	85	0.42	26,026	171	0.66	29,329	396	1.35
Hong Kong	Hang Seng Bank	1,101	15	1.36	1,305	15	1.15	1,903	7	0.37
	The Hongkong and Shanghai Banking Corporation	6,638	13	0.20	7,648	12	0.16	8,389	13	0.15
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	9,701	103	1.06	10,668	159	1.49	10,613	159	1.50
	HSBC Bank Malaysia	865	20	2.31	961	20	2.08	360	9	2.50
MENA	HSBC Bank Middle East	1,488	4	0.27	1,588	6	0.38	1,511	6	0.40
North America	HSBC Bank USA	8,233	17	0.21	7,587	19	0.25	7,730	18	0.23
	HSBC Bank Canada	2,572	22	0.86	1,613	9	0.56	760	15	1.97
Latin America	HSBC Mexico	1,368	64	4.68	1,103	52	4.71	1,167	62	5.31
	Brazilian operations ⁵⁷	3,466	103	2.97	4,323	194	4.49	6,433	331	5.15
	HSBC Bank Argentina	20	2	10.00	44	3	6.82	24	2	8.33
Other operations		1,576	33	2.09	1,542	63	4.09	3,242	42	1.30
		86,882	691	0.80	92,803	1,160	1.25	106,099	1,591	1.50
Financial liabilities designated at fair value own debt issued⁵⁹										
Europe	HSBC Holdings	19,719	366	1.86	23,864	446	1.87	19,654	342	1.74
	HSBC Bank	28,969	443	1.53	28,046	556	1.98	26,504	462	1.74
	HSBC France	9,173	67	0.73	7,147	118	1.65	6,907	174	2.52
North America	HSBC Bank USA	1,933	35	1.81	1,853	38	2.05	1,642	38	2.31
	HSBC Finance	8,878	80	0.90	12,147	184	1.51	17,108	289	1.69

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Other operations	3,661	(24)	(0.66)	1,959	(17)	(0.87)	1,820	8	0.44
	72,333	967	1.34	75,016	1,325	1.77	73,635	1,313	1.78

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Equity and liabilities (continued)*

		2013			2012			2011		
		Average	Interest		Average	Interest		Average	Interest	
		balance	expense	Cost	balance	expense	Cost	balance	expense	Cost
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Customer accounts⁶⁰										
Europe	HSBC Bank	350,722	2,296	0.65	309,808	2,445	0.79	306,060	2,387	0.78
	HSBC Private Banking Holdings (Suisse)	16,453	70	0.43	15,926	84	0.53	22,025	163	0.74
	HSBC France	49,739	255	0.51	47,974	403	0.84	49,363	650	1.32
Hong Kong	Hang Seng Bank	91,778	360	0.39	85,425	365	0.43	83,220	342	0.41
	The Hongkong and Shanghai Banking Corporation	208,859	254	0.12	190,654	250	0.13	177,336	231	0.13
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	136,212	2,300	1.69	129,419	2,381	1.84	121,237	2,277	1.88
	HSBC Bank Malaysia	13,737	296	2.15	13,624	311	2.28	13,326	299	2.24
MENA	HSBC Bank Middle East	18,387	106	0.58	17,477	163	0.93	17,484	237	1.36
North America	HSBC Bank USA	65,578	115	0.18	68,134	224	0.33	83,988	340	0.40
	HSBC Bank Canada	42,936	340	0.79	45,116	344	0.76	44,833	358	0.80
Latin America	HSBC Mexico	16,808	455	2.71	17,735	528	2.98	18,139	538	2.97
	Brazilian operations ⁵⁷	21,596	1,545	7.15	30,352	2,411	7.94	41,194	4,471	10.85
	HSBC Bank Argentina	3,318	343	10.34	3,594	268	7.46	3,149	200	6.35
Other operations		68,521	328	0.48	77,574	701	0.90	76,972	963	1.25
		1,104,644	9,063	0.82	1,052,812	10,878	1.03	1,058,326	13,456	1.27
Debt securities in issue										
Europe	HSBC Bank	64,528	768	1.19	69,294	989	1.43	79,670	982	1.23
	HSBC France	13,365	54	0.40	14,801	118	0.80	18,043	260	1.44
Hong Kong	Hang Seng Bank	1,393	12	0.86	1,606	15	0.93	1,424	13	0.91
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	7,493	186	2.48	7,732	241	3.12	7,918	263	3.32
	HSBC Bank Malaysia	967	26	2.69	1,016	25	2.46	568	18	3.17
MENA	HSBC Bank Middle East	3,057	64	2.09	3,769	83	2.20	3,870	77	1.99
North America	HSBC Bank USA	14,012	415	2.96	12,738	390	3.06	12,535	395	3.15
	HSBC Finance	19,888	739	3.72	29,198	1,059	3.63	40,629	1,413	3.48
	HSBC Bank Canada	13,158	342	2.60	12,675	390	3.08	12,061	392	3.25
Latin America	HSBC Mexico	813	41	5.04	897	51	5.69	1,074	57	5.31
	Brazilian operations ⁵⁷	10,963	863	7.87	9,114	732	8.03	6,825	708	10.37
	HSBC Bank Argentina	52	10	19.23	121	20	16.53	66	11	16.67

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Other operations	1,287	662	51.44	(1,613)	642	(39.80)	(3,201)	671	(20.96)
	150,976	4,182	2.77	161,348	4,755	2.95	181,482	5,260	2.90

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

		Average	2013		Average	2012		Average	2011	
		balance	Interest	Cost	balance	Interest	Cost	balance	Interest	Cost
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Other interest-bearing liabilities										
Europe	HSBC Bank	96,464	659	0.68	126,279	671	0.53	66,449	595	0.90
	HSBC Private Banking Holdings (Suisse)	7,869	13	0.17	4,195	4	0.10	3,006	8	0.27
	HSBC France	26,159	77	0.29	20,853	28	0.13	20,294	170	0.84
	HSBC Finance	23			303	2	0.66	828	6	0.72
Hong Kong	Hang Seng Bank	2,021	48	2.38	1,715	39	2.27	1,422	25	1.76
	The Hongkong and Shanghai Banking Corporation	14,280	76	0.53	11,213	71	0.63	12,759	72	0.56
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	45,776	414	0.90	40,827	406	0.99	35,562	361	1.02
	HSBC Bank Malaysia	1,339	8	0.60	1,069	16	1.50	1,121	17	1.52
MENA	HSBC Bank Middle East	2,557	58	2.27	1,681	76	4.52	1,506	50	3.32
North America	HSBC Bank USA	17,793	176	0.99	26,255	408	1.55	23,431	820	3.50
	HSBC Finance	5,265	220	4.18	3,196	162	5.07	4,345	29	0.67
	HSBC Bank Canada	3,007	25	0.83	772	4	0.52	360	2	0.56
	HSBC Markets Inc	3,330	36	1.08	1,202	36	3.00	2,193	40	1.82
Latin America	HSBC Mexico	1,658	19	1.15	1,305	19	1.46	1,379	22	1.60
	Brazilian operations ⁵⁷	3,497	189	5.40	4,705	362	7.69	4,223	335	7.93
	HSBC Bank Argentina	29	3	10.34	26	3	11.54	15	1	6.67
Other operations		(219,722)	(1,271)		(226,321)	(1,395)		(164,869)	(1,830)	
		11,345	750	6.61	19,275	912	4.73	14,024	723	5.16
Total interest-bearing liabilities										
Europe	HSBC Bank	570,077	4,375	0.77	561,165	5,096	0.91	512,447	4,955	0.97
	HSBC Private Banking Holdings (Suisse)	24,701	84	0.34	20,778	90	0.43	25,905	173	0.67
	HSBC France	118,517	538	0.45	116,801	838	0.72	123,936	1,650	1.33
	HSBC Finance	23			303	2	0.66	828	6	0.72
Hong Kong	Hang Seng Bank	96,293	435	0.45	90,051	434	0.48	87,969	387	0.44
	The Hongkong and Shanghai Banking Corporation	229,777	343	0.15	209,515	333	0.16	198,484	316	0.16
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	199,182	3,003	1.51	188,646	3,187	1.69	175,330	3,060	1.75
	HSBC Bank Malaysia	16,908	350	2.07	16,670	372	2.23	15,375	343	2.23
MENA	HSBC Bank Middle East	25,489	232	0.91	24,515	328	1.34	24,371	370	1.52
North America	HSBC Bank USA	107,549	758	0.70	116,567	1,079	0.93	129,326	1,611	1.25
	HSBC Finance	34,031	1,039	3.05	44,541	1,405	3.15	62,082	1,731	2.79
	HSBC Bank Canada	61,673	729	1.18	60,176	747	1.24	58,014	767	1.32
	HSBC Markets Inc	3,330	36	1.08	1,202	36	3.00	2,193	40	1.82

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Latin America	HSBC Mexico	20,647	579	2.80	21,040	650	3.09	21,759	679	3.12
	Brazilian operations ⁵⁷	39,522	2,700	6.83	48,494	3,699	7.63	58,675	5,845	9.96
	HSBC Bank Argentina	3,419	358	10.47	3,785	294	7.77	3,254	217	6.67
Other operations		(124,958)	94		(122,995)	440		(66,382)	193	
		1,426,180	15,653	1.10	1,401,254	19,030	1.36	1,433,566	22,343	1.56

For footnotes, see page 133a.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Net interest margin*⁶¹

		2013	2012	2011
		%	%	%
Total		2.13	2.32	2.51
Europe	HSBC Bank	1.49	1.38	1.60
	HSBC Private Banking Holdings (Suisse)	0.72	1.19	1.22
	HSBC France	1.11	1.03	0.96
	HSBC Finance	5.78	4.50	6.19
Hong Kong	Hang Seng Bank	2.13	2.10	1.97
	The Hongkong and Shanghai Banking Corporation	1.36	1.45	1.35
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	2.06	2.06	2.13
	HSBC Bank Malaysia	2.58	2.62	2.68
MENA	HSBC Bank Middle East	2.51	2.64	2.95
North America	HSBC Bank USA	1.44	1.74	2.40
	HSBC Finance	4.99	5.93	7.10
	HSBC Bank Canada	1.58	1.75	1.91
Latin America	HSBC Mexico	5.88	5.75	5.68
	Brazilian operations ⁵⁷	7.60	7.61	6.59
	HSBC Bank Argentina	9.88	11.74	9.98

Distribution of average total assets

		2013	2012	2011
		%	%	%
Europe	HSBC Bank	40.1	44.8	41.5
	HSBC Private Banking Holdings (Suisse)	2.0	1.7	2.1
	HSBC France	11.4	11.5	10.3
	HSBC Finance	11.4	11.5	10.3
Hong Kong	Hang Seng Bank	5.3	4.8	4.5
	The Hongkong and Shanghai Banking Corporation	13.1	12.0	11.0
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	11.9	11.3	10.6
	HSBC Bank Malaysia	1.0	1.0	0.8
MENA	HSBC Bank Middle East	2.0	1.8	1.6
North America	HSBC Bank USA	8.7	10.2	9.7
	HSBC Finance	1.7	2.1	2.7
	HSBC Bank Canada	3.2	3.2	3.0
Latin America	HSBC Mexico	1.5	1.5	1.5
	Brazilian operations ⁵⁷	2.3	2.7	3.0
	HSBC Bank Argentina	9.88	11.74	9.98

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Other operations (including consolidation adjustments)	(4.2)	(8.8)	(2.6)
	100.0	100.0	100.0

For footnotes, see page 133a.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Analysis of changes in net interest income and net interest expense**

The following tables allocate changes in net interest income and net interest expense between volume and rate for 2013 compared with 2012, and for 2012 compared with 2011. We isolate volume variances and allocate any change arising from both volume and rate to rate.

Interest income

		Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011			
		2013 US\$m	Volume US\$m	Rate US\$m	2012 US\$m	Volume US\$m	Rate US\$m	2011 US\$m
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	938	212	(314)	1,040	456	(602)	1,186
	HSBC Private Banking Holdings (Suisse)	10	57	(56)	9	1	(6)	14
	HSBC France	127	19	(68)	176	(37)	(264)	477
Hong Kong	Hang Seng Bank	251	2	(34)	283	(26)	(25)	334
	The Hongkong and Shanghai Banking Corporation	192	(25)	(7)	224	(39)	30	233
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	853	73	(25)	805	25	(140)	920
	HSBC Bank Malaysia	173	14	2	157	(19)	2	174
MENA	HSBC Bank Middle East	34	(2)	(5)	41	14	(15)	42
North America	HSBC Bank USA	87	6	(25)	106	(13)	22	97
	HSBC Bank Canada	30	15	(2)	17	(10)	4	23
Latin America	HSBC Mexico	114	(3)	(2)	119	(13)	2	130
	Brazilian operations ⁵⁷	788	(280)	(87)	1,155	(467)	(414)	2,036
	HSBC Bank Argentina	31	107	(121)	45	5	7	33
Other operations		27	(69)	(34)	130	55	(86)	161
		3,655	394	(1,046)	4,307	319	(1,872)	5,860
Loans and advances to customers								
Europe	HSBC Bank	10,686	603	(513)	10,596	(347)	718	10,225
	HSBC Private Banking Holdings (Suisse)	194	42	(47)	199	(35)	(21)	255
	HSBC France	1,670	(49)	6	1,713	(167)	(207)	2,087
	HSBC Finance	10	(34)	2	42	(40)	(16)	98
Hong Kong	Hang Seng Bank	2,179	223	61	1,895	42	284	1,569
	The Hongkong and Shanghai Banking Corporation	2,631	331	(110)	2,410	195	240	1,975
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	5,427	805	(609)	5,231	469	(101)	4,863
	HSBC Bank Malaysia	683	25	(49)	707	73	(23)	657
MENA	HSBC Bank Middle East	1,124	77	(167)	1,214	87	(169)	1,296
North America	HSBC Bank USA	1,786	(47)	91	1,742	(381)	(1,103)	3,226
	HSBC Finance	3,064	(867)	27	3,904	(1,559)	(379)	5,842
	HSBC Bank Canada	1,497	35	(126)	1,588	6	(101)	1,683
Latin America	HSBC Mexico	1,658	103	(58)	1,613	14	(31)	1,630
	Brazilian operations ⁵⁷	4,608	(374)	(486)	5,468	(565)	(551)	6,584
	HSBC Bank Argentina	799	(6)	87	718	51	143	524

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Other operations

704	(761)	(538)	2,003	659	(1,392)	2,736
38,720	531	(2,854)	41,043	(509)	(3,698)	45,250

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Interest income (continued)*

		Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011			
		2013	Volume	Rate	2012	Volume	Rate	2011
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Financial investments								
Europe	HSBC Bank	1,223	125	(177)	1,275	(257)	(99)	1,631
	HSBC Private Banking Holdings (Suisse)	183	146	(70)	107	(143)	3	247
	HSBC France	94	29	(65)	130	187	(190)	133
Hong Kong	Hang Seng Bank	601	44	(33)	590	74	(80)	596
	The Hongkong and Shanghai Banking Corporation	291	50	(79)	320	(28)	(51)	399
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	1,490	76	(87)	1,501	215	(136)	1,422
	HSBC Bank Malaysia	72	13		59	26		33
MENA	HSBC Bank Middle East	113	17	(17)	113	(9)	(28)	150
North America	HSBC Bank USA	884	(93)	(115)	1,092	277	(435)	1,250
	HSBC Finance		(67)		67	(71)	34	104
	HSBC Bank Canada	279	(11)	(7)	297	58	(68)	307
Latin America	HSBC Mexico	351	(11)	(17)	379	(85)	(9)	473
	Brazilian operations ⁵⁷	740	(227)	(52)	1,019	(65)	(122)	1,206
	HSBC Bank Argentina	71	(34)	9	96	8	(11)	99
Other operations		1,610	(658)	235	2,033	162	(308)	2,179
		8,002	140	(1,216)	9,078	87	(1,238)	10,229

Interest expense

		Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011			
		2013	Volume	Rate	2012	Volume	Rate	2011
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Deposits by banks								
Europe	HSBC Bank	209	26	(252)	435	(95)	1	529
	HSBC Private Banking Holdings (Suisse)	1	(1)		2			2
	HSBC France	85	(39)	(47)	171	(45)	(180)	396
Hong Kong	Hang Seng Bank	15	(2)	2	15	(2)	10	7
	The Hongkong and Shanghai Banking Corporation	13	(2)	3	12	(1)		13
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	103	(14)	(42)	159	1	(1)	159
	HSBC Bank Malaysia	20	(2)	2	20	15	(4)	9
MENA	HSBC Bank Middle East	4		(2)	6			6

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North America	HSBC Bank USA	17	2	(4)	19		1	18
	HSBC Bank Canada	22	5	8	9	17	(23)	15
Latin America	HSBC Mexico	64	12		52	(3)	(7)	62
	Brazilian operations ⁵⁷	103	(39)	(52)	194	(109)	(28)	331
	HSBC Bank Argentina	2	(2)	1	3	2	(1)	2
Other operations		33		(30)	63	(22)	43	42
		691	(74)	(395)	1,160	(199)	(232)	1,591

For footnote, see page 133a.

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Report of the Directors: Financial Review (continued)

		Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011			
		2013 US\$m	Volume US\$m	Rate US\$m	2012 US\$m	Volume US\$m	Rate US\$m	2011 US\$m
Customer accounts								
Europe	HSBC Bank	2,296	323	(472)	2,445	29	29	2,387
	HSBC Private Banking Holdings (Suisse)	70	3	(17)	84	(45)	(34)	163
	HSBC France	255	15	(163)	403	(18)	(229)	650
Hong Kong	Hang Seng Bank	360	27	(32)	365	9	14	342
	The Hongkong and Shanghai Banking Corporation	254	24	(20)	250	17	2	231
Rest of Asia Pacific	The Hongkong and Shanghai Banking Corporation	2,300	125	(206)	2,381	154	(50)	2,277
	HSBC Bank Malaysia	296	3	(18)	311	7	5	299
MENA	HSBC Bank Middle East	106	8	(65)	163		(74)	237
North America	HSBC Bank USA	115	(8)	(101)	224	(63)	(53)	340
	HSBC Bank Canada	340	(17)	13	344	2	(16)	358
Latin America	HSBC Mexico	455	(28)	(45)	528	(12)	2	538
	Brazilian operations ⁵⁷	1,545	(695)	(171)	2,411	(1,176)	(884)	4,471
	HSBC Bank Argentina	343	(21)	96	268	28	40	200
Other operations		328	(82)	(291)	701	8	(270)	963
		9,063	534	(2,349)	10,878	(70)	(2,508)	13,456
Financial liabilities designated at fair value – own debt issued		967	(47)	(311)	1,325	25	(13)	1,313
Debt securities in issue								
Europe	HSBC Bank	768	(68)	(153)	989	(128)	135	982
	HSBC France	54	(11)	(53)	118	(47)	(95)	260
Hong Kong	Hang Seng Bank	12	(2)	(1)	15	2		13
Rest of Asia Pacific	The Hongkong and Shanghai Banking Corporation	186	(7)	(48)	241	(6)	(16)	263
	HSBC Bank Malaysia	26	(1)	2	25	14	(7)	18
MENA	HSBC Bank Middle East	64	(16)	(3)	83	(2)	8	77
North America	HSBC Bank USA	415	39	(14)	390	6	(11)	395
	HSBC Finance	739	(338)	18	1,059	(398)	44	1,413
	HSBC Bank Canada	342	15	(63)	390	20	(22)	392
Latin America	HSBC Mexico	41	(5)	(5)	51	(9)	3	57
	Brazilian operations ⁵⁷	863	148	(17)	732	237	(213)	708
	HSBC Bank Argentina	10	(11)	1	20	9		11
Other operations		662	(1,154)	1,174	642	(333)	304	671
		4,182	(306)	(267)	4,755	(588)	83	5,260

For footnote, see page 133a.

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Report of the Directors: Financial Review (continued)**Short-term borrowings**

We include short-term borrowings within customer accounts, deposits by banks, debt securities in issue and trading liabilities and do not show short-term borrowings separately on the balance sheet. Short-term borrowings are defined by the US Securities and Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

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

Repos and short-term bonds

	2013	2012	2011
	US\$m	US\$m	US\$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	181,641	170,790	135,239
Average amount outstanding during the year	218,580	206,352	236,290
Maximum quarter-end balance outstanding during the year	210,452	176,162	202,305
Weighted average interest rate during the year	0.3%	0.4%	0.6%
Weighted average interest rate at the year-end	0.5%	0.5%	1.0%
Short-term bonds			
Outstanding at 31 December	40,667	44,240	35,415
Average amount outstanding during the year	46,455	40,349	40,679
Maximum quarter-end balance outstanding during the year	54,933	44,240	42,785
Weighted average interest rate during the year	1.4%	1.4%	1.9%
Weighted average interest rate at the year-end	0.7%	1.3%	2.2%
Contractual obligations			

The table below provides details of our material contractual obligations as at 31 December 2013.

	Payments due by period				
	Total	Less than			More than
	US\$m	1 year	1 3 years	3 5 years	5 years
	US\$m	US\$m	US\$m	US\$m	US\$m
Long-term debt obligations	210,509	59,855	56,428	28,467	65,759
Term deposits and certificates of deposit	129,172	122,673	4,328	1,142	1,029
Capital (finance) lease obligations	376	59	101	31	185

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Operating lease obligations	5,496	971	1,482	1,031	2,012
Purchase obligations	402	212	12	178	
Short positions in debt securities and equity shares	74,052	53,030	5,469	4,271	11,282
Current tax liability	607	607			
Pension/healthcare obligation	18,959	1,618	3,328	3,605	10,408
	439,573	239,025	71,148	38,725	90,675

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Report of the Directors: Financial Review (continued)**Loan maturity and interest sensitivity analysis**

At 31 December 2013, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Rest of Asia-						Total
	Europe US\$m	Hong Kong US\$m	Pacific US\$m	MENA US\$m	North America US\$m	Latin America US\$m	US\$m
Maturity of 1 year or less							
Loans and advances to banks	67,104	32,242	49,476	6,037	29,982	12,244	197,085
Commercial loans to customers							
Manufacturing and international trade and services	94,400	44,139	45,007	9,222	8,407	14,356	215,531
Real estate and other property related	13,517	13,757	7,144	1,474	4,356	1,614	41,862
Non-bank financial institutions	64,616	5,980	7,535	238	38,694	864	117,927
Governments	2,204		102	1,280	169	319	4,074
Other commercial	41,448	3,314	10,083	2,245	2,904	2,736	62,730
	216,185	67,190	69,871	14,459	54,530	19,889	442,124
Maturity after 1 year but within 5 years							
Loans and advances to banks	6,187	1,706	1,125	406	157	549	10,130
Commercial loans to customers							
Manufacturing and international trade and services	28,981	9,731	9,841	1,989	13,306	5,652	69,500
Real estate and other property related	19,148	23,083	8,618	453	6,575	775	58,652
Non-bank financial institutions	8,576	1,592	987	2,294	3,512	495	17,456
Governments	344	187	143	163	387	197	1,421
Other commercial	15,445	7,729	5,576	1,372	5,968	2,548	38,638
	72,494	42,322	25,165	6,271	29,748	9,667	185,667
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	14,968	195	1,817	1,341	5,558	3,303	27,182
Variable interest rate	63,713	43,833	24,473	5,336	24,347	6,913	168,615
	78,681	44,028	26,290	6,677	29,905	10,216	195,797
Maturity after 5 years							
Loans and advances to banks	613	1,202	36		25	2,488	4,364
Commercial loans to customers							
Manufacturing and international trade and services	9,652	753	655	598	1,816	501	13,975
Real estate and other property related	5,969	8,064	1,041	45	3,685	360	19,164
Non-bank financial institutions	2,358	38			385	17	2,798
Governments	792	552	37		8	458	1,847
Other commercial	10,207	3,523	819	919	3,004	672	19,144
	28,978	12,930	2,552	1,562	8,898	2,008	56,928
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							

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Fixed interest rate	7,283	1,089	62	358	773	382	9,947
Variable interest rate	22,308	13,043	2,526	1,204	8,150	4,114	51,345
	29,591	14,132	2,588	1,562	8,923	4,496	61,292

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Report of the Directors: Financial Review (continued)**Deposits**

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

with the average interest rates paid thereon for each of the past three years. The geographical analysis of average deposits is based on the location of the office in which the deposits are recorded and excludes balances with HSBC companies. The Other category includes securities sold under agreements to repurchase.

Deposits by banks

	2013		2012		2011	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	63,213		64,497		75,890	
Demand and other non-interest bearing	13,198		9,377		10,788	
Demand interest bearing	5,154	0.5	8,988	0.4	16,492	0.8
Time	17,465	1.1	24,698	1.5	19,893	2.2
Other	27,396	0.4	21,434	1.1	28,717	1.3
Hong Kong	14,686		13,355		13,222	
Demand and other non-interest bearing	7,271		4,727		3,047	
Demand interest bearing	6,217	0.1	5,643	0.1	6,052	0.1
Time	1,072	0.7	2,013	0.4	3,347	0.3
Other	126	3.2	972	0.6	776	0.1
Rest of Asia-Pacific	12,919		14,485		13,650	
Demand and other non-interest bearing	2,334		2,495		2,535	
Demand interest bearing	5,965	1.0	6,190	1.1	5,802	1.2
Time	3,210	0.8	3,879	1.5	4,218	1.6
Other	1,410	2.5	1,921	3.1	1,095	3.0
Middle East and North Africa	2,546		1,892		2,060	
Demand and other non-interest bearing	1,058		301		548	
Demand interest bearing	12		8	6.5	20	
Time	1,422	0.2	1,543	0.4	1,424	0.4
Other	54	1.9	40	1.8	68	1.6
North America	15,820		13,695		11,904	
Demand and other non-interest bearing	3,488		4,470		2,367	
Demand interest bearing	2,787	0.1	2,996	0.1	3,849	0.1

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Time	5,110	0.3	4,756	0.4	4,797	0.4
Other	4,435	0.5	1,473	0.5	891	1.3
Latin America	5,166		6,463		8,819	
Demand and other non-interest bearing	118		212		161	
Demand interest bearing	333	4.5	333	3.9	545	3.7
Time	2,783	3.1	3,665	3.7	4,924	4.3
Other	1,932	4.8	2,253	6.1	3,189	6.0
Total	114,350		114,385		125,545	
Demand and other non-interest bearing	27,467		21,582		19,446	
Demand interest bearing	20,468	0.5	24,157	0.5	32,760	0.7
Time	31,062	1.1	40,553	1.4	38,603	2.0
Other	35,353	0.7	28,093	1.7	34,736	1.7

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Report of the Directors: Financial Review (continued)*Customer accounts*

	2013		2012		2011	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	508,783		467,472		467,393	
Demand and other non-interest bearing	75,480		71,342		72,743	
Demand interest bearing	272,973	0.4	242,769	0.4	220,314	0.4
Savings	63,585	1.4	62,626	1.8	57,070	1.7
Time	50,010	1.1	59,034	1.3	67,499	1.5
Other	46,735	0.3	31,701	0.5	49,767	0.7
Hong Kong	351,790		325,909		307,513	
Demand and other non-interest bearing	36,336		34,714		31,694	
Demand interest bearing	264,508		236,198		219,581	
Savings	38,447	0.9	39,752	0.8	38,283	0.7
Time	11,396	0.8	14,252	1.0	16,910	1.0
Other	1,103	0.2	993	0.3	1,045	0.3
Rest of Asia-Pacific	181,386		179,587		170,008	
Demand and other non-interest bearing	22,687		20,914		19,283	
Demand interest bearing	83,019	0.8	78,563	1.0	74,636	1.1
Savings	65,652	2.9	67,424	2.9	63,500	2.8
Time	9,581	0.7	12,381	1.0	11,815	1.0
Other	447	2.0	305	3.6	774	2.2
Middle East and North Africa	40,451		37,604		36,105	
Demand and other non-interest bearing	16,801		14,564		13,016	
Demand interest bearing	13,248	0.4	10,967	0.6	9,887	0.6
Savings	9,981	2.6	11,555	3.0	12,596	3.2
Time	357	1.4	452	2.2	530	2.5
Other	64		66	1.5	76	
North America	157,549		153,057		165,779	
Demand and other non-interest bearing	27,992		28,403		26,524	
Demand interest bearing	37,837	0.3	38,419	0.3	35,440	0.3
Savings	63,565	0.6	68,039	0.7	75,866	0.8
Time	7,673	0.3	9,587	0.4	13,835	0.4
Other	20,482	0.1	8,609	0.2	14,114	0.1
Latin America	57,066		73,323		89,603	
Demand and other non-interest bearing	13,084		14,203		14,815	
Demand interest bearing	7,237	1.8	8,258	2.2	8,374	1.7
Savings	24,652	7.4	35,294	7.5	47,197	9.8
Time	9,459	4.4	13,095	4.0	16,567	3.9
Other	2,634	6.2	2,473	4.7	2,650	7.2

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Total	1,297,032			1,236,953		1,236,401	
Demand and other non-interest bearing	192,388			184,140		178,075	
Demand interest bearing	678,821	0.3		615,175	0.4	568,232	0.4
Savings	265,882	2.1		284,690	2.4	294,512	2.9
Time	88,477	1.3		108,801	1.5	127,156	1.6
Other	71,464	0.4		44,147	0.7	68,426	0.9

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Report of the Directors: Financial Review (continued)*Customer accounts by country*

	At 31 December	
	2013	2012
	US\$m	US\$m
Europe	644,816	555,009
UK ³⁴	504,984	426,144
France ³⁵	65,844	55,578
Germany	16,615	15,611
Malta	6,222	5,957
Switzerland	16,796	20,211
Turkey	7,795	7,629
Other	26,560	23,879
Hong Kong	365,993	346,208
Rest of Asia-Pacific	182,626	183,621
Australia	19,812	20,430
India	11,549	10,415
Indonesia	5,865	6,512
Mainland China	40,579	35,572
Malaysia	17,139	17,641
Singapore	43,988	47,862
Taiwan	12,758	12,497
Vietnam	2,426	2,147
Other	28,510	30,545
Middle East and North Africa		
(excluding Saudi Arabia)	38,683	39,583
Egypt	7,401	7,548
Qatar	2,861	2,704
UAE	18,433	18,448
Other	9,988	10,883
North America	196,495	149,037
US ³⁴	135,531	90,627
Canada	48,065	47,049
Bermuda	12,899	11,361
Latin America	54,199	66,556
Argentina	4,468	5,351
Brazil	24,353	30,144
Mexico	23,975	22,724
Panama		5,940
Other	1,403	2,397

Total
For footnotes, see page 132.

1,482,812

1,340,014

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Report of the Directors: Financial Review (continued)*Certificates of deposit and other money market instruments*

	2013		2012		2011	
	Average		Average		Average	
	Average balance US\$m	rate %	Average balance US\$m	rate %	Average balance US\$m	rate %
Europe	28,680	0.5	32,602	0.4	46,641	0.6
Hong Kong	1,400	0.7	1,458	0.9	932	1.0
Rest of Asia-Pacific	1,799	2.9	3,863	3.0	3,951	3.4
North America	5,583	0.6	9,339	0.6	10,936	0.5
Latin America	9,335	8.3	7,344	8.5	5,499	9.2
	46,797	2.3	54,606	1.8	67,959	1.4

Certificates of deposit and other time deposits

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

	At 31 December 2013				
	3 months or less US\$m	3 months but within 6 months US\$m	6 months but within 12 months US\$m	12 months US\$m	Total US\$m
		After	After	After	
Europe	57,584	9,610	7,326	4,298	78,818
Certificates of deposit	8,910	5,070	1,779		15,759
Time deposits:					
banks	12,778	595	516	1,074	14,963
customers	35,896	3,945	5,031	3,224	48,096
Hong Kong	10,713	783	743	47	12,286
Certificates of deposit		21	5		26
Time deposits:					
banks	354	36			390
customers	10,359	726	738	47	11,870
Rest of Asia-Pacific	11,219	963	358	1,159	13,699
Certificates of deposit	1,582	317	111	617	2,627
Time deposits:					

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banks	3,281	399	1	25	3,706
customers	6,356	247	246	517	7,366
Middle East and North Africa	1,372	45	122	36	1,575
Time deposits:					
banks	742	10	14		766
customers	630	35	108	36	809
North America	9,673	733	267	228	10,901
Time deposits:					
banks	3,747	3			3,750
customers	5,926	730	267	228	7,151
Latin America	9,169	1,087	906	731	11,893
Certificates of deposit	11		228	463	702
Time deposits:					
banks	784	583	404	244	2,015
customers	8,374	504	274	24	9,176
Total	99,730	13,221	9,722	6,499	129,172
Certificates of deposit	10,503	5,408	2,123	1,080	19,114
Time deposits:					
banks	21,686	1,626	935	1,343	25,590
customers	67,541	6,187	6,664	4,076	84,468

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Reconciliation of RoRWA measures****Performance Management**

We target a return on average ordinary shareholders' equity of 12%–15%. For internal management purposes we monitor global businesses and geographical regions by pre-tax return on RWAs, a metric which combines return on equity and regulatory capital efficiency objectives.

In addition to measuring return on average risk-weighted assets (RoRWA) we measure our performance internally using the non-GAAP measure of underlying RoRWA, which is underlying profit before tax as a percentage of average risk-weighted assets adjusted for the effects of foreign currency translation differences and business disposals. Underlying RoRWA adjusts performance for certain items which distort year-on-year performance as explained on page 47.

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

The CRS average RWAs in the table below represent the average of the associated operational risk RWAs that were not immediately released on disposal and have not already been adjusted as part of the underlying RoRWA calculation. The 2012 pre-tax loss for CRS primarily relates to litigation expenses incurred after the sale of the business that have not been adjusted as part of the underlying RoRWA calculation.

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

	2013			2012		
	Pre-tax return US\$m	Average RWAs ³⁶ US\$bn	RoRWA ³⁷ %	Pre-tax return US\$m	Average RWAs ³⁶ US\$bn	RoRWA ³⁷ %
Reported	22,565	1,104	2.0	20,649	1,172	1.8
Underlying ³⁷	21,586	1,088	2.0	15,286	1,078	1.4
Run-off portfolios	68	124	0.1	(1,624)	166	(1.0)
Legacy credit in GB&M	185	33	0.6	(274)	45	(0.6)
US CML and other ³⁸	(117)	91	(0.1)	(1,350)	121	(1.1)
Card and Retail Services		4		(150)	5	(3.0)
	21,518	960	2.2	17,060	906	1.9

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Underlying (excluding run-off portfolios and Card and Retail Services)



Reconciliation of reported and underlying average risk-weighted assets

	Year ended 31 December		
	2013 US\$bn	2012 US\$bn	Change %
Average reported RWAs ³⁶	1,104	1,172	(6)
Currency translation adjustment ³²		(6)	
Acquisitions, disposals and dilutions	(16)	(88)	
Average underlying RWAs ³⁶	1,088	1,078	1

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)

Ratio of earnings to fixed charges⁶²

	2013	2012	2011	2010	2009
Ratio of earnings to fixed charges					
excluding interest on deposits ⁶³	3.84	3.03	2.82	2.71	1.53
including interest on deposits	2.09	1.76	1.68	1.73	1.22
Ratio of earnings to combined fixed charges and preference share dividends					
excluding interest on deposits ⁶³	3.50	2.79	2.64	2.56	1.48
including interest on deposits	2.01	1.71	1.64	1.69	1.20

For footnotes, see page 133a.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Critical accounting policies

(Audited)

Introduction

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

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

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

Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

The largest concentration of collectively assessed loan impairment allowances are in North America, where they were US\$3.8bn, representing 47% (2012: US\$5.2bn; 54%) of the Group's total collectively assessed loan impairment allowances and 25% of the Group's total impairment allowances. Of the North American collective impairment allowances approximately 79% (2012: 86%) related to the US CML portfolio.

The methods used to calculate collective impairment allowances on homogeneous groups of loans and advances that are not considered individually significant are disclosed in Note 2g on the Financial Statements. They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of

incurred losses is likely to be greater or less than that suggested by historical experience. Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

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During 2013, we reviewed the impairment allowance methodology used for retail banking and small business portfolios across the Group to ensure that the assumptions used in our collective impairment assessment models continue to appropriately reflect the periods of time between a loss event occurring, the discovery of the loss event and the eventual write off. As a result of this review, the collective impairment allowances were increased by US\$251m.

Where loans are individually assessed for impairment, management judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, which is not restricted to the consideration of whether payments are contractually past-due but includes broader consideration of factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

Under certain specified conditions, we provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default or repossession. Where forbearance activities are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation. Where collectively assessed loan portfolios include significant levels of loan forbearance, portfolios are segmented to reflect the different credit risk characteristics of forbearance cases, and estimates are made of the incurred losses inherent within the forbearance portfolio segments at the reporting date. Forbearance activities take place in both retail and wholesale loan portfolios, but our largest concentration is in the US, in HSBC Finance's CML portfolio.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive, though they are particularly sensitive to general economic and credit conditions in North America. For example, a 10% increase in impairment allowances on collectively assessed loans and advances in North America would have increased loan impairment allowances by US\$0.4bn at 31 December 2013 (2012: US\$0.5bn).

It is possible that the outcomes within the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

Our accounting policy for goodwill is described in Note 2p on the Financial Statements. Note 22 on the Financial Statements lists our cash generating units (CGUs) by geographical region and global business. HSBC's total goodwill amounted to US\$21bn at 31 December 2013 (2012: US\$21bn).

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

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

the rates used to discount future expected cash flows are based on the costs of capital assigned to individual CGUs and the rates can have a significant effect on their valuation. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic

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conditions beyond our control and are consequently subject to uncertainty and require the exercise of significant judgement. A decline in a CGU's expected cash flows and/or an increase in its cost of capital reduces the CGU's estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill is recognised in our income statement for the year.

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

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During 2013, no impairment of goodwill was identified (2012: nil). In addition to the annual impairment test which was performed as at 1 July 2013, management reviewed the current and expected performance of the CGUs as at 31 December 2013 and determined that there was no indication of impairment of the goodwill allocated to them, except for the GPB Europe CGU, for which reduced forecast profitability triggered the re-testing of the related goodwill as at 31 December 2013. Although the results of the goodwill impairment testing for this CGU are more sensitive to key assumptions used, the re-test of the goodwill concluded that there was no impairment.

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

Interests in associates

Under the equity accounting method, investments in associates are initially stated at cost, and are adjusted thereafter for the post-acquisition change in HSBC's share of the net assets of the associate. An investment in an associate is tested for impairment when there is an indication that the investment may be impaired. At 31 December 2013, the fair value of HSBC's investment in BoCom had been below the carrying amount for approximately 20 months, apart from a short period in 2013. The conclusion of the impairment test, based on the assessment of the value in use, was that the investment is not impaired. The measurement of value in use involves significant judgement in estimating the present values of cash flows expected to arise from continuing to hold the investment. Note 21 on the Financial Statements includes detailed information on HSBC's investment in BoCom. It provides a description of the key assumptions used in estimating value in use, the sensitivity of the value in use calculation to different assumptions and a sensitivity analysis that shows the changes in key assumptions that would reduce the excess of value in use over the carrying amount (headroom) to nil.

Valuation of financial instruments

Our accounting policy for determining the fair value of financial instruments is described in Note 2d on the Financial Statements. The best evidence of fair value is a quoted price for the instrument being measured in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that include one or more significant inputs that are unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

Valuation techniques used to calculate fair values are discussed in Note 15 on the Financial Statements. The main assumptions and estimates which management consider when applying a model with valuation techniques are:

the likelihood and expected timing of future cash flows on the instrument. These cash flows are estimated based on the terms of the instrument, and judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;

selecting an appropriate discount rate for the instrument. The determination of this rate is based on an assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and

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judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in

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the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even when unobservable inputs are significant.

The fair values of financial assets and liabilities of US\$547bn (2012: US\$718bn) and US\$467bn (2012: US\$622bn), respectively, were determined using valuation techniques and represented 53% (2012: 60%) and 82% (2012: 83%), respectively, of financial assets and liabilities measured at fair value.

The types and amounts of adjustments made in determining the fair value of financial instruments measured at fair value using valuation techniques, and a sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions, are described in Note 15 on the Financial Statements.

Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

HSBC does not include a funding spread in the discount rate applied to the fair value measurement of uncollateralised derivatives. The application of such a funding fair value adjustment is under consideration by the financial services industry, although no consensus has yet emerged. In the future, and possibly in 2014, HSBC may adopt a funding fair value adjustment to reflect funding of uncollateralised derivatives at rates other than interbank offer rates.

Deferred tax assets

Our accounting policy for the recognition of deferred tax assets is described in Note 2s on the Financial Statements. The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

The most significant judgements concern the US deferred tax asset, given the recent history of losses in our US operations. The net US deferred tax asset amounted to US\$4.4bn or 59% (2012: US\$4.6bn; 61%) of deferred tax assets recognised on the Group's balance sheet. These judgements take into consideration the reliance placed on the use of tax planning strategies.

The most significant tax planning strategy is the retention of capital in our US operations to ensure the realisation of the deferred tax assets. The principal strategy involves generating future taxable profits through the retention of capital in the US in excess of normal regulatory requirements in order to reduce deductible funding expenses or otherwise deploy such capital or increase levels of taxable income. Management expects that, with this strategy, the US operations will generate sufficient future profits to support the recognition of the deferred tax assets. If HSBC Holdings were to decide not to provide this ongoing support, the full recovery of the deferred tax asset may no longer be probable and could result in a significant reduction of the deferred tax asset which would be recognised as a charge in the income statement.

Provisions

The accounting policy for provisions is described in Note 2w on the Financial Statements. Note 31 on the Financial Statements discloses the major categories of provisions recognised. The closing balance of provisions amounted to US\$5.2bn (2012: US\$5.3bn), of which US\$1.8bn

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(2012: US\$1.7bn) related to legal proceedings and regulatory matters and US\$2.4bn (2012: US\$2.4bn) related to customer remediation.

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Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on litigation provisions, property provisions (including onerous contracts) and similar liabilities.

Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress through various stages of development, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised and their estimated amounts, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically possible to make judgements and estimates around a better defined set of possible outcomes. However, such judgements can be very difficult and the amount of any provision can be very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of

possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. For a detailed description of the nature of uncertainties and assumptions and the effect on the amount and timing of possible cash outflows on material matters, see Note 43 on the Financial Statements.

Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, for example, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition and measurement of provisions, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different amounts of provisions recognised and outflows of economic benefits from those estimated by management for the purposes of the 2013 Financial Statements.

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Summary	

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

The commentaries below present global businesses followed by geographical regions (page 96). Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region.

All commentaries are on a constant currency basis (page 47) unless stated otherwise, while tables are on a reported basis.

Basis of preparation

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

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

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

Profit/(loss) before tax

	2013		2012		2011	
	US\$m	%	US\$m	%	US\$m	%
Retail Banking and Wealth Management	6,649	29.5	9,575	46.4	4,270	19.6
Commercial Banking	8,441	37.4	8,535	41.3	7,947	36.3
Global Banking and Markets	9,441	41.8	8,520	41.3	7,049	32.2
Global Private Banking	193	0.9	1,009	4.9	944	4.3
Other ³⁹	(2,159)	(9.6)	(6,990)	(33.9)	1,662	7.6
	22,565	100.0	20,649	100.0	21,872	100.0

Total assets⁴⁰

	2013		2012	
	US\$m	%	US\$m	%
Retail Banking and Wealth Management	517,085	19.4	536,244	19.9
Commercial Banking	360,623	13.5	363,659	13.5
Global Banking and Markets	1,975,509	74.0	1,942,470	72.1
Global Private Banking	97,655	3.7	118,440	4.4
Other	171,812	6.4	201,741	7.5
Intra-HSBC items	(451,366)	(17.0)	(470,016)	(17.4)
	2,671,318	100.0	2,692,538	100.0

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)*Risk-weighted assets*

	At 31 December			
	2013		2012	
	US\$bn	%	US\$bn	%
Retail Banking and Wealth Management	233.5	21.4	276.6	24.6
Commercial Banking	391.7	35.8	397.0	35.3
Global Banking and Markets	422.3	38.6	403.1	35.9
Global Private Banking	21.7	2.0	21.7	1.9
Other	23.5	2.2	25.5	2.3
	1,092.7	100.0	1,123.9	100.0

Selected items included in profit before tax by global business

The table below shows the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and the operating profit or loss of the

acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses which are eliminated from underlying results so that results can be viewed on a like-for-like basis.

*Acquisitions, disposals and dilutions*⁴¹

	2013 US\$m	2012 US\$m
Retail Banking and Wealth Management	264	5,565
Commercial Banking	541	922
Global Banking and Markets	404	516
Global Private Banking	1	57
Other ³⁹	1,015	3,106
	2,225	10,166

For footnotes, see page 132.

Principal RBWM business

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The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed of US CRS business. We believe that looking at the Principal RBWM business without the run-off and disposed of businesses allows management to more clearly discuss the cause of material changes from

year-to-year in the ongoing business and to assess the factors and trends in the business which are anticipated to have a material effect in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are provided in the Form 20-F filed with the SEC, which is available on www.hsbc.com.

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HSBC HOLDINGS PLC

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Products and services

Retail Banking and Wealth Management

RBWM serves over 50 million personal customers. We take deposits and provide transactional banking services to enable customers to manage their day-to-day finances and save for the future. We selectively offer credit facilities to assist customers in their short or longer-term borrowing requirements; and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

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

Typically, customer offerings include:

liability-driven services: deposits and account services;

asset-driven services: credit and lending, both secured and unsecured; and

fee-driven and other services: financial advisory, broking, life insurance manufacturing and asset management.

We deliver services through four principal channels: branches, self-service terminals, telephone service centres and digital (internet and mobile). Customers can transact with the bank via a combination of these channels, through the following offerings:

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

HSBC Advance: we provide a range of preferential products and services to simplify the banking needs of customers and to help them manage and plan their money to achieve their financial goals and ambitions.

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

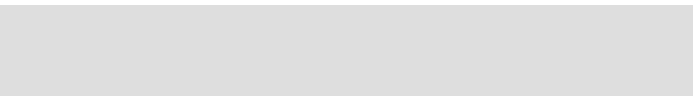
Basic banking: we increasingly provide globally standardised but locally delivered, reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

Total RBWM comprises our Principal RBWM business and the US run-off portfolio.

Commercial Banking

Our CMB business is segmented into large corporates, mid-market companies and Business Banking. This allows us to provide an appropriate level of support to companies with more sophisticated needs and SMEs as they grow both domestically and internationally, and ensures a clear focus on internationally aspirant customers.

We place particular emphasis on international connectivity to meet the needs of our business customers. We aim to be recognised as the leading international trade and business bank by focusing on faster-growing markets, repositioning towards international business and enhancing collaboration across the Group. This will be underpinned by reducing complexity and operational risk and driving efficiency gains through adopting a global operating model.



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

Global Trade and Receivables Finance: we provide the services and finance our clients need throughout the trade cycle including; letters of credit, collections, guarantees; receivables finance; supply chain solutions; commodity and structured finance; and risk distribution. HSBC is supporting the development of renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Payments and Cash Management: we are a leading provider of domestic and cross-border payments, collections, liquidity management and account services offering local, regional and global solutions delivered via e-enabled platforms designed to address the current and future needs of our clients.

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

GB&M: our CMB franchise represents a key client base for GB&M products and services, including foreign exchange and interest rate products, together with capital raising on debt and equity markets and advisory services.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Global Banking and Markets

GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements. Sector-focused client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With a presence in over 60 countries/territories and access to HSBC's worldwide presence and capabilities, this business serves subsidiaries and offices of our clients on a global basis.

In August 2013, GB&M was reshaped to more effectively focus resources on clients and enhance relationships, and to better capture growth opportunities which create greater value for our clients and our shareholders.

GB&M is managed within the following framework:

Client Coverage contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together HSBC's broad array of product capabilities.

Markets provides sales and trading services which are categorised as follows:

Credit and Rates sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They also offer clients risk management solutions.

Foreign Exchange provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of SMEs, MMEs and large corporates in GB&M and CMB, and the needs of RBWM customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.

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

Capital Financing offers financing and advisory services. Products include debt and equity capital raising, advisory, corporate lending, leveraged finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.

Payments and Cash Management products include non-retail deposit taking and international, regional and domestic payments and cash management services.

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

Global Trade and Receivable Finance provides trade services for our clients.

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

Global Private Banking

GPB provides investment management and trustee solutions to high net worth individuals and their families in the Group's priority markets. We aim to meet the needs of our clients by providing excellent customer service and offering a comprehensive suite of solutions.

Drawing on the strength of the HSBC Group and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage, and preserve wealth for today and for the future.

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

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

Private Trust Solutions comprise trusts and estate planning, designed to protect wealth and preserve it for future generations through structures tailored to meet the individual needs of each client.

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Report of the Directors: Financial Review (continued)**Retail Banking and Wealth Management**

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

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	18,339	20,298	24,101
Net fee income	7,021	7,205	8,226
Other income ⁷	1,380	6,358	1,206
Net operating income⁴	26,740	33,861	33,533
LICs ⁴²	(3,227)	(5,515)	(9,319)
Net operating income	23,513	28,346	24,214
Total operating expenses	(17,248)	(19,769)	(21,202)
Operating profit	6,265	8,577	3,012
Income from associates ⁴³	384	998	1,258
Profit before tax	6,649	9,575	4,270
RoRWA ³⁶	2.6%	3.1%	1.2%

77%

of profit before tax from

Hong Kong, Rest of Asia-Pacific, Latin America**and Middle East and North Africa****Managing the US run-off portfolio****releasing over US\$28bn of RWAs****Best Wealth Management Firm***(Banker Middle East Industry Awards, 2013)*

Strategic direction

RBWM provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale in our target customer segments to do so cost effectively.

We focus on three strategic imperatives:

building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our Insurance and Asset Management businesses;

leveraging global expertise to improve customer service and productivity, to provide a high standard of banking solutions and service to our customers efficiently; and

simplifying and re-shaping the RBWM portfolio of businesses globally, to focus our capital and resources on key markets. Our three growth priorities are customer growth in target segments, deepening customer relationships through wealth management and relationship-led lending, and enhancing distribution capabilities, including digital.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

RBWM reported profit before tax of US\$6.6bn compared with US\$9.6bn in 2012 on a reported basis and US\$9.5bn on a constant currency basis. The decrease arose from lower net gains on sale, most notably following the sale of the CRS business and US branches (US\$3.7bn) in 2012, and the absence of profits from non-strategic businesses sold or closed in that year, including Ping An.

On an underlying basis, profit before tax increased by US\$2.4bn, driven by a fall in loan impairment charges in the US run-off portfolio. In addition, operating expenses declined, mainly driven by a reduction in customer redress provisions in the UK.

In the US run-off portfolio, the loss before tax decreased due to lower loan impairment charges reflecting improvements in housing market conditions, decreased lending balances, reduced new impaired loans and lower delinquency levels. Revenue reduced, reflecting lower average lending balances from the continued run-off of the CML portfolio, losses on early termination of cash flow hedges and portfolio disposals. These factors were partly offset by favourable movements in the fair value of non-qualifying hedges in HSBC Finance of US\$315m, compared with adverse movements of US\$227m in 2012.

The commentary that follows reflects performance in our Principal RBWM business (see page 78).

Profit before tax fell by US\$208m, reflecting lower net gains on sale of our non-strategic operations and the reduction in profit following these disposals. This was largely offset by a decrease in operating expenses which reflected lower customer redress provisions in the UK and sustainable cost savings resulting from our organisational effectiveness programmes.

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Revenue declined by 4% reflecting lower net gains on sale of our non-strategic operations (most notably the US branches), the loss on sale of the HFC Bank UK secured lending portfolio and the consequent reduction in operating revenue. Excluding these, revenue grew by 1%, mainly in Hong Kong and Europe.

Net interest income increased by 1% despite lower revenue from businesses that had been disposed of or closed since the beginning of 2012. The increase was driven by improved mortgage spreads and growth in mortgage

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Report of the Directors: Financial Review (continued)*RBWM profit/(loss) before tax*

	US			
	Total	US	run-off	Prin-
	RBWM	CRS	port-	cipal
	US\$m	US\$m	folio	RBWM
	US\$m	US\$m	US\$m	US\$m
2013				
Net interest income	18,339		2,061	16,278
Net fee income	7,021		11	7,010
Other income/(expense) ⁷	1,380		(400)	1,780
Net operating income⁴	26,740		1,672	25,068
LICs ⁴²	(3,227)		(705)	(2,522)
Net operating income	23,513		967	22,546
Total operating expenses	(17,248)		(1,166)	(16,082)
Operating profit/(loss)	6,265		(199)	6,464
Income/(expense) from associates ⁴³	384		(1)	385
Profit/(loss) before tax	6,649		(200)	6,849
RoRWA ³⁶	2.6%		(0.2%)	4.4%
2012				
Net interest income	20,298	1,267	2,563	16,468
Net fee income	7,205	395	33	6,777
Other income/(expense) ⁷	6,358	3,155	(200)	3,403
Net operating income ⁴	33,861	4,817	2,396	26,648
LICs ⁴²	(5,515)	(322)	(2,569)	(2,624)
Net operating income/(expense)	28,346	4,495	(173)	24,024
Total operating expenses	(19,769)	(729)	(1,103)	(17,937)
Operating profit/(loss)	8,577	3,766	(1,276)	6,087
Income from associates ⁴³	998		2	996
Profit/(loss) before tax	9,575	3,766	(1,274)	7,083
RoRWA ³⁶	3.1%	14.7%	(1.1%)	4.2%
2011				
Net interest income	24,101	4,128	2,990	16,983
Net fee income/(expense)	8,226	1,273	(49)	7,002
Other income/(expense) ⁷	1,206	61	(1,196)	2,341
Net operating income ⁴	33,533	5,462	1,745	26,326
LICs ⁴²	(9,319)	(1,600)	(4,982)	(2,737)
Net operating income/(expense)	24,214	3,862	(3,237)	23,589
Total operating expenses	(21,202)	(1,801)	(1,238)	(18,163)

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Operating profit/(expense)	3,012	2,061	(4,475)	5,426
Income from associates ⁴³	1,258		3	1,255
Profit/(loss) before tax	4,270	2,061	(4,472)	6,681
RoRWA ³⁶	1.2%	3.9%	(3.3%)	4.0%

For footnotes, see page 132.

balances in Hong Kong, the UK and France, although the rate of balance growth in Hong Kong began to slow in 2013 as transaction volumes in the property market reduced. In Hong Kong, the increase was also driven by growth in the insurance investment portfolio. Deposit balances increased, particularly in the UK and Hong Kong, though the benefit was more than offset by deposit spread compression, particularly in Hong Kong, reflecting the sustained low interest rate environment.

Net fee income grew by 5%, primarily due to higher sales of investment products in Hong Kong, where growth in unit trusts and brokerage income was driven by favourable market sentiment and strong customer demand. This was supported by increased foreign exchange revenue in the UK and higher management fees reflecting growth in average assets under management, most notably in North America and Hong Kong.

Other income declined by US\$1.5bn as a result of portfolio rationalisations and other items described above. The decline also reflected a fall in sales of manufactured insurance products, which led to lower favourable value of new business movements in the PVIF asset in Europe, Hong Kong and Rest of Asia-Pacific. Lower favourable PVIF movements also reflected the non-recurrence of the recognition of a PVIF asset in Brazil in 2012 and adverse experience and assumption changes in Latin America in 2013.

LICs increased by 1%, mainly driven by higher collective provisions resulting from model changes and assumption revisions for restructured loans in Brazil and assumption changes to our emergence period methodology across all regions (see page 72). Impairments also increased in Mexico and Turkey reflecting higher lending balances. These increases were largely offset by better underlying credit quality in Brazil, improvements in housing market conditions, and lower charge-offs in North America and recoveries from debt sales in the UK.

Operating expenses decreased by US\$1.4bn, mainly as a result of lower customer redress provisions in the UK of US\$953m compared with US\$1.8bn in 2012, sustainable cost savings of over US\$300m from organisational effectiveness programmes, and the disposal and run-off of businesses in 2012 and 2013. In addition, we recorded an accounting gain of US\$189m relating to changes in delivering ill-

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Report of the Directors: Financial Review (continued)

health benefits in 2013. These were partly offset by higher staff and premises costs in Latin America and Hong Kong, driven by inflationary pressures.

Income from associates and joint ventures decreased following the disposal of our associate Ping An in December 2012 and the reclassification of Industrial Bank as a financial investment in 2013. On an underlying basis, income from associates rose, primarily in BoCom reflecting balance sheet growth and increased fee income, and in Hong Kong due to the price appreciation of real estate properties. Growth priorities

Grow in priority markets and deepen customer relationships

Our focus remains on growing the number of customers in our target segments and serving their domestic and international needs whilst de-risking the overall portfolio. HSBC Premier (Premier) is our core retail Wealth offering, and our strategy continues to be to grow the number of customers in this segment and generate more business from the existing client base. Growth and development of this area represents a significant opportunity and is key to reaching our US\$3bn incremental Wealth revenue target by 2016, of which US\$0.9bn has been achieved to date. In 2013, Wealth revenue of US\$6.3bn remained broadly unchanged, with favourable investment sales in Hong Kong and higher foreign exchange income in the UK and Hong Kong being offset by lower insurance revenue, mainly in Latin America.

The total number of active customers in our Principal RBWM business decreased by 5% to 50.4m following business closures and disposals, most notably the sale of the UK HFC Bank lending portfolio and the business in Panama. However, we made good progress in refining and rebalancing the Premier portfolio towards quality long-term sustainable relationships and grew our Premier client base in mainland China, Hong Kong, France and Turkey. Overall, Premier customer numbers remained broadly unchanged at 4.2m as new account growth was offset by reclassification of non-qualifying customers.

At the beginning of the year we introduced a new incentive plan for our Wealth Management relationship managers (RM s) globally. This new plan removes the formulaic link between product sales and variable pay and is instead premised on RM activities that support meeting customer needs, improving customer experience and sales quality. This represents a significant shift in our approach to remuneration and we believe better aligns customer and staff interests, with a focus on building total relationship balances rather than product volume.

We provide our customers with access to a range of wealth management products and are able to leverage HSBC Group-wide capabilities in extending managed solutions, delivering research, expanding renminbi offerings and improving foreign exchange services online. We are also increasing the number of senior RMs dealing with our Premier customers to improve client contact.

Distribution

We continued to invest heavily in enhancing our digital capabilities. The global mobile application which was launched in the fourth quarter of 2012 was deployed in 25 markets by the end of 2013 as we migrated customers to digital channels. This application was downloaded by 2.5m customers, with over 1.1m downloads in the fourth quarter of 2013 alone. Benefits to customers include the ability to engage in stock

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trading and foreign exchange transactions, bill payment and fund transfers, and increased options to purchase products with improved speed and security.

We deployed digital tools to our front-line staff to raise financial planning standards and gain a more detailed understanding of clients aspirations, risk appetites and investment horizons. We invested significantly in our Wealth Platform with the aim of improving both RM efficiency and customer experience. We rolled out tablet-based tools and applications to RMs in France, UAE and Indonesia with plans to deploy these in 6 further markets in 2014.

We have made good progress in consolidating our Internet Banking systems, reducing the number from 59 to 41 with plans to implement a global solution by the end of 2015. In the third quarter of 2012, we launched the product range review programme and have subsequently reduced the number of retail banking products currently offered from just under 1,000 to 730. We will continue to review our product range to simplify and standardise our offering and to optimise customer choice, increase efficiencies and lower transactional costs.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Commercial Banking**

CMB offers a full range of commercial financial services and tailored solutions to more than three million customers ranging from small and medium-sized enterprises to publicly quoted companies in almost 60 countries.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	10,200	10,361	9,931
Net fee income	4,717	4,470	4,291
Other income ⁷	1,448	1,720	1,389
Net operating income⁴	16,365	16,551	15,611
LICs ⁴²	(2,384)	(2,099)	(1,738)
Net operating income	13,981	14,452	13,873
Total operating expenses	(7,049)	(7,598)	(7,221)
Operating profit/(loss)	6,932	6,854	6,652
Income from associates ⁴³	1,509	1,681	1,295
Profit/(loss) before tax	8,441	8,535	7,947
RoRWA ³⁶	2.2%	2.2%	2.2%

5%

growth in customer lending balances

on a constant currency basis

11%

increase in gross revenues from sales**of GB&M products to CMB customers****Best Transaction Banking House****and Best Cash Management Bank***(Euromoney Poll 2013)*

Strategic direction

CMB aims to be the banking partner of choice for international businesses by building on our rich heritage, international capabilities and relationships to enable connectivity and support trade and capital flows around the world, thereby strengthening our leading position in international business and trade.

We have three growth priorities:

grow coverage in faster growing markets;

drive revenue growth through our international network; and

grow collaboration revenues.

Implementing Global Standards, enhancing risk management controls models and simplifying processes also remain top priorities for CMB.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

In 2013, CMB reported a profit before tax of US\$8.4bn, which was marginally lower on a reported basis and was broadly unchanged on a constant currency basis compared with 2012. 2013 results included gains of US\$470m mainly from the sale of our operations in Panama, compared with gains of US\$468m in 2012 which included the sales of branches in the US. Share of profit in associates was lower due to the reclassification of Industrial Bank from an associate to a financial investment and the disposal of our investment in Ping An.

On an underlying basis, which excludes the disposal gains and associated operating results, profit before tax rose by 5%. This was driven by increased revenues, a reduction in operating expenses, and higher income from our associates, partly offset by a rise in loan impairment charges.

Revenue on a constant currency basis remained broadly unchanged compared with 2012. Disposal gains in Latin America and increased revenue in Europe were largely offset by the effect of business disposals in the US in 2012. On an underlying basis revenue increased by 2%, with growth in Hong Kong and Europe partly offset by falls in North America and Latin America. Higher net interest income from average balance sheet growth was partly offset by spread compression. Higher net fee income was driven by an increase in lending fees and enhanced collaboration with GB&M.

Management view of revenue

	2013	2012	2011
	US\$m	US\$m	US\$m
Global Trade and Receivables Finance	2,929	2,968	2,019
Credit and Lending	6,103	6,246	6,329
Payments and Cash Management, current accounts and savings deposits	5,287	5,369	4,584
Other	2,046	1,968	2,679

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Net operating income ⁴ <i>For footnote, see page 132.</i>	16,365	16,551	15,611
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Global Trade and Receivables Finance revenue was broadly unchanged compared with 2012. Double digit lending growth, primarily in Hong Kong and Rest of Asia-Pacific, was offset by spread compression, particularly in Hong Kong and Latin America, reflecting competition and increased liquidity in the markets.

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Report of the Directors: Financial Review (continued)

Credit and Lending revenue remained largely unchanged, as higher average balances in Hong Kong and increased net fee income were broadly offset by lower average balances in Latin America and spread compression in Europe, Middle East and North Africa and North America.

Payments and Cash Management revenue remained broadly unchanged compared with 2012. This reflected liability growth, notably in Hong Kong and the UK, which was driven by new mandates and increased transaction volumes and supported by our focus on international customers, offset by the effect of business disposals in the US.

The movement in *Other* reflected the gains on business disposals recorded in both 2012 and 2013.

LICs increased by US\$344m, driven by higher individually assessed loan impairments in Latin America, in particular specific impairments in Mexico relating to homebuilders from a change in public housing policy and in Brazil relating to certain corporate exposures. In Europe, lower individual impairments, mainly in the UK and Greece, were partly offset by higher provisions in Spain due to the continued challenging economic conditions.

Operating expenses decreased by 5%, primarily in Europe due to an accounting gain arising from a change in the basis of delivering ill-health benefits in 2013 of US\$161m and lower customer redress provisions of US\$148m (2012: US\$258m). Operating expenses also decreased due to the effects of business disposals. In 2013, we generated over US\$80m of sustainable savings. These factors were partly offset by increased costs in Hong Kong and Rest of Asia-Pacific due to inflationary pressures and investment for growth.

Income from associates declined by 12%, reflecting the reclassification of Industrial Bank as an investment and the disposal of our investment in Ping An. Excluding these events, income from associates grew by 11% as BoCom benefited from a rise in lending and associated fee income.

Growth priorities

Grow coverage in faster-growing markets

Revenues in Hong Kong, Rest of Asia-Pacific, Latin America and Middle East and North Africa increased by 3% compared with 2012 and represented over 55% of our revenues in 2013. CMB's top 20 markets contributed around 90% of our profit before tax in 2013.

Our global network helps connect customers internationally. For example, we expanded our renminbi offering to Latin America as trade with mainland China gathered pace. In addition, we opened the first China desk in Argentina to support mainland Chinese businesses operating in Argentina as well as local companies interested in doing business in mainland China.

Drive revenue growth through our international network

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HSBC has a competitive advantage by being present and able to capture business at both ends of the top twenty global trade corridors. The opportunities this presents to generate additional revenues has helped us grow underlying revenue faster than GDP growth in Europe, Hong Kong and Rest of Asia-Pacific.

In addition, we continue to invest in organic growth in city clusters with international business opportunities as we have done in the US, mainland China, Germany and other markets.

We continued to expand our international relationship managers (IRM) programme and now have almost 500 IRMs supporting SME clients with international growth ambitions, having extended our programme from three markets in 2012 to 12 in 2013. The new markets include Hong Kong, US, Canada, Egypt, Singapore, India, Argentina, UAE and Turkey. There are plans to expand the model into a further five key Business Banking markets next year.

We continued to support SMEs by launching funds to support those businesses that trade or aspire to trade internationally. SME funds were launched in the first half of 2013 in the UK,

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Report of the Directors: Financial Review (continued)

France and Mexico, and subsequently we launched two SME funds of US\$1bn in US and Canada. In the UAE, a fourth SME fund of AED1bn (US\$272m) targeted at international trade customers was also launched.

Grow collaboration revenues

CMB's ongoing collaboration with HSBC's other global businesses resulted in revenue growth of over US\$0.3bn for the Group, a 9% increase compared with 2012. Our collaboration with global businesses has now delivered US\$1.3bn in incremental revenue for the Group since 2010, achieving 65% of our medium-term target. Gross revenues from sales of GB&M products to CMB customers, which are shared by the two global businesses, grew by 11%, mainly driven by sales of foreign exchange products and debt capital markets activities. Close collaboration across international borders and global businesses resulted in a number of high-profile deals in 2013.

To serve our clients in each segment better, and to further enhance the collaboration efforts with GB&M, we have created two senior management roles – Global Head of Large Corporates and Global Head of Mid-market and Business Banking – to focus on our largest clients who are internationally connected and prime candidates for collaboration activities with an emphasis on markets and capital financing. This should ensure better coverage of our target segments in the future.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Global Banking and Markets**

GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	6,766	6,960	7,263
Net fee income	3,482	3,329	3,227
Net trading income ⁴⁴	6,780	5,690	5,204
Other income	2,148	2,294	1,363
Net operating income⁴	19,176	18,273	17,057
LICs ⁴²	(207)	(670)	(984)
Net operating income	18,969	17,603	16,073
Total operating expenses	(9,960)	(9,907)	(9,722)
Operating profit	9,009	7,696	6,351
Income from associates ⁴³	432	824	698
Profit before tax	9,441	8,520	7,049
RoRWA ³⁶	2.3%	2.1%	1.8%

Resilient performance in**a challenging environment****Increased client flows in the majority****of our customer-facing businesses****Best Global Emerging****Market Investment Bank**

(Euromoney Awards for Excellence 2013)

Strategic direction

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GB&M continues to pursue its emerging markets-led and financing-focused strategy, with the objective of being a top 5 bank to our priority clients. This strategy has evolved to include a greater emphasis on connectivity between the global businesses, across the regions and within GB&M, leveraging the Group's extensive distribution network.

We focus on four growth priorities:

leveraging our distinctive geographical network which connects developed and faster-growing regions;

connecting clients to global growth opportunities;

continuing to be well positioned in products that will benefit from global trends; and

enhancing collaboration with other global businesses to appropriately service the needs of our international client base.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for GB&M.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

GB&M reported profit before tax of US\$9.4bn, 11% higher than in 2012. Reported results in 2013 included a number of gains on disposal, particularly of our business in Panama. Reported results in 2012 included income from associates Industrial Bank and Ping An. On an underlying basis, which excludes these items, the results of other disposed of operations and the effect of currency movements, profit before tax rose by 15%. This was driven by increased revenue and significantly lower impairment charges and other credit risk provisions.

Revenue rose by 6%, in part reflecting resilient performance in the majority of our customer facing businesses. 2013 revenue included a DVA of US\$105m and a gain on disposal of our operations in Panama of US\$316m. In 2012, revenue included a reported net charge of US\$385m as a result of a change in estimation methodology in respect of CVAs of US\$903m, and a DVA of US\$518m to reflect evolving market practices.

LICs decreased significantly by US\$458m or 69%. Credit risk provisions declined, driven by net releases on available-for-sale ABSs in our legacy portfolio compared with impairment charges in 2012, and the non-recurrence of impairments on certain available-for-sale debt securities in Principal Investments. Impairment charges in the legacy credit loans and advances portfolio also declined.

Operating expenses increased marginally by 2%, despite a decline in performance-related costs and sustainable savings of US\$74m achieved from identifying savings and simplifying our processes. There was an increase in 2013 in litigation-related costs, primarily Madoff-related, of US\$293m, coupled with an increase in investment in regulatory and compliance resources. These costs were offset in part by a lower customer redress provision relating to interest rate protection products of US\$134m (2012: US\$329m) and an accounting gain of US\$81m relating to changes in delivering employee ill-health benefits.

Income from associates was lower, largely due to the reclassification of Industrial Bank as a financial investment and following the sale of our shareholding in Ping An.

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Report of the Directors: Financial Review (continued)*Management view of total operating income⁴⁵*

	2013	2012	2011
	US\$m	US\$m	US\$m
Markets ⁴⁶	6,935	6,105	5,749
Credit	796	485	133
Rates	1,653	1,607	1,238
Foreign Exchange	3,186	3,215	3,269
Equities	1,300	798	1,109
Capital Financing	3,994	3,758	3,711
Payments and Cash Management	1,770	1,680	1,561
Securities Services	1,662	1,623	1,669
Global Trade and Receivables Finance	741	740	601
Balance Sheet Management	3,110	3,738	3,418
Principal Investments	512	188	277
Debit valuation adjustment	105	518	
Other ⁴⁷	347	(77)	71
Net operating income ⁴	19,176	18,273	17,057

The management view of income above reflects the new management structure of GB&M which has been in place since 12 August 2013 (comparatives have been re-presented for this change).

For footnotes, see page 132.

Markets reported a resilient performance with revenue of US\$6.9bn. Revenue in Credit increased, reflecting higher secondary market activity and improved investor appetite, along with revaluation gains from price appreciation on assets in the legacy portfolio. Despite competitive pressure, revenue in primary credit rose. We also increased market share and improved our league table position, particularly in the issue of sterling and Hong Kong dollar bonds in which we led the market.

Despite difficult market conditions, Equities revenue rose, in part, due to increased client flows and larger market share in Hong Kong. Equities also reported increased revaluation gains along with minimal fair value movements on own credit spreads on structured liabilities, compared with adverse movements in 2012.

Foreign Exchange income was broadly in line with 2012. Revenues rose due to increased client demand for foreign exchange hedging solutions, which benefited from GB&M's collaboration with CMB. This was partly offset, however by margin compression and reduced market volatility in the second half of 2013.

Revenue in Rates in 2012 included a charge as a result of the change in estimation methodology in respect of CVAs, as noted above. In 2013, we won new client mandates and improved market share, despite price compression, particularly in European government bonds. This was coupled with smaller adverse fair value movements on our own credit spreads on structured liabilities compared with 2012. These factors

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were broadly offset, as revenue in 2012 benefited from the significant tightening of spreads following the ECB liquidity intervention. Revenue in 2013 was affected by uncertainty regarding the tapering of quantitative easing in the US.

Revenue in Capital Financing rose due to higher volumes and spreads in Credit and Lending and gains on sale of equity positions compared with losses on syndicated loans in 2012. In addition, income grew in Project and Export Finance, in part due to increased market share in export credit agency financing, and revenue rose, due to increased issuance demand in debt capital markets.

Payments and Cash Management revenue also grew, in part due to increased customer activity reflecting new mandates, with growth in deposit balances and transaction volumes compared with 2012.

As expected, Balance Sheet Management revenue decreased as proceeds from the sale and maturity of investments were reinvested at prevailing rates which were lower, together with reduced gains on the disposal of available-for-sale debt securities.

Revenue in Principal Investments rose during the year, mainly driven by lower equity impairments. In addition, there were higher gains on disposal of units held in third-party managed private equity funds than in 2012 due to increased refinancing and exit opportunities as market conditions improved.

Other included a gain on the disposal of our operations in Panama of US\$316m in 2013.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Growth priorities

Leveraging our distinctive geographical network which connects developed and faster-growing regions

As a universal bank with a distinctive international network and business model, we have provided innovative solutions to multinational corporates including advisory, financing and foreign exchange services.

We advised on the largest M&A transaction by a foreign company in India for a stake enhancement in an India-listed subsidiary. Examples like this reinforce our ability to execute complex cross-border M&A transactions.

We also acted as sole bookrunner on a *dim sum* bond issuance for the first foreign government to issue in the mainland China market, highlighting our leading role in the internationalisation of the renminbi.

Connecting clients to global growth opportunities

GB&M's product expertise supports our clients in the growth of their business activities. In equity capital markets, we were joint lead manager and bookrunner for a large Chinese bank initial public offering (IPO) in Hong Kong and also led the Hong Kong advisory market. This demonstrated our strength in providing cross-border capital markets access and advisory services to clients in mainland China.

We were voted 'Best for Innovation in Securities Services' by *The Banker* magazine following the redesign and development of our Securities Services web portal. This is now more intuitive, consistent across product lines, multi-lingual and accessible from tablets. The award recognised our commitment to innovation and connecting clients to information using new technology.

Continuing to be well positioned in products that will benefit from global trends

We continued to build on the strength of our product offering, with a particular focus on renminbi, which became the second most utilised trade finance currency in 2013. We were voted 'Best Overall for Products and Services' by *Asiamoney* Offshore RMB Services Survey 2013, for the second consecutive year.

We also delivered a broad range of GB&M products in a number of transactions relating to resource and energy companies. This included providing advisory and financing services to a consortium in the acquisition of an energy from waste company, and to a liquified natural gas company.

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We remain focused on opportunities in Project and Export Finance, which will benefit as emerging countries pursue economic growth through infrastructure investment and as institutional investors seek out long-term real assets. We were voted Best Project Finance House in Asia, Africa and Latin America by *Euromoney* and Best Global Export Finance Arranger by *Trade Finance* magazine.

With globalisation increasing the number of cross-border payment flows, our leadership in Payments and Cash Management was recognised by *Euromoney*, who named HSBC the Best Global Cash Manager for the second consecutive year.

Enhancing collaboration with other global businesses to appropriately service the needs of our customers

We continued to strengthen collaboration with other global businesses to better meet the needs of our customers across the Group. Gross revenues from sales of GB&M products to CMB customers, which are shared by the two global businesses, grew by 11% mainly driven by sales of foreign exchange products. Revenue from equity capital markets activities for CMB clients also increased significantly as a result of a larger number of deals.

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Report of the Directors: Financial Review (continued)**Global Private Banking**

GPB serves high net worth individuals and families with complex and international needs within the Group's priority markets.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	1,146	1,294	1,439
Net fee income	1,150	1,232	1,382
Other income	143	646	471
Net operating income⁴	2,439	3,172	3,292
LICs ⁴²	(31)	(27)	(86)
Net operating income	2,408	3,145	3,206
Total operating expenses	(2,229)	(2,143)	(2,266)
Operating profit	179	1,002	940
Income from associates ⁴³	14	7	4
Profit before tax	193	1,009	944
RoRWA ³⁶	0.9%	4.6%	3.9%

Profit before tax was significantly lower

as we continued to address legacy issues

and reposition the customer base

Approximately US\$50m of

sustainable cost savings, on top of about

US\$90m already delivered in 2011 and 2012

Best Private Bank in Hong Kong

(The Banker Global Private Banking Awards)

Strategic direction

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GPB aims to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners.

We have two growth priorities:

repositioning the business to concentrate on home and priority markets, particularly onshore, aligned with Group priorities; and

capturing growth opportunities from Group collaboration, particularly by accessing owners and principals of CMB and GB&M clients. Implementing Global Standards, enhancing risk management controls, tax transparency and simplifying processes also remain top priorities for GPB.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

Reported profit before tax of US\$193m was US\$816m lower than in 2012 and US\$800m lower on a constant currency basis.

On an underlying basis, which excludes the gain on the sale of our operations in Japan in 2012 of US\$67m and associated operating results, profit before tax was US\$744m lower, primarily due to reduced revenue.

Revenue declined by 23%, mainly due to the loss on write-off of goodwill relating to our Monaco business of US\$279m and the non-recurrence of the sale of our operations in Japan and our headquarters building in Switzerland (US\$120m) reported in 2012. Net interest income fell as higher-yielding positions matured and opportunities for reinvestment were limited by prevailing rates. Narrower lending spreads coupled with a decline in average deposit balances also contributed to the fall in net interest income. In addition, brokerage fees decreased, reflecting a fall in client transaction volumes due to lower volatility, and account services fees were lower due to the reduction in client numbers and client assets as we repositioned our client base. Trading income also fell, in part due to lower foreign exchange volumes and lower volatility in the market, notably in the second half of 2013.

Operating expenses increased by 4%, primarily due to regulatory investigation provisions of US\$352m, partly offset by lower staff costs from a managed reduction in average staff numbers, reduced performance costs and the non-recurrence of customer redress provisions and costs relating to the merger of pension funds in Switzerland. We also delivered further sustainable savings of approximately US\$50m in 2013.

Client assets⁴⁸

	2013 US\$bn	2012 US\$bn
At 1 January	398	377
Net new money	(26)	(7)
Value change	12	17
Exchange and other	(2)	11
At 31 December	382	398

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Client assets, which include funds under management and cash deposits, decreased by US\$16bn in 2013 primarily due to negative net new money, the effects of the disposal of our operations in Panama and ongoing client transfers in relation to the disposal of our HSBC Trinkaus & Burkhardt AG (HSBC Trinkaus) business in Luxembourg, partly offset by favourable market movements. Negative net new money was mainly driven by the repositioning of our business by moving from offshore to domestic banking, refocusing our client base towards higher net worth relationships, and adopting new compliance and tax transparency standards. There were also a large number of client withdrawals, notably in Switzerland. However, we attracted positive net new money of US\$4.6bn from clients in Asia.

Our return on assets, defined as the percentage of revenue to average client assets, was 62bps in 2013 compared with 79bps in 2012. The reduction was primarily due to the write-off of goodwill noted above and the non-recurrence of the gains on the sale of our operations in Japan and our headquarters in Switzerland reported in 2012. Excluding the effect of these items, our return on assets was 69bps in 2013 compared with 76bps in 2012, primarily reflecting the fall in net interest income.

Growth priorities

Repositioning the business

The repositioning of GPB's business model and target client base that commenced in 2012 was accelerated in 2013. Our focus remained on home and priority growth markets where wealth creation is strong and where the Group's presence could be leveraged.

During 2013, we began to implement Global Standards and continued to reposition our business through the adoption of new compliance and tax transparency standards. In addition, we initiated a detailed review of our portfolio which will continue in 2014.

We also took actions to simplify and rationalise our portfolio. For example, we agreed to sell our HSBC Trinkaus private banking and related fund business in Luxembourg. We also reviewed our operations in Monaco following receipt of unsolicited expressions of interest, though it was decided in July to retain the business. Furthermore, to help integrate GPB with HSBC's other global businesses, we transferred the ownership of our operations in Asia and the Channel Islands into the main banking entities in these areas to more closely align management responsibility.

Capturing growth opportunities

Referral flows from collaboration with other global businesses generated net new money of US\$5bn in 2013. An enhanced strategy based on closer alignment with CMB will focus on driving collaboration in 12 priority markets where both GPB and CMB have significant scale. Staff will be dedicated to focusing on identifying new prospects and an improved coverage model will be implemented in 2014 to pursue opportunities.

The Global Priority Clients initiative – a collaborative venture between GPB, GB&M and CMB for the Group's most significant dual banked clients – was redefined during the second half of 2013. By ensuring an effective and enhanced coverage model to meet the private and corporate needs of our most significant and complex clients, supported by dedicated senior management, we will deepen our client relationships and drive incremental revenue opportunities.

We continued to enhance our product offering to clients through the strengthening of the Alternatives platform, with six product launches during 2013 comprising three private equity funds, two real estate club deals and a fund of hedge funds.

In addition, we continued to focus on enhancing the service offering to clients. For example, recently we significantly upgraded the relationship management systems used by all front-office staff in Switzerland. We are also establishing a common banking platform which will provide consistent, tailored products and services globally. This will initially be implemented across continental Europe (including in Switzerland in 2015), and in other countries shortly thereafter.

In 2014, we will be developing our digital strategy to provide an upgraded multi-channel offering enabling us to keep pace with changing industry dynamics and competitor developments as well as meet clients' growing digital expectations.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Other**⁴⁰

Other contains the results of certain property transactions, unallocated investment activities, centrally held investment companies, movements in fair value of own debt, central support and functional costs with associated recoveries, HSBC's holding company and financing operations.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest expense	(737)	(730)	(911)
Net fee income	64	194	34
Net trading income/(expense) ⁴⁴	6	(537)	(355)
Changes in fair value of long-term debt issued and related derivatives	(1,228)	(4,327)	4,161
Changes in other financial instruments designated at fair value	(576)	(1,136)	78
Net income/(expense) from financial instruments designated at fair value	(1,804)	(5,463)	4,239
Other income	8,122	8,868	6,138
Net operating income ⁴	5,651	2,332	9,145
LICs ⁴²			
Net operating income	5,651	2,332	9,145
Total operating expenses	(7,796)	(9,369)	(7,492)
Operating profit/(loss)	(2,145)	(7,037)	1,653
Income/(expense) from associates ⁴³	(14)	47	9
Profit/(loss) before tax	(2,159)	(6,990)	1,662

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Notes

Reported loss before tax of US\$2.2bn compared with a loss of US\$7.0bn in 2012. On a constant currency basis, the pre-tax loss decreased by US\$5.0bn.

These results included lower adverse movements on the fair value of our own debt as credit spreads tightened to a lesser extent, notably in Europe and North America. Reported results also included a number of gains and losses on disposal totalling US\$1.1bn (see page 49). These included a gain of US\$1.1bn arising from the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties. Reported profits in 2012 included a gain of US\$3.0bn on the disposal of our associate, Ping An, and a gain on disposal of US\$130m from the sale of our shareholding in a property company in the Philippines.

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On an underlying basis, excluding the gains and losses on disposal noted above and the associated operating results, the pre-tax loss of US\$1.9bn decreased by US\$3.1bn, driven by the non-recurrence of charges for US AML, BSA and OFAC investigations of US\$1.9bn. In addition, we recognised a net gain of US\$553m on completion of the sale of our investment in Ping An in 2013, compared with adverse fair value movements of US\$553m on the Ping An contingent forward sale contract recorded in 2012.

Net fee income decreased by US\$130m, reflecting the expiring of most of the transition services agreement entered into during 2012 following the sale of the CRS business in North America. We received fee income relating to the above agreement while the associated costs were reported in *Operating expenses* .

Net trading income of US\$6m in 2013 compared with a net trading expense of US\$538m in 2012, driven by foreign exchange gains of US\$442m relating to sterling debt issued by HSBC Holdings. In addition, there were favourable fair value movements on non-qualifying hedges, notably in Europe, mainly related to the cross-currency swaps used to economically hedge fixed rate long-term debt, compared with adverse movements in 2012. This was partly offset by adverse fair value movements of US\$682m on the contingent forward sale contract relating to Ping An in 2013 compared with US\$553m in 2012.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Net expense from financial instruments designated at fair value reduced by US\$3.6bn. We reported adverse movements of US\$1.2bn on the fair value of our own debt attributable to a tightening of credit spreads in 2013, notably in Europe and North America, compared with adverse movements of US\$5.2bn in 2012. Excluding this, net expense increased due to higher adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt designated at fair value issued principally by HSBC Holdings and its European subsidiaries.

Gains less losses from financial investments increased by US\$868m, driven by a gain of US\$1.2bn on the disposal of our investment in Ping An, partly offset by the non-recurrence of gains of US\$314m from the sale of our shares in four Indian banks in 2012.

Dividend income increased by US\$124m on a reported basis, mainly due to dividends received from Industrial Bank following its reclassification as a financial investment.

Other operating income increased by US\$1.5bn, driven by an accounting gain of US\$1.1bn arising from the reclassification of Industrial Bank as a financial investment.

Operating expenses reduced by US\$1.5bn, mainly from the non-recurrence of the US fines and penalties noted above, together with lower restructuring costs across all our regions. These factors were partly offset by the UK bank levy charge of US\$904m in 2013, which was higher than the charge of US\$571m in 2012, mainly due to an increase in the rate of the levy. In addition, operating expenses in both years included adjustments relating to the previous year's bank levy charge (2013: US\$12m adverse adjustment; 2012: US\$99m favourable adjustment).

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Reconciliation of reported to constant currency and underlying profit/(loss) before tax****Retail Banking and Wealth Management***2013 compared with 2012*

	2012					
	2012 as reported	Currency translation adjustment ¹	at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	20,298	(368)	19,930	18,339	(10)	(8)
Net fee income	7,205	(113)	7,092	7,021	(3)	(1)
Net trading income	304	(18)	286	686	126	140
Net income from financial instruments designated at fair value	1,893	(26)	1,867	1,638	(13)	(12)
Gains on disposal of US branch network and cards business	3,735		3,735		(100)	(100)
Gains less losses from financial investments	96	(7)	89	55	(43)	(38)
Net earned insurance premiums	11,191	(68)	11,123	10,543	(6)	(5)
Other operating income (including dividend income)	1,496	(34)	1,462	565	(62)	(61)
Total operating income	46,218	(634)	45,584	38,847	(16)	(15)
Net insurance claims incurred and movement in liabilities to policyholders	(12,357)	44	(12,313)	(12,107)	2	2
Net operating income⁴	33,861	(590)	33,271	26,740	(21)	(20)
LICs ⁴²	(5,515)	135	(5,380)	(3,227)	41	40
Net operating income	28,346	(455)	27,891	23,513	(17)	(16)
Operating expenses	(19,769)	415	(19,354)	(17,248)	13	11
Operating profit	8,577	(40)	8,537	6,265	(27)	(27)
Income from associates ⁴³	998	14	1,012	384	(62)	(62)
Profit before tax	9,575	(26)	9,549	6,649	(31)	(30)

*For footnotes, see page 132.**2012 compared with 2011*

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	2011					
	2011 as reported	Currency translation adjustment ¹	at 2012 exchange rates	2012 as reported	Reported	Constant currency
		US\$m	US\$m		US\$m	change ²
Net interest income	24,101	(702)	23,399	20,298	(16)	(13)
Net fee income	8,226	(187)	8,039	7,205	(12)	(10)
Gains on disposal of US branch network and cards business				3,735		
Other income ⁷	1,206	(100)	1,106	2,623	117	137
Net operating income ⁴	33,533	(989)	32,544	33,861	1	4
LICs ⁴²	(9,319)	181	(9,138)	(5,515)	41	40
Net operating income	24,214	(808)	23,406	28,346	17	21
Operating expenses	(21,202)	712	(20,490)	(19,769)	7	4
Operating profit	3,012	(96)	2,916	8,577	185	194
Income from associates ⁴³	1,258	25	1,283	998	(21)	(22)
Profit before tax	4,270	(71)	4,199	9,575	124	128

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	Year ended 31 December					
	2013 US\$m	2012 US\$m	Change ² %	2012 US\$m	2011 US\$m	Change ² %
Net interest income						
Reported	18,339	20,298	(10)	20,298	24,101	(16)
Currency translation adjustment ¹		(368)			(701)	
Acquisitions, disposals and dilutions	(151)	(1,735)		(1,504)	(4,611)	
Underlying	18,188	18,195		18,794	18,789	
Other operating income						
Reported	544	1,472	(63)	1,472	907	62
Currency translation adjustment ¹		(33)			(38)	
Acquisitions, disposals and dilutions	(312)	(395)		(363)	(159)	
Underlying	232	1,044	(78)	1,109	710	56
Revenue⁴						
Reported	26,740	33,861	(21)	33,861	33,533	1
Currency translation adjustment ¹		(590)			(989)	
Acquisitions, disposals and dilutions	(494)	(6,447)		(6,164)	(6,427)	
Underlying	26,246	26,824	(2)	27,697	26,117	6
LICs⁴²						
Reported	(3,227)	(5,515)	41	(5,515)	(9,319)	41
Currency translation adjustment ¹		135			181	
Acquisitions, disposals and dilutions	33	377		339	1,616	
Underlying	(3,194)	(5,003)	36	(5,176)	(7,522)	31
Operating expenses						
Reported	(17,248)	(19,769)	13	(19,769)	(21,202)	7
Currency translation adjustment ¹		415			712	
Acquisitions, disposals and dilutions	203	1,176		873	2,429	
Underlying	(17,045)	(18,178)	6	(18,896)	(18,061)	(5)
Underlying cost efficiency ratio	64.9%	67.8%		68.2%	69.2%	
Share of profit in associates and joint ventures						
Reported	384	998	(62)	998	1,258	(21)
Currency translation adjustment ¹		14			25	
Acquisitions, disposals and dilutions	(6)	(670)		(622)	(946)	
Underlying	378	342	11	376	337	12
Profit before tax						
Reported	6,649	9,575	(31)	9,575	4,270	124
Currency translation adjustment ¹		(26)			(71)	
Acquisitions, disposals and dilutions	(264)	(5,565)		(5,574)	(3,328)	
Underlying	6,385	3,984	60	4,001	871	359

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Principal Retail Banking and Wealth Management business

2013 compared with 2012

	2012 as reported	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	16,468	(368)	16,100	16,278	(1)	1
Net fee income	6,777	(113)	6,664	7,010	3	5
Other income ⁷	3,403	(109)	3,294	1,780	(48)	(46)
Net operating income⁴	26,648	(590)	26,058	25,068	(6)	(4)
LICs ⁴²	(2,624)	135	(2,489)	(2,522)	4	(1)
Net operating income	24,024	(455)	23,569	22,546	(6)	(4)
Total operating expenses	(17,937)	415	(17,522)	(16,082)	10	8
Operating profit	6,087	(40)	6,047	6,464	6	7
Income from associates ⁴³	996	14	1,010	385	(61)	(62)
Profit before tax	7,083	(26)	7,057	6,849	(3)	(3)

For footnotes, see page 132.

Analysis of reported RBWM and Principal RBWM business

	2013	2012	Change ²	2012	2011	Change ²
	US\$m	US\$m	%	US\$m	US\$m	%
Net interest income						
Reported RBWM	18,339	20,298	(10)	20,298	24,101	(16)
US CRS		1,267	(100)	1,267	4,128	(69)
US run-off portfolio	2,061	2,563	(20)	2,563	2,990	(14)
Principal RBWM business	16,278	16,468	(1)	16,468	16,983	(3)
Net fee income						
Reported RBWM	7,021	7,205	(3)	7,205	8,226	(12)
US CRS		395	(100)	395	1,273	(69)
US run-off portfolio	11	33	(67)	33	(49)	
Principal RBWM business	7,010	6,777	3	6,777	7,002	(3)
Other income/(expense)⁷						

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Reported RBWM	1,380	6,358	(78)	6,358	1,206	427
US CRS		3,155	(100)	3,155	61	5,072
US run-off portfolio	(400)	(200)	(100)	(200)	(1,196)	83
Principal RBWM business	1,780	3,403	(48)	3,403	2,341	45
Net operating income⁴						
Reported RBWM	26,740	33,861	(21)	33,861	33,533	1
US CRS		4,817	(100)	4,817	5,462	(12)
US run-off portfolio	1,672	2,396	(30)	2,396	1,745	37
Principal RBWM business	25,068	26,648	(6)	26,648	26,326	1
LICs⁴²						
Reported RBWM	(3,227)	(5,515)	41	(5,515)	(9,319)	41
US CRS		(322)	100	(322)	(1,600)	80
US run-off portfolio	(705)	(2,569)	73	(2,569)	(4,982)	48
Principal RBWM business	(2,522)	(2,624)	4	(2,624)	(2,737)	4
Net operating income						
Reported RBWM	23,513	28,346	(17)	28,346	24,214	17
US CRS		4,495	(100)	4,495	3,862	16
US run-off portfolio	967	(173)		(173)	(3,237)	95
Principal RBWM business	22,546	24,024	(6)	24,024	23,589	2

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

	2013	2012	Change ²	2012	2011	Change ²
	US\$m	US\$m	%	US\$m	US\$m	%
Total operating expenses						
Reported RBWM	(17,248)	(19,769)	13	(19,769)	(21,202)	7
US CRS		(729)	100	(729)	(1,801)	60
US run-off portfolio	(1,166)	(1,103)	(6)	(1,103)	(1,238)	11
Principal RBWM business	(16,082)	(17,937)	10	(17,937)	(18,163)	1
Operating profit/(loss)						
Reported RBWM	6,265	8,577	(27)	8,577	3,012	185
US CRS		3,766	(100)	3,766	2,061	83
US run-off portfolio	(199)	(1,276)	84	(1,276)	(4,475)	71
Principal RBWM business	6,464	6,087	6	6,087	5,426	12
Income from associates⁴³						
Reported RBWM	384	998	(62)	998	1,258	(21)
US CRS						
US run-off portfolio	(1)	2		2	3	(33)
Principal RBWM business	385	996	(61)	996	1,255	(21)
Profit/(loss) before tax						
Reported RBWM	6,649	9,575	(31)	9,575	4,270	124
US CRS		3,766	(100)	3,766	2,061	83
US run-off portfolio	(200)	(1,274)	84	(1,274)	(4,472)	72
Principal RBWM business	6,849	7,083	(3)	7,083	6,681	6

For footnotes, see page 132.

Retail Banking and Wealth Management Reconciliation of reported and underlying items

HSBC Finance

	2013	2012	Change ²	2012	2011	Change ²
	US\$m	US\$m	%	US\$m	US\$m	%
Revenue⁴						
Reported	1,672	7,251	(77)	7,251	7,216	
Acquisitions, disposals and dilutions	105	(4,888)		(4,830)	(5,462)	
Underlying	1,777	2,363	(25)	2,421	1,754	38
Profit/(loss) before tax						
Reported	(200)	2,443		2,443	(2,405)	
Acquisitions, disposals and dilutions	120	(3,889)		(3,916)	(2,061)	
Underlying	(80)	(1,446)	94	(1,473)	(4,466)	67

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	<i>US run-off</i>			<i>Principal business</i>		
	Year ended 31 December			Year ended 31 December		
	2013	2012	Change ²	2013	2012	Change ²
	US\$m	US\$m	%	US\$m	US\$m	%
Revenue⁴						
Reported	1,672	2,396	(30)	25,068	26,648	(6)
Currency translation adjustment					(590)	
Acquisitions, disposals and dilutions	105			(599)	(1,630)	
Underlying	1,777	2,396	(26)	24,469	24,428	

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Commercial Banking***2013 compared with 2012*

	2012 as reported	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	10,361	(220)	10,141	10,200	(2)	1
Net fee income	4,470	(69)	4,401	4,717	6	7
Net trading income	633	(15)	618	649	3	5
Net income from financial instruments designated at fair value	250	(17)	233	332	33	42
Gains on disposal of US branch network and cards business	277		277		(100)	(100)
Gains less losses from financial investments	22	(2)	20	1	(95)	(95)
Net earned insurance premiums	1,786	(49)	1,737	1,375	(23)	(21)
Other operating income (including dividend income)	554	(10)	544	636	15	17
Total operating income	18,353	(382)	17,971	17,910	(2)	
Net insurance claims incurred and movement in liabilities to policyholders	(1,802)	53	(1,749)	(1,545)	15	12
Net operating income⁴	16,551	(329)	16,222	16,365	(1)	1
LICs ⁴²	(2,099)	59	(2,040)	(2,384)	(14)	(17)
Net operating income	14,452	(270)	14,182	13,981	(3)	(1)
Operating expenses	(7,598)	149	(7,449)	(7,049)	7	5
Operating profit	6,854	(121)	6,733	6,932	1	3
Income from associates ⁴³	1,681	25	1,706	1,509	(10)	(12)
Profit before tax	8,535	(96)	8,439	8,441	(1)	

*For footnotes, see page 132.**2012 compared with 2011*

2011 as reported	Currency translation	2011 at 2012	2012 as reported	Reported change ²	Constant currency
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	US\$m	adjustment ¹	exchange	US\$m	%	change ²
		US\$m	rates			%
			US\$m			
Net interest income	9,931	(381)	9,550	10,361	4	8
Net fee income	4,291	(132)	4,159	4,470	4	7
Gains on disposal of US branch network				277		
Other income ⁷	1,389	(58)	1,331	1,443	4	8
Net operating income ⁴	15,611	(571)	15,040	16,551	6	10
LICs ⁴²	(1,738)	81	(1,657)	(2,099)	(21)	(27)
Net operating income	13,873	(490)	13,383	14,452	4	8
Operating expenses	(7,221)	288	(6,933)	(7,598)	(5)	(10)
Operating profit	6,652	(202)	6,450	6,854	3	6
Income from associates ⁴³	1,295	22	1,317	1,681	30	28
Profit before tax	7,947	(180)	7,767	8,535	7	10

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	2013 US\$m	2012 US\$m	Year ended 31 December		2011 US\$m	Change ² %
			Change ² %	2012 US\$m		
Net interest income						
Reported	10,200	10,361	(2)	10,361	9,931	4
Currency translation adjustment ¹		(220)			(381)	
Acquisitions, disposals and dilutions	(92)	(211)		(83)	(139)	
Underlying	10,108	9,930	2	10,278	9,411	9
Other operating income						
Reported	621	536	16	536	483	11
Currency translation adjustment ¹		(10)			(10)	
Acquisitions, disposals and dilutions	(470)	(187)		(203)	6	
Underlying	151	339	(55)	333	479	(30)
Revenue⁴						
Reported	16,365	16,551	(1)	16,551	15,611	6
Currency translation adjustment ¹		(329)			(571)	
Acquisitions, disposals and dilutions	(593)	(762)		(605)	(232)	
Underlying	15,772	15,460	2	15,946	14,808	8
LICs⁴²						
Reported	(2,384)	(2,099)	(14)	(2,099)	(1,738)	(21)
Currency translation adjustment ¹		59			81	
Acquisitions, disposals and dilutions	(1)			(1)	3	
Underlying	(2,385)	(2,040)	(17)	(2,100)	(1,654)	(27)
Operating expenses						
Reported	(7,049)	(7,598)	7	(7,598)	(7,221)	(5)
Currency translation adjustment ¹		149			288	
Acquisitions, disposals and dilutions	63	191		100	162	
Underlying	(6,986)	(7,258)	4	(7,498)	(6,771)	(11)
Underlying cost efficiency ratio	44.3%	46.9%		47.0%	45.7%	
Share of profit in associates and joint ventures						
Reported	1,509	1,681	(10)	1,681	1,295	30
Currency translation adjustment ¹		25			21	
Acquisitions, disposals and dilutions	(10)	(351)		(88)	(9)	
Underlying	1,499	1,355	11	1,593	1,307	22
Profit before tax						
Reported	8,441	8,535	(1)	8,535	7,947	7
Currency translation adjustment ¹		(96)			(180)	
Acquisitions, disposals and dilutions	(541)	(922)		(594)	(76)	
Underlying	7,900	7,517	5	7,941	7,691	3

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Global Banking and Markets***2013 compared with 2012*

	2012 as reported	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	6,960	(127)	6,833	6,766	(3)	(1)
Net fee income	3,329	(22)	3,307	3,482	5	5
Net trading income	5,690	(90)	5,600	6,780	19	21
Net income from financial instruments designated at fair value	1,094	(13)	1,081	599	(45)	(45)
Gains less losses from financial investments	730	(8)	722	747	2	3
Net earned insurance premiums	25	(3)	22	6	(76)	(73)
Other operating income (including dividend income)	461	9	470	799	73	70
Total operating income	18,289	(254)	18,035	19,179	5	6
Net insurance claims incurred and movement in liabilities to policyholders	(16)	1	(15)	(3)	81	80
Net operating income⁴	18,273	(253)	18,020	19,176	5	6
LICs ⁴²	(670)	5	(665)	(207)	69	69
Net operating income	17,603	(248)	17,355	18,969	8	9
Operating expenses	(9,907)	95	(9,812)	(9,960)	(1)	(2)
Operating profit	7,696	(153)	7,543	9,009	17	19
Income from associates ⁴³	824	6	830	432	(48)	(48)
Profit before tax	8,520	(147)	8,373	9,441	11	13

*For footnotes, see page 132.**2012 compared with 2011*

2011 as reported	Currency translation	2011 at 2012	2012 as reported	Reported change ²	Constant currency
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	US\$m	adjustment ¹	exchange	US\$m	%	change ²
		US\$m	rates			%
			US\$m			
Net interest income	7,263	(197)	7,066	6,960	(4)	(2)
Net fee income	3,227	(92)	3,135	3,329	3	6
Net trading income	5,204	(116)	5,088	5,690	9	12
Other income ⁷	1,363	(26)	1,337	2,294	68	72
Net operating income ⁴	17,057	(431)	16,626	18,273	7	10
LICs ⁴²	(984)	14	(970)	(670)	32	31
Net operating income	16,073	(417)	15,656	17,603	10	12
Operating expenses	(9,722)	208	(9,514)	(9,907)	(2)	(4)
Operating profit	6,351	(209)	6,142	7,696	21	25
Income from associates ⁴³	698	9	707	824	18	17
Profit before tax	7,049	(200)	6,849	8,520	21	24

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency management view of total operating income of Global Banking and Markets

2013 compared with 2012

	2012 as reported US\$m	Currency translation adjustment ¹ US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change ² %	Constant currency change ² %
Markets ⁴⁶	6,105	(75)	6,030	6,935	14	15
Credit	485	(2)	483	796	64	65
Rates	1,607	(18)	1,589	1,653	3	4
Foreign Exchange	3,215	(54)	3,161	3,186	(1)	1
Equities	798	(1)	797	1,300	63	63
Capital Financing	3,758	(34)	3,724	3,994	6	7
Payments and Cash Management	1,680	(32)	1,648	1,770	5	7
Securities Services	1,623	(20)	1,603	1,662	2	4
Global Trade and Receivables Finance	740	(14)	726	741		2
Balance Sheet Management	3,738	(64)	3,674	3,110	(17)	(15)
Principal Investments	188	(3)	185	512	172	177
Debit valuation adjustment	518	(6)	512	105	(80)	(79)
Other ⁴⁷	(77)	(5)	(82)	347		
Total operating income	18,273	(253)	18,020	19,176	5	6

*For footnotes, see page 132.**2012 compared with 2011*

	2011 as reported US\$m	Currency translation adjustment ¹ US\$m	2011 at 2012 exchange rates	2012 as reported US\$m	Reported change ² %	Constant currency change ² %
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	US\$m					
Markets ⁴⁶	5,749	(138)	5,611	6,104	6	9
Credit	133	(6)	127	485	265	282
Rates	1,238	(16)	1,222	1,607	30	32
Foreign Exchange	3,269	(77)	3,192	3,214	(2)	1
Equities	1,109	(39)	1,070	798	(28)	(25)
Capital Financing	3,711	(114)	3,597	3,758	1	4
Payments and Cash Management	1,561	(27)	1,534	1,679	8	9
Securities Services	1,669	(44)	1,625	1,624	(3)	
Global Trade and Receivables Finance	601	(18)	583	740	23	27
Balance Sheet Management	3,418	(73)	3,345	3,738	9	12
Principal Investments	277	(7)	270	188	(32)	(31)
Debit valuation adjustment				518		
Other ⁴⁷	71	(10)	61	(76)		
Total operating income	17,057	(431)	16,626	18,273	7	10

The management view of income above reflects the new management structure of GB&M which has been in place since 12 August 2013 (comparatives have been re-presented for this change).

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	2013 US\$m	2012 US\$m	Year ended 31 December		2011 US\$m	Change ² %
			Change ² %	2012 US\$m		
Net interest income						
Reported	6,766	6,960	(3)	6,960	7,263	(4)
Currency translation adjustment ¹		(127)			(198)	
Acquisitions, disposals and dilutions	(26)	(56)		(24)	(31)	
Underlying	6,740	6,777	(1)	6,936	7,034	(1)
Other operating income						
Reported	670	313	114	313	577	(46)
Currency translation adjustment ¹		10			(10)	
Acquisitions, disposals and dilutions	(407)	(78)		(30)	7	
Underlying	263	245	7	283	574	(51)
Revenue⁴						
Reported	19,176	18,273	5	18,273	17,057	7
Currency translation adjustment ¹		(253)			(431)	
Acquisitions, disposals and dilutions	(460)	(219)		(107)	(81)	
Underlying	18,716	17,801	5	18,166	16,545	10
LICs⁴²						
Reported	(207)	(670)	69	(670)	(984)	32
Currency translation adjustment ¹		5			14	
Acquisitions, disposals and dilutions						
Underlying	(207)	(665)	69	(670)	(970)	31
Operating expenses						
Reported	(9,960)	(9,907)	(1)	(9,907)	(9,722)	(2)
Currency translation adjustment ¹		95			208	
Acquisitions, disposals and dilutions	54	107		21	34	
Underlying	(9,906)	(9,705)	(2)	(9,886)	(9,480)	(4)
Underlying cost efficiency ratio	52.9%	54.5%		54.4%	57.3%	
Share of profit in associates and joint ventures						
Reported	432	824	(48)	824	698	18
Currency translation adjustment ¹		6			9	
Acquisitions, disposals and dilutions	2	(404)		(63)	(67)	
Underlying	434	426	2	761	640	19
Profit before tax						
Reported	9,441	8,520	11	8,520	7,049	21
Currency translation adjustment ¹		(147)			(200)	
Acquisitions, disposals and dilutions	(404)	(516)		(149)	(114)	
Underlying	9,037	7,857	15	8,371	6,735	24

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Balance sheet data significant to Global Banking and Markets*

	Rest of						Total
	Europe	Hong Kong	Asia-Pacific	MENA	North America	Latin America	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
At 31 December 2013							
Trading assets ⁶⁴	212,941	27,998	11,942	432	38,709	6,660	298,682
Derivative assets ⁶⁵	227,985	34,353	24,558	1,143	57,131	5,971	351,141
Trading liabilities	137,448	10,377	3,958	1,230	38,850	2,823	194,686
Derivative liabilities ⁶⁵	273,086	32,269	23,597	1,158	55,105	5,499	390,714
At 31 December 2012							
Trading assets ⁶⁴	242,175	31,614	22,804	530	95,347	9,506	401,976
Derivative assets ⁶⁵	287,427	28,531	22,700	1,417	80,096	5,117	425,288
Trading liabilities	176,838	9,345	4,470	1,081	94,943	5,950	292,627
Derivative liabilities ⁶⁵	292,711	27,720	22,900	1,430	79,437	4,899	429,097
At 31 December 2011							
Trading assets ⁶⁴	180,790	38,637	19,167	938	69,568	14,370	323,470
Derivative assets ⁶⁵	272,756	25,203	23,056	1,275	86,619	4,825	413,734
Trading liabilities	157,934	8,282	3,781	757	70,288	5,014	246,056
Derivative liabilities ⁶⁵	274,803	25,186	23,877	1,245	86,697	4,469	416,277

For footnotes, see page 133a.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Global Private Banking***2013 compared with 2012*

	2012 as reported	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	1,294	(6)	1,288	1,146	(11)	(11)
Net fee income	1,232	1	1,233	1,150	(7)	(7)
Net trading income	490	(1)	489	394	(20)	(19)
Net income from financial instruments designated at fair value				4		
Gains less losses from financial investments	(3)		(3)	(3)		
Net earned insurance premiums	42	2	44	16	(62)	(64)
Other operating income/(expense) (including dividend income)	157	(13)	144	(231)		
Total operating income	3,212	(17)	3,195	2,476	(23)	(23)
Net insurance claims incurred and movement in liabilities to policyholders	(40)	(2)	(42)	(37)	8	12
Net operating income⁴	3,172	(19)	3,153	2,439	(23)	(23)
LICs ⁴²	(27)	1	(26)	(31)	(15)	(19)
Net operating income	3,145	(18)	3,127	2,408	(23)	(23)
Operating expenses	(2,143)	2	(2,141)	(2,229)	(4)	(4)
Operating profit	1,002	(16)	986	179	(82)	(82)
Income from associates ⁴³	7		7	14	100	100
Profit before tax	1,009	(16)	993	193	(81)	(81)

*For footnotes, see page 132.**2012 compared with 2011*

	2011 as reported	Currency translation adjustment ¹	2011 at 2012 exchange rates	2012 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%

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		US\$m	rates			%
			US\$m			
Net interest income	1,439	(12)	1,427	1,294	(10)	(9)
Net fee income	1,382	(19)	1,363	1,232	(11)	(10)
Other income ⁷	471	(4)	467	646	37	38
Net operating income ⁴	3,292	(35)	3,257	3,172	(4)	(3)
LICs ⁴²	(86)	1	(85)	(27)	69	68
Net operating income	3,206	(34)	3,172	3,145	(2)	(1)
Operating expenses	(2,266)	26	(2,240)	(2,143)	5	4
Operating profit	940	(8)	932	1,002	7	8
Income from associates ⁴³	4		4	7	75	75
Profit before tax	944	(8)	936	1,009	7	8

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	Year ended 31 December					
	2013 US\$m	2012 US\$m	Change ² %	2012 US\$m	2011 US\$m	Change ² %
Net interest income						
Reported	1,146	1,294	(11)	1,294	1,439	(10)
Currency translation adjustment ¹		(6)			(11)	
Acquisitions, disposals and dilutions	(4)	(13)		(7)	(14)	
Underlying	1,142	1,275	(10)	1,287	1,414	(9)
Other operating income						
Reported	(239)	151		151	30	403
Currency translation adjustment ¹		(13)			(1)	
Acquisitions, disposals and dilutions	(1)	(56)		(56)		
Underlying	(240)	82		95	29	228
Revenue⁴						
Reported	2,439	3,172	(23)	3,172	3,292	(4)
Currency translation adjustment ¹		(19)			(35)	
Acquisitions, disposals and dilutions	(5)	(72)		(65)	(28)	
Underlying	2,434	3,081	(21)	3,107	3,229	(4)
LICs⁴²						
Reported	(31)	(27)	(15)	(27)	(86)	69
Currency translation adjustment ¹		1			1	
Acquisitions, disposals and dilutions						
Underlying	(31)	(26)	(19)	(27)	(85)	68
Operating expenses						
Reported	(2,229)	(2,143)	(4)	(2,143)	(2,266)	5
Currency translation adjustment ¹		2			26	
Acquisitions, disposals and dilutions	4	15		10	37	
Underlying	(2,225)	(2,126)	(5)	(2,133)	(2,203)	3
Underlying cost efficiency ratio	91.4%	69.0%		68.7%	68.2%	
Profit before tax						
Reported	193	1,009	(81)	1,009	944	7
Currency translation adjustment ¹		(16)			(8)	
Acquisitions, disposals and dilutions	(1)	(57)		(55)	9	
Underlying	192	936	(79)	954	945	1

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Other***2013 compared with 2012*

	2012 as reported	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	(730)	(4)	(734)	(737)	(1)	
Net fee income	194		194	64	(67)	(67)
Net trading income	(537)	(1)	(538)	6		
Own credit spread ³	(5,215)	12	(5,203)	(1,246)	76	76
Other expense from financial instruments designated at fair value	(248)	7	(241)	(558)	(125)	(132)
Net expense from financial instruments designated at fair value	(5,463)	19	(5,444)	(1,804)	67	67
Gains on disposal of US branch network, US cards business and Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial investments	344		344	1,212	252	252
Other operating income (including dividend income)	5,512	(210)	5,302	6,910	25	30
Total operating income	2,332	(196)	2,136	5,651	142	165
Net insurance claims incurred and movement in liabilities to policyholders						
Net operating income⁴	2,332	(196)	2,136	5,651	142	165
LICs ⁴²						
Net operating income	2,332	(196)	2,136	5,651	142	165
Operating expenses	(9,369)	81	(9,288)	(7,796)	17	16
Operating loss	(7,037)	(115)	(7,152)	(2,145)	70	70
Income from associates ⁴³	47		47	(14)		
Loss before tax	(6,990)	(115)	(7,105)	(2,159)	69	70

*For footnotes, see page 132.**2012 compared with 2011*

2011 as	Currency	2011	2012 as	Reported	Constant
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	reported	translation	at 2012	reported	change ²	currency
	US\$m	adjustment ¹	exchange	US\$m	%	change ²
		US\$m	rates			%
			US\$m			
Net interest income	(911)	35	(876)	(730)	20	17
Net fee income	34	(6)	28	194	471	593
Own credit spread ³	3,933	(35)	3,898	(5,215)		
Gains on disposal of Ping An				3,012		
Other income ⁷	6,089	(119)	5,970	5,071	(17)	(15)
Net operating income ⁴	9,145	(125)	9,020	2,332	(74)	(74)
LICs ⁴²						
Net operating income	9,145	(125)	9,020	2,332	(74)	(74)
Operating expenses	(7,492)	122	(7,370)	(9,369)	(25)	(27)
Operating profit/(loss)	1,653	(3)	1,650	(7,037)		
Income from associates ⁴³	9	(1)	8	47	422	488
Profit/(loss) before tax	1,662	(4)	1,658	(6,990)		

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and underlying items*

	2013		Year ended 31 December			
	US\$m	2012	Change ²	2012	2011	Change ²
		US\$m	%	US\$m	US\$m	%
Revenue⁴						
Reported	5,651	2,332	142	2,332	9,145	(74)
Currency translation adjustment ¹		(209)			(90)	
Own credit spread ³	1,246	5,215		5,215	(3,933)	
Acquisitions, disposals and dilutions	(1,044)	(3,107)		(3,107)	(208)	
Underlying	5,853	4,231	38	4,440	4,914	(10)
Operating expenses						
Reported	(7,796)	(9,369)	17	(9,369)	(7,492)	(25)
Currency translation adjustment ¹		81			122	
Acquisitions, disposals and dilutions	29	1			4	
Underlying	(7,767)	(9,287)	16	(9,369)	(7,366)	(27)
Underlying cost efficiency ratio	132.7%	219.5%		211.0%	149.9%	
Profit/(loss) before tax						
Reported	(2,159)	(6,990)	69	(6,990)	1,662	
Currency translation adjustment ¹		(127)			31	
Own credit spread ³	1,246	5,215		5,215	(3,933)	
Acquisitions, disposals and dilutions	(1,015)	(3,106)		(3,107)	(141)	
Underlying	(1,928)	(5,008)	62	(4,882)	(2,381)	(105)

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Analysis by global business***HSBC profit/(loss) before tax and balance sheet data*

	2013						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other ³⁹	Inter segment elimination ⁴⁹	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	18,339	10,200	6,766	1,146	(737)	(175)	35,539
Net fee income	7,021	4,717	3,482	1,150	64		16,434
Trading income/(expense) excluding net interest income	689	649	4,953	390	(38)		6,643
Net interest income/(expense) on trading activities	(3)		1,827	4	44	175	2,047
Net trading income ⁴⁴	686	649	6,780	394	6	175	8,690
Changes in fair value of long- term debt issued and related derivatives					(1,228)		(1,228)
Net income/(expense) from other financial instruments designated at fair value	1,638	332	599	4	(576)	(1)	1,996
Net income/(expense) from financial instruments designated at fair value	1,638	332	599	4	(1,804)	(1)	768
Gains less losses from financial investments	55	1	747	(3)	1,212		2,012
Dividend income	21	15	129	8	149		322
Net earned insurance premiums	10,543	1,375	6	16			11,940
Other operating income/ (expense)	544	621	670	(239)	6,761	(5,725)	2,632
Total operating income	38,847	17,910	19,179	2,476	5,651	(5,726)	78,337
Net insurance claims ⁵⁰	(12,107)	(1,545)	(3)	(37)			(13,692)
Net operating income⁴	26,740	16,365	19,176	2,439	5,651	(5,726)	64,645
Loan impairment charges and other credit risk provisions	(3,227)	(2,384)	(207)	(31)			(5,849)
Net operating income	23,513	13,981	18,969	2,408	5,651	(5,726)	58,796

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Employee expenses ⁵¹	(5,219)	(2,327)	(3,549)	(776)	(7,325)		(19,196)
Other operating expenses	(12,029)	(4,722)	(6,411)	(1,453)	(471)	5,726	(19,360)
Total operating expenses	(17,248)	(7,049)	(9,960)	(2,229)	(7,796)	5,726	(38,556)
Operating profit/(loss)	6,265	6,932	9,009	179	(2,145)		20,240
Share of profit/(loss) in associates and joint ventures	384	1,509	432	14	(14)		2,325
Profit/(loss) before tax	6,649	8,441	9,441	193	(2,159)		22,565
	%	%	%	%	%		%
Share of HSBC's profit before tax	29.5	37.4	41.8	0.9	(9.6)		100.0
Cost efficiency ratio	64.5	43.1	51.9	91.4	138.0		59.6
<i>Balance sheet data</i> ⁴⁰							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	375,115	297,852	360,659	44,224	2,454		1,080,304
Total assets	517,085	360,623	1,975,509	97,655	171,812	(451,366)	2,671,318
Customer accounts	579,994	354,298	450,315	96,770	1,435		1,482,812

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

	2012						Total US\$m
	Retail		Global		Inter		
	Banking	Commercial	Banking	Global	Private	segment	
	and Wealth	Banking	and Markets	Banking	Other ³⁹	elimination ⁴⁹	
Management US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
<i>Profit before tax</i>							
Net interest income/(expense)	20,298	10,361	6,960	1,294	(730)	(511)	37,672
Net fee income	7,205	4,470	3,329	1,232	194		16,430
Trading income/(expense) excluding net interest income	276	617	3,588	476	(549)		4,408
Net interest income on trading activities	28	16	2,102	14	12	511	2,683
Net trading income/(expense) ⁴⁴	304	633	5,690	490	(537)	511	7,091
Changes in fair value of long- term debt issued and related derivatives					(4,327)		(4,327)
Net income/(expense) from other financial instruments designated at fair value	1,893	250	1,094		(1,136)		2,101
Net income/(expense) from financial instruments designated at fair value	1,893	250	1,094		(5,463)		(2,226)
Gains less losses from financial investments	96	22	730	(3)	344		1,189
Dividend income	24	18	148	6	25		221
Net earned insurance premiums	11,191	1,786	25	42			13,044
Gains on disposal of US branch network, US cards business and Ping An	3,735	277			3,012		7,024
Other operating income	1,472	536	313	151	5,487	(5,859)	2,100
Total operating income	46,218	18,353	18,289	3,212	2,332	(5,859)	82,545
Net insurance claims ⁵⁰	(12,357)	(1,802)	(16)	(40)			(14,215)
Net operating income ⁴	33,861	16,551	18,273	3,172	2,332	(5,859)	68,330
Loan impairment charges and other credit risk provisions	(5,515)	(2,099)	(670)	(27)			(8,311)
Net operating income	28,346	14,452	17,603	3,145	2,332	(5,859)	60,019
Employee expenses ⁵¹	(5,532)	(2,247)	(3,764)	(915)	(8,033)		(20,491)
Other operating expenses	(14,237)	(5,351)	(6,143)	(1,228)	(1,336)	5,859	(22,436)
Total operating expenses	(19,769)	(7,598)	(9,907)	(2,143)	(9,369)	5,859	(42,927)
Operating profit/(loss)	8,577	6,854	7,696	1,002	(7,037)		17,092
Share of profit in associates and joint ventures	998	1,681	824	7	47		3,557
Profit/(loss) before tax	9,575	8,535	8,520	1,009	(6,990)		20,649
	%	%	%	%	%		%
Share of HSBC's profit before tax	46.4	41.3	41.3	4.9	(33.9)		100.0

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Cost efficiency ratio	58.4	45.9	54.2	67.6			62.8
<i>Balance sheet data</i> ⁴⁰							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	378,040	288,033	283,842	45,213	2,495		997,623
Total assets	536,244	363,659	1,942,470	118,440	201,741	(470,016)	2,692,538
Customer accounts	562,151	338,405	332,115	105,772	1,571		1,340,014
<i>For footnotes, see page 132.</i>							

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data (continued)*

	2011						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other ³⁹	Inter- segment elimination ⁴⁹	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income/(expense)	24,101	9,931	7,263	1,439	(911)	(1,161)	40,662
Net fee income	8,226	4,291	3,227	1,382	34		17,160
Trading income/(expense) excluding net interest income	(562)	565	3,306	415	(441)		3,283
Net interest income on trading activities	43	19	1,898	16	86	1,161	3,223
Net trading income/(expense) ⁴⁴	(519)	584	5,204	431	(355)	1,161	6,506
Changes in fair value of long- term debt issued and related derivatives					4,161		4,161
Net income/(expense) from other financial instruments designated at fair value	(761)	33	(72)		78		(722)
Net income/(expense) from financial instruments designated at fair value	(761)	33	(72)		4,239		3,439
Gains less losses from financial investments	124	20	761	3	(1)		907
Dividend income	27	15	75	7	25		149
Net earned insurance premiums	10,882	1,956	47		(13)		12,872
Other operating income	907	483	577	30	6,127	(6,358)	1,766
Total operating income	42,987	17,313	17,082	3,292	9,145	(6,358)	83,461
Net insurance claims ⁵⁰	(9,454)	(1,702)	(25)				(11,181)
Net operating income ⁴	33,533	15,611	17,057	3,292	9,145	(6,358)	72,280
Loan impairment charges and other credit risk provisions	(9,319)	(1,738)	(984)	(86)			(12,127)
Net operating income	24,214	13,873	16,073	3,206	9,145	(6,358)	60,153
Employee expenses ⁵¹	(6,538)	(2,184)	(4,196)	(1,351)	(6,897)		(21,166)
Other operating expenses	(14,664)	(5,037)	(5,526)	(915)	(595)	6,358	(20,379)
Total operating expenses	(21,202)	(7,221)	(9,722)	(2,266)	(7,492)	6,358	(41,545)
Operating profit	3,012	6,652	6,351	940	1,653		18,608
Share of profit in associates and joint ventures	1,258	1,295	698	4	9		3,264

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Profit before tax	4,270	7,947	7,049	944	1,662		21,872
	%	%	%	%	%		%
Share of HSBC's profit before tax	19.6	36.3	32.2	4.3	7.6		100.0
Cost efficiency ratio	63.2	46.3	57.0	68.8	81.9		57.5
<i>Balance sheet data</i> ⁴⁰							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	357,907	262,039	276,463	41,856	2,164		940,429
Total assets	540,548	334,966	1,877,627	119,839	180,126	(497,527)	2,555,579
Customer accounts	529,017	306,174	306,454	111,814	466		1,253,925
<i>For footnotes, see page 132.</i>							

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Report of the Directors: Financial Review (continued)**Geographical regions**

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<u>North America</u>	120
<u>Latin America</u>	125

Summary

Additional information on results in 2013 may be found in the Financial Summary on pages 47 to 76.

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US\$3,377m (2011: US\$3,358m; 2010: US\$3,421m).

All commentaries are on a constant currency basis (page 47) unless otherwise stated, while tables are on a reported basis.

Profit/(loss) before tax

	2013		2012		2011	
	US\$m	%	US\$m	%	US\$m	%
Europe	1,825	8.1	(3,414)	(16.5)	4,671	21.3
Hong Kong	8,089	35.9	7,582	36.7	5,823	26.6
Rest of Asia-Pacific	7,764	34.4	10,448	50.6	7,471	34.2
Middle East and North Africa	1,694	7.5	1,350	6.5	1,492	6.8
North America	1,221	5.4	2,299	11.1	100	0.5
Latin America	1,972	8.7	2,384	11.6	2,315	10.6
Total assets⁴⁰	22,565	100.0	20,649	100.0	21,872	100.0

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	At 31 December			
	2013		2012	
	US\$m	%	US\$m	%
Europe	1,392,959	52.1	1,389,240	51.6
Hong Kong	555,413	20.8	518,334	19.3
Rest of Asia-Pacific	335,937	12.6	342,269	12.7
Middle East and North Africa	60,810	2.3	62,605	2.3
North America	432,035	16.2	490,247	18.2
Latin America	113,999	4.3	131,277	4.9
Intra-HSBC items	(219,835)	(8.3)	(241,434)	(9.0)
	2,671,318	100.0	2,692,538	100.0

*Risk-weighted assets*⁵²

	At 31 December			
	2013		2012	
	US\$bn	%	US\$bn	%
Total	1,092.7		1,123.9	
Europe	300.1	27.1	314.7	27.6
Hong Kong	138.3	12.5	111.9	9.8
Rest of Asia-Pacific	292.4	26.4	302.2	26.4
Middle East and North Africa	62.5	5.7	62.2	5.4
North America	223.8	20.2	253.0	22.2
Latin America	89.5	8.1	97.9	8.6

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)

Selected items included in profit before tax by geographical region

Fair value movements arising from changes in own credit spreads³

	2013	2012	2011
	US\$m	US\$m	US\$m
Europe	(1,015)	(4,110)	2,947
Hong Kong	(1)		
Rest of Asia-Pacific	(1)	(3)	2
Middle East and North Africa	(4)	(12)	14
North America	(225)	(1,090)	970
	(1,246)	(5,215)	3,933

Acquisitions, disposals and dilutions⁴¹

The table below shows the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and the operating profit or loss of

the acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses which are eliminated from underlying results so that results can be viewed on a like-for-like basis.

	2013	2012
	US\$m	US\$m
Europe	18	(10)
Hong Kong		420
Rest of Asia-Pacific	1,086	4,649
Middle East and North Africa		(18)
North America	(103)	4,861
Latin America	1,224	264
	2,225	10,166

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Europe**

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

	2013	2012	2011
	US\$m	US\$m	US\$m
Net interest income	10,693	10,394	11,001
Net fee income	6,032	6,169	6,236
Net trading income	4,423	2,707	2,161
Other income/(expense)	(181)	(1,662)	4,848
Net operating income⁴	20,967	17,608	24,246
LICs ⁴²	(1,530)	(1,921)	(2,512)
Net operating income	19,437	15,687	21,734
Total operating expenses	(17,613)	(19,095)	(17,069)
Operating profit/(loss)	1,824	(3,408)	4,665
Income/(expense) from associates ⁴³	1	(6)	6
Profit/(loss) before tax	1,825	(3,414)	4,671
Cost efficiency ratio	84.0%	108.4%	70.4%
RoRWA ³⁶	0.6%	(1.0%)	1.5%
Year-end staff numbers	68,334	70,061	74,892

Best Export Finance Arranger EMEA*(Trade Finance Magazine 2013)***Best Bank Mortgage Provider Award***(Moneyfacts Awards, 2013)*

Fifth consecutive year

Resilient GB&M performance**in a challenging market**

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

UK Gross Domestic Product (GDP) growth rose to 1.9% in 2013, higher than in previous years, though the level of real GDP remained below the level seen prior to the recession. The recovery was driven in part by stronger household consumption. The Bank of England policy rate remained at 0.5% and the Asset Purchase Scheme came to a halt. The Bank of England announced a forward guidance policy in August in which it indicated Bank Rate would not rise until unemployment had fallen towards 7%. Labour market conditions improved more rapidly than expected and the headline unemployment rate fell to 7.1% in December. The annual rate of Consumer Prices Index (CPI) inflation fell in December to 2.0%, the lowest level of inflation in almost four years.

The **eurozone** emerged from recession in the second quarter of 2013 with the improvement early in the year driven by Germany and France. However, activity failed to gain momentum since quarterly GDP growth averaged just 2.0% in the second half of the year. Domestic demand improved on the back of improving real wage growth and a slower pace of austerity but recovery remained heavily dependent on external demand. Given the weakness of the economy in early 2013, the ECB cut its refinancing rate from 0.75% to 0.5% in May and then in July adopted a forward guidance policy under which it committed to keep rates at present or lower levels for an extended period . Despite the return to growth, CPI inflation dropped to 0.7% in October 2013 prompting the ECB to cut the refinancing rate by a further 0.25% in November. A combination of improving growth and the ECB's Outright Monetary Transactions programme, which enables it to buy eurozone government bonds in time of market stress, helped alleviate the sovereign crisis evident in former years and bond yields in Italy and Spain fell to their lowest levels since 2010.

Review of performance

Our European operations reported a profit before tax of US\$1.8bn in 2013 compared with a loss of US\$3.4bn in 2012 (US\$3.3bn on a constant currency basis). On an underlying basis, excluding fair value movements on own debt, the effects of foreign currency translation and acquisitions and disposals, profit before tax increased by US\$2.1bn. This was due to significantly lower operating expenses, driven by a decrease in charges relating to UK customer redress programmes, an accounting gain of US\$430m relating to changes in delivering

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by country within global businesses*

	Retail		Global			Total
	Banking	Commercial	Banking	Global	Other	
	and Wealth	Banking	and	Private		
	Management	Banking	Markets	Banking		
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
2013						
UK	1,471	1,684	1,246	252	(3,493)	1,160
France ³⁵	285	255	351	21	(162)	750
Germany	30	70	183	44	(25)	302
Malta	34	51	35			120
Switzerland		2	2	(291)		(287)
Turkey	(74)	36	108	(1)	1	70
Other	7	(10)	(124)	(190)	27	(290)
	1,753	2,088	1,801	(165)	(3,652)	1,825
2012						
UK	343	832	(111)	235	(6,355)	(5,056)
France ³⁵	135	203	514	(11)	(263)	578
Germany	29	64	283	40	(72)	344
Malta	39	52	31			122
Switzerland		2	1	133		136
Turkey	(32)	71	104		1	144
Other	(5)	(16)	164	102	73	318
	509	1,208	986	499	(6,616)	(3,414)
2011						
UK	1,330	1,227	(265)	192	1,037	3,521
France ³⁵	69	192	(194)	16	18	101
Germany	36	69	203	28	16	352
Malta	31	72	21			124
Switzerland		(8)		225		217
Turkey	7	62	87	2		158
Other	(151)	73	225	94	(43)	198
	1,322	1,687	77	557	1,028	4,671

For footnote, see page 132.

ill-health benefits to certain employees in the UK and sustainable cost savings in 2013.

In the UK, we continued to support the housing market during 2013, approving £14.4bn (US\$22.5bn) of new mortgage lending to over 135,000 customers. This included £3.8bn (US\$6.0bn) to over 30,000 first time buyers. The loan-to-value ratio on new lending was 59.5% compared with

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an average of 48.3% for the total mortgage portfolio. In addition, we implemented the Global Wealth Incentive Plan to better align customer and business interests.

CMB repositioned its Business Banking segment towards international and internationally aspirant customers while streamlining and re-engineering core processes, which enabled it to obtain efficiencies in a number of areas and supported its continued investment in corporate banking and Global Trade and Receivables Finance. Following the success of the 2012 International SME fund, CMB launched a further fund in 2013, continuing its support for UK businesses that trade or aspire to trade internationally with approved lending of £4.8bn (US\$7.5bn), including the renewal

of overdraft and other lending facilities. In addition, CMB won awards for Best Service from a Business Bank and Best Online Banking Provider at the *Business Moneyfacts* awards. GB&M's debt capital markets activity in the Credit and Capital Financing businesses was successful in capturing growth in issuance demand, which resulted in leading market positions and increased market share in the sterling markets. We were ranked first by Bloomberg for primary debt capital market issuances in 2013.

In France, CMB launched a similar SME fund to that in the UK, targeted at international trade customers, approving 1.5bn (US\$2.0bn) of lending in 2013. GB&M acted as joint book runner of a 6.2bn (US\$8.2bn) hybrid bond for a premier French corporate client, demonstrating our ability to deliver large and complex transactions. In RBWM, we increased our market share in the highly competitive home loans market.

In Turkey, unsecured lending grew in RBWM, notably in the credit card business due to new product features and channel capabilities including mobile banking. We launched a similar SME fund to

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

those in the UK and France targeted at international trade customers, approving Turkish lira 1.1bn (US\$0.6bn) of lending in 2013.

We continued to support the programme of renminbi internationalisation during the year with flagship client events taking place in the UK, France and Germany.

In Switzerland we continued to address legacy issues and reposition the customer base.

Net interest income increased by 3%, primarily in the UK. In GB&M, Balance Sheet Management net interest income was higher, reflecting both portfolio growth from rising deposit balances and reduced funding costs. In addition, net interest income increased due to higher lending spreads in Capital Financing and a rise in legacy credit. In RBWM net interest income increased, driven by growth in residential mortgage balances and improved lending spreads. RBWM customer account balances also increased as customers held balances in readily accessible current and savings accounts, although the benefit was restricted by deposit spread compression. In CMB, net interest income in the UK rose as a result of growth in term lending revenue from higher spreads on new and renewed business, as well as deposit growth in Payments and Cash Management. The spreads resulted in increased portfolio margins overall.

In France, net interest income increased due to improved spreads and growth in home loan balances.

These factors were partly offset by a decline, mainly in Switzerland in GPB, as higher yielding positions matured and opportunities for reinvestment were limited by lower prevailing yields. Narrower lending and deposit spreads and reduced average deposit balances also contributed to a fall in net interest income in Switzerland.

Net fee income decreased by US\$138m, mainly in Switzerland in GPB with lower brokerage fees due to a reduction in client transaction volumes, in part reflecting decreased market volatility and fewer large deals.

In the UK, net fee income decreased in RBWM due to higher fees payable under partnership agreements and lower creditor insurance fees. In GB&M, net fee income fell because of higher fees paid to other regions relating to increased foreign exchange trading activities. This was partly offset by increased issuance demand in debt capital markets and event-driven fee income in equity underwriting from increased deal volumes. In addition, we experienced a rise in lending fees in CMB.

In Turkey, net fee income rose due to the growth in card revenue as the business expanded.

Net trading income increased by US\$1.7bn to US\$4.4bn. This was primarily in the UK, driven in part by lower adverse foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value, with the offset reported in Net income from financial instruments designated at fair value. In addition, there was a foreign exchange gain on sterling debt issued by HSBC Holdings and increased favourable fair value movements on non-qualifying hedges compared with 2012.

In GB&M, net trading income included a favourable DVA of US\$65m in 2013. 2012 included a net charge of US\$312m as a result of a change in estimation methodology in respect of CVAs of US\$615m and DVAs of US\$303m, reflecting evolving market practices.

Also in GB&M, Foreign Exchange income rose following increased customer activity, although the rise was offset in part by margin compression and reduced market volatility in the second half of 2013. Net trading income was also higher in the Equities business due to increased deal volumes and revaluation gains. Rates revenue declined due to the benefit in 2012 from tightening spreads following the ECB liquidity intervention, despite new client mandates and increased market participation, particularly in European government bonds. We also experienced lower adverse fair value movements from own credit spreads on structured liabilities.

In France, trading income on non-qualifying hedges increased as long-term interest rates rose.

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Net income from financial instruments designated at fair value was US\$0.4bn compared with net expense of US\$2.2bn in 2012. In the UK, we reported lower adverse movements on the fair value of our own debt of US\$1.0bn, compared with adverse movements of US\$4.1bn in 2012. Excluding this, net income declined, driven by lower favourable foreign exchange movements on foreign currency debt than in 2012, with the offset reported in *Net trading income*. In addition, there were higher adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by HSBC Holdings and its European subsidiaries than in 2012.

By contrast, in the UK and France, we recognised higher net investment gains on the fair value of assets held to meet liabilities under insurance and investment contracts than in 2012, as market conditions improved.

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Gains less losses from financial investments increased by US\$19m as in the UK we reported gains in RBWM in the Asset Management Group. In GB&M, higher disposal gains and lower impairments on available-for-sale equity securities in Principal Investments were more than offset by lower net gains on the disposal of available-for-sale debt securities in Balance Sheet Management, as part of structural interest rate risk management of the balance sheet.

Net earned insurance premiums decreased by 15%, mainly in RBWM in France reflecting lower sales of investment contracts with DPF and the run-off of business from independent financial adviser channels in 2013.

Other operating income decreased by US\$600m due to a loss recognised in GPB following the write-off of goodwill relating to our Monaco business and a loss on sale in RBWM on the disposal of an HFC Bank UK secured loan portfolio.

Net insurance claims incurred and movement in liabilities to policyholders was broadly in line with 2012. Lower reserves established for new business, reflecting the decline in net premium income in France, were partly offset by higher net investment gains on the fair value of assets held to support policyholder contracts in 2013 than in 2012.

LICs decreased by 20% to US\$1.5bn. In the UK, GB&M recorded net releases of credit risk provisions on available-for-sale ABSs compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, loan impairment charges in CMB fell due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales.

In other countries in Europe, lower individually assessed impairment provisions in Greece were

partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM, and a rise in Spain, where the challenging economic conditions continued to affect the market.

Operating expenses decreased by 7%, driven by lower charges relating to UK customer redress programmes, with US\$1.2bn reported in 2013 compared with US\$2.3bn (US\$2.3bn as reported) in 2012. The charges in 2013 included additional estimated redress for possible mis-selling in previous years of US\$756m in respect of PPI compared with US\$1.7bn in 2012, US\$261m in respect of interest rate protection products compared with US\$586m in 2012 and US\$149m in respect of Wealth Management products in 2013. Restructuring costs also fell by US\$78m from 2012. In addition, 2012 included a charge relating to the US OFAC investigation of US\$375m in HSBC Holdings which did not recur.

Excluding these items, operating expenses were broadly unchanged compared with 2012. We benefited from sustainable cost savings of over US\$650m as we continued to streamline the business, and a decline in performance-related costs, notably in GB&M. In addition, we reported an accounting gain of US\$430m relating to changes in delivering ill-health benefits to certain employees in the UK. These factors were partially offset by the higher UK bank levy charge of US\$904m in respect of 2013 compared with a charge of US\$571m in 2012, mainly due to an increase in its rate. In addition, operating expenses in both years included adjustments relating to the prior year charge (2013: US\$12m adverse adjustment; 2012: US\$99m favourable adjustment). In other countries in the region, we experienced higher Madoff-related litigation charges in GB&M in Ireland and a provision in respect of regulatory investigations in GPB in Switzerland.

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Acquisitions, disposals and dilutions	17	15	
Underlying	10,710	10,371	3
Other operating income			
Reported	529	1,080	(51)
Currency translation adjustment ¹		49	
Acquisitions, disposals and dilutions	(69)	(54)	
Underlying	460	1,075	(57)
Revenue⁴			
Reported	20,967	17,608	19
Currency translation adjustment ¹		(35)	
Own credit spread ³	1,015	4,110	
Acquisitions, disposals and dilutions	(51)	(36)	
Underlying	21,931	21,647	1

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Report of the Directors: Financial Review (continued)

	Year ended 31 December		
	2013	2012	Change ²
	US\$m	US\$m	%
LICs⁴²			
Reported	(1,530)	(1,921)	20
Currency translation adjustment ¹		15	
Acquisitions, disposals and dilutions			
Underlying	(1,530)	(1,906)	20
Operating expenses			
Reported	(17,613)	(19,095)	8
Currency translation adjustment ¹		74	
Acquisitions, disposals and dilutions	28	46	
Underlying	(17,585)	(18,975)	7
Underlying cost efficiency ratio	80.2%	87.7%	
Profit/(loss) before tax			
Reported	1,825	(3,414)	
Currency translation adjustment ¹		53	
Own credit spread ³	1,015	4,110	
Acquisitions, disposals and dilutions	(18)	10	
Underlying	2,822	759	272

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**2012 compared with 2011**

Economic background

The **UK** economy remained weak in 2012, with little growth in underlying activity. Preliminary data showed that the level of real Gross Domestic Product (**GDP**) contracted by 0.3% in the fourth quarter, as economic activity fell back after a boost related to the Olympic Games. Despite the lacklustre economy, the labour market remained fairly resilient, with the unemployment rate in the three months to December down to 7.8% from 8.4% in the same period in 2011. In response to the stagnating economy, the Bank of England (**BoE**) increased the size of its Asset Purchase Facility to £375bn (US\$606bn) and launched a new scheme, Funding for Lending, aimed at increasing the supply of credit. Consumer Prices Index (**CPI**) inflation fell during the first half of the year but remained above the **BoE**'s 2% target. In the fourth quarter, it rose back to 2.7%, partly due to increases in tuition fees and energy prices.

The **eurozone** returned to recession in 2012 as the initial resilience in France and Germany was more than offset by deepening contractions in the periphery, where domestic demand was dragged down by austerity and private sector deleveraging. Inflation slowed from 2.7% at the end of 2011 to 2.2% in 2012 and the European Central Bank (**ECB**) cut the refinancing (**refi**) rate by 0.25% to 0.75% in July. The sovereign crisis worsened again in the first half of 2012 but early signs of a roadmap for future integration of the economic and monetary union, additional support for Greece and, most importantly, the **ECB**'s commitment to supporting the euro through its Outright Monetary Transactions bond-buying programme succeeded in lowering peripheral government bond spreads to their lowest level since March 2012.

Review of performance

Our operations in Europe reported a pre-tax loss of US\$3.4bn, compared with a profit of US\$4.7bn in 2011. On a constant currency basis, pre-tax profits declined by US\$8.0bn.

In 2012, there were adverse movements of US\$4.1bn on our own debt designated at fair value, resulting from changes in credit spreads, compared with favourable movements of US\$2.9bn in 2011. On an underlying basis, pre-tax profits decreased by US\$930m due to higher operating expenses reflecting a US\$1.4bn increase in the provision for customer redress programmes in the UK, in particular relating to the possible mis-selling of PPI and interest rate protection products. This was partly offset by higher GB&M revenues, notably in the

Rates and Credit businesses as spreads on eurozone bonds tightened and investor sentiment improved. In addition, impairment charges fell due to lower credit risk provisions in GB&M, notably in the legacy credit portfolio, and improved delinquency rates in RBWM in the UK as we continued to improve the quality of these portfolios with a higher proportion of secured lending.

We made significant progress in reshaping our business in Europe. The disposal of non-core businesses simplified our European portfolio, allowing us to concentrate resources on businesses where we can deliver sustainable profits and growth while managing risks effectively. We exited from Hungary, Georgia, Slovakia, and RBWM in Russia and Poland, and sold Property Vision in the UK, our insurance and reinsurance businesses in Ireland and the retail equities brokerage in Greece.

During 2012, we made progress with our restructuring programme to align our businesses in each country to their respective global business operating models in order to reduce complexity and lower our costs in a sustainable way. Total restructuring costs (including impairment of assets) of US\$299m were incurred across Europe as a result of organisational effectiveness and other initiatives, which delivered sustainable cost savings of approximately US\$770m.

In RBWM, we continued to drive strong growth in mortgage lending in the UK through the success of our competitive offerings and marketing campaigns. Our share of new UK mortgage lending in 2012 was 12%, up from the 10% share of new lending in 2011, while maintaining a loan-to-value ratio of 58%. We have approved new mortgage lending of £19bn (US\$32bn) during 2012, compared with our original lending commitment of £15bn (US\$24bn), with £5bn (US\$8bn) approved for first time buyers. Wealth Management revenue was marginally lower

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during the year reflecting the challenging economic environment. Our Wealth Management products and services were redesigned in accordance with the FSA's Retail Distribution Review, which was introduced on 1 January 2013, and we continue to offer a competitive fee-based financial advice service to Premier customers. The expansion of the RBWM business continued in Turkey, where we are targeting mass affluent customers.

In CMB, we continued to invest in the UK, and have increased the number of International Relationship Managers to over 200 during the year. In the first half of 2012, we launched an International SME fund in the UK to support UK

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businesses that trade, or aspire to trade, internationally. By the end of 2012, we had approved lending through the fund of £5.1bn (US\$8.2bn), exceeding the original target of £4.0bn (US\$6.5bn), and provided £12bn (US\$20bn) of gross new lending to UK SMEs, including the renewal of overdraft and other lending facilities. Over 80% of small business lending applications received during the year were approved. Revenue from international customers increased and our focus on this client base, together with targeted growth initiatives such as deposit acquisition and regional pricing strategies, led to a rise in Payments and Cash Management and Global Trade and Receivable Finance income.

Revenues from CMB's collaboration with GB&M increased primarily from sales of foreign exchange products. During the year, we made a provision for the possible mis-selling of interest rate protection products and the sale of these products to customers in our Business Banking segment, which serves SMEs, was withdrawn.

GB&M continued to develop cross-product capabilities in the growing renminbi market. Early in the year, we issued the first international renminbi bond outside sovereign Chinese territory. Since then, a number of significant transactions were supported by in-depth collaboration between European and other regional teams which reinforced our position as the leading house for international renminbi issuance. In Foreign Exchange, the focus remained on enhancing product offerings in our e-FX platforms for a broader client base, particularly to RBWM and CMB customers. This included the launch of a Dynamic Currency Conversion product within the transactional Foreign Exchange business. To enhance coverage efforts in Global Banking, the Corporate Finance Group was established to strengthen the financial advisory and event financing business. Payments and Cash Management won a number of mandates and implemented the Global Liquidity Solutions platform to provide advanced liquidity management functionality for its clients. In addition, our legacy credit exposure was reduced in Europe by exiting from certain positions and the business will reduce the size of this portfolio further as opportunities arise.

In GPB, we revised our medium-term strategic plan to focus the business on investing in priority markets with a redefined client offering that builds on product strengths and leverages Group capabilities. We concentrated on higher net worth international and domestic customers, enhancing our compliance and risk framework and improving alignment with the other global businesses.

Our activities are likely to be affected by proposed legislation in the UK arising from the recommendations of the UK Independent Commission on Banking (ICB) to ring-fence the retail bank from wholesale operations and to require the retail bank to have a greater primary loss absorbing capacity. Proposed changes in regulations are likely to affect how we conduct activities, with the potential to curtail the types of business we carry out and increase the costs of doing business. The implementation of any proposed changes will take a considerable amount of time and involve significant cost (see page 132).

The following commentary is on a constant currency basis.

Net interest income decreased by 3%. Balance Sheet Management revenues declined, principally in the UK, as yield curves continued to flatten and liquidity arising from maturities and sales of available-for-sale debt securities was re-invested at lower prevailing rates. In addition we placed a greater portion of our liquidity with central banks. GPB was similarly affected as higher yielding positions matured and as we managed selectively our exposures to eurozone sovereign debt. Legacy credit revenues in the UK also fell as a result of higher interest expense on structured debt issued at the end of 2011, coupled with lower effective yields on assets. RBWM net interest income declined mainly in the UK due to lower deposit spreads reflecting strong competition in the low interest rate environment. This was partly offset by strong growth in average residential mortgage balances and improved lending spreads in the UK, along with higher personal lending and cards balances in Turkey as the business expanded. In addition, net interest income in CMB benefited from higher average customer account balances as we continued to attract deposits through our Payments and Cash Management products as a result of competitive pricing, while average lending balances also rose, mainly in the UK, despite muted demand for credit.

Net fee income increased by 2%. CMB fee income rose due to higher transaction volumes reflecting new mandates in Payments and Cash Management. RBWM fee income also increased due to lower commissions paid as a result of the run-off and subsequent disposal of the insurance businesses in Ireland. These increases were partly offset by a fall in brokerage fees in GPB, reflecting a reduction in client transaction volumes, due in part to lower market volatility. Fees from assets under management and account services also declined, as challenging market

conditions in the latter half of 2011 led to a fall in average client assets in 2012,

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coupled with a reduction in client numbers as we repositioned our target client base.

Net trading income increased by 27%, primarily due to significantly higher Rates trading revenues in the UK and France, and higher Credit trading revenues, mainly in the UK, as spreads tightened and investor sentiment improved following stimuli by central banks. This was despite significant adverse fair value movements in Rates, including a charge from own credit spreads on structured liabilities as spreads tightened which compared with a gain reported in 2011, together with a charge as a result of a change in estimation methodology in respect of credit valuation adjustments on derivative assets (see Note 15 on the Financial Statements). Revenues in our legacy credit portfolio increased due to price appreciation and redemption at par of certain assets. Foreign Exchange income was also stronger due to higher income from GB&M's ongoing collaboration with CMB, and increased volumes from improvements in our electronic pricing and distribution capabilities, although this was partly offset by the effect of less volatile markets in 2012. In addition, trading income benefited from the change in estimation methodology for debit valuation adjustments on derivative liabilities (see Note 15 on the Financial Statements).

There were lower adverse fair value movements on non-qualifying hedges, driven by favourable fair value movements on non-qualifying hedges in HSBC Holdings, compared with adverse fair value movements in 2011, reflecting the less pronounced decline in long-term US interest rates relative to sterling and euro interest rates than in 2011. This was partly offset by higher adverse movements on non-qualifying hedges in European operating entities as interest rates fell.

Adverse foreign exchange movements were reported on assets held as economic hedges of foreign currency debt designated at fair value compared with favourable movements in 2011. These offset favourable foreign exchange movements on the foreign currency debt which are reported in Net expense from financial instruments designated at fair value.

Net expense from financial instruments designated at fair value increased by US\$4.8bn. Excluding adverse fair value movements due to the change in credit spreads on our own debt held at fair value, net income from financial instruments designated at fair value of US\$1.9bn in 2012 compared with a net expense of US\$374m in 2011. This reflected favourable foreign exchange movements on foreign currency debt designated

at fair value issued as part of our overall funding strategy compared with adverse movements in 2011, with an offset reported in Net trading income. In addition, net investment gains were recognised on the fair value of assets held to meet liabilities under insurance and investment contracts as market conditions improved, compared with net investment losses in 2011. The corresponding movement in liabilities to customers is recorded under Net insurance claims incurred and movement in liabilities to policyholders to the extent that these investment gains or losses are attributable to policyholders holding unit-linked insurance policies and insurance or investment contracts with DPF.

Gains less losses from financial investments decreased by US\$133m. This was driven by higher impairments in GB&M in the UK of available-for-sale equity securities due to significant write-downs in 2012 on three holdings, two of which were in our direct investment business in run-off. The decline was also driven by losses on the disposal of legacy assets, also in GB&M in the UK (see page 27), together with the non-recurrence of gains in 2011 on the disposal of available-for-sale debt securities in our Insurance business in RBWM. These factors were partly offset by higher gains on the disposal of available-for-sale debt securities in Balance Sheet Management, mainly in the UK, as part of structural interest rate risk management activities, coupled with a rise in disposal gains in Principal Investments in GB&M.

Net earned insurance premiums decreased by 6%. This mainly reflected lower life insurance sales in RBWM in France as a result of the adverse economic environment and increased competition from other banking products. The run-off and subsequent disposal of the insurance businesses in Ireland in 2012 also contributed to the decline. This was partly offset by a rise in net earned premiums in the UK due, in part, to the sale of a unit-linked insurance product through two new third party platforms.

Other operating income decreased by US\$95m. GB&M incurred losses on the sale of certain syndicated loans in the UK. In addition, gains in 2011 on the disposal of a property fund did not recur.

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Net insurance claims incurred and movement in liabilities to policyholders increased by 40%, driven by net investment gains on the fair value of the assets held to support policyholder contracts, compared with net losses in 2011. This was partly offset by lower reserves established for new

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business, reflecting the decline in premiums in France.

Loan impairment charges and other credit risk provisions decreased by 22% to US\$1.9bn. GB&M reported lower credit risk provisions, mainly in the UK, on available-for-sale ABSs, driven by an improvement in underlying asset prices, as well as lower charges on Greek sovereign debt. These were coupled with a reduction in loan impairment charges in RBWM, notably in the UK, as we continued to pro-actively identify and monitor customers facing financial hardship and focused on growing higher quality lending. As a result, delinquency rates improved across both the secured and unsecured lending portfolios. This was partly offset by an increase in loan impairment charges in RBWM in Turkey, reflecting business expansion. In addition, there were higher individually assessed provisions in CMB reflecting, mainly, the challenging economic conditions in the UK, Greece, Spain and Turkey.

Operating expenses increased by 15%, driven by higher charges relating to UK customer redress programmes with US\$2.3bn reported in 2012, compared with a charge of US\$890m (US\$898m as reported) in 2011. In 2012 we included an additional charge of US\$1.7bn for estimated redress for the possible mis-selling of PPI policies and US\$598m in relation to the possible mis-selling of interest rate protection products in previous years, of which

US\$268m related to the estimated redress to be paid to customers and the remainder to costs of closing out these positions and related administration costs. A charge relating to the US Office of Foreign Asset Control (OFAC) investigation of US\$375m was also incurred in HSBC Holdings, along with the UK bank levy of US\$571m. This was partly offset by an adjustment of US\$99m in the 2011 bank levy charge of US\$570m as the basis of calculation was clarified. In addition, 2011 included a credit of US\$570m (US\$587m as reported) arising from the defined benefit pension obligations in the UK which did not recur. Restructuring costs of US\$299m were US\$92m lower than in 2011, as the review initiated in 2011 to improve cost efficiency continued to be implemented and we completed disposals and exits in Europe.

Excluding these items, operating expenses marginally increased compared with 2011. Our organisational effectiveness initiatives progressed, delivering sustainable cost savings of approximately US\$770m in 2012. This enabled us to reinvest in, and reallocate capital, to our designated growth businesses such as our mortgage offering, our international CMB business and our home and priority growth markets (UK, France, Germany and Turkey), as well as launching the M&S Bank in the UK.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit/(loss) before tax Europe*

	2011	Currency	2011	2012		Constant
	as	translation	at 2012	as	Reported	currency
	reported	adjustment ¹	exchange	reported	change ²	change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	11,001	(325)	10,676	10,394	(6)	(3)
Net fee income	6,236	(205)	6,031	6,169	(1)	2
Own credit spread ³	2,947	(35)	2,912	(4,110)		
Other income ⁷	4,062	(17)	4,045	5,155	27	27
Net operating income ⁴	24,246	(582)	23,664	17,608	(27)	(26)
LICs ⁴²	(2,512)	54	(2,458)	(1,921)	24	22
Net operating income	21,734	(528)	21,206	15,687	(28)	(26)
Operating expenses	(17,069)	406	(16,663)	(19,095)	(12)	(15)
Operating profit/(loss)	4,665	(122)	4,543	(3,408)		
Income/(loss) from associates ⁴³	6	(8)	(2)	(6)		(200)
Profit/(loss) before tax	4,671	(130)	4,541	(3,414)		

*For footnotes, see page 132.**Reconciliation of reported and underlying items Europe*

	Year ended 31 December		
	2012	2011	Change ²
	US\$m	US\$m	%
Revenue ⁴			
Reported	17,608	24,246	(27)
Currency translation adjustment ¹		(547)	
Own credit spread ³	4,110	(2,947)	
Acquisitions, disposals and dilutions	3		
Underlying	21,721	20,752	5
LICs ⁴²			
Reported	(1,921)	(2,512)	24
Currency translation adjustment ¹		54	
Acquisitions, disposals and dilutions			
Underlying	(1,921)	(2,458)	22
Operating expenses			
Reported	(19,095)	(17,069)	(12)

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Currency translation adjustment ¹		406	
Acquisitions, disposals and dilutions			
Underlying	(19,095)	(16,663)	(15)
Underlying cost efficiency ratio	87.9%	80.3%	
Profit/(loss) before tax			
Reported	(3,414)	4,671	
Currency translation adjustment ¹		(95)	
Own credit spread ³	4,110	(2,947)	
Acquisitions, disposals and dilutions		3	
Underlying	699	1,629	(57)
<i>For footnotes, see page 132.</i>			

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Europe*

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,600	3,353	1,774	722	(694)	(62)	10,693
Net fee income/(expense)	2,545	1,789	957	744	(3)		6,032
Trading income excluding net interest income	206	30	2,181	192	698		3,307
Net interest income on trading activities	2	5	1,013	4	30	62	1,116
Net trading income ⁴⁴	208	35	3,194	196	728	62	4,423
Changes in fair value of long- term debt issued and related derivatives					(936)		(936)
Net income/(expense) from other financial instruments designated at fair value	1,059	271	591	4	(570)	(1)	1,354
Net income/(expense) from financial instruments designated at fair value	1,059	271	591	4	(1,506)	(1)	418
Gains less losses from financial investments	52		344	(17)			379
Dividend income	4	2	65	4			75
Net earned insurance premiums	2,782	361	(1)	16			3,158
Other operating income/(expense)	(103)	9	110	(253)	766		529
Total operating income/(expense)	12,147	5,820	7,034	1,416	(709)	(1)	25,707
Net insurance claims ⁵⁰	(4,136)	(567)		(37)			(4,740)
Net operating income/(expense)⁴	8,011	5,253	7,034	1,379	(709)	(1)	20,967
Loan impairment charges and other credit risk provisions	(329)	(935)	(242)	(24)			(1,530)
Net operating income/(expense)	7,682	4,318	6,792	1,355	(709)	(1)	19,437
Total operating expenses	(5,934)	(2,231)	(4,987)	(1,519)	(2,943)	1	(17,613)
Operating profit/(loss)	1,748	2,087	1,805	(164)	(3,652)		1,824
Share of profit/(loss) in associates and joint ventures	5	1	(4)	(1)			1
Profit/(loss) before tax	1,753	2,088	1,801	(165)	(3,652)		1,825

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	%	%	%	%	%	%
Share of HSBC's profit before tax	7.8	9.2	8.0	(0.7)	(16.2)	8.1
Cost efficiency ratio	74.1	42.5	70.9	110.2	(415.1)	84.0
<i>Balance sheet data</i> ⁴⁰						
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) ³⁴	177,357	105,498	193,226	27,289	830	504,200
Total assets	238,499	124,242	1,054,506	75,718	72,174	1,392,959
Customer accounts ³⁴	205,288	134,120	254,598	49,789	1,021	644,816

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Report of the Directors: Financial Review (continued)

	2012						
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,437	3,228	1,409	820	(543)	43	10,394
Net fee income	2,622	1,658	1,032	848	9		6,169
Trading income excluding net interest income	67	26	848	216	25		1,182
Net interest income on trading activities	7	14	1,500	14	33	(43)	1,525
Net trading income ⁴⁴	74	40	2,348	230	58	(43)	2,707
Changes in fair value of long- term debt issued and related derivatives					(3,091)		(3,091)
Net income/(expense) from other financial instruments designated at fair value	770	139	1,073		(1,106)		876
Net income/(expense) from financial instruments designated at fair value	770	139	1,073		(4,197)		(2,215)
Gains less losses from financial investments	(5)	(1)	375	(3)	(2)		364
Dividend income		1	104	3	3		111
Net earned insurance premiums	3,150	438		42			3,630
Other operating income	84	58	88	61	796	(9)	1,078
Total operating income/(expense)	12,132	5,561	6,429	2,001	(3,876)	(9)	22,238
Net insurance claims ⁵⁰	(4,054)	(536)		(40)			(4,630)
Net operating income/(expense) ⁴	8,078	5,025	6,429	1,961	(3,876)	(9)	17,608
Loan impairment charges and other credit risk provisions	(347)	(1,109)	(436)	(29)			(1,921)
Net operating income/(expense)	7,731	3,916	5,993	1,932	(3,876)	(9)	15,687
Total operating expenses	(7,225)	(2,708)	(4,999)	(1,431)	(2,741)	9	(19,095)
Operating profit/(loss)	506	1,208	994	501	(6,617)		(3,408)
Share of profit/(loss) in associates and joint ventures	3		(8)	(2)	1		(6)
Profit/(loss) before tax	509	1,208	986	499	(6,616)		(3,414)
	%	%	%	%	%		%
Share of HSBC's profit before tax	2.5	5.9	4.8	2.4	(32.0)		(16.5)
Cost efficiency ratio	89.4	53.9	77.8	73.0	(70.7)		108.4

*Balance sheet data*⁴⁰

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	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	170,002	105,796	156,798	29,963	881		463,440
Total assets	240,744	132,718	1,044,507	76,145	75,513	(180,387)	1,389,240
Customer accounts	191,024	121,648	184,473	57,125	739		555,009

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Europe (continued)*

	2011						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income/(expense)	5,653	3,107	2,102	936	(574)	(223)	11,001
Net fee income	2,633	1,640	989	942	32		6,236
Trading income/(expense) excluding net interest income	40	5	602	191	(201)		637
Net interest income on trading activities	11	16	1,205	16	53	223	1,524
Net trading income/(expense) ⁴⁴	51	21	1,807	207	(148)	223	2,161
Changes in fair value of long- term debt issued and related derivatives					3,180		3,180
Net income/(expense) from other financial instruments designated at fair value	(672)	(21)	(65)		46		(712)
Net income/(expense) from financial instruments designated at fair value	(672)	(21)	(65)		3,226		2,468
Gains less losses from financial investments	51	(1)	453	1	11		515
Dividend income	1	1	42	4	1		49
Net earned insurance premiums	3,768	381			(13)		4,136
Other operating income	95	58	187	5	760	74	1,179
Total operating income	11,580	5,186	5,515	2,095	3,295	74	27,745
Net insurance claims ⁵⁰	(3,212)	(287)					(3,499)
Net operating income ⁴	8,368	4,899	5,515	2,095	3,295	74	24,246
Loan impairment (charges)/recoveries and other credit risk provisions	(596)	(960)	(876)	(82)	2		(2,512)
Net operating income	7,772	3,939	4,639	2,013	3,297	74	21,734
Total operating expenses	(6,450)	(2,252)	(4,569)	(1,456)	(2,268)	(74)	(17,069)
Operating profit	1,322	1,687	70	557	1,029		4,665
Share of profit in associates and joint ventures			7		(1)		6
Profit before tax	1,322	1,687	77	557	1,028		4,671
	%	%	%	%	%		%

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Share of HSBC's profit before tax	6.0	7.7	0.4	2.5	4.7		21.3
Cost efficiency ratio	77.1	46.0	82.8	69.5	68.8		70.4

*Balance sheet data*⁴⁰

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	150,205	98,154	156,903	28,378	696		434,336
Total assets	210,140	124,049	1,021,486	77,410	63,141	(214,281)	1,281,945
Customer accounts	176,134	104,530	154,208	58,265	267		493,404

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**Hong Kong**

HSBC's principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited and Hang Seng Bank Limited. The former is the largest bank incorporated in Hong Kong and is our flagship bank in the Asia-Pacific region. It is one of Hong Kong's three note-issuing banks, accounting for nearly 60% by value of banknotes in circulation in 2013.

	2013	2012	2011
	US\$m	US\$m	US\$m
Net interest income	5,993	5,316	4,691
Net fee income	3,877	3,335	3,097
Net trading income	1,570	1,463	1,189
Other income	1,763	2,308	1,705
Net operating income⁴	13,203	12,422	10,682
LICs ⁴²	(137)	(74)	(156)
Net operating income	13,066	12,348	10,526
Total operating expenses	(5,045)	(4,848)	(4,758)
Operating profit	8,021	7,500	5,768
Income from associates ⁴³	68	82	55
Profit before tax	8,089	7,582	5,823
Cost efficiency ratio	38.2%	39.0%	44.5%
RoRWA ³⁶	6.4%	7.0%	5.3%
Year-end staff numbers	28,367	27,742	28,984

10%**growth in underlying revenue****Strong performance in CMB****with lending growth of****18%****Best M&A House in Hong Kong 2013***(The Asset)*

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

Hong Kong s GDP grew at a faster pace in 2013 than in 2012. This was driven mainly by domestic demand, which offset an ongoing weakness in external orders. Labour market conditions remained resilient and strong nominal wage growth continued to support private consumption. Measures announced in February 2013 by the government and the Hong Kong Monetary Authority to dampen demand in the property market led to a softening in prices and some moderation of demand in the third quarter of the year. Headline CPI inflation fell in the fourth quarter, largely due to lower food prices and housing costs. Underlying inflation averaged 4% in 2013, lower than it was in 2012.

Review of performance

Our operations in Hong Kong reported a pre-tax profit of US\$8.1bn compared with US\$7.6bn in 2012, an increase of 7%. This reflected higher revenue, driven by balance sheet growth, and increased net fees from unit trusts and debt issuance. Excluding the effect of disposals in 2012, underlying profit before tax increased by 13%.

In RBWM, we grew our average mortgage balances by 8% with average loan-to-value ratios of 44% on new mortgage drawdowns and an estimated 32% on the portfolio as a whole. We continued to develop our digital capabilities and launched our mobile banking application. We also developed our Wealth Management capabilities, growing revenue by over 10%. In addition, we enhanced our wealth management systems, simplified the product range and implemented the Global Wealth Incentive Plan to better align customer and business interests.

In CMB, we further strengthened the collaboration with GB&M, raising financing for our clients of over US\$14bn from debt capital markets and nearly US\$4bn from equity capital markets, including the largest IPO in Hong Kong for a mainland Chinese consumer company. In addition, we were awarded Best Trade Finance Bank in Hong Kong by *Global Finance*.

In GB&M, we continued to lead the market in Hong Kong dollar bond issuance and are now one of the top five houses for both equity capital markets and mergers and acquisitions. We were voted Best Debt House in Hong Kong in the *Euromoney* 2013 Awards for Excellence and were involved in seven of the ten largest IPOs in Hong Kong this year.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by global business*

	2013	2012	2011
	US\$m	US\$m	US\$m
Retail Banking and Wealth Management	3,742	3,694	3,022
Commercial Banking	2,110	2,188	1,608
Global Banking and Markets	1,971	1,518	1,316
Global Private Banking	208	249	188
Other	58	(67)	(311)
	8,089	7,582	5,823

We led the market in offshore renminbi (RMB) bond issuance, including the RMB3bn (US\$491m) government bond issue in December 2013 by mainland China's Ministry of Finance, and were voted 'Best provider of offshore renminbi products and services' for the second year running by *Asiamoney*. We also won the award for RMB House of the Year from *Asia Risk*.

We announced the sale of our shareholding in Bank of Shanghai in 2013, a transaction which is expected to complete in the first half of 2014.

Net interest income rose by US\$677m compared with 2012, led by RBWM and supported by GB&M and CMB. The increase was mainly due to higher average lending balances, wider spreads on mortgages in RBWM reflecting lower funding costs, and growth in the insurance debt securities portfolio.

There was strong loan growth in both CMB and GB&M, driven by trade-related lending in the first half of 2013 and an increase in commercial real estate and other property-related lending in the second half of the year, though the benefit of this growth was partly offset by spread compression reflecting competition and increased liquidity in the markets. Mortgage lending in RBWM also increased, although the rate of growth began to slow during 2013 as transaction volumes in the property market reduced.

Average deposit balances increased, in part reflecting new Premier customers in RBWM and increased Payments and Cash Management balances in CMB, though the benefit of this growth was more than offset by narrower deposit spreads due to a fall in short-term interbank interest rates.

Net fee income rose by US\$542m in 2013, led by RBWM as strong customer demand and favourable market sentiment led to higher fees from unit trusts and increased brokerage income. Fee income increased due to a rise in debt and equity underwriting and corporate finance activity compared with 2012, in part reflecting collaboration

between GB&M and CMB. Fee income also rose in CMB as trade and Payments and Cash Management volumes increased.

Net trading income rose by US\$107m in 2013. Rates revenue rose due to greater corporate flow, increased holdings of debt securities and a net favourable movement in respect of the valuation adjustments on derivatives compared with a net charge in 2012. Equities revenues rose from warrant market making as volumes increased while foreign exchange revenue grew due to improved margins and higher customer trading volumes.

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Net income from financial instruments designated at fair value was US\$258m compared with US\$447m in 2012, primarily due to lower net investment returns on assets held by the insurance business reflecting weaker equity markets and falling bond prices. To the extent that these investment returns were attributed to policyholders holding unit-linked insurance policies and insurance contracts with DPF, there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were US\$53m in 2013 compared with US\$322m in 2012, largely due to the non-recurrence of the gain on sale of our shares in four Indian banks in 2012.

Dividend income was US\$150m compared with US\$24m in 2012, mainly due to the dividend from Industrial Bank following its reclassification as a financial investment during the year.

Net earned insurance premiums grew by 2% due to increased renewals of deferred annuity and unit-linked insurance contracts, partly offset by the absence of non-life insurance premiums following the disposal of the HSBC and Hang Seng Bank general insurance businesses in 2012 and lower new business premiums. The growth in premiums resulted in a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Other operating income was US\$131m lower than in 2012 due to the non-recurrence of the gains on sale of Global Payments Asia-Pacific Limited and the non-life insurance businesses reported in 2012, totalling US\$375m on a reported basis. This more than offset higher revaluation and disposal gains on investment properties, which in part reflected the strong commercial property market, and a larger increase in the PVIF asset. The latter arose in 2013 due to favourable interest rate assumption updates, although this was more than offset in *Net insurance claims incurred and movement in liabilities to policyholders*.

LICs were US\$63m higher due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, although these remained low. This was partly offset by collective provision releases in CMB from lower historical loss rates and individual impairment releases in GB&M.

Operating expenses rose by US\$197m in 2013, reflecting higher marketing spend, costs relating to the introduction of updated payment cards and information technology platforms as well as increased property rental and maintenance costs. In addition, staff costs increased as a result of changes to the recognition of pension costs.

Share of profit from associates and joint ventures was US\$15m lower, primarily due to the effect of the disposal of our interest in Global Payments Asia-Pacific Ltd in 2012.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax – Hong Kong*

	2012	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	5,316		5,316	5,993	13	13
Net fee income	3,335		3,335	3,877	16	16
Net trading income	1,463		1,463	1,570	7	7
Own credit spread ³						
Other income from financial instruments designated at fair value	447		447	258	(42)	(42)
Net income from financial instruments designated at fair value	447		447	258	(42)	(42)
Gains less losses from financial investments	322		322	53	(84)	(84)
Net earned insurance premiums	5,957	1	5,958	6,081	2	2
Other operating income (including dividend income)	1,948	(2)	1,946	1,941		
Total operating income	18,788	(1)	18,787	19,773	5	5
Net insurance claims incurred and movement in liabilities to policyholders	(6,366)	(1)	(6,367)	(6,570)	(3)	(3)
Net operating income⁴	12,422	(2)	12,420	13,203	6	6
LICs ⁴²	(74)		(74)	(137)	(85)	(85)
Net operating income	12,348	(2)	12,346	13,066	6	6
Operating expenses	(4,848)		(4,848)	(5,045)	(4)	(4)
Operating profit	7,500	(2)	7,498	8,021	7	7
Income from associates ⁴³	82	1	83	68	(17)	(18)
Profit before tax	7,582	(1)	7,581	8,089	7	7

For footnotes, see page 132.

Reconciliation of reported and underlying items – Hong Kong

	Year ended 31 December		
	2013 US\$m	2012 US\$m	Change ² %
Net interest income			
Reported	5,993	5,316	13
Currency translation adjustment ¹		(9)	
Acquisitions, disposals and dilutions			
Underlying	5,993	5,307	13

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Other operating income			
Reported	1,791	1,924	(7)
Currency translation adjustment ¹		(2)	
Acquisitions, disposals and dilutions		(375)	
Underlying	1,791	1,547	16
Revenue⁴			
Reported	13,203	12,422	6
Currency translation adjustment ¹		(2)	
Own credit spread ³			
Acquisitions, disposals and dilutions		(445)	
Underlying	13,203	11,975	10

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

	Year ended 31 December		
	2013	2012	Change ²
LICs⁴²			
Reported	(137)	(74)	(85)
Currency translation adjustment ¹			
Acquisitions, disposals and dilutions			
Underlying	(137)	(74)	(85)
Operating expenses			
Reported	(5,045)	(4,848)	(4)
Currency translation adjustment ¹			
Acquisitions, disposals and dilutions		34	
Underlying	(5,045)	(4,814)	(5)
Underlying cost efficiency ratio	38.2%	40.2%	
Profit before tax			
Reported	8,089	7,582	7
Currency translation adjustment ¹		(1)	
Own credit spread ⁶			
Acquisitions, disposals and dilutions		(420)	
Underlying	8,089	7,161	13

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

2012 compared with 2011

Economic background

The **Hong Kong** economy started 2012 on a strong footing, but lost momentum in the second quarter as global trade flows slowed and the mainland Chinese economy cooled, causing GDP to contract slightly. Domestic demand stayed resilient, however, supported by continued wage growth, and firm job market conditions and asset prices. This underpinned investment and private consumption growth, leading the economy back into expansion in the third quarter (0.6%, quarter-on-quarter, seasonally adjusted). Slower economic momentum and deflationary pressures in mainland China allowed the pressure on Hong Kong's asset prices to ease through most of 2012, resulting in reduced CPI inflation of 4.1%, compared with 5.3% in 2011.

Review of performance

Reported pre-tax profits from our operations in Hong Kong were US\$7.6bn compared with US\$5.8bn in 2011, an increase of 30% on both a reported and a constant currency basis.

Reported profits included gains on the sale of our shares in Global Payments Asia-Pacific Ltd of US\$212m and the HSBC and Hang Seng Bank general insurance businesses of US\$117m and US\$46m, respectively. Excluding these gains and associated operating results, underlying profit of US\$7.2bn increased by 24%, driven by higher net interest income in CMB and RBWM, the gain of US\$314m on the sale of non-strategic investments in India, 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 which attracted over US\$1bn of subscriptions by the end of the year. The sale of the general insurance businesses enabled 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. We now offer renminbi current accounts for non-residents and launched the first mobile payment solution in the region, enabling contactless credit card transactions through Visa payWave terminals.

In CMB, we capitalised on our international connectivity and our standing as a leading trade finance bank to grow trade-related revenues by 10%, particularly with mainland China. 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 ten *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 with several high-profile deals completed in 2012 for multinationals accessing the market.

We also 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.

The following commentary is on a constant currency basis.

Net interest income was 13% higher than in 2011, notably in CMB and RBWM, driven by increased customer loans and deposit balances and by growth in the insurance portfolio.

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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 in CMB were marginally wider than in 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 into investments. In addition, deposit spreads widened.

Net fee income of US\$3.3bn was 7% higher than in 2011. Fees rose from increased transaction volumes in trade services, remittances and account services as we continued to intermediate international trade and capital flows. Fee income also increased in both CMB and GB&M as we arranged more debt issues for our customers to

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

satisfy their funding requirements while the market for corporate debt improved. In RBWM, fees from unit trusts rose reflecting increased sales volumes, despite customers increasingly preferring lower risk products with lower fees. These increases were largely offset by a reduction in brokerage income from lower market turnover as a result of weaker investor sentiment.

Net trading income increased by 23% from lower adverse fair value movements on derivatives relating to certain provident funds, following reductions in long-term investment returns 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 US\$447m compared with an expense of US\$540m in 2011, due to net investment gains on assets held by the Insurance business (compared with net losses in 2011) 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 DPF, there was a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were US\$322m compared with US\$25m in 2011, largely from the gain of US\$314m on the sale of our shares in four non-strategic investments 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 US\$1.9bn was US\$235m higher than in 2011. We completed the sale of our shares in Global Payments Asia-Pacific Ltd and the HSBC and Hang Seng Bank general insurance businesses, realising gains of US\$212m, US\$117m and US\$46m, respectively. While the value of the PVIF asset rose, this was not to the same extent as in 2011 as increased insurance sales in 2012 were more than offset by lower positive assumption updates during 2012 compared with 2011 and the non-recurrence of the benefit from the refinement to the PVIF asset calculation in 2011.

Net insurance claims incurred and movement in liabilities to policyholders increased by 38%, driven by net investment gains on fair value of the assets held to support policyholder contracts, compared with net losses in 2011. In addition, policyholder liabilities were established for new business, reflecting the higher premiums, though this was partly offset by the disposal of the insurance businesses in 2012.

Loan impairment charges and other credit risk provisions reduced to US\$74m from US\$157m in 2011, largely due to lower specific impairment charges in CMB and the non-recurrence of charges relating to available-for-sale Greek sovereign debt securities.

Operating expenses increased by 2%, primarily due to higher systems implementation and processing costs as we continued to invest in our technology infrastructure, and increased property rental costs. Salaries and wages were broadly unchanged as wage inflation was largely offset by reduced average staff numbers as we continued to improve efficiency across our operations, generating sustainable annual savings of approximately US\$190m.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax Hong Kong*

	2011					
	2011	Currency	at 2012	2012		Constant
	as	translation	exchange	as	Reported	currency
	reported	adjustment ¹	rates	reported	change ²	change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	4,691	20	4,711	5,316	13	13
Net fee income	3,097	11	3,108	3,335	8	7
Other income ⁷	2,894	8	2,902	3,771	30	30
Net operating income ⁴	10,682	39	10,721	12,422	16	16
LICs ⁴²	(156)	(1)	(157)	(74)	53	53
Net operating income	10,526	38	10,564	12,348	17	17
Operating expenses	(4,758)	(18)	(4,776)	(4,848)	(2)	(2)
Operating profit	5,768	20	5,788	7,500	30	30
Income from associates ⁴³	55		55	82	49	49
Profit before tax	5,823	20	5,843	7,582	30	30

*For footnotes, see page 132.**Reconciliation of reported and underlying items Hong Kong*

	Year ended 31 December		
	2012	2011	Change ²
	US\$m	US\$m	%
Revenue ⁴			
Reported	12,422	10,682	16
Currency translation adjustment ¹		39	
Own credit spread ³			
Acquisitions, disposals and dilutions	(445)	(109)	
Underlying	11,977	10,612	13
LICs ⁴²			
Reported	(74)	(156)	53
Currency translation adjustment ¹		(1)	
Acquisitions, disposals and dilutions			
Underlying	(74)	(157)	53
Operating expenses			
Reported	(4,848)	(4,758)	(2)
Currency translation adjustment ¹		(18)	

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Acquisitions, disposals and dilutions	34	40	
Underlying	(4,814)	(4,736)	(2)
Underlying cost efficiency ratio	40.2%	44.6%	
Profit before tax			
Reported	7,582	5,823	30
Currency translation adjustment ¹		20	
Own credit spread ³			
Acquisitions, disposals and dilutions	(420)	(82)	
Underlying	7,162	5,761	24
<i>For footnotes, see page 132.</i>			

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Hong Kong*

	2013					Inter- segment elimination ⁴⁹	Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other		
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income/(expense)	3,177	1,729	1,338	124	(347)	(28)	5,993
Net fee income	2,030	963	697	179	8		3,877
Trading income/(expense) excluding net interest income	139	182	779	134	(17)		1,217
Net interest income on trading activities	3		307		15	28	353
Net trading income/(expense) ⁴⁴	142	182	1,086	134	(2)	28	1,570
Changes in fair value of long- term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	256		7		(5)		258
Net income/(expense) from financial instruments designated at fair value	256		7		(5)		258
Gains less losses from financial investments			42	10	1		53
Dividend income		1	6		143		150
Net earned insurance premiums	5,612	469					6,081
Other operating income	619	91	78	9	1,302	(308)	1,791
Total operating income	11,836	3,435	3,254	456	1,100	(308)	19,773
Net insurance claims ⁵⁰	(6,025)	(545)					(6,570)
Net operating income⁴	5,811	2,890	3,254	456	1,100	(308)	13,203
Loan impairment (charges)/recoveries and other credit risk provisions	(137)	(16)	20	(4)			(137)
Net operating income	5,674	2,874	3,274	452	1,100	(308)	13,066
Total operating expenses	(1,999)	(764)	(1,304)	(244)	(1,042)	308	(5,045)
Operating profit	3,675	2,110	1,970	208	58		8,021
Share of profit in associates and joint ventures	67		1				68
Profit before tax	3,742	2,110	1,971	208	58		8,089

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	%	%	%	%	%	%
Share of HSBC's profit before tax	16.6	9.4	8.7	0.9	0.3	35.9
Cost efficiency ratio	34.4	26.4	40.1	53.5	94.7	38.2
<i>Balance sheet data</i> ⁴⁰						
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	64,990	74,125	48,117	6,928	1,387	195,547
Total assets	103,816	84,143	311,771	8,020	59,970	555,413
Customer accounts	213,471	97,191	35,617	19,428	286	365,993

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Hong Kong (continued)*

	2012						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	2,851	1,629	1,087	149	(482)	82	5,316
Net fee income	1,769	850	548	155	13		3,335
Trading income/(expense) excluding net interest income	176	163	666	170	(2)		1,173
Net interest income on trading activities	10	2	352		8	(82)	290
Net trading income ⁴⁴	186	165	1,018	170	6	(82)	1,463
Changes in fair value of long- term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	511	(53)	23		(34)		447
Net income/(expense) from financial instruments designated at fair value	511	(53)	23		(34)		447
Gains less losses from financial investments			2	7	313		322
Dividend income		1	5		18		24
Net earned insurance premiums	5,294	655	8				5,957
Other operating income	711	253	77	13	1,152	(282)	1,924
Total operating income	11,322	3,500	2,768	494	986	(282)	18,788
Net insurance claims ⁵⁰	(5,757)	(602)	(7)				(6,366)
Net operating income ⁴	5,565	2,898	2,761	494	986	(282)	12,422
Loan impairment (charges)/recoveries and other credit risk provisions	(97)	3	17	3			(74)
Net operating income	5,468	2,901	2,778	497	986	(282)	12,348
Total operating expenses	(1,819)	(719)	(1,263)	(248)	(1,081)	282	(4,848)
Operating profit/(loss)	3,649	2,182	1,515	249	(95)		7,500
Share of profit in associates and joint ventures	45	6	3		28		82
Profit/(loss) before tax	3,694	2,188	1,518	249	(67)		7,582

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	%	%	%	%	%	%
Share of HSBC's profit before tax	17.9	10.6	7.3	1.2	(0.3)	36.7
Cost efficiency ratio	32.7	24.8	45.7	50.2	109.6	39.0

*Balance sheet data*⁴⁰

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	62,533	62,944	40,223	6,464	1,449	173,613
Total assets	96,185	72,056	256,295	20,705	81,085	(7,992) 518,334
Customer accounts	201,649	90,152	34,171	19,566	670	346,208

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Hong Kong (continued)*

	2011						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	2,571	1,317	1,051	173	(464)	43	4,691
Net fee income	1,741	706	475	160	15		3,097
Trading income/(expense) excluding net interest income	120	169	652	135	(116)		960
Net interest income on trading activities	9	1	246		16	(43)	229
Net trading income/(expense) ⁴⁴	129	170	898	135	(100)	(43)	1,189
Changes in fair value of long- term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	(475)	(72)	(5)		15		(537)
Net income/(expense) from financial instruments designated at fair value	(475)	(72)	(5)		15		(537)
Gains less losses from financial investments	3	10	21		(10)		24
Dividend income		1	14		24		39
Net earned insurance premiums	4,317	758	13				5,088
Other operating income	505	175	79	8	1,185	(268)	1,684
Total operating income	8,791	3,065	2,546	476	665	(268)	15,275
Net insurance claims ⁵⁰	(3,887)	(697)	(9)				(4,593)
Net operating income ⁴	4,904	2,368	2,537	476	665	(268)	10,682
Loan impairment (charges)/recoveries and other credit risk provisions	(77)	(66)	23	(36)			(156)
Net operating income	4,827	2,302	2,560	440	665	(268)	10,526
Total operating expenses	(1,811)	(703)	(1,248)	(252)	(1,012)	268	(4,758)
Operating profit/(loss)	3,016	1,599	1,312	188	(347)		5,768
Share of profit in associates and joint ventures	6	9	4		36		55
Profit/(loss) before tax	3,022	1,608	1,316	188	(311)		5,823

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	%	%	%	%	%	%
Share of HSBC's profit before tax	13.8	7.3	6.0	0.9	(1.4)	26.6
Cost efficiency ratio	36.9	29.7	49.2	52.9	152.2	44.5

*Balance sheet data*⁴⁰

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	56,296	54,986	39,667	5,447	1,269	157,665
Total assets	85,866	63,516	238,892	20,680	84,782	(20,712) 473,024
Customer accounts	181,316	79,225	35,283	19,622	(101)	315,345

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**Rest of Asia-Pacific**

We offer a full range of banking and financial services in mainland China, mainly through our local subsidiary, HSBC Bank (China) Company Limited. We also participate indirectly in mainland China through our associate, Bank of Communications.

Outside mainland China, we conduct business in 18 countries and territories in the Rest of Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in Australia, India, Indonesia, Malaysia and Singapore.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	5,439	5,391	5,102
Net fee income	2,059	2,083	2,111
Net trading income	456	1,053	1,658
Other income	4,024	5,057	1,842
Net operating income⁴	11,978	13,584	10,713
LICs ⁴²	(361)	(436)	(267)
Net operating income	11,617	13,148	10,446
Total operating expenses	(5,640)	(5,806)	(5,806)
Operating profit	5,977	7,342	4,640
Income from associates ⁴³	1,787	3,106	2,831
Profit before tax	7,764	10,448	7,471
Cost efficiency ratio	47.1%	42.7%	54.2%
RoRWA ³⁶	2.7%	3.5%	3.1%
Year-end staff numbers	85,334	85,024	91,051

13%**growth in customer lending balances**

on a constant currency basis

Market leader in mainland China's**state-owned enterprise bond issuances****Domestic Bond House of the Year***(IFR Asia)*

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

In **mainland China**, the annual pace of GDP growth was unchanged at 7.7% in 2013, above the official GDP growth target of 7.5%. The rebound in activity in the second half of the year was mainly due to measures announced by the government during the summer. Export growth remained moderate through most of 2013, only accelerating in the final months. Annual growth in fixed asset investment remained steady at an annual rate of nearly 20% and consumer spending remained resilient. Headline annual CPI inflation rose modestly to 2.6%, remaining below the government's target of 3.5%. The People's Bank of China maintained a relatively restrictive credit policy but overall liquidity conditions remained loose as the M2 measure of money growth expanded by 13.6% on the year.

Economic activity in **Japan** picked up considerably in 2013, thanks to large-scale stimuli from both the government and the Bank of Japan. Annualised growth slowed to just over 1% in the third quarter although it accelerated in the final months of the year as consumer spending rose in advance of the sales tax increase due in April 2014.

During the course of the summer, there were concerns in financial markets that global liquidity may become more expensive and less abundant as the US Federal Reserve Board indicated it may begin to taper its purchases of financial assets. Interest rates on US Treasuries rose, attracting global capital back to developed markets. Some emerging economies suffered considerable capital outflows with large declines in the value of their currencies against the US dollar and central banks were forced to raise interest rates to attract capital. This in turn led to a slowdown in activity.

In Asia-Pacific, India and Indonesia were most affected. The current account positions of both economies had significantly deteriorated in recent years, leaving them vulnerable to changes in external financing conditions. In **India**, structural constraints on growth, including infrastructure bottlenecks, also contributed to a slowdown in activity. The central bank tightened monetary policy during the second half of 2013 in response to concerns over inflation.

Similar constraints in **Indonesia** saw GDP growth slow in 2013. However, concerted measures to reduce fuel subsidies and narrow the current account deficit should make the economy more resilient to any tightening in monetary conditions in the West. Economic activity also reduced in **Malaysia** as the boost to growth in 2012 from public spending abated. In **Thailand**, the economy slowed

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by country within global businesses*

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
2013						
Australia	100	131	189		26	446
India	(21)	113	418	7	136	653
Indonesia	12	106	126		36	280
Mainland China	223	1,536	842	(4)	1,644	4,241
Malaysia	148	105	236		25	514
Singapore	147	120	262	74	22	625
Taiwan	7	30	158		5	200
Vietnam	86	(34)	25		(12)	65
Other	(25)	241	448	(1)	77	740
	677	2,348	2,704	76	1,959	7,764
2012						
Australia	97	38	184		(44)	275
India	41	89	497	7	175	809
Indonesia	29	124	146		7	306
Mainland China	838	1,724	1,257	(4)	2,525	6,340
Malaysia	183	131	242		8	564
Singapore	201	139	296	97	(65)	668
Taiwan	62	36	136			234
Vietnam	9	45	57		9	120
Other	57	276	510	59	230	1,132
	1,517	2,602	3,325	159	2,845	10,448
2011						
Australia	88	106	108		5	307
India	(14)	122	539	5	161	813
Indonesia	6	89	157		7	259
Mainland China	1,112	1,340	1,116	(4)	117	3,681
Malaysia	173	118	228	1	9	529
Singapore	183	133	189	97	(7)	595
Taiwan	45	23	130		12	210
Vietnam		51	79		24	154
Other	48	264	543	(8)	76	923
	1,641	2,246	3,089	91	404	7,471

Analysis of mainland China

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
2013						
Industrial Bank					1,089	1,089
Ping An					553	553
Other associates	247	1,360	284		(38)	1,853
Other mainland China	(24)	176	558	(4)	40	746
	223	1,536	842	(4)	1,644	4,241
2012						
Industrial Bank	54	273	343			670
Ping An	622	82	60		2,459	3,223
Other associates	214	1,193	248			1,655
Other mainland China	(52)	176	606	(4)	66	792
	838	1,724	1,257	(4)	2,525	6,340
2011						
Industrial Bank	52	229	190			471
Ping An	946		63		117	1,126
Other associates	181	921	276			1,378
Other mainland China	(67)	190	587	(4)		706
	1,112	1,340	1,116	(4)	117	3,681

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Report of the Directors: Financial Review (continued)

following the rapid post-flood recovery in 2012 and, more recently, political uncertainty. Elsewhere in the ASEAN region GDP growth improved during 2013. **Singapore**'s economic recovery gathered pace, led by net external demand, and the **Philippines** continued to grow robustly in the year, led by household spending. The devastating typhoon that hit the country in November disrupted activity in the fourth quarter, but will also induce reconstruction spending in 2014.

Growth in **South Korea** stabilised in 2013 supported by a monetary and fiscal stimulus package delivered at the start of the year. Exports remained resilient. **Taiwan**'s trade-dependent economy was weak in the first half of 2013, but strengthened in the second half as global trade improved.

Australian GDP growth slowed to an annual rate of around 2.5% in 2013 and unemployment rose to 5.7% towards the end of the year. This reflected a slowdown in mining investment after years of strong growth. To stimulate growth elsewhere, the Reserve Bank of Australia cut its cash rate from 3.0% to 2.5% during the year. Low interest rates drove a strong rise in housing prices. The Australian dollar remained well above its long run average levels in 2013, but fell towards the end of the year.

Review of performance

In Rest of Asia-Pacific, reported profit before tax was US\$7.8bn compared with US\$10.4bn in 2012. On a constant currency basis, profit before tax decreased by US\$2.5bn.

The decrease in reported profits was mainly due to the gain on disposal of our shareholding in Ping An in 2012 of US\$3.0bn and a reduction in our share of profit from associates of US\$1.4bn due to the disposal of Ping An and the reclassification of Industrial Bank as a financial investment following its issue of share capital to third parties. These items were partly offset by the accounting gain of US\$1.1bn in 2013 on the reclassification of Industrial Bank.

On an underlying basis, which excludes the items above as well as other disposals and the results of disposed of operations, profit before tax increased by 20% due to the net gain of US\$553m on completion of the sale of our investment in Ping An in 2013, compared with adverse fair value movements of US\$553m on the Ping An contingent forward sale contract recorded in 2012. Excluding these items, underlying profit before tax was marginally lower as increased operating expenses and lower revenues were offset by reduced loan

impairment charges and increased income from associates.

The implementation of our strategy to reduce fragmentation across the region continued, leading to the disposal of non-core insurance businesses in Vietnam, South Korea, Taiwan and Singapore, and we announced the closure of a retail brokerage in India and our retail banking operations in South Korea. We also completed the sale of our investment in Ping An.

In mainland China, where we continued to expand our branch network, we had 162 HSBC outlets, 23 HSBC rural bank outlets and 48 Hang Seng Bank outlets at the end of the year. We expanded our wealth management capabilities, and were one of the first foreign banks to be approved to distribute domestic funds to retail investors. We were the market leader in mainland China's state-owned enterprise bond issuances and we were awarded Best Foreign Commercial Bank in China by *FinanceAsia*.

We continued to promote the internationalisation of the renminbi as regulations developed. We were the first foreign bank in mainland China to implement a customised renminbi cross-border centralised settlement solution and were also the first foreign bank to complete a two-way cross-border renminbi lending transaction.

In India, we revised our Wealth Management product offering to ensure customers' needs were being met and to improve customer satisfaction levels. In Payments and Cash Management, we were awarded the Best Domestic Cash Management Bank in 2013 by *Euromoney*. Our strength

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in debt capital markets (DCM) continued, acting as a joint lead manager and bookrunner for the largest US dollar-denominated single tranche bond issuance by an Indian corporate in 2013.

In Singapore, we led the market in foreign currency DCM issuance, continuing to demonstrate our ability to structure DCM transactions. In CMB, we began to offer a renminbi settlement service.

We continued to develop our Payments and Cash Management product offering across the region and were awarded the Best Cash Management House in Asia by *Euromoney*. We also strengthened our Project and Export Finance capabilities and were named the Best Project Finance House in Asia by *Euromoney* for the third consecutive year. Our strength in DCM continued we were the No.1 bookrunner in Asia-ex Japan bonds. We were awarded the Domestic Bond House of the Year by *IFR Asia*.

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Report of the Directors: Financial Review (continued)

Net interest income increased by US\$167m from balance sheet growth, partly offset by spread compression in many countries from competition and increased liquidity.

Average residential mortgage balances grew, primarily in mainland China and Australia, as we focused on secured lending and in Singapore reflecting lending growth in 2012. Term and trade-related lending in CMB rose, notably in mainland China, Singapore and Indonesia, from continued client demand. Increased average loan balances were broadly offset by lending spread compression, notably on trade finance lending, reflecting competitive pressures and increased liquidity in the market.

We grew average deposit balances in both Payments and Cash Management and RBWM, though the benefit of this growth was partly offset by narrower liability spreads in many countries following central bank interest rate cuts and increased liquidity.

Net fee income rose by US\$53m, primarily in GB&M, in part from increased activity in bond sales in Singapore and in CMB from increased credit facilities, notably in mainland China. These factors were partly offset by reductions in RBWM, notably in India, from lower Wealth Management sales as we revised our product offerings.

Net trading income was US\$541m lower, in part from further adverse fair value movements on the Ping An contingent forward sale contract of US\$682m, compared with US\$553m in 2012. Rates revenues decreased, largely from reduced bond holdings in a number of countries and revaluation losses as bond yields rose, notably in mainland China. Foreign Exchange revenues also fell as market conditions in 2012 were not repeated.

Net income from financial instruments designated at fair value was US\$56m compared with US\$108m in 2012 from lower gains on assets held by the insurance business in Singapore driven by rising bond yields.

Gains less losses from financial investments were US\$1.2bn higher, due to the gain on disposal

of our investment in Ping An of US\$1.2bn, which was partly offset by the adverse fair value movement of US\$682m on the contingent forward sale contract included in *Net trading income* leading to a net gain of US\$553m.

We reported a *gain on disposal of Ping An* of US\$3.0bn in 2012.

Other operating income increased by US\$1.0bn. We recorded an accounting gain of US\$1.1bn on the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties and a gain on the disposal of our investment in Bao Viet Holdings of US\$104m. In 2012, we recorded gains totalling US\$305m on a reported basis on the sale of our RBWM business in Thailand, our GPB business in Japan and our interest in a property company in the Philippines.

LICs decreased by US\$63m as 2012 included a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M. These factors were partly offset by an increase in individually assessed impairments in GB&M and CMB in a number of countries across the region.

Operating expenses increased by US\$38m. Costs rose in India from increased use of the service centres and in mainland China from wage inflation, higher staff numbers and branch expansion. These increases were offset by the partial write back of a litigation provision in Singapore and Australia compared with a charge in 2012. In addition, in 2013 there were lower restructuring and other related costs, including termination benefits, than in 2012, and the non-recurrence of costs following the sale or closure of operations.

Share of profit from associates and joint ventures reduced by US\$1.4bn following the disposal of Ping An, the reclassification of Industrial Bank as a financial investment and an impairment charge of US\$106m on our banking associate in Vietnam. Excluding these factors, income from

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associates rose, primarily in BoCom as a result of balance sheet growth and increased fee income, partly offset by higher operating expenses and a rise in loan impairment charges.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax – Rest of Asia-Pacific*

	2012	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported US\$m	Reported change ² %	Constant currency change ² %
Net interest income	5,391	(119)	5,272	5,439	1	3
Net fee income	2,083	(77)	2,006	2,059	(1)	3
Net trading income	1,053	(56)	997	456	(57)	(54)
Own credit spread ³	(3)		(3)	(1)	67	67
Other income from financial instruments designated at fair value	109	2	111	57	(48)	(49)
Net income from financial instruments designated at fair value	106	2	108	56	(47)	(48)
Gains on disposal of Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial investments	16	(1)	15	1,222	7,538	8,047
Net earned insurance premiums	812	(1)	811	837	3	3
Other operating income (including dividend income)	1,829	(237)	1,592	2,635	44	66
Total operating income	14,302	(489)	13,813	12,704	(11)	(8)
Net insurance claims incurred and movement in liabilities to policyholders	(718)	1	(717)	(726)	(1)	(1)
Net operating income⁴	13,584	(488)	13,096	11,978	(12)	(9)
LICs ⁴²	(436)	12	(424)	(361)	17	15
Net operating income	13,148	(476)	12,672	11,617	(12)	(8)
Operating expenses	(5,806)	204	(5,602)	(5,640)	3	(1)
Operating profit	7,342	(272)	7,070	5,977	(19)	(15)
Income from associates ⁴³	3,106	45	3,151	1,787	(42)	(43)
Profit before tax	10,448	(227)	10,221	7,764	(26)	(24)

*For footnotes, see page 132.**Reconciliation of reported and underlying items – Rest of Asia-Pacific*

	Year ended 31 December		Change ²
	2013	2012	%
	US\$m	US\$m	
Net interest income			
Reported	5,439	5,391	1
Currency translation adjustment ¹		(119)	
Own credit spread ³	1	3	

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Acquisitions, disposals and dilutions		(22)	
Underlying	5,440	5,253	4
Other operating income			
Reported	2,633	1,823	44
Currency translation adjustment ¹		(233)	
Acquisitions, disposals and dilutions	(1,139)	(299)	
Underlying	1,494	1,291	
Revenue⁴			
Reported	11,978	13,584	(12)
Currency translation adjustment ¹		(488)	
Own credit spread ³	1	3	
Acquisitions, disposals and dilutions	(1,139)	(3,342)	
Underlying	10,840	9,757	11

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	Year ended 31 December		Change ² %
	2013 US\$m	2012 US\$m	
LICs⁴²			
Reported	(361)	(436)	17
Currency translation adjustment ¹		12	
Acquisitions, disposals and dilutions		(2)	
Underlying	(361)	(426)	15
Operating expenses			
Reported	(5,640)	(5,806)	3
Currency translation adjustment ¹		204	
Acquisitions, disposals and dilutions	72	111	
Underlying	(5,568)	(5,491)	(1)
Underlying cost efficiency ratio	51.4%	56.3%	
Share of profit in associates and joint ventures			
Reported	1,787	3,106	(42)
Currency translation adjustment ¹		45	
Acquisitions, disposals and dilutions	(19)	(1,416)	
Underlying	1,768	1,735	2
Profit before tax			
Reported	7,764	10,448	(26)
Currency translation adjustment ¹		(227)	
Own credit spread ³	1	3	
Acquisitions, disposals and dilutions	(1,086)	(4,649)	
Underlying	6,679	5,575	20

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**2012 compared with 2011**

Economic background

In mainland **China**, economic growth slowed through the first three quarters of 2012 due to a decline in external demand driven by the eurozone crisis, the effect of tightening domestic monetary policy measures and sharp de-stocking by industry. This greater than expected deceleration and increasing pressure on the labour market prompted policy makers to ease monetary policy in the summer of 2012, following two interest rate cuts totalling 50bps and two cuts in the reserve requirement ratio amounting to 100bps in the first half of the year, and speeded up the approval of new infrastructure projects. As these measures took effect, the mainland Chinese economy began to show signs of recovery in the fourth quarter of 2012. GDP slowed to 7.8% in 2012 from 9.3% in 2011, but remained above Beijing's target of 7.5%. CPI inflation was a modest 2.6%.

Japan's economy experienced a turbulent 2012. After a very strong start supported by reconstruction demand and government subsidies, growth turned sharply negative in the third quarter as tepid overseas demand prompted a deep slump in exports and manufacturing. Sentiment improved by the end of 2012. The Bank of Japan took steps to ease monetary policy in 2012, establishing a 1% inflation goal in February 2012 and expanding its Asset Purchase Programme by JPY46 trillion (US\$534bn).

Slowing global trade reduced growth in the Rest of Asia-Pacific region. **South Korea's** full-year growth slowed to 2.1% in 2012, the lowest annual rate for three years, as the slowdown in global trade hit the export-dependent economy hard in the third quarter. To support domestic demand, the Bank of Korea lowered its policy rate from 3.25% to 2.75%. **Singapore's** economy slowed notably, with GDP growth declining to 1.2% in 2012 from 5% the year before. 2012 was a tumultuous year for **Taiwan's** export-reliant economy, as both western and mainland China demand weakened, particularly from April onwards. However, the impetus provided by key electronic product launches helped to maintain manufacturing activity and jobs, enabling domestic demand to underpin growth more effectively than it did in earlier recessions. The other ASEAN (Association of Southeast Asian Nations) countries demonstrated more resilience, supported by domestic growth. Growth in **Indonesia** was driven by favourable demographics and a growing middle-income class. In **Thailand**, rebuilding activity and policy support after the floods in 2011 led to a rebound in economic activity. Growth in **India**

continued to slow during the course of 2012, with weaker external demand, the lagged effects of monetary policy normalisation and the absence in recent years of structural policies and infrastructure investment playing a role in the slowdown. Encouragingly, the government embarked on a reform programme towards the end of the year which helped lift sentiment and stabilise growth.

Growth in the **Australian** economy was uneven in 2012 as it absorbed a mining boom which had the effect of slowing investment in other sectors. For 2012 as a whole, growth was strong at around 3.5%. Unemployment edged up to 5.4%. In response to the global slowdown and to help re-balance growth away from mining and towards the non-mining sectors, the Reserve Bank of Australia reduced its cash rate from 4.25% to 3.00%.

Review of performance

Our operations in the Rest of Asia-Pacific region reported pre-tax profits of US\$10.4bn compared with US\$7.5bn in 2011, an increase of 40% or 41% on a constant currency basis.

Reported profits included a gain on the disposal of our associate, Ping An of US\$3.0bn. Our remaining shareholding has been classified as a financial investment (see Note 26 on the Financial Statements). Reported profits also included gains from the sale of the RBWM business in Thailand (US\$108m), the GPB business in Japan (US\$67m) and our interest in a property company in the Philippines (US\$130m). Reported profits in 2011 included an accounting gain of US\$181m arising from the dilution of our shareholding in Ping An, offset by a remeasurement loss of US\$48m on its consolidation of Ping An Bank (formerly Shenzhen Development Bank).

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On an underlying basis, which excludes the items described above and the associated operating results, pre-tax profit rose by 2%. This was driven by higher net interest income, notably from Balance Sheet Management in GB&M in mainland China, and strong growth in average lending balances across most of the region, as well as increased profits from our associates in mainland China. These factors were partly offset by adverse fair value movements of US\$553m on the contingent forward sale contract related to the Ping An sale, the effect of which was offset in 2013 on completion of the transaction, and higher operating expenses, in part due to restructuring costs 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

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charges, but remained low as credit quality remained broadly stable.

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 US\$1.7bn in 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.

In Malaysia, we now have the largest branch network amongst foreign banks and were designated *Best Bank* for the 10th consecutive year by the *Asset Triple A Country Awards*.

In RBWM, we made progress in re-shaping the business in line with our strategy, completing the disposal of the non-strategic business in Thailand and announcing the sale of our life insurance business in Taiwan. With our focus on secured lending, we recorded mortgage growth in mainland China, Singapore, Australia and Malaysia, reflecting the continued strength of the property market and the expansion of our distribution network.

In CMB, trade revenues grew as we capitalised on our global network to capture cross-border trade and capital flows, particularly with mainland China. We continued to strengthen our infrastructure to capture the outbound opportunities from mainland China and now have 14 China desks established globally to assist customers with their international trade requirements. Significant new mandates in 2012 in CMB and GB&M reflected investment in our Payments and Cash Management infrastructure. We were recognised as *Best Domestic Cash Management Bank* by *Euromoney* in fourteen countries across the region, *Best Overall Cash Management Bank in Asia* by *Global Finance* and *Best International Trade Bank in China* by *Trade Finance Magazine*.

In GB&M, we continued to be a key participant in the internationalisation of the renminbi and enhanced our Payments and Cash Management systems with renminbi capabilities. We continued to build our debt and equity capital markets capabilities in key countries in the region and were involved in several significant government and large corporate issues in Australia, Singapore, India and Indonesia. Revenues from the collaboration between CMB and GB&M increased by 13% as we enhanced sales coordination between the global businesses.

The following commentary is on a constant currency basis.

Net interest income increased by 8%, 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.

We grew average deposit balances, notably in GB&M and CMB reflecting new Payments and Cash Management mandates, and in RBWM from deposit acquisition. 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. However, net interest income was broadly unchanged 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 increased by US\$29m, primarily in GB&M, from higher fee income from our participation in more debt capital markets transactions across the region as we continued to strengthen our capabilities in this area, and lower regulatory fee expenses on Foreign Exchange and Rates transactions in mainland China as volumes reduced. RBWM reported higher income from cards in Australia from increased spending and card issuance and Wealth Management fees in mainland China. The increase from cards was more than offset by the discontinuation of our Premier business in Japan, the sale of our RBWM business in Thailand, and a fall in fund management fees as we saw a move into lower yielding products reflecting investor's lower risk appetite.

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Net trading income decreased by 34% compared with 2011, mainly from adverse fair value movements on the contingent forward sale contract of US\$553m relating to Ping An (see Note 26 on the Financial Statements). Trading income was also lower, primarily in mainland China due to lower GB&M revenues in Foreign Exchange reflecting reduced volatility. 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 US\$110m in 2012 compared with a net expense of US\$19m in 2011. This was driven by

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Report of the Directors: Financial Review (continued)

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 DPF, there was a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders* .

Gains less losses from financial investments were US\$16m compared with net losses of US\$23m 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 7% to US\$812m 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* .

We reported a *Gain on disposal of Ping An*, an associate of Mainland China, of US\$3.0bn. Our remaining shareholding has been classified as a financial investment.

Other operating income increased by US\$201m due to gains on the sale of our RBWM business in Thailand of US\$108m, our GPB business in Japan of US\$67m and our interest in a property company in the Philippines of US\$130m. These were partly offset by the non-recurrence of an accounting gain of US\$181m arising from the dilution of our shareholding in Ping An in 2011.

Net insurance claims incurred and movement in liabilities to policyholders increased by 22%, driven by net investment gains on the fair value of the assets held to support the policyholder contracts compared with net losses in 2011. In addition, policyholder liabilities were established for new business, reflecting the rise in premiums across mainland China, Singapore and Taiwan.

Loan impairment charges and other credit risk provisions increased by US\$170m 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 as well as a credit risk provision on an available-for-sale debt security in GB&M. These were partly offset by an impairment release in Singapore compared with a charge in 2011.

Operating expenses increased by 3%, due to restructuring and other related costs of US\$131m (2011: US\$45m) incurred across 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 approximately 6,000 FTE staff numbers and generated sustainable annual savings of approximately US\$200m, which were more than offset by inflationary pressures and investment for business growth, including branch expansion in mainland China. Costs also increased from a litigation provision of US\$98m made in respect of a long-standing court case and the write down by US\$51m of our interest in a joint venture.

Share of profit from associates and joint ventures increased by US\$212m, driven by higher profits from BoCom and Industrial Bank which reflected loan growth and higher fee income, partly offset by increased operating expenses and loan impairment charges. The contribution from Ping An reduced due to market valuation losses on equity securities held by their insurance business, which reflected volatile domestic equity markets, partly offset by increased income from the banking business, Ping An Bank. The disposal of Ping An and the dilution of our holding in Industrial Bank, following its issue of additional share capital to third parties on 7 January 2013, are expected to have a significant impact on future profits in the region.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax – Rest of Asia-Pacific*

	2011					
	2011	Currency	at 2012	2012	Constant	
	as	translation	exchange	as	Reported	currency
	reported	adjustment ¹	rates	reported	change ²	change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	5,102	(111)	4,991	5,391	6	8
Net fee income	2,111	(57)	2,054	2,083	(1)	1
Own credit spread ³	2		2	(3)		
Gains on disposal of Ping An				3,012		
Other income ⁷	3,498	(148)	3,350	3,101	(11)	(7)
Net operating income ⁴	10,713	(316)	10,397	13,584	27	31
LICs ⁴²	(267)	1	(266)	(436)	(63)	(64)
Net operating income	10,446	(315)	10,131	13,148	26	30
Operating expenses	(5,806)	173	(5,633)	(5,806)		(3)
Operating profit	4,640	(142)	4,498	7,342	58	63
Income from associates ⁴³	2,831	63	2,894	3,106	10	7
Profit before tax	7,471	(79)	7,392	10,448	40	41

*For footnotes, see page 132.**Reconciliation of reported and underlying items – Rest of Asia-Pacific*

	Year ended 31 December		
	2012	2011	Change ²
	US\$m	US\$m	%
Revenue ⁴			
Reported	13,584	10,713	27
Currency translation adjustment ¹		(316)	
Own credit spread ³	3	(2)	
Acquisitions, disposals and dilutions	(3,342)	(295)	
Underlying	10,245	10,100	1
LICs ⁴²			
Reported	(436)	(267)	(63)
Currency translation adjustment ¹		1	
Acquisitions, disposals and dilutions	(2)	4	

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Underlying	(438)	(262)	(67)
Operating expenses			
Reported	(5,806)	(5,806)	
Currency translation adjustment ¹		173	
Acquisitions, disposals and dilutions	60	96	
Underlying	(5,746)	(5,537)	(4)
Underlying cost efficiency ratio	56.1%	54.8%	
Profit before tax			
Reported	10,448	7,471	40
Currency translation adjustment ¹		(79)	
Own credit spread ³	3	(2)	
Acquisitions, disposals and dilutions	(4,048)	(1,141)	
Underlying	6,403	6,249	2

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit before tax and balance sheet data Rest of Asia-Pacific*

	2013						
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income	1,718	1,374	1,907	81	223	136	5,439
Net fee income/(expense)	728	555	722	70	(16)		2,059
Trading income/(expense) excluding net interest income	99	195	704	41	(722)		317
Net interest income/(expense) on trading activities	(19)	(6)	301		(1)	(136)	139
Net trading income/(expense) ⁴⁴	80	189	1,005	41	(723)	(136)	456
Changes in fair value of long- term debt issued and related derivatives					(1)		(1)
Net income/(expense) from other financial instruments designated at fair value	59				(2)		57
Net income/(expense) from financial instruments designated at fair value	59				(3)		56
Gains less losses from financial investments	(1)		16	4	1,203		1,222
Dividend income					2		2
Net earned insurance premiums	651	185	1				837
Other operating income	145	6	85	3	2,569	(175)	2,633
Total operating income	3,380	2,309	3,736	199	3,255	(175)	12,704
Net insurance claims ⁵⁰	(584)	(142)					(726)
Net operating income⁴	2,796	2,167	3,736	199	3,255	(175)	11,978
Loan impairment charges and other credit risk provisions	(210)	(128)	(23)				(361)
Net operating income	2,586	2,039	3,713	199	3,255	(175)	11,617
Total operating expenses	(2,139)	(1,022)	(1,256)	(123)	(1,275)	175	(5,640)
Operating profit	447	1,017	2,457	76	1,980		5,977
Share of profit/(loss) in associates and joint ventures	230	1,331	247		(21)		1,787
Profit before tax	677	2,348	2,704	76	1,959		7,764
	%	%	%	%	%		%

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Share of HSBC's profit before tax	3.0	10.4	12.0	0.3	8.7		34.4
Cost efficiency ratio	76.5	47.2	33.6	61.8	39.2		47.1
<i>Balance sheet data</i> ⁴⁰							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	46,808	48,757	48,023	3,976	233		147,797
Total assets	54,640	62,755	203,252	4,974	22,483	(12,167)	335,937
Customer accounts	64,921	44,767	61,065	11,822	51		182,626

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit before tax and balance sheet data Rest of Asia-Pacific (continued)*

	2012						
	Retail Banking	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income	1,787	1,396	2,156	102	137	(187)	5,391
Net fee income/(expense)	854	499	666	71	(7)		2,083
Trading income/(expense) excluding net interest income	96	188	1,002	67	(592)		761
Net interest income/(expense) on trading activities	(6)	(3)	100		14	187	292
Net trading income/(expense) ⁴⁴	90	185	1,102	67	(578)	187	1,053
Changes in fair value of long-term debt issued and related derivatives					(4)		(4)
Net income/(expense) from other financial instruments designated at fair value	109	1	(3)		3		110
Net income/(expense) from financial instruments designated at fair value	109	1	(3)		(1)		106
Gains less losses from financial investments	(1)	2	(10)		25		16
Dividend income			1		4		5
Net earned insurance premiums	569	243					812
Gain on disposal of Ping An					3,012		3,012
Other operating income	211	64	82	68	1,571	(172)	1,824
Total operating income	3,619	2,390	3,994	308	4,163	(172)	14,302
Net insurance claims ⁵⁰	(523)	(195)					(718)
Net operating income ⁴	3,096	2,195	3,994	308	4,163	(172)	13,584
Loan impairment charges and other credit risk provisions	(234)	(154)	(48)				(436)
Net operating income	2,862	2,041	3,946	308	4,163	(172)	13,148
Total operating expenses	(2,238)	(993)	(1,279)	(149)	(1,319)	172	(5,806)
Operating profit	624	1,048	2,667	159	2,844		7,342
Share of profit in associates and joint ventures	893	1,554	658		1		3,106
Profit before tax	1,517	2,602	3,325	159	2,845		10,448
	%	%	%	%	%		%
Share of HSBC's profit before tax	7.3	12.6	16.1	0.8	13.8		50.6
Cost efficiency ratio	72.3	45.2	32.0	48.4	31.7		42.7
<i>Balance sheet data</i> ⁴⁰							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m

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Loans and advances to customers (net)	46,027	43,968	44,721	3,238	165		138,119
Total assets	55,509	59,123	201,774	12,142	24,534	(10,813)	342,269
Customer accounts	63,230	44,865	64,392	11,095	39		183,621

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Rest of Asia-Pacific (continued)*

	2011						
	Retail Banking	Commercial Banking	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit before tax</i>							
Net interest income	1,838	1,254	1,964	116	123	(193)	5,102
Net fee income/(expense)	904	513	621	82	(9)		2,111
Trading income/(expense) excluding net interest income	94	156	1,153	66	(90)		1,379
Net interest income/(expense) on trading activities	(2)	1	76		11	193	279
Net trading income/(expense) ⁴⁴	92	157	1,229	66	(79)	193	1,658
Changes in fair value of long- term debt issued and related derivatives					4		4
Net income/(expense) from other financial instruments designated at fair value	(38)	2	1		15		(20)
Net income/(expense) from financial instruments designated at fair value	(38)	2	1		19		(16)
Gains less losses from financial investments		2	(25)	1	(1)		(23)
Dividend income			2				2
Net earned insurance premiums	493	266					759
Other operating income	145	72	75	5	1,592	(178)	1,711
Total operating income	3,434	2,266	3,867	270	1,645	(178)	11,304
Net insurance claims ⁵⁰	(351)	(240)					(591)
Net operating income ⁴	3,083	2,026	3,867	270	1,645	(178)	10,713
Loan impairment (charges)/recoveries and other credit risk provisions	(222)	10	(57)	2			(267)
Net operating income	2,861	2,036	3,810	272	1,645	(178)	10,446
Total operating expenses	(2,409)	(945)	(1,268)	(181)	(1,181)	178	(5,806)
Operating profit	452	1,091	2,542	91	464		4,640
Share of profit/(loss) in associates and joint ventures	1,189	1,155	547		(60)		2,831
Profit before tax	1,641	2,246	3,089	91	404		7,471
	%	%	%	%	%		%
Share of HSBC's profit before tax	7.5	10.3	14.1	0.4	1.9		34.2
Cost efficiency ratio	78.1	46.6	32.8	67.0	71.8		54.2

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*Balance sheet data*⁴⁰

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	40,970	38,404	41,114	3,190	190		123,868
Total assets	54,484	50,688	195,549	12,879	16,616	(12,400)	317,816
Customer accounts	60,831	40,423	60,855	11,872	31		174,012

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Middle East and North Africa**

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

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	1,486	1,470	1,432
Net fee income	622	595	627
Net trading income	357	390	482
Other income	38	(25)	66
Net operating income⁴	2,503	2,430	2,607
LICs ⁴²	42	(286)	(293)
Net operating income	2,545	2,144	2,314
Total operating expenses	(1,289)	(1,166)	(1,159)
Operating profit	1,256	978	1,155
Income from associates ⁴³	438	372	337
Profit before tax	1,694	1,350	1,492
Cost efficiency ratio	51.5%	48.0%	44.5%
RoRWA ³⁶	2.7%	2.2%	2.6%
Year-end staff numbers	8,618	8,765	8,373

Best Regional**Best Trade****Cash Management****Bank in the****Provider in the****Middle East****Middle East***(Trade and Forfeiting**(Euromoney)**Review Excellence*

Fifth consecutive year

awards 2013)

**Improvement in the financial position of key
customers and loan portfolios contributed
to lower loan impairment charges**

Approximately

US\$40m

**of sustainable cost savings from our
organisational effectiveness programmes**

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

Real GDP in the Middle East and North Africa grew by an estimated 4.0% in 2013, led by the Gulf Cooperation Council (GCC) and Saudi Arabia's expansionary fiscal policy and infrastructure investment programme. With oil prices steady in the US\$100-110 per barrel range throughout the year, revenues were more than sufficient to fund this spending, and the region ended 2013 with both current and fiscal accounts amply in surplus. The UAE saw an accelerating recovery in 2013 led by real estate and services, but boosted towards the end of the year by an increasingly expansionary fiscal policy. Despite strong demand and loose fiscal policy, inflation remained very subdued across the region throughout 2013, apart from UAE real estate.

For **Egypt**, political uncertainty gave rise to a third year of sub-par growth and rising unemployment. Real GDP grew by 2.2% in the 2012/13 fiscal year, while the budget deficit widened to 14% of GDP. The country's external position improved substantially in July, following the receipt of concessionary financing from the GCC. However, while reserves and the currency stabilised, stringent exchange rate and capital controls were still in place at the end of December 2013.

Review of performance

Our operations in the Middle East and North Africa reported a profit before tax of US\$1.7bn, an increase of 25% compared with 2012. On a constant currency basis, pre-tax profits increased by 29%.

Our reported results in 2013 included adverse movements of US\$4m on our own debt designated at fair value resulting from tightening of credit spreads. Our reported results in 2012 included an investment loss on a subsidiary of US\$85m and adverse movements of US\$12m on our own debt designated at fair value resulting from tightening credit spreads, partly offset by gains recognised on acquisitions totalling US\$21m. On an underlying basis, excluding the items noted above and the results of a deconsolidated subsidiary and the Private Equity business disposed of in 2012, profit before tax increased by 26%, mainly due to lower loan impairment charges and higher income from our associate, The Saudi British Bank.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by country within global businesses*

	Retail		Global			Total
	Banking and Wealth Management	Commercial Banking	Banking	Global		
			and	Private		
			Markets	Banking	Other	
US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	
2013						
Egypt	31	37	166		(29)	205
Qatar	10	37	62			109
United Arab Emirates	142	290	275	1	(72)	636
Other	(7)	135	178			306
MENA (excluding Saudi Arabia)	176	499	681	1	(101)	1,256
Saudi Arabia	82	146	188	15	7	438
	258	645	869	16	(94)	1,694
2012						
Egypt	67	71	157		(5)	290
Qatar	9	36	84			129
United Arab Emirates	143	235	141	1	(56)	464
Other	(27)	125	29		(37)	90
MENA (excluding Saudi Arabia)	192	467	411	1	(98)	973
Saudi Arabia	60	120	170	9	18	377
	252	587	581	10	(80)	1,350
2011						
Egypt	43	55	129		(2)	225
Qatar	(4)	35	81			112
United Arab Emirates	134	240	200	(6)	7	575
Other	17	109	93			219
MENA (excluding Saudi Arabia)	190	439	503	(6)	5	1,131
Saudi Arabia	57	98	140	4	62	361
	247	537	643	(2)	67	1,492

In the UAE, we inaugurated a new strategic plan for growth with investment committed across all businesses, and with commensurate investment in the risk management functions including Regulatory and Financial Crime Compliance. In RBWM, we focused on improving our retail customer experience through the new Customer at the Heart campaign and were ranked number one in the Customer Recommendation Index for banks in the UAE. We also invested in mobile and digital technologies to enhance our Wealth Management offering and to grow our retail foreign exchange revenues.

In CMB, our fourth international trade fund for SMEs of AED1bn (US\$272m) was launched to support new and existing customers with cross-border trading requirements or with aspirations to grow internationally.

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In GB&M, there was a focus on cross-border connectivity and CMB collaboration, with tailored risk management solutions. We supported sovereign wealth funds and government-related entities and won several *Euromoney* awards including The Best Investment Bank in Middle East , The Best Risk Advisor in Middle East , Best Cash Management House in the Middle East and No 1 Debt House for MENA and GCC issuer bonds .

We were awarded the Best Trade Bank in the MENA region by *GTR Leaders in Trade 2013* and we enhanced Global Trade and Receivables Finance by investing in sales staff and giving priority to commodity structured trade finance and receivables finance. The level of service provided by our Payments and Cash Management business was reflected in our fifth consecutive *Euromoney* award.

In Egypt, we continued to manage risk in the uncertain political and economic environment. Surplus liquidity levels in Egyptian pounds, which arose following the introduction of foreign currency restrictions at the end of 2012, were managed through the downward re-pricing of deposits. Despite these difficult operating conditions, we continued to invest in the business, through the deployment of new automated teller machines (ATMs) and the launch of a new mobile banking application. Our RBWM business was ranked number 1 in the Customer Recommendation Index while our CMB business launched an Egypt SME Fund for EGP300m (US\$44m) targeting international SME growth and trade customers.

We renewed our primary dealer licence for trading in Government of Egypt treasury bills and

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Report of the Directors: Financial Review (continued)

bonds, ranking as one of the largest primary dealers in the Egyptian market.

In Oman, following the completion of the merger in June 2012 with OIB, we completed the conversion to HSBC systems of our merged operation. We made a number of improvements to our mobile banking and internet banking applications, introducing enhanced security features including the HSBC secure key for internet banking. We also upgraded our e-platform for cash management services for our corporate banking customers. HSBC Bank Oman won *Euromoney* s Best Domestic Cash Management Bank in Oman award for the second consecutive year.

In Saudi Arabia, our associate, The Saudi British Bank, won *The Banker* magazine s award as The Best Bank in Saudi Arabia, 2013 and achieved a record net profit before tax exceeding US\$1bn.

In line with our commitment to drive growth and improve returns in businesses that do not meet our six filters criteria (see page 15), we entered into an agreement to sell our operation in Jordan. The transaction is expected to complete in 2014.

Net interest income rose by 4%, mainly in Egypt in GB&M, driven by higher yields and balances on available-for-sale investment portfolios and higher balances on corporate deposits as more liquid assets were held in the volatile political environment. In Oman, net interest income increased, notably in RBWM, following the merger with OIB in June 2012. The higher net interest income in the UAE from growth in GB&M in the Credit and Lending portfolio and in RBWM from the Lloyds business acquired in 2012, was more than offset by a decline in CMB, where the business was repositioned to lower risk segments.

Net fee income increased by 7%, primarily in the UAE in GB&M due to an increase in advisory mandates in Capital Financing and higher institutional equities fee income from increased deal volumes, partially offset by lower fees from reduced volumes on Global Trade and Receivables Finance products in CMB. In Egypt, net fee income increased, notably in RBWM from cards and consumer loan fees.

Net trading income decreased by 6%, notably in Egypt from lower foreign exchange revenues, reflecting the political instability, and lower Rates trading income driven by a reduction in deal volumes. The decrease in trading income also reflected the deconsolidation of a subsidiary in 2012. These factors were partly offset by CVA releases on trading positions relating to a small number of exposures in the UAE in GB&M, compared with charges in 2012.

Gains less losses from financial investments decreased by US\$27m, driven by losses on the disposal of the available-for-sale debt securities in Egypt in the first half of 2013 as we adjusted our risk positions.

Other operating income increased by US\$76m, due to the non-recurrence of an US\$85m investment loss on a subsidiary in 2012.

A net *loan impairment release* of US\$42m was recorded in 2013 compared with a charge of US\$282m in 2012. There were provision releases, mainly in GB&M, for a small number of UAE related exposures, reflecting an overall improvement in the loan portfolio compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

Operating expenses increased by 13%, mainly in the UAE from the Lloyds business acquired in 2012, expenses for regulatory projects, operational losses and charges from a customer redress programme in RBWM relating to fees charged on overseas credit card transactions. Expenses also increased in Egypt from changes in the interpretation of tax regulations and in Oman following the merger with OIB. These factors were partly offset by approximately US\$40m of sustainable savings from our organisational effectiveness programmes.

Share of profits from associates and joint ventures increased by 18%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth, and the effective management of costs.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax Middle East and North Africa*

	2012			2013		
	2012 as reported	Currency translation adjustment ¹	at 2013 exchange rates	2013 as reported	Reported change ²	Constant currency change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	1,470	(43)	1,427	1,486	1	4
Net fee income	595	(11)	584	622	5	7
Net trading income	390	(9)	381	357	(8)	(6)
Own credit spread ³	(12)		(12)	(4)	67	67
Other income from financial instruments designated at fair value				2		
Net expense from financial instruments designated at fair value	(12)		(12)	(2)	83	83
Gains less losses from financial investments	9		9	(18)		
Net earned insurance premiums						
Other operating income/(expense) (including dividend income)	(22)		(22)	58		
Total operating income	2,430	(63)	2,367	2,503	3	6
Net insurance claims incurred and movement in liabilities to policyholders						
Net operating income⁴	2,430	(63)	2,367	2,503	3	6
LICs ⁴²	(286)	4	(282)	42		
Net operating income	2,144	(59)	2,085	2,545	19	22
Operating expenses	(1,166)	23	(1,143)	(1,289)	(11)	(13)
Operating profit	978	(36)	942	1,256	28	33
Income from associates ⁴³	372		372	438	18	18
Profit before tax	1,350	(36)	1,314	1,694	25	29

*For footnotes, see page 132.**Reconciliation of reported and underlying items Middle East and North Africa*

	Year ended 31 December		Change ² %
	2013 US\$m	2012 US\$m	
Net interest income			
Reported	1,486	1,470	1
Currency translation adjustment ¹		(43)	
Acquisitions, disposals and dilutions		(8)	
Underlying	1,486	1,419	5

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Other operating income			
Reported	49	(27)	
Currency translation adjustment ¹			
Acquisitions, disposals and dilutions		64	
Underlying	49	37	32
Revenue⁴			
Reported	2,503	2,430	3
Currency translation adjustment ¹		(63)	
Own credit spread ³	4	12	
Acquisitions, disposals and dilutions		3	
Underlying	2,507	2,382	5

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Report of the Directors: Financial Review (continued)

	Year ended 31 December		Change ² %
	2013 US\$m	2012 US\$m	
LICs⁴²			
Reported	42	(286)	
Currency translation adjustment ¹		4	
Acquisitions, disposals and dilutions			
Underlying	42	(282)	
Operating expenses			
Reported	(1,289)	(1,166)	(11)
Currency translation adjustment ¹		23	
Acquisitions, disposals and dilutions		15	
Underlying	(1,289)	(1,128)	(14)
Underlying cost efficiency ratio	51.4%	47.4%	
Profit before tax			
Reported	1,694	1,350	25
Currency translation adjustment ¹		(36)	
Own credit spread ³	4	12	
Acquisitions, disposals and dilutions		18	
Underlying	1,698	1,344	26

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**2012 compared with 2011**

Economic background

Real GDP in the **Middle East and North Africa** region grew by an estimated 4.5% in 2012. However, this weighted aggregate figure masked a wide disparity between oil producers (5.1%) and non-oil producers (2.9%). For the Gulf Cooperation Council's top performers, energy output volumes remained high and revenues rose, fuelling government spending-driven domestic demand which fed through to a stronger non-oil private sector performance, job creation and a recovery in bank lending. **Saudi Arabia** (which recorded growth of nearly 7% in 2012), **Qatar** (6%) and **Oman** (5%) fell into this category. In the **UAE**, more muted fiscal and monetary stimuli meant overall growth was slower, but Dubai's export-oriented service sector recorded a good recovery in 2012, and Abu Dhabi picked up in the second half of the year. Despite the strong growth, inflation remained low across the Gulf region.

In **Egypt**, growth remained weak, held back by ongoing political uncertainty which continued to weigh on domestic and foreign investment and consumption. Pressure on public finances and Egypt's external accounts remained pronounced, with the Egyptian pound weakening significantly. Elsewhere in the oil importing parts of the region, the pressures were not as great, but in Lebanon, Jordan, Morocco and Tunisia, growth fell and their external balances deteriorated, with the latter three, following a significant worsening of public finances, approaching the International Monetary Fund for assistance by the end of the year.

Review of performance

Our operations in the Middle East and North Africa reported a profit before tax of US\$1.4bn, a decrease of 10% compared with 2011. On a constant currency basis, pre-tax profits decreased by 9%.

Our reported results in 2012 included an investment loss on a subsidiary of US\$85m and adverse movements of US\$12m on our own debt designated at fair value resulting from tightening credit spreads, partly offset by gains recognised on acquisitions totalling US\$21m. Reported profits in 2011 included a dilution gain of US\$27m on our holding in HSBC Saudi Arabia Ltd following its merger with SABB Securities Ltd and a loss of US\$7m relating to the disposal of our Private Equity business. On an underlying basis, excluding the items noted above, profit before tax decreased by 3% as a result of a small number of significant impairments on GB&M exposures.

During 2012, we focused on simplifying our operations in the Middle East and North Africa by disposing of non-strategic businesses and continuing to improve our organisational efficiency while investing in strategic acquisitions.

We made significant progress in integrating our operations in Oman with OIB following the merger in June 2012. The combined entity, HSBC Bank Oman S.A.O.G., of which we own 51%, is now the third largest bank in the Sultanate. We also completed the acquisition of the onshore retail and commercial banking business of Lloyds Banking Group in the UAE in the fourth quarter of 2012. Lloyds' strong presence in expatriate retail banking and commercial banking was a good strategic fit with our position as the leading international bank in the UAE. We also completed the disposal of 80.1% of our Private Equity business in December. We announced in September our agreement to sell our operations in Pakistan and, in October, the restructuring of our Amanah business in the region outside Saudi Arabia.

We remained focused on our priority markets, delivering profit growth in Egypt and Saudi Arabia. The strong performance in Egypt was driven by robust deposit growth in RBWM which led to higher net interest income. We also achieved growth in profits from our associates, mainly The Saudi British Bank, which won the *EuroMoney* award for excellence as The Best Bank in Saudi Arabia and The Best Debt House in Saudi Arabia. Although profit before tax declined in the UAE as a result of the impairments in GB&M noted above, it remains a priority market for HSBC and the economy continued to improve in 2012.

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Delivery of sustainable cost savings remained a priority for 2012. Our organisational effectiveness initiatives included streamlining procedures by delayering our management structure and transferring additional operational processes to our global service centres. We realised about US\$70m in sustainable savings from our organisational effectiveness programmes.

In RBWM, we remained focused on growing Wealth Management revenues. We entered into a strategic alliance with Zurich Life International (Zurich) in 2012 to provide wealth and general insurance products to our customers in the region. Our focus on foreign exchange resulted in increased transaction volumes, which provided us with higher Wealth Management revenues for 2012. In addition, we enhanced our internet banking capabilities in the UAE to provide improved security and rolled out our

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

digital solution for mobile banking in the region to allow customers greater accessibility.

In CMB, we continued to support internationally oriented SMEs. This was evidenced by the launch of our third SME fund in the UAE of AED1bn (US\$272m), targeted at international trade customers. We continued to invest in the Global Trade and Receivables Finance client service and business development teams, and enhanced our Receivables Finance products across the region. We endeavoured to strengthen this position by holding mainland China and Turkey events to focus on these emerging trade routes.

Our Payments and Cash Management business continued to record strong revenue growth, and was named The Best Cash Management House in the Middle East 2012 in the *Euromoney* awards for excellence for the fourth consecutive year.

In GB&M, we continued to focus on South-South connectivity. We leveraged our global expertise to provide access to Asian investors for issuers in the region with funding requirements with our dedicated coverage teams on our mainland China, South Korea and India desks in the UAE and Saudi Arabia. We also completed a significant number of bond issuances, reflecting the continuing investor appetite for the region's debt. We won several *Euromoney* awards for excellence including The Best Debt House in the Middle East and The Best Flow House in the Middle East. GB&M also won *Global Investor's* The Best Domestic Custodian.

The following commentary is on a constant currency basis.

Net interest income rose by 3%, driven by higher average deposit balances in RBWM, primarily savings accounts in Egypt, reflecting the competitive pricing introduced at the beginning of the year. Despite this, we benefited from wider spreads as interest rates rose in Egypt. Net interest income in CMB was in line with 2011 as higher income resulting from the merger with OIB was offset by competitive asset pricing across most of the region.

Net fee income decreased by 4% due to a decline in credit and lending, Securities Services and advisory fees in GB&M, which were affected by lower levels of deal activity and the challenging political and economic environment. Fees also declined in RBWM due to higher reward scheme charges in the UAE following revisions to the agreement with our partner aimed at improving card utilisation, partly offset by higher insurance revenues

as a result of the strategic alliance with Zurich. The decline in fees was also attributable to our exit from domestic private banking in the UAE. These factors were partly offset by higher trade import fees in CMB in Algeria, Oman and Jordan driven by higher volumes from targeted sales activity.

Net trading income decreased by 18%, mainly due to unfavourable credit valuation adjustments on trading positions relating to a small number of exposures in GB&M. We also reported adverse fair value movements on certain economic hedges as well as on structured liabilities as credit spreads tightened. This was partly offset by higher revaluation gains on equity holdings in Principal Investments.

Gains less losses from financial investments increased by US\$17m, driven by the non-recurrence of impairments on two available-for-sale equity securities in 2011, together with gains on the disposal of available-for-sale equity and debt securities in 2012.

Other operating income decreased by US\$89m, driven by the US\$85m investment loss on a subsidiary.

Loan impairment charges and other credit risk provisions decreased by US\$6m. Lower impairments in RBWM attributable to an improvement in delinquency rates reflected the repositioning of the book towards higher quality lending in previous years. In addition, CMB recorded a modest reduction in loan impairment charges as higher customer recoveries were largely offset by individually assessed impairments. These were partly offset by significant loan impairment charges recorded for a small number of large exposures in GB&M.

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Operating expenses increased by 1% as a result of employee and legal costs relating to the merger of our Omani operations with OIB and the acquisition of the onshore retail and commercial banking business of Lloyds Banking Group in the UAE. This was partially offset by the benefit arising from sustainable cost saving initiatives implemented in 2011 and throughout 2012. Excluding the effect of the two acquisitions, we reduced both our employee numbers and our cost base.

Share of profits from associates and joint ventures increased by 10%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth, together with lower costs derived from effective control and monitoring.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax – Middle East and North Africa*

	2011	Currency	2011	2012		Constant
	as	translation	at 2012	as	Reported	currency
	reported	adjustment ¹	exchange	reported	change ²	change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	1,432	(9)	1,423	1,470	3	3
Net fee income	627	(4)	623	595	(5)	(4)
Own credit spread ³	14		14	(12)		
Other income ⁷	534	(1)	533	377	(29)	(29)
Net operating income ⁴	2,607	(14)	2,593	2,430	(7)	(6)
LICs ⁴²	(293)	1	(292)	(286)	2	2
Net operating income	2,314	(13)	2,301	2,144	(7)	(7)
Operating expenses	(1,159)	6	(1,153)	(1,166)	(1)	(1)
Operating profit	1,155	(7)	1,148	978	(15)	(15)
Income from associates ⁴³	337		337	372	10	10
Profit before tax	1,492	(7)	1,485	1,350	(10)	(9)

*For footnotes, see page 132.**Reconciliation of reported and underlying items – Middle East and North Africa*

	2012	Year ended 31 December	Change ²
	US\$m	2011	%
Revenue ⁴			
Reported	2,430	2,607	(7)
Currency translation adjustment ¹		(14)	
Own credit spread ³	12	(14)	
Acquisitions, disposals and dilutions	3	(79)	
Underlying	2,445	2,500	(2)
LICs ⁴²			
Reported	(286)	(293)	2
Currency translation adjustment ¹		1	
Acquisitions, disposals and dilutions			
Underlying	(286)	(292)	2

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Operating expenses			
Reported	(1,166)	(1,159)	(1)
Currency translation adjustment ¹		6	
Acquisitions, disposals and dilutions	15	25	
Underlying	(1,151)	(1,128)	(2)
Underlying cost efficiency ratio	47.1%	45.1%	
Profit before tax			
Reported	1,350	1,492	(10)
Currency translation adjustment ¹		(7)	
Own credit spread ³	12	(14)	
Acquisitions, disposals and dilutions	18	(54)	
Underlying	1,380	1,417	(3)
<i>For footnotes, see page 132.</i>			

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Middle East and North Africa*

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	585	486	390		4	21	1,486
Net fee income/(expense)	161	269	197		(5)		622
Trading income excluding net interest income	59	85	220				364
Net interest income/(expense) on trading activities			14			(21)	(7)
Net trading income ⁴⁴	59	85	234			(21)	357
Net income from financial instruments designated at fair value					(2)		(2)
Gains less losses from financial investments			(18)				(18)
Dividend income			9				9
Other operating income	25	30	15		99	(120)	49
Total operating income	830	870	827		96	(120)	2,503
Net insurance claims ⁵⁰							
Net operating income⁴	830	870	827		96	(120)	2,503
Loan impairment (charges)/recoveries and other credit risk provisions	(49)	(20)	110	1			42
Net operating income	781	850	937	1	96	(120)	2,545
Total operating expenses	(606)	(350)	(256)		(197)	120	(1,289)
Operating profit/(loss)	175	500	681	1	(101)		1,256
Share of profit in associates and joint ventures	83	145	188	15	7		438
Profit/(loss) before tax	258	645	869	16	(94)		1,694
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.1	2.9	3.8	0.1	(0.4)		7.5
Cost efficiency ratio	73.0	40.2	31.0		205.2		51.5
<i>Balance sheet data⁴⁰</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	6,152	11,814	9,241		4		27,211
Total assets	7,016	13,776	39,302	64	3,340	(2,688)	60,810
Customer accounts	18,771	12,402	7,432	1	77		38,683

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Report of the Directors: Financial Review (continued)

	2012						Total
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	597	492	367	1	42	(29)	1,470
Net fee income/(expense)	164	279	160	1	(9)		595
Trading income excluding net interest income	68	94	208		3		373
Net interest income/(expense) on trading activities		2	30		(44)	29	17
Net trading income ⁴⁴	68	96	238		(41)	29	390
Net income from financial instruments designated at fair value					(12)		(12)
Gains less losses from financial investments			9				9
Dividend income			5				5
Other operating income/(expense)	(16)	21	14	1	47	(94)	(27)
Total operating income	813	888	793	3	27	(94)	2,430
Net insurance claims ⁵⁰							
Net operating income ⁴	813	888	793	3	27	(94)	2,430
Loan impairment charges and other credit risk provisions	(55)	(110)	(119)	(2)			(286)
Net operating income	758	778	674	1	27	(94)	2,144
Total operating expenses	(561)	(311)	(264)		(124)	94	(1,166)
Operating profit/(loss)	197	467	410	1	(97)		978
Share of profit in associates and joint ventures	55	120	171	9	17		372
Profit/(loss) before tax	252	587	581	10	(80)		1,350
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.2	2.8	2.8		(0.3)		6.5
Cost efficiency ratio	69.0	35.0	33.3		459.3		48.0
<i>Balance sheet data⁴⁰</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	5,828	13,559	8,699				28,086
Total assets	6,562	15,651	36,582	50	6,840	(3,080)	62,605
Customer accounts	19,802	12,826	6,880	3	72		39,583

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data Middle East and North Africa (continued)*

	2011						Total
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	589	496	371	2	2	(28)	1,432
Net fee income/(expense)	173	271	173	13	(3)		627
Trading income/(expense) excluding net interest income	62	95	266	1	(1)		423
Net interest income/(expense) on trading activities			32		(1)	28	59
Net trading income/(expense) ⁴⁴	62	95	298	1	(2)	28	482
Net income from financial instruments designated at fair value					10		10
Gains less losses from financial investments	1	1	(7)		(3)		(8)
Dividend income	1	1	3				5
Other operating income/(expense)	22	11	11	(1)	124	(108)	59
Total operating income	848	875	849	15	128	(108)	2,607
Net insurance claims ⁵⁰							
Net operating income ⁴	848	875	849	15	128	(108)	2,607
Loan impairment charges and other credit risk provisions	(126)	(116)	(51)				(293)
Net operating income	722	759	798	15	128	(108)	2,314
Total operating expenses	(535)	(320)	(295)	(21)	(96)	108	(1,159)
Operating profit/(loss)	187	439	503	(6)	32		1,155
Share of profit in associates and joint ventures	60	98	140	4	35		337
Profit/(loss) before tax	247	537	643	(2)	67		1,492
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.1	2.5	2.9		0.3		6.8
Cost efficiency ratio	63.1	36.6	34.7	140.0	75.0		44.5
<i>Balance sheet data⁴⁰</i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net)	4,921	12,446	8,479	26	3		25,875
Total assets	6,549	14,556	34,676	72	4,792	(3,181)	57,464
Customer accounts	18,549	10,943	6,703	114	113		36,422

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**North America**

Our North American businesses are located in the US, Canada and Bermuda. Operations in the US are primarily conducted through HSBC Bank USA, N.A., and HSBC Finance, a national consumer finance company. HSBC Markets (USA) Inc. is the intermediate holding company of, *inter alia*, HSBC Securities (USA) Inc. HSBC Bank Canada and HSBC Bank Bermuda operate in their respective countries.

	2013 US\$m	2012 US\$m	2011 US\$m
Net interest income	5,742	8,117	11,480
Net fee income	2,143	2,513	3,308
Net trading income/(expense)	948	507	(362)
Gains on disposals of US branch network and cards business		4,012	
Other income/(expense)	(30)	(456)	1,574
Net operating income⁴	8,803	14,693	16,000
LICs ⁴²	(1,197)	(3,457)	(7,016)
Net operating income	7,606	11,236	8,984
Total operating expenses	(6,416)	(8,940)	(8,919)
Operating profit	1,190	2,296	65
Income from associates ⁴³	31	3	35
Profit before tax	1,221	2,299	100
Cost efficiency ratio	72.9	60.8%	55.7%
RoRWA ³⁶	0.5%	0.8%	
Year-end staff numbers	20,871	22,443	30,981

14%

growth in revenues from collaboration**between CMB and GB&M****Completed sales:**

US\$5.7bn of real estate secured loans;

US\$3.7bn non-real estate

personal loan portfolio; and

US\$1.6bn US insurance business

Best Regional Cash Manager

in North America

(Euromoney Awards for Excellence 2013)

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

In the **US**, real GDP rose by 1.9% in 2013, after 2.8% growth in 2012. Both consumer spending and business fixed investment grew at a moderate pace in 2013. Residential investment rose by 12.1% in 2013, following 12.9% growth in 2012. Sales of new and existing homes increased in 2013, and average national home prices rose over the course of the year. Export growth slowed to 2.8% in 2013 from 3.5% in 2012. Budgetary caps on federal spending contributed to a 5.1% decline in federal government expenditure in 2013, in real terms. State and local government expenditure also contracted, though by less than in 2012. The unemployment rate fell during the year reaching 6.7% in December although, in part, this reflected the long-term unemployed leaving the labour market rather than job creation. Both headline and core CPI inflation moderated in 2013 as subdued growth in hourly wages continued to constrain labour costs. A lack of consensus between the main political parties about how best to reduce the US fiscal deficit led to a government shutdown on 1 October. An agreement was finally reached on 16 October which allowed the US debt ceiling to be raised and ended the shutdown. The Federal Reserve Board continued to pursue a highly accommodative monetary policy in 2013, keeping the Federal Funds rate in a zero to 0.25% range. It continued with monthly purchases of longer-term treasury securities and agency mortgage-backed securities but announced in December that it would begin to taper asset purchases from January 2014.

The **Canadian** economy grew by 1.6% during the first three quarters of 2013, down from 1.9% in the comparable period in 2012. Led by auto sales, consumer spending rose by 1.8%, contributing 1.2 percentage points to the expansion in 2013. Exports grew by 1.0% in 2013, which was well below the 3% export growth in 2012. Housing starts fell by 14% in 2013 though the level of activity improved during the year after a very weak start. The annual rate of CPI inflation remained close to 1% throughout the year, well below the Bank of Canada's 2% inflation target. The Bank of Canada's policy rate has remained at 1% since September 2010.

Review of performance

Our operations in North America reported a profit before tax of US\$1.2bn in 2013, compared with US\$2.3bn in 2012 on both a reported and constant currency basis.

Reported profits in both years included gains and losses on disposal of businesses not aligned to our long-term strategy, notably gains in the US of

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by country within global businesses*

	Global					Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Banking and Markets US\$m	Private Banking US\$m	Other US\$m	
2013						
US	(358)	296	633	53	(350)	274
Canada	131	506	280		(3)	914
Bermuda	20	(16)	16	4	9	33
	(207)	786	929	57	(344)	1,221
2012						
US	2,746	637	661	72	(2,901)	1,215
Canada	207	577	314	(1)	(16)	1,081
Bermuda	42	(15)	(18)	1	(7)	3
	2,995	1,199	957	72	(2,924)	2,299
2011						
US	(2,861)	431	567	83	782	(998)
Canada	147	545	265		8	965
Bermuda	49	26	43	7	9	134
Other					(1)	(1)
	(2,665)	1,002	875	90	798	100

US\$3.1bn and US\$864m following the sales of the CRS business and 195 non-strategic retail branches, respectively, in 2012.

On an underlying basis, pre-tax profit was US\$1.6bn in 2013 compared with a pre-tax loss of US\$1.5bn in 2012. This was mainly due to a decline in loan impairment charges in 2013 in the US, primarily in the CML portfolio, and a reduction in operating expenses, as 2012 included a US\$1.5bn expense as part of the settlement of investigations into inadequate compliance with AML laws in the past. These were partly offset by losses on certain portfolio disposals described further below.

Underlying profit before tax in Canada reduced due to the closure to new business in 2012 of the Canadian consumer finance company and lower revenues, reflecting spread compression due to the low interest rate environment and competitive market. These were partly offset by lower costs following cost control and sustainable savings from organisational effectiveness initiatives.

We continued to make progress in our strategy to accelerate the run-off and sales of our CML portfolio, and simplify operations. We completed the sale of the CML non-real estate personal loan portfolio with an unpaid principal balance of US\$3.7bn on 1 April 2013 and recognised a loss on sale of US\$271m. We completed the sales of several tranches of real estate secured accounts with an aggregate unpaid principal balance of US\$5.7bn during 2013 and recognised a cumulative loss on

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sale of US\$153m. Gross lending balances in the CML portfolio, including loans held for sale, at 31 December 2013 were US\$30.4bn, a decline of US\$12.3bn from 31 December 2012.

We identified real estate secured loan balances with unpaid principal of US\$3.5bn that we plan to actively market in multiple transactions over the next 15 months. The carrying value of these loans was approximately US\$230m greater than their estimated fair value at 31 December 2013.

In the US, we made progress on re-engineering our processes, such as account opening and customer information management, creating standardisation and alignment with our target business and operating models and a simpler relationship experience for our customers. The US has been at the forefront of foundational work to implement Global Standards. We also launched a US\$1bn SME fund in CMB to support those businesses that trade or aspire to trade internationally.

In Canada, we continued to deliver internationally oriented organic business growth and streamlined processes and procedures. In CMB, we focused on positioning ourselves as the leading international trade and business bank, and deployed several new Global Trade products to assist international clients with working capital management. In GB&M, we launched Project and Export Financing and had a strong pipeline of business going into 2014. In RBWM, we continued to work on increasing the Premier customer base, resulting in 3% growth.

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Report of the Directors: Financial Review (continued)

Net interest income decreased by 29% to US\$5.7bn, primarily due to the sale of the CRS business and retail branches, lower average lending balances from the continued run-off of the CML portfolio and other portfolio disposals during the year, lower reinvestment rates in Balance Sheet Management and the closure of the Canada consumer finance company to new business in 2012.

Net fee income decreased by 14% to US\$2.1bn, primarily due to the sale of the CRS business and the retail branches in 2012 and the expiry of the majority of the Transition Servicing Agreements with the buyer of the CRS business. This was partly offset by favourable adjustments to mortgage servicing rights valuations as a result of interest rate increases in 2013.

Net trading income was US\$948m, an increase of 89%, primarily due to favourable fair value movements on non-qualifying hedges in HSBC Finance of US\$315m in 2013 due to a rise in interest rates (compared with adverse movements of US\$227m in 2012) and lower provisions for mortgage loan repurchase obligations related to loans previously sold. The increase was partly offset by a loss of US\$199m arising from the early termination of qualifying accounting hedges in 2013 as a result of expected changes in funding.

Net trading income increased in GB&M as a result of favourable fair value movements on structured liabilities, in addition to higher Credit trading revenue from revaluation gains on securities, monoline reserve releases in the legacy portfolio and reduced losses from credit default swaps. Net trading income also benefited from the performance of economic hedges used to manage interest rate risk, which was positively affected by favourable interest rate movements. This was partly offset by lower Foreign Exchange revenue as a result of reduced trading volumes, and lower Rates trading revenue due to a decline in trading activities.

Net expense from financial instruments designated at fair value was US\$288m compared with US\$1.2bn in 2012. The increase was due to lower adverse fair value movements on our own debt designated at fair value as credit spreads tightened to a lesser extent in 2013 than in 2012.

Gains less losses from financial investments increased by 18% as Balance Sheet Management recognised higher gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes in the low interest rate environment.

Net earned insurance premiums decreased by US\$159m due to the sale of our US insurance business. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating expense was US\$108m in 2013 compared with income of US\$408m in 2012. This was primarily due to the loss of US\$424m on the sales of the CML non-real estate personal loan portfolio and several tranches of real estate secured loans. In addition, the decrease reflected the sale of our US insurance business and the non-recurrence of the gain on sale of the full service retail brokerage business in Canada in 2012.

LICs decreased by US\$2.3bn to US\$1.2bn, mainly in the US due in part to improvements in housing market conditions. In addition, the decrease reflected lower lending balances from continued run-off and loan sales, and reduced levels of new impaired loans and delinquency in the CML portfolio. US\$322m of the decline in loan impairment charges was due to the sale of the CRS business in 2012. These factors were partly offset by an increase of US\$130m relating to a rise in the estimated average period of time from a loss event occurring to writing off real estate loans to 12 months (previously a period of 10 months was used). In CMB, loan impairment charges increased by US\$77m, reflecting higher collectively assessed charges in the US as a result of increased lending balances in key growth markets and higher individually assessed impairments on a small number of exposures mainly in Canada.

Operating expenses were US\$2.5bn, 28% lower than in 2012, primarily due to the non-recurrence of a US\$1.5bn settlement of investigations into inadequate compliance with AML laws in the past, lower average staff numbers and costs following business disposals in the US and Canada, and a reduction in litigation provisions and consultancy expenses in relation to US mortgage foreclosure servicing matters. Resources working on the independent foreclosure review were no longer required following the February 2013 Independent Foreclosure Review Settlement Agreement. We also achieved over US\$330m of sustainable cost savings, primarily reflecting organisational effectiveness initiatives.

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency profit before tax – North America

	2012			2013		
	2012	Currency	at 2013	2013	Reported	Constant
	as	translation	exchange	as	change ²	currency
	reported	adjustment ¹	rates	reported	change ²	change ²
	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	8,117	(42)	8,075	5,742	(29)	(29)
Net fee income	2,513	(18)	2,495	2,143	(15)	(14)
Net trading income	507	(6)	501	948	87	89
Own credit spread ³	(1,090)		(1,090)	(226)	79	79
Other expense from financial instruments designated at fair value	(129)		(129)	(62)	52	52
Net income/(expense) from financial instruments designated at fair value	(1,219)		(1,219)	(288)	76	76
Gains on disposal of US branch network and US cards business	4,012		4,012		(100)	(100)
Gains less losses from financial investments	251	(1)	250	294	17	18
Net earned insurance premiums	193		193	34	(82)	(82)
Other operating income/(expense)(including dividend income)	467	3	470	(31)		
Total operating income	14,841	(64)	14,777	8,842	(40)	(40)
Net insurance claims incurred and movement in liabilities to policyholders	(148)		(148)	(39)	74	74
Net operating income⁴	14,693	(64)	14,629	8,803	(40)	(40)
LICs ⁴²	(3,457)	6	(3,451)	(1,197)	65	65
Net operating income	11,236	(58)	11,178	7,606	(32)	(32)
Operating expenses	(8,940)	30	(8,910)	(6,416)	28	28
Operating profit	2,296	(28)	2,268	1,190	(48)	(48)
Income from associates ⁴³	3		3	31	933	933
Profit before tax	2,299	(28)	2,271	1,221	(47)	(46)

For footnotes, see page 132.

Reconciliation of reported and underlying items – North America

	Year ended 31 December		
	2013 US\$m	2012 US\$m	Change ² %
Net interest income			
Reported	5,742	8,117	(29)
Currency translation adjustment ¹		(42)	
Acquisitions, disposals and dilutions	(14)	(1,433)	

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Underlying	5,728	6,642	(14)
Other operating income/(expense)			
Reported	(108)	406	
Currency translation adjustment ¹		3	
Acquisitions, disposals and dilutions	97	(134)	
Underlying	(11)	275	
Revenue⁴			
Reported	8,803	14,693	(40)
Currency translation adjustment ¹		(64)	
Own credit spread ³	226	1,090	
Acquisitions, disposals and dilutions	89	(5,982)	
Underlying	9,118	9,737	(6)

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Report of the Directors: Financial Review (continued)

	Year ended 31 December		Change ² %
	2013	2012	
	US\$m	US\$m	
LICs⁴²			
Reported	(1,197)	(3,457)	65
Currency translation adjustment ¹		6	
Acquisitions, disposals and dilutions		325	
Underlying	(1,197)	(3,126)	62
Operating expenses			
Reported	(6,416)	(8,940)	28
Currency translation adjustment ¹		30	
Acquisitions, disposals and dilutions	14	796	
Underlying	(6,402)	(8,114)	21
Underlying cost efficiency ratio	70.2%	83.3%	
Profit/(loss) before tax			
Reported	1,221	2,299	(47)
Currency translation adjustment ¹		(28)	
Own credit spread ³	226	1,090	
Acquisitions, disposals and dilutions	103	(4,861)	
Underlying	1,550	(1,500)	

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**2012 compared with 2011**

Economic background

In the US, real GDP expanded by 2.2% in 2012, following 1.8% growth in 2011. Consumer spending increased at a moderate pace as households continued to pay down debt and rebuild wealth. The housing market improved in 2012. Residential investment rose by 11.9%, climbing from a multi-decade low in 2011. Sales of new and existing homes also increased, and house prices rose modestly during the year. The growth in fixed investment by business faltered in the middle of 2012, evidenced by a slowdown in capital equipment orders, but began to recover towards the end of the year. Export growth slowed to 3.2% in 2012, about half the growth recorded in 2011. Fiscal consolidation continued to hold back the economy. Budgetary caps on spending contributed to a 2.2% decline in federal government expenditure in 2012, in real terms. State and local government expenditure also continued to contract, though the severity of the cutbacks diminished compared with 2011.

Inflation was generally subdued in 2012. Headline and core CPI inflation for the year were each recorded at 2.1%. High unemployment and low wage growth continued to hold back labour costs. In addition, prices for goods imported into the US experienced very little inflation in 2012. The Federal Reserve continued to pursue a highly supportive monetary policy. At meetings in January, September, and December, the Federal Open Market Committee adjusted its forward guidance for an exceptionally low federal funds rate and agreed on open-ended purchases of longer-term securities in an effort to maintain downward pressure on interest rates, support mortgage markets and help make broader financial conditions more accommodating.

In Canada, GDP growth slowed in 2012 to 2.0% from 2.6% in 2011. The slowdown in economic activity was particularly notable in the second half of the year. One factor contributing to the slowdown, which took effect in July 2012, was the introduction of measures by the federal government to cool the housing market by tightening mortgage lending conditions. House prices, home sales and housing starts declined after those initiatives came into force. In addition, exports fell sharply with the deceleration in global manufacturing activity and global trade, and temporary disruptions in energy production in Eastern Canada and capacity constraints on Western Canada pipelines. An uncertain US economic outlook together with weakness in key Canadian commodity prices and a sharp decline in corporate

performance weighed on business investment. Headline CPI inflation fell steadily through the year to 1.5%, from 2.9% in 2011. Though the Bank of Canada slightly tightened monetary policy early in 2012, the economic slowdown and the decline in the rate of CPI inflation led the Bank to leave rates on hold throughout the year.

Review of performance

Our operations in North America reported a profit before tax of US\$2.3bn in 2012, compared with US\$100m in 2011. Our reported profits included gains in the US of US\$3.1bn and US\$864m on completion of the sale of the Card and Retail Services business in May 2012 and the 195 non-strategic retail branches in May and August 2012, respectively. Also included in our reported profits was US\$618m relating to profit before tax in Card and Retail Services prior to the disposal (2011: US\$2.1bn). In addition, we recorded a gain of US\$83m from the sale of the full service retail brokerage business in Canada. We also recognised US\$1.2bn of adverse movements on our own debt designated at fair value resulting from tightening in credit spreads, compared with favourable movements of US\$964m in 2011.

On an underlying basis, our pre-tax loss of US\$1.5bn in 2012 compared with a pre-tax loss of US\$3.1bn in 2011. This was due to lower loan impairment charges, primarily in CML, reflecting a decline in lending balances as the portfolio continued to run off, lower delinquency levels, and higher revenue mainly driven by lower adverse movements on non-qualifying hedges in HSBC Finance. This was partly offset by higher operating expenses due to fines and penalties paid of US\$1.5bn by HNAH and its subsidiaries as part of the settlement of investigations into inadequate compliance with anti-money laundering laws in the past.

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Underlying profit before tax in Canada rose, as revenues benefited from an increase in fees from commercial lending activities and collaboration with GB&M, higher Rates revenue due to increased trading volumes, and higher revenues in Balance Sheet Management reflecting an increase in gains on sales of available-for-sale assets. These results were partly offset by lower net interest income due to the closure of the Canadian consumer finance company to new business, spread compression from strong competition and the prolonged low interest rate environment. Our operations in Bermuda reported a significantly reduced profit before tax, primarily due to higher loan impairment charges on a small number of exposures in GB&M and CMB.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

We made significant progress in disposing of businesses not aligned with our long-term strategy. On completing the sale of our US Card and Retail Services business, we transferred over 5,000 employees and certain real estate facilities to the purchaser. In addition, we entered into a transition services agreement to support some of the account servicing operations until all systems, processes and equipment are integrated into the purchaser's existing infrastructure. We also completed the sale of the retail branches, principally in upstate New York, recognising gains of US\$586m in RBWM and US\$278m in CMB.

In Canada, we completed the sale of the full service retail brokerage business. We also announced the closure of our consumer finance business, which had net customer loan balances of US\$1.5bn at 31 December 2012, and ceased the origination of loans as this business did not fit with our core strategy.

We continued to manage the run-off of lending balances in our CML portfolio and, in the third quarter of 2012, we reclassified non-real estate personal loan balances of US\$3.7bn, net of impairment allowances, from our CML portfolio to Assets held for sale as we actively marketed the portfolio. We also identified real estate secured loan balances, with a carrying amount of US\$3.8bn, which, as part of our strategy, we have announced we plan to actively market in multiple transactions over the next two years. At 31 December 2012, the carrying value of the non-real estate and the real estate secured loans which we intend to sell was approximately US\$1bn greater than their estimated fair value. We expect to recognise a loss on sale for these loans over the next few years, the actual amount of which will depend on market conditions at the time of the sales. It is expected that reduction in these loans in our CML portfolio will be capital accretive and will reduce funding requirements, accelerate the winding down of the portfolio and also alleviate some of the operational burdens, given that these loans are servicing intensive and subject to foreclosure delays.

At 31 December 2012, lending balances in CML, including loans held for sale, were US\$43bn, a decline of 14% from December 2011, of which 8% was attributable to the balances written off.

We incurred costs of US\$221m in 2012 (2011: US\$235m) as a result of restructuring activities in the region. These costs were mainly related to the business disposals, the closure of our consumer finance operations in Canada and the continuation of

our organisational effectiveness initiatives. We also achieved approximately US\$230m of additional sustainable cost savings in 2012, primarily derived from operational efficiencies.

Following the disposals noted above, we are reshaping our US operations to focus on core activities and are continuing to reposition our businesses in both the US and Canada towards international customers.

In RBWM, we continued to develop our Wealth Management capabilities across the region, targeting internationally connected customers in key US and Canadian urban centres. Our relationship-based model offers a suite of wealth services incorporating HSBC and third-party products, enabling our internationally-minded customers to invest in global markets. In the US, we launched a renminbi fixed income fund to provide investors with the opportunity to access mainland China's bond market.

In CMB, we increased the number of relationship managers and specialist sales staff in 2012 in areas with strong international connectivity, notably the West Coast, South East and Midwest of the US, leading to higher lending balances than in 2011. In Canada, we introduced the first renminbi currency account. We also established dedicated sales teams to enhance CMB's collaboration with GB&M. In addition, in CMB and GB&M, we continued to target companies with international banking requirements, leading to a rise in Global Trade and Receivables Finance revenues in both the US and Canada.

In GB&M, we continued to work on delivering integrated solutions for our customers across the region, increasing our lending to Latin American corporates. In addition, we actively reduced our legacy credit exposure in the US by exiting certain positions. We will continue to reduce the size of this portfolio as opportunities arise.

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The following commentary is on a constant currency basis.

Net interest income decreased by 29% to US\$8.1bn, due to the loss of income from the Card and Retail Services business together with the continued reduction of the CML portfolio in run-off. Also contributing to the decrease was a change in composition of our lending book towards higher levels of lower yielding real estate loans.

Net fee income decreased by 24% to US\$2.5bn, primarily due to the sale of the Card and Retail Services business, the retail branches and the full service retail brokerage business in Canada. This

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

was partly offset by fees from the transition service agreement with the purchaser of the Card and Retail Services business and increased revenues from debt capital markets origination activity due to the strong debt issuance market.

Net trading income of US\$507m was US\$871m higher than in 2011, primarily due to lower adverse fair value movements on non-qualifying hedges in RBWM as long-term interest rates declined to a lesser extent than in 2011. This was partly offset by an increase from US\$92m in 2011 to US\$134m in 2012 of loss provisions for mortgage loan repurchase obligations related to loans previously sold.

Net trading income increased in GB&M during 2012 as a result of the improved performance of economic hedges used to manage interest rate risk, which benefited from a more stable interest rate environment. Rates revenue was higher due to increased trading volumes. In addition, credit market conditions generally reflected tighter credit spreads, which led to higher income from our credit-related products. These factors were partly offset by adverse fair value movements on structured liabilities as own credit spreads tightened, together with the closure of our bank notes business in 2011, and a reduction in foreign exchange revenue as a result of lower trading volumes in less volatile markets.

Net loss from financial instruments designated at fair value was US\$1.2bn compared with net gains of US\$964m in 2011. We recognised adverse fair value movements on our own debt designated at fair value as credit spreads tightened during 2012, having widened in 2011. In addition, there were adverse fair value movements from interest rate ineffectiveness in the economic hedging of our long-term debt during the year.

Gains on disposal of US branch network and cards business included a gain of US\$3.1bn from the sale of the Card and Retail Services business and US\$864m from the sale of 195 retail branches in upstate New York.

Other operating income increased by US\$176m to US\$405m, reflecting lower losses on foreclosed properties due to the reduction in foreclosure activity, less deterioration in housing prices during 2012 and, in some markets, improvements in pricing compared with 2011.

Loan impairment charges and other credit risk provisions decreased by 51% to US\$3.5bn, mainly in the US, reflecting lower lending balances in CML as we continued to run off the portfolio, and lower delinquency levels. Loan impairment charges remained adversely affected by delays in expected cash flows from mortgage loans due, in part, to delays in foreclosure processing and the higher costs to obtain and realise collateral, although the effects were less pronounced than in 2011. In addition, loan impairment charges declined by US\$1.3bn due to the sale of the Card and Retail Services business. These decreases were partly offset by an adjustment made following a review completed in the fourth quarter of 2012 which concluded that the estimated average period of time from current status to write-off was ten months for real estate loans (previously a period of seven months was used).

In CMB and GB&M, loan impairment charges increased, mainly in Bermuda, due to individually assessed impairments on a small number of exposures. Credit quality in Canada remained broadly unchanged.

Operating expenses increased by less than 1% to US\$8.9bn, primarily due to a US\$1.5bn charge for the settlement of investigations noted above. Compliance costs increased by US\$307m, mainly due to investment in process enhancements and infrastructure related to anti-money laundering and Bank Secrecy Act consent orders, along with actions to address the regulatory consent orders relating to foreclosure activities. In addition, following a review of our mortgage foreclosure process, we entered into an agreement in principle with US regulators to pay into a fund and provide other customer assistance to help eligible borrowers who were active in foreclosure during 2009 and 2010 and were financially disadvantaged during the process, for which we recognised a US\$104m expense in 2012. These increases were partly offset by the effect of the sale of the Card and Retail Services business and organisational effectiveness initiatives to reduce costs as we achieved approximately US\$230m of additional sustainable cost savings primarily derived from operational efficiencies. Average employee numbers decreased from organisational effectiveness initiatives and business disposals. In addition, marketing costs fell and costs of holding foreclosed properties declined, while software impairment charges in 2011 did not recur.

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Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit before tax North America*

	2011	Currency translation adjustment ¹	2011 at 2012 exchange rates	2012 as reported	Reported change ²	Constant currency change ²
	as reported US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	11,480	(17)	11,463	8,117	(29)	(29)
Net fee income	3,308	(7)	3,301	2,513	(24)	(24)
Own credit spread ³	970		970	(1,090)		
Gains on disposal of US branch network and cards business				4,012		
Other income ⁷	242		242	1,141	371	371
Net operating income ⁴	16,000	(24)	15,976	14,693	(8)	(8)
LICs ⁴²	(7,016)	1	(7,015)	(3,457)	51	51
Net operating income	8,984	(23)	8,961	11,236	25	25
Operating expenses	(8,919)	9	(8,910)	(8,940)		
Operating profit	65	(14)	51	2,296		
Income from associates ⁴³	35		35	3	(91)	(91)
Profit before tax	100	(14)	86	2,299		

*For footnotes, see page 132.**Reconciliation of reported and underlying items North America*

	Year ended 31 December		
	2012	2011	Change ²
	US\$m	US\$m	%
Revenue ⁴			
Reported	14,693	16,000	(8)
Currency translation adjustment ¹		(24)	
Own credit spread ³	1,090	(970)	
Acquisitions, disposals and dilutions	(5,924)	(6,001)	
Underlying	9,859	9,005	9
LICs ⁴²			
Reported	(3,457)	(7,016)	51
Currency translation adjustment ¹		1	
Acquisitions, disposals and dilutions	324	1,599	
Underlying	(3,133)	(5,416)	42

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Operating expenses			
Reported	(8,940)	(8,919)	
Currency translation adjustment ¹		9	
Acquisitions, disposals and dilutions	712	2,210	
Underlying	(8,228)	(6,700)	(23)
Underlying cost efficiency ratio	83.5%	74.4%	
Profit/(loss) before tax			
Reported	2,299	100	
Currency translation adjustment ¹		(14)	
Own credit spread ³	1,090	(970)	
Acquisitions, disposals and dilutions	(4,888)	(2,192)	
Underlying	(1,499)	(3,076)	51
<i>For footnotes, see page 132.</i>			

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data North America*

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking ⁵³ US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	3,483	1,430	582	195	89	(37)	5,742
Net fee income	605	593	741	125	79		2,143
Trading income excluding net interest income	48	40	613	19	7		727
Net interest income on trading activities	11	1	172			37	221
Net trading income ⁴⁴	59	41	785	19	7	37	948
Changes in fair value of long- term debt issued and related derivatives					(288)		(288)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(288)		(288)
Gains less losses from financial investments	4		282		8		294
Dividend income	12	9	48	4	4		77
Net earned insurance premiums	34						34
Other operating income/(expense)	(454)		229	1	1,829	(1,713)	(108)
Total operating income	3,743	2,073	2,667	344	1,728	(1,713)	8,842
Net insurance claims ⁵⁰	(39)						(39)
Net operating income⁴	3,704	2,073	2,667	344	1,728	(1,713)	8,803
Loan impairment charges and other credit risk provisions	(950)	(223)	(20)	(4)			(1,197)
Net operating income	2,754	1,850	2,647	340	1,728	(1,713)	7,606
Total operating expenses	(2,960)	(1,096)	(1,718)	(283)	(2,072)	1,713	(6,416)
Operating profit/(loss)	(206)	754	929	57	(344)		1,190
Share of profit/(loss) in associates and joint ventures	(1)	32					31
Profit/(loss) before tax	(207)	786	929	57	(344)		1,221
	%	%	%	%	%		%
Share of HSBC's profit before tax	(0.9)	3.5	4.1	0.3	(1.6)		5.4
Cost efficiency ratio	79.9	52.9	64.4	82.3	119.9		72.9
<i>Balance sheet data⁴⁰</i>							

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	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) ³⁴	66,192	37,735	51,746	5,956		161,629
Total assets	82,530	45,706	313,701	8,542	13,211	432,035
Customer accounts reported in: customer accounts ³⁴	53,600	49,225	79,799	13,871		196,495

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data North America (continued)*

	2012						
	Retail Banking	Commercial Banking ⁵³	Global Banking and Markets	Global Private Banking	Other	Inter- segment elimination ⁴⁹	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	5,481	1,443	948	192	118	(65)	8,117
Net fee income	923	562	716	124	188		2,513
Trading income/(expense) excluding net interest income	(216)	47	466	20	16		333
Net interest income on trading activities	17	1	91			65	174
Net trading income/(expense) ⁴⁴	(199)	48	557	20	16	65	507
Changes in fair value of long- term debt issued and related derivatives					(1,219)		(1,219)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(1,219)		(1,219)
Gains less losses from financial investments	27		223	(7)	8		251
Dividend income	15	11	32	3			61
Net earned insurance premiums	193						193
Gains on disposal of US branch network and cards business	3,735	277					4,012
Other operating income	173	149	191	5	1,787	(1,899)	406
Total operating income	10,348	2,490	2,667	337	898	(1,899)	14,841
Net insurance claims ⁵⁰	(148)						(148)
Net operating income ⁴	10,200	2,490	2,667	337	898	(1,899)	14,693
Loan impairment (charges)/recoveries and other credit risk provisions	(3,241)	(148)	(71)	3			(3,457)
Net operating income	6,959	2,342	2,596	340	898	(1,899)	11,236
Total operating expenses	(3,966)	(1,144)	(1,639)	(268)	(3,822)	1,899	(8,940)
Operating profit/(loss)	2,993	1,198	957	72	(2,924)		2,296
Share of profit in associates and joint ventures	2	1					3
Profit/(loss) before tax	2,995	1,199	957	72	(2,924)		2,299
	%	%	%	%	%		%
Share of HSBC's profit before tax	14.5	5.8	4.6	0.3	(14.2)		11.1
Cost efficiency ratio	38.9	45.9	61.5	79.5	425.6		60.8

Balance sheet data⁴⁰

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	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net)	76,414	36,387	22,498	5,457		140,756
Total assets	101,103	48,604	345,040	8,828	12,659	490,247
Customer accounts reported in:						
customer accounts	57,758	48,080	29,595	13,553	51	149,037
<i>For footnotes, see page 132.</i>						

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Profit/(loss) before tax and balance sheet data North America (continued)*

	2011						
	Retail Banking and Wealth Management US\$m	Commercial Banking ⁵⁷ US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	8,931	1,528	893	187	9	(68)	11,480
Net fee income/(expense)	1,836	551	773	149	(1)		3,308
Trading income/(expense) excluding net interest income	(946)	34	261	17	(26)		(660)
Net interest income/(expense) on trading activities	25	1	205		(1)	68	298
Net trading income/(expense) ⁴⁴	(921)	35	466	17	(27)	68	(362)
Changes in fair value of long- term debt issued and related derivatives					967		967
Net income/(expense) from other financial instruments designated at fair value			(5)		2		(3)
Net income/(expense) from financial instruments designated at fair value			(5)		969		964
Gains less losses from financial investments	58	7	195		2		262
Dividend income	15	9	13	3			40
Net earned insurance premiums	236						236
Other operating income	(125)	110	193	11	2,244	(2,207)	226
Total operating income	10,030	2,240	2,528	367	3,196	(2,207)	16,154
Net insurance claims ⁵⁰	(154)						(154)
Net operating income ⁴	9,876	2,240	2,528	367	3,196	(2,207)	16,000
Loan impairment (charges)/recoveries and other credit risk provisions	(6,929)	(105)	(11)	30	(1)		(7,016)
Net operating income	2,947	2,135	2,517	397	3,195	(2,207)	8,984
Total operating expenses	(5,615)	(1,166)	(1,642)	(307)	(2,396)	2,207	(8,919)
Operating profit/(loss)	(2,668)	969	875	90	799		65
Share of profit/(loss) in associates and joint ventures	3	33			(1)		35
Profit/(loss) before tax	(2,665)	1,002	875	90	798		100
	%	%	%	%	%		%
Share of HSBC's profit before tax	(12.2)	4.6	4.0	0.4	3.7		0.5
Cost efficiency ratio	56.9	52.1	65.0	83.7	75.0		55.7

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*Balance sheet data*⁴⁰

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) reported in:						
loans and advances to customers (net)	86,490	32,215	19,289	4,753		142,747
assets held for sale (disposal groups)	31,058	520				31,578
Total assets	144,278	43,747	320,783	7,138	10,378	(22,022) 504,302
Customer accounts reported in:						
customer accounts	63,558	47,003	30,465	14,862	94	155,982
liabilities of disposal groups held for sale	10,104	5,040				15,144

For footnotes, see page 132.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)**Latin America**

Our operations in Latin America principally comprise HSBC Bank Brasil S.A.-Banco Múltiplo, HSBC México, S.A. and HSBC Bank Argentina S.A. In addition to banking services, we operate insurance businesses in Brazil, Mexico and Argentina.

	2013	2012	2011
	US\$m	US\$m	US\$m
Net interest income	6,186	6,984	6,956
Net fee income	1,701	1,735	1,781
Net trading income	936	971	1,378
Other income	1,745	1,261	1,338
Net operating income⁴	10,568	10,951	11,453
LICs ⁴²	(2,666)	(2,137)	(1,883)
Net operating income	7,902	8,814	9,570
Total operating expenses	(5,930)	(6,430)	(7,255)
Operating profit	1,972	2,384	2,315
Income from associates ⁴³			
Profit before tax	1,972	2,384	2,315
Cost efficiency ratio	56.1%	58.7%	63.3%
RoRWA ³⁶	2.0%	2.4%	2.3%
Year-end staff numbers	42,542	46,556	54,035

Best Infrastructure Bank**in Latin America***(LatinFinance Awards, 2013)***Gain of**

US\$1.1bn

on the sale of our**operations in Panama****Over**

US\$200m

of sustainable cost savings

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Economic background

In Latin America, average GDP growth fell to 2.4% in 2013 from 2.9% in 2012. **Brazil**'s GDP growth accelerated from 1% in 2012 to above 2% by the end of 2013. However, this was the third year of below-trend growth. Brazil's growing current account deficit raised concerns during the summer. The resulting capital flight and decline in the currency served to put further upward pressure on prices, pushing CPI inflation above the mid-point of the central bank's target for the fourth consecutive year.

Mexico saw a material slowdown in economic activity in 2013, with GDP growth likely to have slowed to 1.3% from 3.9% in 2012. Inflationary pressures remained subdued and Banco de México cut its key policy rate to 3.5% from 4.5% at the start of the year. However, a significant number of structural reforms should aid the long-term performance of the Mexican economy.

The **Argentinian** economy accelerated in 2013 following a good agricultural harvest and a modest recovery in the Brazilian economy. Structural problems became increasingly evident with high inflation and, eventually, currency weakness.

Review of performance

In Latin America, reported profit before tax of US\$2.0bn was US\$412m lower than in 2012, and US\$239m lower on a constant currency basis.

On an underlying basis, which excludes the US\$1.1bn gain on the sale of our operations in Panama and the effect of other non-strategic business disposals, pre-tax profits decreased by US\$1.2bn. This was driven by a US\$714m rise in loan impairment charges and a decline in revenue of US\$348m, in part reflecting adverse movements in the PVIF asset compared with 2012.

We made significant progress on repositioning our business in the region, with a particular focus on our priority growth markets of Brazil, Mexico and Argentina. We also completed the disposal of operations in Panama, Peru and Paraguay, along with the sale of a portfolio of our non-life insurance assets and liabilities and a non-strategic business in Mexico. We expect to complete the sale of our operations in Colombia and Uruguay in 2014, subject to regulatory approvals.

While our performance was affected by slower economic growth and inflationary pressures, we continued to implement the Group's strategy in our core priority markets in order to reposition our portfolios. We made significant progress in exiting

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Report of the Directors: Financial Review (continued)*Profit/(loss) before tax by country within global businesses*

	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Total US\$m
2013						
Argentina	97	142	170		(1)	408
Brazil	(114)	(43)	514	5	(11)	351
Mexico	154	(160)	115	(3)	11	117
Panama	335	522	362	2	(37)	1,184
Other	(46)	3	6	(3)	(48)	(88)
	426	464	1,167	1	(86)	1,972
2012						
Argentina	209	169	174		(46)	506
Brazil	94	359	696	17	(43)	1,123
Mexico	338	176	201	2	(18)	699
Panama	29	62	48	2		141
Other	(62)	(15)	34	(1)	(41)	(85)
	608	751	1,153	20	(148)	2,384
2011						
Argentina	91	107	148		(2)	344
Brazil	241	566	515	13	(105)	1,230
Mexico	403	129	268	4	(178)	626
Panama	23	59	52	3	(9)	128
Other	(55)	6	66		(30)	(13)
	703	867	1,049	20	(324)	2,315

certain businesses and products, strengthening transaction monitoring and account opening, and investing in improved compliance across the region.

In Brazil, we focused on growing secured lending balances for corporates and Premier customers in order to increase connectivity and reduce our risk exposure. We tightened origination criteria in unsecured lending in RBWM, resulting in slower loan growth, and in Business Banking, where volumes declined. We were awarded Best Debt House in Brazil by *Euromoney*, and received the Best Infrastructure Financing in Brazil award from *LatinFinance* in GB&M.

In Mexico, we increased our market share in personal lending, and launched a successful residential mortgage campaign in RBWM. In CMB, we launched a new US\$1bn SME fund to support businesses that trade or aspire to trade internationally, and approved lending of US\$274m. We grew revenue from collaboration between CMB and GB&M by 11%, were awarded the Best Domestic Cash Manager award by *Euromoney* and won two awards for Infrastructure Financing from *LatinFinance*.

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In Argentina, we continued to manage our business conservatively as the economic environment remained challenging. We focused on GB&M and corporate CMB customers, and

tightened credit origination criteria and strengthened our collections capabilities in Business Banking and RBWM.

Net interest income decreased by US\$358m, driven by the effect of the disposal of non-strategic businesses and a decline in Brazil, partly offset by growth in Argentina.

Net interest income decreased in Brazil due to a shift to lower yielding assets in CMB with reduced lending balances in Business Banking as we focused on growing secured balances for corporates. The reduction in net interest income in RBWM reflected lower average lending balances as a result of more restrictive origination criteria, which included reducing credit limits where appropriate, the rundown of non-strategic portfolios and a change in the product mix towards more secured assets. In addition, spreads were narrower in CMB reflecting competition, notably in working capital products. Net interest income also decreased in Balance Sheet Management due to lower reinvestment rates.

In Argentina, higher net interest income was driven by increased average credit card and personal lending balances, coupled with higher deposits in RBWM and CMB, both reflecting successful sales and marketing campaigns launched during 2013.

In Mexico, net interest income remained broadly unchanged. It decreased in CMB reflecting large

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Report of the Directors: Financial Review (continued)

prepayments relating to a small number of corporates, and in GB&M as maturing investments were renewed at lower reinvestment rates. These falls were offset by an increase in RBWM as the launch of successful sales campaigns resulted in higher average lending balances, notably in payroll and personal lending.

Net fee income increased by 4%, mainly in Argentina. This was driven by business growth, notably in Payments and Cash Management, and the sale of the non-life insurance business which resulted in the non-recurrence of sales commissions previously paid to third party distribution channels. In Brazil and Mexico, fees rose, mainly in RBWM, where higher volumes and re-pricing initiatives drove fee increases in current accounts and credit cards.

Net trading income increased by US\$39m, primarily reflecting favourable results in GB&M in Argentina and Brazil. This was partly offset by lower average trading assets as maturing investments in Brazil were not renewed.

Net income from financial instruments designated at fair value decreased by US\$274m, notably in Brazil, as a result of lower investment gains due to market movements. To the extent that these investment gains were attributed to policyholders there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments fell by 62% due to lower gains on disposal of available-for-sale government debt securities in Balance Sheet Management and the non-recurrence of the gain on sale of shares in a non-strategic investment in 2012.

Net earned insurance premiums decreased by 19%, driven by lower sales of unit-linked pension products in Brazil. Premiums also fell in Argentina

as a result of the sale of the non-life insurance business in 2012. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating income increased by US\$910m, driven by the US\$1.1bn gain on the sale of our operations in Panama. This was partly offset by a significant reduction in the PVIF asset due to an increase in lapse rates and interest rate movements in Brazil and Mexico, and the non-recurrence of the favourable effect of the recognition of a PVIF asset in Brazil in 2012.

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

Operating expenses decreased by US\$112m as a result of business disposals, continued strict cost control and progress with our organisational effectiveness programmes which resulted in sustainable cost savings of over US\$200m. The decrease was largely offset by the effect of inflationary pressures, union-agreed salary increases in Brazil and Argentina, and higher compliance and risk costs from the implementation of Global Standards and portfolio repositioning, notably in Mexico.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency profit/(loss) before tax Latin America

	2012	Currency translation adjustment ¹	2012 at 2013 exchange rates	2013 as reported US\$m	Reported change ² %	Constant currency change ² %
Net interest income	6,984	(440)	6,544	6,186	(11)	(5)
Net fee income	1,735	(98)	1,637	1,701	(2)	4
Net trading income	971	(74)	897	936	(4)	4
Own credit spread ³						
Other income/(expense) from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Net income/(expense) from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Gains less losses from financial investments	227	(11)	216	82	(64)	(62)
Net earned insurance premiums	2,452	(203)	2,249	1,830	(25)	(19)
Other operating income (including dividend income)	268	(49)	219	1,124	319	413
Total operating income	13,304	(942)	12,362	12,185	(8)	(1)
Net insurance claims incurred and movement in liabilities to policyholders	(2,353)	217	(2,136)	(1,617)	31	24
Net operating income⁴	10,951	(725)	10,226	10,568	(3)	3
LICs ⁴²	(2,137)	164	(1,973)	(2,666)	(25)	(35)
Net operating income	8,814	(561)	8,253	7,902	(10)	(4)
Operating expenses	(6,430)	388	(6,042)	(5,930)	8	2
Operating profit	2,384	(173)	2,211	1,972	(17)	(11)
Income from associates ⁴³						
Profit before tax	2,384	(173)	2,211	1,972	(17)	(11)

For footnotes, see page 132.

Reconciliation of reported and underlying items Latin America

	Year ended 31 December		
	2013 US\$m	2012 US\$m	Change ² %
Net interest income			
Reported net interest income	6,186	6,984	(11)
Currency translation adjustment ¹		(440)	

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Acquisitions, disposals and dilutions	(277)	(561)	
Underlying net interest income	5,909	5,983	(1)
Other operating income			
Reported other operating income	1,115	253	341
Currency translation adjustment ¹		(48)	
Acquisitions, disposals and dilutions	(1,123)	(14)	
Underlying other operating income	(8)	191	
Revenue⁴			
Reported revenue	10,568	10,951	(3)
Currency translation adjustment ¹		(725)	
Acquisitions, disposals and dilutions	(1,495)	(805)	
Underlying revenue	9,073	9,421	(4)

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Report of the Directors: Financial Review (continued)

	Year ended 31 December		Change ² %
	2013 US\$m	2012 US\$m	
LICs⁴²			
Reported	(2,666)	(2,137)	(25)
Currency translation adjustment ¹		164	
Acquisitions, disposals and dilutions	32	53	
Underlying	(2,634)	(1,920)	(37)
Operating expenses			
Reported	(5,930)	(6,430)	8
Currency translation adjustment ¹		388	
Acquisitions, disposals and dilutions	239	488	
Underlying	(5,691)	(5,554)	(2)
Underlying cost efficiency ratio	62.7%	59.0%	
Profit before tax			
Reported	1,972	2,384	(17)
Currency translation adjustment ¹		(173)	
Acquisitions, disposals and dilutions	(1,224)	(264)	
Underlying	748	1,947	(62)

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)**2012 compared with 2011**

Economic background

Brazil's GDP growth slowed further in 2012, mostly due to the effects of higher input costs, concern about global financial stability, and domestic regulatory uncertainty. Despite growth remaining low, consumer inflation remained above the 4.5% inflation target pursued by the Central Bank, ending 2012 at 5.8%.

By contrast, growth held up well in **Mexico** in 2012 led, in particular, by favourable industrial exports to the US. Enhanced competitiveness helped Mexican exports to gain a larger share of total US imports. Domestically, demand stayed largely unchanged, encouraged by labour reforms passed by the new administration. Despite the growth figures, inflation ended 2012 slightly below 4% and converging on the 3% inflation target pursued by Banco de Mexico.

Argentina reported a sharp slowdown in 2012. Balance of payments restrictions gradually escalated from capital flows to the current account, including imports of intermediate goods, which generated disruption in production and deterioration in business confidence. Despite this sharp slowdown, inflation continued to remain high, partly due to regulated price increases and import restrictions that lowered domestic supply.

Review of performance

Our operations in Latin America reported a profit before tax of US\$2.4bn in 2012, 3% higher than in 2011 and an increase of 16% on a constant currency basis. This included a gain of US\$102m following the completion of the sale of our general insurance manufacturing business in Argentina, a loss of US\$62m on the sale of our operations in Costa Rica, Honduras and El Salvador and a loss of US\$96m recognised following the reclassification of our non-strategic businesses in Colombia, Peru, and Paraguay to Assets held for sale.

On an underlying basis, pre-tax profits rose by 19%, primarily due to increased revenues across all global businesses, partly offset by higher loan impairment charges. In RBWM, the revenue increase reflected growth in average lending balances in Argentina and a higher yielding portfolio mix in Brazil while, in CMB, it resulted from continued balance sheet growth in Brazil which was driven by a strong demand for trade-related lending and higher balances of Payment and Cash Management current accounts in Argentina. In addition, there were higher Balance Sheet Management revenues in Brazil following a downward movement in interest rates which lowered

the cost of funding. In Brazil, loan impairment charges rose, primarily as a result of increased delinquency rates in RBWM and CMB, particularly in the Business Banking portfolio, reflecting lower economic growth in 2012. Loan impairment charges improved during the second half of 2012, mainly due to lower collective portfolio provisions in Brazil.

We made significant progress in reducing the fragmentation in our Latin American businesses through disposals in our non-strategic markets. In May 2012, we announced the sale of our businesses in Colombia, Peru, Uruguay and Paraguay, with completion expected in 2013. We will continue to offer full branch services to our customers during transition. In the second half of 2012, we completed the sale of our businesses in Costa Rica, El Salvador and Honduras. In addition, we completed the sale of our general insurance manufacturing business in Argentina and announced the agreement to sell a portfolio of general insurance assets and liabilities in Mexico with completion expected in 2013. Under the terms of these agreements, the purchasers will provide general insurance products to HSBC to sell to our retail customers in the two countries. This long-term collaboration will broaden and strengthen the suite of general insurance products available to our customers. In February 2013, we announced an agreement to sell our operations in Panama. The transaction is subject to regulatory approvals and other conditions and is expected to complete by the third quarter of 2013.

In our RBWM business, we made good progress in developing a wealth management service that addresses our customers' needs and we strengthened our sales force capabilities to capture wealth creation in the region. Wealth Management revenues increased by over US\$275m or 36%. This included the favourable effect of the recognition of a PVIF asset in Brazil. Excluding this gain, Wealth Management revenues rose

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by 17%, mainly from insurance and mutual funds.

In CMB, we worked closely with GB&M to ensure our clients had access to appropriate products. In addition, our relationships with CMB payroll customers enabled us to increase personal lending to their employees, who became our RBWM customers. We were able to provide support to companies as they grow internationally through our Global Trade and Receivables Finance products, and used our international expertise to capture trade and capital flows, notably in the Brazil-China trade corridors. We continued to strengthen our service to international SMEs by increasing the number of specialist International Relationship Managers in Brazil.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

In GB&M, we continued to target international corporate customers throughout Latin America. We were awarded First place in International Debt Capital Markets by the Brazilian Financial and Capital Markets Association and Best Project Finance House in Latin America from *Euromoney*. We also maintained a strong presence in the foreign exchange and derivatives markets.

Across the region, we continued to implement measures to improve operational efficiency, incurring US\$167m of restructuring costs in 2012. We achieved a 14% net reduction of almost 7,500 FTEs, including more than 4,000 employees transferred with the disposals described earlier, and approximately US\$285m of additional sustainable savings.

The following commentary is on a constant currency basis.

Net interest income increased by 12% compared with 2011, with growth across all global businesses.

In RBWM, net interest income rose due to higher average lending volumes, mainly in personal loans and credit cards in Argentina as a result of successful marketing and sales campaigns. We also benefited from a change in the composition of the lending book in Brazil as we increased our balances of higher yielding assets. Net interest income from deposits also increased due to higher balances in current accounts in Mexico and savings accounts in Argentina supported by marketing campaigns.

In CMB, higher net interest income reflected a rise in average loans and advances to customers in Brazil, driven by strong demand for trade-related lending and our focus on corporate relationships and sectors with potential for international expansion. Net interest income also rose in Argentina, mainly in Payments and Cash Management current accounts, reflecting higher balances which were supported by successful marketing campaigns, and wider spreads driven by a rise in interest rates.

In GB&M, net interest income increased, notably in Balance Sheet Management in Brazil, as we benefited from the downward movements in interest rates which lowered the cost of funding assets in this portfolio.

Net fee income increased by 8% to US\$1.7bn, mainly due to higher Payments and Cash Management revenues, which benefited from mandates from new customers and repricing initiatives in Argentina and Brazil. Fee income was also higher as a result of the sale of the general insurance business as fee expense associated with

this business was no longer incurred.

Net trading income of US\$971m was 19% lower than in 2011, primarily due to lower reverse repos driven by positions in GB&M in Brazil that had matured but had not been renewed, and lower income related to government debt securities. This was partly offset by gains in the Rates business as a result of favourable rate movements.

Net income from financial instruments designated at fair value increased by 39%, or US\$187m, mainly in Brazil, reflecting higher investment gains arising from favourable equity and debt market movements and growth in policyholder assets from higher sales of unit-linked pension products. To the extent that these investment gains were attributed to policyholders there was a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments of US\$227m were 80% or US\$100m higher than in 2011, primarily in Brazil due to gains on sale of shares in non-strategic investments and disposals of government debt securities in GB&M in 2012, partly offset by the non-recurrence of a gain in GB&M on the sale of shares in a Mexican listed company in 2011.

Net earned insurance premiums increased by 5% to US\$2.5bn, driven by increased sales in Brazil of unit-linked pension products and term life insurance products. Premiums also rose in Mexico, mainly due to growth in sales of an endowment product. In Argentina, premiums were lower,

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following the sale of the general insurance business in 2012.

Other operating income decreased by 8% to US\$253m, driven by a loss of US\$62m on the sale of our operations in Costa Rica, Honduras and El Salvador, and a loss of US\$96m recognised following the reclassification of our non-strategic businesses in Colombia, Peru, and Paraguay to held for sale. In addition, in 2011, we reported a gain on sale of the Mexican pension administration business, HSBC Afore, of US\$83m and a gain on the sale and leaseback of branches of US\$53m. These factors were partly offset by the favourable effect of the recognition of a PVIF asset in Brazil of US\$119m relating to unit-linked pensions, together with an increase in the value of new term life business in Brazil, as well as the gain on sale of the general insurance business in Argentina of US\$102m.

Net insurance claims incurred and movement in liabilities to policyholders increased by 15%, driven

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Report of the Directors: Financial Review (continued)

by higher net investment gains on the fair value of the assets held to support policyholder contracts. In addition, liabilities to policyholders were established for new business, reflecting the increase in premiums in Brazil, though this was partly offset by the disposal of the general insurance business in Argentina in 2012.

Loan impairment charges and other credit risk provisions increased by 29%. This was mainly in Brazil, driven by increased delinquency rates in RBWM and CMB, particularly in Business Banking, reflecting lower economic growth in 2012. We took a number of steps to reposition our portfolios in RBWM and CMB including reducing third-party originations and lowering credit limits where appropriate. We also improved our collections capabilities. Loan impairment charges improved during the second half of the year in Brazil.

Operating expenses decreased by US\$83m compared with 2011. Restructuring costs declined by US\$137m as 2011 included costs associated with the consolidation of the branch network and the reorganisation of regional and country support functions. These restructuring initiatives and our continued efforts to exercise strict cost control and progress with our organisational effectiveness programmes resulted in approximately US\$285m of additional sustainable cost savings and a net 7% reduction in average FTEs of around 4,000 in 2012. These savings were partly offset by inflationary pressures, union-agreed wage increases in Brazil and Argentina and a payment of fines and penalties of US\$29m in connection with non-compliance with anti-money laundering systems and controls including requirements to report unusual transactions, in Mexico.

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)*Reconciliation of reported and constant currency profit/(loss) before tax Latin America*

	2011	Currency translation adjustment ¹	2011 at 2012 exchange rates	2012	Reported change ²	Constant currency change ²
	as reported US\$m	US\$m	US\$m	as reported US\$m	%	%
Net interest income	6,956	(709)	6,247	6,984		12
Net fee income	1,781	(174)	1,607	1,735	(3)	8
Other income ⁷	2,716	(333)	2,383	2,232	(18)	(6)
Net operating income ⁴	11,453	(1,216)	10,237	10,951	(4)	7
LICs ⁴²	(1,883)	221	(1,662)	(2,137)	(13)	(29)
Net operating income	9,570	(995)	8,575	8,814	(8)	3
Operating expenses	(7,255)	742	(6,513)	(6,430)	11	1
Operating profit	2,315	(253)	2,062	2,384	3	16
Income from associates ⁴³						
Profit before tax	2,315	(253)	2,062	2,384	3	16

*For footnotes, see page 132.**Reconciliation of reported and underlying items Latin America*

	Year ended 31 December		Change ²
	2012	2011	
	US\$m	US\$m	%
Revenue ⁴			
Reported	10,951	11,453	(4)
Currency translation adjustment ¹		(1,216)	
Acquisitions, disposals and dilutions	(343)	(492)	
Underlying	10,608	9,745	9
LICs ⁴²			
Reported	(2,137)	(1,883)	(13)
Currency translation adjustment ¹		221	
Acquisitions, disposals and dilutions	16	16	
Underlying	(2,121)	(1,646)	(29)
Operating expenses			
Reported	(6,430)	(7,255)	11
Currency translation adjustment ¹		742	

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Acquisitions, disposals and dilutions	183	295	
Underlying	(6,247)	(6,218)	
Underlying cost efficiency ratio	58.9%	63.8%	
Profit before tax			
Reported	2,384	2,315	3
Currency translation adjustment ¹		(253)	
Acquisitions, disposals and dilutions	(144)	(181)	
Underlying	2,240	1,881	19
<i>For footnotes, see page 132.</i>			

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HSBC HOLDINGS PLC

Report of the Directors: Financial Review (continued)

Profit/(loss) before tax and balance sheet data Latin America

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination ⁴⁹ US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	3,776	1,828	775	24	(12)	(205)	6,186
Net fee income	952	548	168	32	1		1,701
Trading income/(expense) excluding net interest income	138	117	456	4	(4)		711
Net interest income on trading activities							