

HSBC HOLDINGS PLC
Form 6-K
August 05, 2011
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FORM 6-K
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

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

the Securities Exchange Act of 1934

For the month of August 2011

HSBC Holdings plc

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

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

Form 20-F Form 40-F

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

Yes No

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

This Report on Form 6-K with respect to our Interim Financial Statements and Notes thereon for the six-month period ended June 30, 2011 is hereby incorporated by reference in the following HSBC Holdings plc registration statements: file numbers 333-10474, 333-92024, 333-102027, 333-103887, 333-104203, 333-109288, 333-113427, 333-127327, 333-126531, 333-135007, 333-143639, 333-145859, 333-155338, 333-158054, 333-158065, 333-162565 and 333-17025.

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HSBC HOLDINGS PLC

Interim Report 2011

Certain defined terms

Unless the context requires otherwise, *HSBC Holdings* means *HSBC Holdings plc* and *HSBC*, the *Group*, *we*, *us* and *our* refers 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* represents millions and billions (thousands of millions) of US dollars, respectively.

Interim financial statements and notes

HSBC's Interim Consolidated Financial Statements and Notes thereon, as set out on pages 171 to 218, have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Services Authority and International Accounting Standard (IAS) 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). The consolidated financial statements of *HSBC* at 31 December 2010 were prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the IASB, and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards effective for the year ended 31 December 2010 affecting the consolidated financial statements at that date, 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 2010 were prepared in accordance with IFRSs as issued by the IASB. At 30 June 2011, there were no unendorsed standards effective for the period ended 30 June 2011 affecting these interim consolidated 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*.

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

When reference is made to *underlying* or *underlying basis* in tables or commentaries, comparative information has been expressed at constant currency (see page 10) eliminating the impact of fair value movements in respect of credit spread changes on *HSBC's* own debt and adjusted for the effects of acquisitions and disposals.

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HSBC HOLDINGS PLC

Interim Report 2011

Headquartered in London, HSBC is one of the world's largest banking and financial services organisations and one of the industry's most valuable brands. We provide a comprehensive range of financial services to around 89 million customers through two customer groups, Retail Banking and Wealth Management (formerly Personal Financial Services) and Commercial Banking, and two global businesses, Global Banking and Markets and Global Private Banking.

Our international network covers 87 countries and territories in six geographical regions: Europe, Hong Kong, Rest of Asia-Pacific, Middle East and North Africa, North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 220,000 shareholders in 129 countries and territories.

Highlights

Profit attributable to ordinary shareholders of US\$8.9bn, up 35% on 1H10 and 46% on 2H10.

Earnings per share of US\$0.51, up 34% on 1H10 and 46% on 2H10.

Net assets per share of US\$8.59, up 17% on 1H10 and 8% on 2H10.

Reported pre-tax profit of US\$11.5bn, up 3% on 1H10, and 45% on 2H10.

Profitable in all regions, with profits up in Hong Kong, Rest of Asia-Pacific, Latin America, Middle East and North Africa and North America.

Cost efficiency ratio of 57.5% compared with 50.9% in 1H10 and 59.9% in 2H10.

Return on average ordinary shareholders' equity of 12.3%, up from 10.4% in 1H10, and 8.9% in 2H10.

Dividends declared in respect of 2011 totalling US\$0.18 per ordinary share, up 12.5%.

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Core tier 1 ratio increased from 10.5% to 10.8% during the period, driven by profit generation.
Cover theme

An evening view of the Central Elevated Walkway in Hong Kong's business district. Used by tens of thousands of commuters every day, this walkway forms a vital artery through the heart of Asia's pre-eminent financial centre, which hosts over 190 banks and deposit-taking companies from all over the world.

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HSBC HOLDINGS PLC

Overview

Financial highlights

Earnings per share

US\$0.51 *up 34%*

30 June 2010: US\$0.38

31 December 2010: US\$0.35

Dividends per share¹

US\$0.21

30 June 2010: US\$0.18

31 December 2010: US\$0.16

Net assets per share

US\$8.59

30 June 2010: US\$7.35

31 December 2010: US\$7.94

For the period

Profit before taxation

US\$11,474m *up 3%*

30 June 2010: US\$11,104m

31 December 2010: US\$7,933m

Underlying profit before taxation

US\$11,437m *up 13%*

30 June 2010: US\$10,109m

31 December 2010: US\$8,918m

Total operating income

US\$42,311m *up 4%*

30 June 2010: US\$40,672m

31 December 2010: US\$39,342m

Net operating income before loan

impairment charges and other credit risk

provisions

Profit attributable to ordinary shareholders of the

parent company

US\$8,929m *up 35%*

US\$35,694m

30 June 2010: US\$6,629m

30 June 2010: US\$35,551m

31 December 2010: US\$6,117m

31 December 2010: US\$32,696m

At the period-end

Loans and advances to

customers

US\$1,038bn *up 8%*

30 June 2010: US\$893bn

31 December 2010: US\$958bn

Customer accounts

US\$1,319bn *up 7%*

30 June 2010: US\$1,147bn

31 December 2010: US\$1,228bn

Average total shareholders' equity

Ratio of customer advances to customer accounts

78.7%

30 June 2010: 77.9%

31 December 2010: 78.1%

Total equity

US\$168bn *up 8%*

30 June 2010: US\$143bn

31 December 2010: US\$155bn

to average total assets

5.7%

30 June 2010: 5.5%

31 December 2010: 5.5%

Risk-weighted assets

US\$1,169bn *up 6%*

30 June 2010: US\$1,075bn

31 December 2010: US\$1,103bn

Capital ratios

Core tier 1 ratio

10.8%

30 June 2010: 9.9%

31 December 2010: 10.5%

Tier 1 ratio

12.2%

30 June 2010: 11.5%

31 December 2010: 12.1%

Total capital ratio

14.9%

30 June 2010: 14.4%

31 December 2010: 15.2%

Percentage growth rates compare with figures at 30 June 2010 for income statement items and 31 December 2010 for balance sheet items.

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Overview (continued)

Performance ratios (annualised)

Credit coverage ratios

| Loan impairment charges to total operating income | Loan impairment charges to average gross customer advances | Total impairment allowances to impaired loans at period-end |
|--|---|--|
| 11.8% | 1.0% | 72.2% |
| 30 June 2010: 17.8% | 30 June 2010: 1.7% | 30 June 2010: 79.0% |
| 31 December 2010: 16.1% | 31 December 2010: 1.4% | 31 December 2010: 71.6% |

| Return on average invested capital ² | Return on average ordinary shareholders' equity | Post-tax return on average total assets | Pre-tax return on average risk-weighted assets |
|--|--|--|---|
| 11.4% | 12.3% | 0.7% | 2.0% |
| 30 June 2010: 9.4% | 30 June 2010: 10.4% | 30 June 2010: 0.6% | 30 June 2010: 2.0% |
| 31 December 2010: 8.2% | 31 December 2010: 8.9% | 31 December 2010: 0.5% | 31 December 2010: 1.4% |

| Cost efficiency ratio ⁴ | Net interest income to | Net fee income to | Net trading income to |
|------------------------------------|------------------------|-------------------|-----------------------|
|------------------------------------|------------------------|-------------------|-----------------------|

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| | total operating income | total operating income | total operating income |
|-------------------------|-------------------------|-------------------------|------------------------|
| | 57.5% | 47.8% | 20.8% |
| 30 June 2010: 50.9% | 30 June 2010: 48.6% | 30 June 2010: 20.9% | 30 June 2010: 8.7% |
| 31 December 2010: 59.9% | 31 December 2010: 50.0% | 31 December 2010: 22.5% | 31 December 2010: 9.3% |

Share information at the period-end

| | Market | Closing market price | | |
|--|--|--|---|--|
| US\$0.50 ordinary shares in issue | capitalisation | London | Hong Kong | American Depositary Share ⁵ |
| | 17,818m | US\$177bn | £6.18 | HK\$77.05 |
| | US\$49.62 | | | |
| 30 Jun 2010: 17,510m 31 Dec 2010: 17,686m | 30 Jun 2010: US\$161bn 31 Dec 2010: US\$180bn | 30 Jun 2010: £6.15 31 Dec 2010: £6.51 | 30 Jun 2010: HK\$72.65 31 Dec 2010: HK\$79.70 | 30 Jun 2010: US\$45.59 31 Dec 2010: US\$51.04 |
| | | Over 1 year | Total shareholder return ⁶ Over 3 years | Over 5 years |
| To 30 June 2011 | | 104.6 | 104.9 | 95.6 |
| Benchmarks: | | | | |
| FTSE 100 | | 124.9 | 118.4 | 122.6 |
| MSCI World | | 122.3 | 127.9 | 132.6 |
| MSCI Banks | | 111.0 | 103.2 | 77.5 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Overview (continued)

Cautionary statement regarding forward-looking statements

This *Interim Report 2011* contains certain forward-looking statements with respect to the financial condition, results of operations and business of HSBC. These forward-looking statements represent HSBC's expectations or beliefs concerning future events and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ, in some instances materially, from those expressed or implied in such statements. For example, certain of the market risk disclosures, some of which are only estimates and, therefore, could be materially different from actual results, are dependent on key model characteristics and assumptions and are subject to various limitations. Certain statements that are not historical facts, such as those that include the words "potential", "value at risk", "expects", "anticipates", "objective", "intends", "seeks", "plans", "believes", "estimates", and similar expressions or variations on such expressions may be considered 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. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events. Past performance cannot be relied on as a guide to future performance. Trends and factors that are expected to affect HSBC's results of operations are described in the *Interim Management Report*. A more detailed cautionary statement is given on page 379 of the *Annual Report and Accounts 2010*.

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Overview (continued)

Group Chairman's Statement

Good progress has been made during the first half of 2011 in setting the necessary course to build further sustainable value from HSBC's many advantaged positions in attractive markets and customer-facing businesses. The priorities, set out in the Strategy Day which Stuart Gulliver, Group Chief Executive, presented with his team in early May this year, are now being actioned, as Stuart sets out clearly in his review. Against the backdrop of the significant regulatory change which is under way, our clear focus is to concentrate HSBC's capital allocation and resources on the market segments which we are best able to serve competitively and efficiently.

Our ability to make progress on these strategic issues has been enhanced by a period of relative stability in operating performance as revenue strength in the faster growing economies continued to offset the constraining impact of the wind-down of our exit portfolios. With credit experience also continuing to improve, earnings per share for the first half of 2011 of US\$0.51 were 34% higher than those delivered in the first half of last year. The Group Chief Executive's review describes in more detail the drivers of this encouraging performance.

As foreshadowed when we reported our 2010 results, the Board has declared two interim dividends of US\$0.09 per ordinary share in respect of 2011, with the second interim dividend payable on 6 October 2011 to holders of record on 18 August 2011 on the Hong Kong Overseas Branch Register and 19 August 2011 on the Principal Register in the United Kingdom or on the Bermuda Overseas Branch Register. These dividends are 12.5% higher than those declared at the comparable stages last year.

Given the intense current focus amongst the regulatory and political communities on bank capital strength, it is very positive to note both that our capital position strengthened during the period and that we comfortably passed the European Banking Authority's industry wide stress test, the results of which were made public on 15 July 2011. The Group's core tier 1 ratio, which is the ratio most critically monitored by regulators, increased to 10.8% at 30 June 2011 from 10.5% at 31 December 2010 and 9.9% at 30 June 2010.

There has been significant further activity on the regulatory reform front in the period. The Independent Commission on Banking in the UK published its Interim Report on 11 April 2011 and we submitted our comments on its preliminary conclusions on 4 July 2011 in line with the timetable laid down. HSBC has been very actively involved in the debate around one of the principal reform ideas raised in this report, namely the concept of structurally ring-fencing certain of the core activities contained within UK-incorporated universal banks; in our case this would affect our UK subsidiary, HSBC Bank plc. The objective of ring-fencing certain activities from other activities is to facilitate the resolution and continuation of the core activities contained within the ring-fence, at little or no cost to the taxpayer in the event of a future crisis.

Much of the ongoing debate is around assessing the likely impact of various alternative ring-fencing definitions on credit supply to the real economy in the UK and on the competitiveness of UK-incorporated banks. We believe the critical judgements ultimately to be made must consider two principal factors. The first of these is how any restructuring will likely affect the quantum and cost of credit supply to the real economy. The second is whether the benefit of this incremental restructuring on top of the aggregate of all the reform measures already in hand under Basel III and EU directives outweighs the considerable cost and time commitment involved.

In another major new development, the Basel Committee and the Financial Stability Board have now issued consultation documents concerning additional capital requirements for banks identified as global systemically important financial institutions. Incremental common equity of between 1% and 2.5% of risk-weighted assets on top of Basel III requirements is being proposed. We expect HSBC will fall at the higher end of incremental capital requirements. This level of capital is consistent with the expectation of Basel III common

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HSBC HOLDINGS PLC

Overview (continued)

equity tier 1 ratio levels of between 9.5% and 10.5% referred to in our *Annual Report and Accounts 2010*.

The pace and quantum of regulatory reform continues to increase at the same time as the global economy appears to be losing momentum in its recovery. We are concerned about the possible pro-cyclical impacts of further deleveraging of the global economy arising from the regulatory reform agenda, at the same time as sovereign credit concerns and fiscal consolidation challenges become more critical.

Financial markets globally will likely be volatile over the rest of this year and into 2012 as participants assess and react to the possibility of political constraints preventing timely or optimal economic decisions. The global economy is currently facing many such situations, ranging from reaching a sustainable solution to eurozone sovereign indebtedness through dealing with the impact of inflationary pressures and commodity price increases on developing economies, supporting social reform and cohesion in the Middle East, balancing the growth imperative in the faster-growing economies with the consequences of asset price bubbles and, most importantly, negotiating a long-term framework for budget discipline and related financing in the United States.

Finally, I am delighted to report how effectively the new management team under the leadership of Stuart Gulliver is working together and making progress, under the governance and supervision of the Board, in delivering the strategic agenda which has been agreed. There is much to do and, as noted above, the current economic backdrop contains many challenges. However, the mood in the organisation is upbeat and there is real commitment and enthusiasm to tackle the tasks ahead of us.

D J Flint, *Group Chairman*

1 August 2011

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HSBC HOLDINGS PLC

Overview (continued)

Group Chief Executive's Review

HSBC's financial performance improved.

Reported profit before tax was US\$11.5bn, up 3% from 1H10 and 45% from 2H10.

Profit attributable to ordinary shareholders was US\$8.9bn, up 35% from 1H10 and 46% from 2H10.

Return on average ordinary shareholders' equity was 12.3%, up from 10.4% in 1H10 and 8.9% in 2H10.

The cost efficiency ratio was 57.5%, up from 50.9% in 1H10 but down from 59.9% in 2H10.

The advances-to-deposits ratio was 78.7%, up from 77.9% in 1H10 and 78.1% in 2H10.

We declared two interim dividends in respect of 2011 totalling US\$0.18 per ordinary share, up 12.5% year on year.

The core tier 1 capital ratio was 10.8% at 30 June 2011, compared with 10.5% at 31 December 2010.

Progress on strategy

HSBC's global network covers the majority of world trade and capital flows, and provides access to faster-growing economies as well as the mature economies where wealth is stored. In May, we articulated our strategy to become the world's leading international bank by building on this distinctive position to leverage global economic and demographic trends. We also outlined our plans to deploy capital more efficiently, to improve cost efficiency and to target growth in selected markets. We are making progress in all three areas:

First, as a result of our portfolio review and application of a five-filter framework, we announced a number of closures and disposals. These included the closure of our retail businesses in Russia and Poland and the disposal of three insurance businesses. More materially, in the US we are progressing the strategic review of our credit card business, and announced the disposal of 195 non-strategic branches, principally in upstate New York.

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Second, we are targeting US\$2.5-3.5bn of sustainable cost savings by 2013. Since the start of 2011, we have begun operational restructurings in Latin America, the US, the UK, France and the Middle East which will reduce headcount by around 5,000. We launched a programme to reduce the costs of our head office and global support functions. We also initiated more efficient business operating models for Commercial Banking and Retail Banking and Wealth Management. We expect there will be some 25,000 job losses by the end of 2013, although we plan to recruit in support of our strategic initiatives.

Third, we continued to position the business for growth. We increased revenues in target markets and we made progress in wealth management, where we saw higher investment income, especially in Asia, and funds under management in Global Asset Management reached a record high at the end of the period.

Revenues

At US\$35.7bn, total Group revenues were stable compared with 1H10 and up 9% compared with 2H10.

We recorded double-digit revenue growth in Hong Kong, Rest of Asia-Pacific and Latin America compared with 1H10.

As we had forecast, revenue declined in the US as we continued to manage down balances in the run-off portfolios, and in Balance Sheet Management as positions matured. Along with many peers, we saw weaker Credit and Rates revenues in Europe in Global Banking and Markets.

Loan impairment charges

Loan impairment charges were US\$5.3bn compared with US\$7.5bn in 1H10 and US\$6.5bn in 2H10.

Most of the improvement was in the US. The Consumer Finance run-off and Cards portfolios

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Overview (continued)

recorded lower balances as well as improved delinquency rates, although we saw a slowing of delinquency trend improvements in the second quarter.

In Global Banking and Markets, loan impairment charges and other credit risk provisions were lower.

Cost efficiency

The cost efficiency ratio rose from 50.9% to 57.5% compared with 1H10. Reflecting strategic investment in the business, key drivers behind the increase were higher staff numbers, wage inflation, and other costs related to business growth. We also reported a number of notable cost items during the period.

The cost efficiency ratio fell compared with 59.9% in 2H10 as we controlled discretionary spend and took action to make sustainable savings.

Significantly, on a quarterly basis, the cost efficiency ratio was 54.4% in 2Q11, lower than in each of the previous three quarters.

Balance sheet

Compared with year-end 2010, customer account balances increased by 7% or US\$91.3bn to US\$1.3 trillion, with most of the increase in Europe and Asia.

Compared with year-end 2010, total customer loan balances increased by 8% or US\$79.5bn to US\$1.0 trillion, rising in all regions except North America, where we managed down balances in the Consumer Finance portfolios.

The core tier 1 ratio increased during the period from 10.5% at the end of 2010 to 10.8%, driven primarily by profit generation.

Economic outlook

We remain positive on the outlook for emerging markets. We expect a soft landing in China and we believe Hong Kong is well-equipped to mitigate overheating pressures. We expect continued growth in the rest of Asia-Pacific and Latin America and take comfort from the focus of the authorities on managing inflationary pressures. In the Middle East, the outlook for the Gulf Cooperation Council economies is also positive.

In the developed world, growth in the US and Europe is likely to remain sluggish as long as the impact of high debt levels and government budget cuts weigh on economic activity. In the UK, we remain concerned that regulatory actions being contemplated and the ongoing regulatory uncertainty will constrain the supply of credit to the real economy and contribute to sub-par economic growth.

In closing, I would add that I am pleased with these results, which mark a first step in the right direction on what will be a long journey.

S T Gulliver, *Group Chief Executive*

1 August 2011

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HSBC HOLDINGS PLC

Overview (continued)

Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US\$177bn at 30 June 2011.

Through our subsidiaries and associates, we provide a comprehensive range of banking and related financial services. Headquartered in London, we operate through long-established businesses and have an international network of around 7,500 offices in 87 countries and territories in six geographical regions: Europe, Hong Kong, Rest of Asia-Pacific, Middle East and North Africa (MENA), North America and Latin America. Within these regions, a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit bases.

HSBC's values

The role of HSBC's values in daily operating practice has taken on increased significance in the context of the global financial crisis, with changes to regulatory policy, investor confidence and society's view of the role of banks. We expect our executives and staff to act with courageous integrity in the execution of their duties.

HSBC's values are being:

dependable and doing the right thing;

open to different ideas and cultures; and

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

We have strengthened our values-led culture by embedding HSBC's values into our operating standards, training, development and employee induction, and through the personal sponsorship of senior executives. These initiatives will continue in 2011 and beyond.

Strategic direction

HSBC's objective is to deliver sustainable long-term value to shareholders through consistent earnings and superior risk-adjusted returns. We have a clear strategy to become the leading international bank, based on two main elements which are aligned with the key trends shaping the global economy:

international connectivity we are strengthening our presence in those markets and businesses that are most relevant to global trade and capital flows; and

economic development and wealth creation we are investing to capture wealth creation in the selected markets and focusing on retail banking only in those markets where we can achieve profitable scale.

To deliver on our strategy, we are taking action in three areas:

Capital deployment we are improving the way we deploy capital as part of our efforts to achieve our targeted return on equity of 12% to 15% over the business cycle. We have introduced a strategic framework assessing each of our businesses on a set of five strategic evaluation criteria, namely international connectivity, economic development, profitability, cost efficiency and liquidity. The results of this review determine whether we invest in, turn around, continue with or exit businesses;

Cost efficiency we have launched a transformation programme to achieve sustainable cost savings of between US\$2.5bn and US\$3.5bn over the next three years. Sustainable cost savings are intended to facilitate self-funded growth in key markets and investment in new products, processes and technology, and provide a buffer against regulatory and inflationary headwinds; and

Growth we continue to position ourselves for growth. We are increasing our relevance in fast-growing markets and in wealth management, and are improving the collaboration between our international network of businesses, particularly between Commercial Banking and Global Banking and Markets.

The objectives and incentives of management are aligned to delivering the strategy. Progress is measured through our quarterly financial performance and will be reviewed at the annual Strategy Investor Day.

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HSBC HOLDINGS PLC

Overview (continued)

Top and emerging risks

All of our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks which we assess on a Group-wide basis. We classify certain risks as top or emerging. A top risk is a current, visible risk with the potential to have a material effect on our financial results or our reputation. An emerging risk is one with large unknown components which could have a material impact on our long-term strategy. Top and emerging risks are viewed as falling under the following four broad categories:

challenges to our business operations;

challenges to our governance and internal control systems;

macro-economic and geopolitical risk; and

macro-prudential and regulatory risks to our business model.

The top and emerging risks are summarised below:

Challenges to our business operations

Challenges to our operating model in an economic downturn (in developed countries) and rapid growth (in emerging markets)

Internet crime and fraud

Challenges to our governance and internal control systems

Level of change creating operational complexity

Information security risk

Macro-economic and geopolitical risk

Eurozone crisis, US deficit and elevated risk from potentially overheating economies in emerging markets

Increased geopolitical risk in the Middle East and North Africa

Macro-prudential and regulatory risks to our business model

Regulatory change impacting our business model and Group profitability

Regulatory and legislative requirements affecting conduct of business

A detailed account of HSBC's challenges and uncertainties is provided on pages 84 to 88. Further comments on expected risks and uncertainties are made throughout the Interim Management Report, particularly in the section on Risk.

Basis of preparation

The results of customer groups and 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 customer group and global business data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and Group Management Office (GMO) functions, to the extent that these can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity.

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

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| <u>Movement in the first half of 2011</u> | 26 |
| <u>Economic profit</u> | 28 |
| <u>Ratio of earnings to combined fixed charges</u> | 28a |
| <u>Customer accounts by country</u> | 28b |

Reconciliation of reported and underlying profit before tax

In addition to results reported on an IFRSs basis, we measure our performance internally on a like-for-like basis by eliminating the effects of foreign currency translation differences, acquisitions and disposals of subsidiaries and businesses, and fair value movements on own debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt; all of which distort period-on-period comparisons. We refer to this as our underlying performance.

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

Constant currency

Constant currency comparatives for the half-years to 30 June 2010 and 31 December 2010, used in the 2011 commentaries, are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

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the income statements for the half-years to 30 June 2010 and 31 December 2010 at the average rates of exchange for the half-year to 30 June 2011; and

the balance sheets at 30 June 2010 and 31 December 2010 at the rates of exchange ruling at 30 June 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 period on the basis described above.

Underlying performance

The tables below compare our underlying performance for the half-year to 30 June 2011 with the half-years to 30 June 2010 and 31 December 2010. Equivalent tables are provided for each of HSBC's customer groups, global businesses and geographical segments on www.hsbc.com and on pages 37a and 79a.

The foreign currency translation differences reflect the relative weakening of the US dollar against most major currencies.

The following acquisitions and disposals were adjusted for in arriving at the underlying comparison:

the gain of US\$62m on reclassification of Bao Viet Holdings (Bao Viet) from an available-for-sale asset to an associate in January 2010;

the gain of US\$66m on sale of our stake in Wells Fargo HSBC Trade Bank in March 2010;

the gain of US\$107m on disposal of HSBC Insurance Brokers Limited in April 2010;

the dilution gains which arose on our holding in Ping An Insurance (Group) Company of China, Limited (Ping An) following the issue of share capital to third parties in both May 2010 and June 2011 of US\$188m and US\$181m, respectively;

the loss on the sale of our investment in British Arab Commercial Bank plc in 2010;

the gain of US\$74m on the deconsolidation of private equity funds following the management buy-out of Headland Capital Partners Ltd (formerly known as HSBC Private Equity (Asia) Ltd) in November 2010;

the operating results of Eversholt Rail Group for the half year to 30 June 2010 and the gain on the sale of US\$255m in December 2010.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Reconciliation of reported and underlying profit before tax*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|---------------------------|------------------------------------|--------------------------------------|---------------|---------------------------|-------------|-----------------------------|----------------------------|
| | 1H10 | 1H10 | 1H10 | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as reported | adjust-ments ⁹ | Currency translation ¹⁰ | at 1H11 exchange rates ¹¹ | as reported | adjust-ments ⁹ | under-lying | ported change ¹² | lying change ¹² |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| HSBC | | | | | | | | | |
| Net interest income | 19,757 | 17 | 698 | 20,472 | 20,235 | 20,235 | 2 | (1) | |
| Net fee income | 8,518 | (50) | 288 | 8,756 | 8,807 | 8,807 | 3 | 1 | |
| Changes in fair value ¹³ | 1,074 | (1,074) | | | (143) | 143 | | | |
| Other income ¹⁴ | 6,202 | (404) | 254 | 6,052 | 6,795 | (180) | 10 | 9 | |
| Net operating income¹⁵ | 35,551 | (1,511) | 1,240 | 35,280 | 35,694 | (37) | | 1 | |
| Loan impairment charges and other credit risk provisions | (7,523) | | (176) | (7,699) | (5,266) | (5,266) | 30 | 32 | |
| Net operating income | 28,028 | (1,511) | 1,064 | 27,581 | 30,428 | (37) | 9 | 10 | |
| Operating expenses | (18,111) | 148 | (737) | (18,700) | (20,510) | (20,510) | (13) | (10) | |
| Operating profit | 9,917 | (1,363) | 327 | 8,881 | 9,918 | (37) | | 11 | |
| Share of profit in associates and joint ventures | 1,187 | | 41 | 1,228 | 1,556 | 1,556 | 31 | 27 | |
| Profit before tax | 11,104 | (1,363) | 368 | 10,109 | 11,474 | (37) | 3 | 13 | |
| By geographical region | | | | | | | | | |
| Europe | 3,521 | (594) | 140 | 3,067 | 2,147 | 2,147 | (39) | (28) | |
| Hong Kong | 2,877 | (56) | (3) | 2,818 | 3,081 | 3,081 | 7 | 9 | |
| Rest of Asia-Pacific | 2,985 | (188) | 151 | 2,948 | 3,742 | 3,564 | 25 | 21 | |
| Middle East and North Africa | 346 | 47 | (5) | 388 | 747 | 751 | 116 | 94 | |
| North America | 492 | (572) | 29 | (51) | 606 | 66 | 23 | | |
| Latin America | 883 | | 56 | 939 | 1,151 | 1,151 | 30 | 23 | |
| Profit before tax | 11,104 | (1,363) | 368 | 10,109 | 11,474 | (37) | 3 | 13 | |
| By customer group and global business | | | | | | | | | |

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| | | | | | | | | | |
|--|--------|---------|-----|--------|---------|------|---------|------|------|
| Retail Banking and Wealth Management ¹⁶ | 1,352 | (3) | 85 | 1,434 | 3,126 | | 3,126 | 131 | 118 |
| Commercial Banking | 3,204 | (116) | 99 | 3,187 | 4,189 | | 4,189 | 31 | 31 |
| Global Banking and Markets ¹⁶ | 5,452 | 80 | 183 | 5,715 | 4,811 | | 4,811 | (12) | (16) |
| Global Private Banking | 556 | | 5 | 561 | 552 | | 552 | (1) | (2) |
| Other | 540 | (1,324) | (4) | (788) | (1,204) | (37) | (1,241) | | (57) |
| Profit before tax | 11,104 | (1,363) | 368 | 10,109 | 11,474 | (37) | 11,437 | 3 | 13 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Reconciliation of reported and underlying profit before tax (continued)*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | | |
|--|---|--------------------|---------------------------|---------------------|----------|--------------------|----------|----------------------|----------------------|
| | 2H10 | 2H10 | | at 1H11 | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | adjust- | Currency | exchange | as | adjust- | under- | ported | lying |
| | reported | ments ⁹ | translation ¹⁰ | rates ¹⁷ | reported | ments ⁹ | lying | change ¹² | change ¹² |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| HSBC | | | | | | | | | |
| Net interest income | 19,684 | 1 | 424 | 20,109 | 20,235 | | 20,235 | 3 | 1 |
| Net fee income | 8,837 | | 195 | 9,032 | 8,807 | | 8,807 | | (2) |
| Changes in fair value ¹³ | (1,137) | 1,137 | | | (143) | 143 | | 87 | |
| Other income ¹⁴ | 5,312 | (334) | 123 | 5,101 | 6,795 | (180) | 6,615 | 28 | 30 |
| Net operating income ¹⁵ | 32,696 | 804 | 742 | 34,242 | 35,694 | (37) | 35,657 | 9 | 4 |
| Loan impairment charges and other credit risk provisions | (6,516) | | (116) | (6,632) | (5,266) | | (5,266) | 19 | 21 |
| Net operating income | 26,180 | 804 | 626 | 27,610 | 30,428 | (37) | 30,391 | 16 | 10 |
| Operating expenses | (19,577) | | (471) | (20,048) | (20,510) | | (20,510) | (5) | (2) |
| Operating profit | 6,603 | 804 | 155 | 7,562 | 9,918 | (37) | 9,881 | 50 | 31 |
| Share of profit in associates and joint ventures | 1,330 | (1) | 27 | 1,356 | 1,556 | | 1,556 | 17 | 15 |
| Profit before tax | 7,933 | 803 | 182 | 8,918 | 11,474 | (37) | 11,437 | 45 | 28 |
| By geographical region | | | | | | | | | |
| Europe | 781 | 518 | 52 | 1,351 | 2,147 | 71 | 2,218 | 175 | 64 |
| Hong Kong | 2,815 | (74) | (5) | 2,736 | 3,081 | | 3,081 | 9 | 13 |
| Rest of Asia-Pacific | 2,917 | 1 | 83 | 3,001 | 3,742 | (178) | 3,564 | 28 | 19 |
| Middle East and North Africa | 546 | (5) | (4) | 537 | 747 | 4 | 751 | 37 | 40 |
| North America | (38) | 363 | 19 | 344 | 606 | 66 | 672 | | 95 |
| Latin America | 912 | | 37 | 949 | 1,151 | | 1,151 | 26 | 21 |
| Profit before tax | 7,933 | 803 | 182 | 8,918 | 11,474 | (37) | 11,437 | 45 | 28 |

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By customer group and global business

| | | | | | | | | | |
|--|---------|-------|-----|-------|---------|------|---------|----|-------|
| Retail Banking and Wealth Management ¹⁶ | 2,487 | | 51 | 2,538 | 3,126 | | 3,126 | 26 | 23 |
| Commercial Banking | 2,886 | (3) | 54 | 2,937 | 4,189 | | 4,189 | 45 | 43 |
| Global Banking and Markets ¹⁶ | 3,763 | (331) | 65 | 3,497 | 4,811 | | 4,811 | 28 | 38 |
| Global Private Banking | 498 | | 3 | 501 | 552 | | 552 | 11 | 10 |
| Other | (1,701) | 1,137 | 9 | (555) | (1,204) | (37) | (1,241) | 29 | (124) |
| | | | | | | | | | |
| Profit before tax | 7,933 | 803 | 182 | 8,918 | 11,474 | (37) | 11,437 | 45 | 28 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Consolidated income statement***Summary income statement*

| | 30 June | Half-year to 30 June | 31 December |
|---|-----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 20,235 | 19,757 | 19,684 |
| Net fee income | 8,807 | 8,518 | 8,837 |
| Net trading income | 4,812 | 3,552 | 3,658 |
| Net income/(expense) from financial instruments designated at fair value | (100) | 1,085 | 135 |
| Gains less losses from financial investments | 485 | 557 | 411 |
| Gains arising from dilution of interests in associates | 181 | 188 | |
| Dividend income | 87 | 59 | 53 |
| Net earned insurance premiums | 6,700 | 5,666 | 5,480 |
| Other operating income | 1,104 | 1,290 | 1,084 |
| Total operating income | 42,311 | 40,672 | 39,342 |
| Net insurance claims incurred and movement in liabilities to policyholders | (6,617) | (5,121) | (6,646) |
| Net operating income before loan impairment charges and other credit risk provisions | 35,694 | 35,551 | 32,696 |
| Loan impairment charges and other credit risk provisions | (5,266) | (7,523) | (6,516) |
| Net operating income | 30,428 | 28,028 | 26,180 |
| Total operating expenses | (20,510) | (18,111) | (19,577) |
| Operating profit | 9,918 | 9,917 | 6,603 |
| Share of profit in associates and joint ventures | 1,556 | 1,187 | 1,330 |
| Profit before tax | 11,474 | 11,104 | 7,933 |
| Tax expense | (1,712) | (3,856) | (990) |
| Profit for the period | 9,762 | 7,248 | 6,943 |

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| | | | |
|---|--------------|-------|-------|
| Profit attributable to shareholders of the parent company | 9,215 | 6,763 | 6,396 |
| Profit attributable to non-controlling interests | 547 | 485 | 547 |
| Average foreign exchange translation rates to US\$: | | | |
| US\$1: £ | 0.619 | 0.656 | 0.639 |
| US\$1: | 0.714 | 0.755 | 0.755 |

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Interim Management Report (continued)

Reported profit before tax of US\$11.5bn in the first half of 2011 was 3% higher than in the first half of 2010, 13% on an underlying basis, with a continued reduction in loan impairment charges more than offsetting higher operating costs. The difference between reported and underlying results is explained on page 10. Except where otherwise stated, the commentaries in the Financial Summary are on an underlying basis.

Net operating income before loan impairment charges and other credit risk provisions (revenue) was marginally higher than in the first half of 2010. Revenue rose across Hong Kong, Rest of Asia-Pacific and Latin America supported by strong lending growth, notably in Commercial Banking (CMB) and Global Banking and Markets (GB&M), and increasing trade and transaction volumes. This was coupled with growth in investment and insurance income in Retail Banking and Wealth Management (RBWM) as markets improved. We also recorded sustained growth in our mortgage portfolios, notably in the UK and Hong Kong. Offsetting these factors were the ongoing decrease in balances in North America in the Cards and run-off portfolios. Performance in GB&M was affected by lower revenues in legacy Credit, and in Balance Sheet Management.

Loan impairment charges and other credit risk provisions were US\$2.4bn or 32% lower than in the first half of 2010 and the lowest reported since the first half of 2006, reflecting the benefits of our exit strategies for higher risk portfolios, ongoing risk management, a sustained trend towards higher quality, more secure lending and a general improvement in credit quality. This was most notable in North America in HSBC Finance as we continued the managed run-off of our sub-prime mortgage portfolio and the loss experience on credit card portfolios improved.

Operating expenses of US\$20.5bn were 10% higher than in the first half of 2010, reflecting increased headcount, wage inflation in key markets and ongoing investment in strategic projects in GB&M and in the branch network, as well as a number of notable items. These included an increase of US\$477m in restructuring costs which were incurred as a result of actions taken following the review of our businesses announced on the Strategy Day and the ongoing review of our cost base. In addition, operating expenses included provisions relating to customer redress programmes of US\$61m, including a provision in respect of the adverse judgement in the Judicial Review relating to sales of payment protection insurance (PPI) in the UK. This was offset by a credit of US\$587m resulting from a change in the inflation measure used to calculate the defined benefit obligation of the HSBC Bank (UK) Pension Scheme defined benefit plan for deferred pensions (for further details see Note 5 on page 183). As a result of the increasing costs, our cost efficiency ratio for the first half of 2011 was 57.5%, higher than in the first half of 2010 and outside our target range. Significantly, however, it improved compared with both the second half of 2010 and the first quarter of 2011.

Reported profit after tax was US\$2.5bn or 35% higher than in the first half of 2010, reflecting the increase in profit before tax and a lower tax charge in the first half of 2011. The latter included the benefit of deferred tax now eligible to be recognised in respect of foreign tax credits, partly offset by a current period tax charge in respect of prior periods. The tax charge in the first half of 2010 was exceptionally high as it included US\$1.6bn attributable to a taxable gain arising from an internal reorganisation within our North American operations.

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Interim Management Report (continued)**Group performance by income and expense item****Net interest income**

| | 30 June | Half-year to 30 June | 31 December |
|---|-----------------------|-------------------------|---------------|
| | 2011 US\$m | 2010 US\$m | 2010 US\$m |
| Interest income | 31,046 | 28,686 | 29,659 |
| Interest expense | (10,811) | (8,929) | (9,975) |
| Net interest income ¹⁸ (US\$m) | 20,235 | 19,757 | 19,684 |
| Average interest-earning assets (US\$m) | 1,607,626 | 1,431,458 | 1,512,462 |
| Gross interest yield ¹⁹ (%) | 3.89 | 4.04 | 3.89 |
| Net interest spread ²⁰ (%) | 2.37 | 2.68 | 2.43 |
| Net interest margin ²¹ (%) | 2.54 | 2.78 | 2.58 |

For footnotes, see page 81.

Net interest income increased by 2% compared with the first half of 2010. On an underlying basis, net interest income was broadly in line with the first half of 2010, as significant balance growth was offset by continuing pressure on spreads.

Average loans and advances to customers grew strongly in the first half of 2011, particularly in commercial lending in CMB and GB&M Group-wide and mortgages in the UK and Hong Kong. The benefit to interest income from higher balances was partly offset by the effect of declining yields on lending, as we continued to reposition the customer loan portfolio towards higher quality assets and reduce our exposure to higher yielding unsecured personal lending, coupled with intensive competition in certain markets.

The average balance of loans and advances to banks and financial investments also rose due to higher placements with central and commercial banks and this, together with rising yields in Asia, led to an increase in interest income. This was partly offset by Balance Sheet Management, where revenues continued to fall as higher-yielding positions matured and the opportunity to maintain yields on reinvestment was limited by the prevailing low interest rate environment, notably in Europe.

The increase in interest income was offset by higher interest expense on customer accounts and debt issued by the Group. Average customer account balances grew significantly, notably in Hong Kong and Rest of Asia-Pacific, reflecting the growth in

customer numbers and the success of deposit campaigns. The cost of funds across the Group also rose, driven by base rate increases and higher rates paid to customers in competitive markets.

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The interest expense on debt issued by the Group also rose, reflecting a general rise in credit spreads in the financial sector which led to an increase in the cost of funds for new issuances in most regions during the second half of 2010 and the first half of 2011.

Net interest income includes the expense of internally funding trading assets, while related revenue is reported in Net trading income . The cost of funding these assets rose as a result of growth in average trading assets. In reporting our customer group and global business results, this cost is included within Net trading income .

The net interest spread decreased due to lower yields on loans and advances to customers as we continued to target higher quality assets, and the rising cost of funds relating to customer accounts and debt issued by the Group. Our net interest margin fell by a lesser amount due to the benefit from net free funds. The increase in net free funds was partly attributable to a rise in funding in line with the growth in trading assets. In addition, customers held more funds in liquid non-interest bearing current accounts in the low interest rate environment. The rise in the Group's cost of funds also contributed to the benefit from net free funds.

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Interim Management Report (continued)**Net fee income**

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Cards | 1,977 | 1,900 | 1,901 |
| Account services | 1,846 | 1,821 | 1,811 |
| Funds under management | 1,414 | 1,181 | 1,330 |
| Broking income | 933 | 766 | 1,023 |
| Credit facilities | 849 | 827 | 808 |
| Imports/exports | 552 | 466 | 525 |
| Insurance | 545 | 578 | 569 |
| Global custody | 391 | 439 | 261 |
| Unit trusts | 374 | 267 | 293 |
| Remittances | 371 | 329 | 351 |
| Underwriting | 332 | 264 | 359 |
| Corporate finance | 235 | 248 | 192 |
| Trust income | 148 | 141 | 150 |
| Mortgage servicing | 56 | 60 | 58 |
| Taxpayer Financial Services | 1 | 91 | (18) |
| Maintenance income on operating leases | | 53 | 46 |
| Other | 920 | 974 | 1,053 |
| Fee income | 10,944 | 10,405 | 10,712 |
| Less: fee expense | (2,137) | (1,887) | (1,875) |
| Net fee income | 8,807 | 8,518 | 8,837 |

Reported net fee income rose by 3.4% to US\$8.8bn, and was in line on an underlying basis.

Fee income from wealth management products increased considerably within Asia and Europe, due to higher transaction volumes. This was particularly so for unit trusts in Hong Kong and funds under management in Europe, where growth was driven by stronger investment performance due to improved market conditions.

Trade-related fee income increased, notably in Hong Kong and the Rest of Asia-Pacific region due to higher trade and transaction volumes.

Net fee income related to cards increased in the first half of 2011, notably in the UK and in Hong Kong due to higher transaction volumes which were driven by increased retail spending and customer promotions. This was partly offset in North America,

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where reduced late and overlimit fees reflected lower delinquency and an increased willingness by customers to pay down their credit card debt, combined with the effects of lower balances and changes to charging practices under the Credit Card Accountability, Responsibility and Disclosure Act (CARD Act).

Underwriting fees increased in GB&M as we increased our market share of global bond issuance volumes in the first half of 2011.

The negligible income from Taxpayer Financial Services in the US resulted from the decision to exit the business.

Fee expenses increased, notably in GB&M, which benefited from higher recoveries from the securities investment conduits in the first half of 2010.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Net trading income**

| | 30 June | Half-year to 30 June | 31 December |
|---|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Trading activities | 3,615 | 3,419 | 2,289 |
| Net interest income on trading activities | 1,581 | 1,242 | 1,288 |
| Gain/(loss) on termination of hedges | 5 | (3) | 3 |
| Other trading income – hedge ineffectiveness: | | | |
| on cash flow hedges | 2 | (24) | 15 |
| on fair value hedges | (77) | 17 | 21 |
| Non-qualifying hedges | (314) | (1,099) | 42 |
| Net trading income ^{22,23} | 4,812 | 3,552 | 3,658 |

For footnotes, see page 81.

Reported net trading income was US\$4.8bn, 35% higher than in the first half of 2010. On an underlying basis, it rose by 23%.

This increase was driven by lower adverse fair value movements on non-qualifying hedges compared with the first half of 2010. These instruments are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, or could not be, applied. They are principally cross-currency and interest rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings and floating rate debt issued by HSBC Finance Corporation (HSBC Finance). Long-term US interest rates declined during the first half of 2011 but to a lesser extent than in the corresponding period in 2010, and the decrease relative to sterling and euro rates was also less pronounced, benefiting net trading income in North America and Europe. The size and direction of the changes in fair value of non-qualifying hedges that are recognised in the income statement can be volatile from period to period, 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.

Net interest income earned on trading activities increased by 21%, attributable to a rise in holdings of government and government agency debt securities. The cost of internally funding these assets also

increased, but this interest expense is reported under Net interest income and excluded from net trading income.

In GB&M, net income from trading activities declined, mainly driven by Rates, largely due to lower favourable fair value movements on structured liabilities as credit spreads widened to a lesser extent than in the first half of 2010. The decline was partly offset by higher revenues as customer demand for structured products increased.

This was partly offset by a rise in Equities revenues as improved competitive positioning helped capture increasing client flows, particularly during the global rally in the first quarter of 2011.

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In addition, net trading income included favourable foreign exchange movements on trading assets held as economic hedges of foreign currency debt designated at fair value. These offset adverse foreign exchange movements on the foreign currency debt which are reported in Net income from financial instruments designated at fair value .

The decline in GB&M was offset by other movements, notably in RBWM in North America where, in the first half of 2011, provisions for mortgage loan repurchase obligations associated with loans previously sold were lower. This related mainly to mortgages originated through broker channels. We regard these mortgage loan repurchase obligations as trading assets.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Net income/(expense) from financial instruments designated at fair value**

| | 30 June | Half-year to | 31 December |
|--|----------------|--------------|-------------|
| | 2011 | 30 June | 2010 |
| | US\$m | US\$m | US\$m |
| Net income/(expense) arising from: | | | |
| financial assets held to meet liabilities under insurance and investment contracts | 547 | (229) | 2,578 |
| liabilities to customers under investment contracts | (186) | 184 | (1,130) |
| HSBC's long-term debt issued and related derivatives | (494) | 1,125 | (1,383) |
| Change in own credit spread on long-term debt ²⁴ | (143) | 1,074 | (1,137) |
| Other changes in fair value ²⁵ | (351) | 51 | (246) |
| other instruments designated at fair value and related derivatives | 33 | 5 | 70 |
| Net income/(expense) from financial instruments designated at fair value | (100) | 1,085 | 135 |

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

| | 30 June | At | 31 December |
|--|----------------|---------|-------------|
| | 2011 | 30 June | 2010 |
| | US\$m | US\$m | US\$m |
| Financial assets designated at fair value at period-end | 39,565 | 32,243 | 37,011 |
| Financial liabilities designated at fair value at period-end | 98,280 | 80,436 | 88,133 |
| Including: | | | |
| Financial assets held to meet liabilities under: | | | |
| insurance contracts and investment contracts with DP ⁶ | 8,109 | 5,894 | 7,167 |
| unit-linked insurance and other insurance and investment contracts | 21,584 | 16,145 | 19,725 |
| Long-term debt issues designated at fair value | 79,574 | 63,692 | 69,906 |

For footnotes, see page 81.

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 of the *Annual Report and Accounts 2010*, respectively.

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The majority of the financial liabilities designated at fair value relate to certain fixed-rate long-term debt issues whose rate profile has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues 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 period to period, but do not alter the cash flows envisaged 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

customer groups or global businesses, but are reported in Other . Credit spread movements on own debt are excluded from underlying results, and related fair value movements are not included in the calculation of regulatory capital.

We reported a net expense from financial instruments designated at fair value of US\$0.1bn in the first half of 2011 compared with net income of US\$1.1bn in the first half of 2010. On an underlying basis, the equivalent figures were income of US\$43m and an expense of US\$5m, respectively. The difference between the reported and underlying results arose from the exclusion from the latter of 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\$143m in the first half of 2011 and favourable movements of US\$1.1bn in the first half of 2010. The adverse fair value movements during the first half of 2011 were driven by the tightening of credit spreads in Europe and North America, compared with widening credit spreads in the first half of 2010.

Net income arising from financial assets held to meet liabilities under insurance and investment contracts reflected investment gains in the period as equity markets improved, compared with losses in the first half of 2010. This predominantly affected

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Interim Management Report (continued)

the value of assets held to support unit-linked insurance and investment contracts in the UK and Hong Kong and participating contracts in France, while gains in Brazil were higher than in the comparable period in 2010.

The investment gains arising from the improved equity markets resulted in a corresponding increase 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 the gains relate to assets held to back investment contracts, the corresponding increase in liabilities to customers is also recorded under Net income from financial

instruments designated at fair value. This is in contrast to gains related to assets held to back insurance contracts or investment contracts with discretionary participation features (DPF), where the corresponding increase in liabilities to customers is recorded under Net insurance claims incurred and movement in liabilities to policyholders.

Net income from financial instruments designated at fair value also included adverse foreign exchange movements on foreign currency debt designated at fair value, issued as part of our overall funding strategy, with an offset from trading assets held as economic hedges reported in Net trading income.

Gains less losses from financial investments

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net gains/(losses) from disposal of: | | | |
| debt securities | 306 | 382 | 182 |
| equity securities | 213 | 223 | 293 |
| other financial investments | (3) | (8) | 1 |
| | 516 | 597 | 476 |
| Impairment of available-for-sale equity securities | (31) | (40) | (65) |
| Gains less losses from financial investments | 485 | 557 | 411 |

Net gains from financial investments decreased by 13% and 5% on a reported and an underlying basis, respectively, the latter excluding an accounting gain from the reclassification of Bao Viet as an associate following the purchase of additional shares in the first half of 2010.

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The decline was driven by lower net gains on the disposal of debt securities, including available-for-sale government debt securities and mortgage-backed

securities, mostly due to the high level of realised gains in Hong Kong and Rest of Asia-Pacific in the first half of 2010.

The decrease was partly offset by an increase in net gains on the disposal of available-for-sale equity investments, and a lower level of impairments on available-for-sale investments reflecting a general improvement in the economic environment.

Net earned insurance premiums

| | 30 June | Half-year to 30 June | 31 December |
|--------------------------------|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Gross insurance premium income | 6,928 | 5,902 | 5,707 |
| Reinsurance premiums | (228) | (236) | (227) |
| Net earned insurance premiums | 6,700 | 5,666 | 5,480 |

Net earned insurance premiums increased by 18% and 14% on a reported and an underlying basis, respectively. This was primarily attributable to the continued growth of the life insurance business, particularly in Hong Kong.

In Hong Kong, sales of unit-linked and deferred annuity products rose. This resulted from increased demand for insurance products, together with higher levels of renewals from a larger in-force book of

business. Sales were also higher in Rest of Asia-Pacific, particularly in Singapore and Malaysia, driven by successful sales initiatives and increased demand for insurance products as economic conditions in the region continued to improve.

Investment products with DPF continued to generate strong net earned premium income in France, driven by successful targeted sales campaigns. Life insurance premiums in the UK were

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also higher, due to increased sales of a unit-linked product driven by our enhanced distribution capabilities.

In Latin America, net earned premium growth was strong, particularly for credit-related, term life and unit-linked products in Brazil, reflecting the improved economic environment and an increase in

the salesforce. In Argentina, repricing initiatives drove higher premiums on the motor book.

The above growth was partly offset by a reduction in premiums resulting from the non-renewal and transfer to third parties of certain contracts in our Irish business, and the run-off of the legacy motor book in the UK.

Other operating income

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Rent received | 75 | 297 | 238 |
| Losses recognised on assets held for sale | (4) | (100) | (163) |
| Valuation gains/(losses) on investment properties | 38 | (8) | 101 |
| Gain on disposal of property, plant and equipment, intangible assets and non-financial investments | 27 | 274 | 427 |
| Gains arising from dilution of interests in associates | 181 | 188 | |
| Change in present value of in-force long-term insurance business | 658 | 325 | 380 |
| Other | 310 | 502 | 101 |
| Other operating income | 1,285 | 1,478 | 1,084 |

Reported other operating income of US\$1.3bn decreased by 13% in the first half of 2011. Income in the period included a gain of US\$181m arising from a further dilution of our holding in Ping An following its issue of share capital to a third party. Income in the first half of 2010 also included a gain of US\$188m following a dilution of our holding in Ping An, a gain of US\$107m from the sale of HSBC Insurance Brokers, a gain of US\$66m from the disposal of our interest in the Wells Fargo HSBC Trade Bank and a write-down of US\$47m resulting from an agreement to sell our shareholding in British Arab Commercial Bank plc. The first half of 2010 also included rent received as a component of the operating result of Eversholt Rail Group which was sold in December 2010.

On an underlying basis, excluding these items, other operating income increased by 13% as the non-recurrence of gains of US\$194m and US\$56m

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recognised in 2010 on the sale and leaseback of our Paris and New York headquarters, respectively, was more than offset by favourable movements in the present value of in-force (PVIF) long-term insurance business. The calculation of the PVIF asset was refined during the period to bring greater comparability and consistency across our insurance operations, which led to a gain of US\$243m (see footnote 27 on page 81). Higher sales of life insurance products, notably in Hong Kong, also contributed to the increase in the PVIF asset.

Net losses recognised on assets held for sale declined as a US\$77m loss recognised on the sale of the US vehicle finance servicing operations and associated US\$1.0bn loan portfolio in the first half of 2010 did not recur. In addition, the first half of 2011 included gains on the sale of buildings including the sale and leaseback of branches in Mexico.

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Interim Management Report (continued)**Net insurance claims incurred and movement in liabilities to policyholders**

| | 30 June | Half-year to 30 June | 31 December |
|---|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Insurance claims incurred and movement in liabilities to policyholders: | | | |
| gross | 6,761 | 5,281 | 6,688 |
| reinsurers share | (144) | (160) | (42) |
| net | 6,617 | 5,121 | 6,646 |

For footnote, see page 81.

Net insurance claims incurred and movement in liabilities to policyholders increased by 29% on a reported basis and by 26% on an underlying basis.

Additional reserves were established for new business written, driven by premium growth in Hong Kong, Rest of Asia-Pacific, Latin America and Europe, reflecting sales campaigns and improved market conditions.

Further increases in the movement in liabilities to policyholders resulted from gains on the fair value of the assets held to support policyholder funds as equity markets improved, particularly on unit-linked contracts in the UK and Hong Kong and on investment contracts with DPF in France, compared with losses in the first half of 2010. Gains on the fair

value of the assets held to support unit-linked contracts in Brazil increased compared with the equivalent period in 2010.

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

The non-renewal and transfer to third parties of certain contracts in the Irish business and the run-off of the legacy motor book in the UK resulted in a decrease in net insurance claims incurred and movement in liabilities to policyholders, partly offsetting the above.

Loan impairment charges and other credit risk provisions

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| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Loan impairment charges | | | |
| New allowances net of allowance releases | 5,703 | 7,687 | 6,881 |
| Recoveries of amounts previously written off | (730) | (453) | (567) |
| | 4,973 | 7,234 | 6,314 |
| Individually assessed allowances | 638 | 1,069 | 1,556 |
| Collectively assessed allowances | 4,335 | 6,165 | 4,758 |
| Impairment of available-for-sale debt securities | 308 | 282 | 190 |
| Other credit risk provisions/(recoveries) | (15) | 7 | 12 |
| Loan impairment charges and other credit risk provisions | 5,266 | 7,523 | 6,516 |
| | % | % | % |
| as a percentage of net operating income excluding the effect of fair value movements in respect of credit spread on own debt and before loan impairment charges and other credit risk provisions | 14.7 | 21.8 | 19.3 |
| Impairment charges on loans and advances to customers as a percentage of gross average loans and advances to customers (annualised) | 1.0 | 1.7 | 1.4 |
| | US\$m | US\$m | US\$m |
| Customer impaired loans | 25,982 | 27,887 | 28,091 |
| Customer loan impairment allowances | 18,732 | 22,033 | 20,083 |

On a reported basis loan impairment charges and other credit risk provisions decreased from US\$7.5bn to US\$5.3bn, a decline of 30% compared with the first half of 2010 and 32% on an underlying

basis. Within this, collectively assessed allowances and individually assessed impairment allowances fell by 31% and 43%, respectively.

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At 30 June 2011, the aggregate balance of customer loan impairment allowances was US\$18.7bn. This represented 2% of gross loans and advances to customers (net of reverse repos and settlement accounts) compared with 3% at 30 June 2010.

The improvement in loan impairment charges and other credit risk provisions was seen across all regions. The most significant diminution in loan impairment charges was in RBWM in North America due to the continued decline in the run-off portfolios and the ongoing reduction of outstanding credit card debt by customers in the Card and Retail Services business, as well as a general improvement in credit quality. In addition, credit quality also improved for our RBWM business in Europe, reflecting the continued shift from unsecured to secured lending. Loan impairment charges and other credit risk provisions in GB&M and CMB also declined.

Impairments on available-for-sale debt securities were broadly in line with the first half of 2010.

In North America, loan impairment charges and other credit risk provisions fell by 33% to US\$3bn, representing 62% of the Group's reduction in loan impairment charges and other credit risk provisions compared with the first half of 2010.

Loan impairment charges in our Consumer Lending and Mortgage Services businesses in the US fell by 30% to US\$2.2bn, driven by lower lending balances, delinquency and write-off levels as the portfolios continued to run off. These decreases were partly offset by an incremental charge resulting from changes to economic assumptions on the pace of recovery in home prices and delays in the timing of expected cash flows as a consequence of the suspension of foreclosure activity which began in late 2010.

In Card and Retail Services, loan impairment charges fell by 47% to US\$705m. The decrease was driven by lower lending balances reflecting fewer active accounts and consumers' continued efforts to reduce their credit card debt. The easing in economic conditions, lower delinquency levels and higher recovery rates were also factors in the reduction.

In Europe, loan impairment charges and other credit risk provisions decreased by 26% to US\$1.2bn. In RBWM, loan impairment charges declined due to improved delinquency trends across both the secured and unsecured portfolios, reflecting enhanced credit risk management practices, improved collections and the effects of the low interest rate environment in the UK. In CMB, loan

impairment charges and other credit risk provisions fell by US\$69m, driven by lower customer-specific impairments.

In Europe we recorded an impairment of US\$105m in the first half of 2011 in respect of available-for-sale Greek sovereign debt. Further information on our exposures to countries in the eurozone, is provided in 'Areas of special interest - wholesale lending' on page 98.

In the Middle East and North Africa, loan impairment charges and other credit risk provisions declined by 77% to US\$99m, primarily in our GB&M business, due to the non-recurrence of impairment charges against a small number of large corporate customers in the United Arab Emirates (UAE) in the first half of 2010. In our RBWM business, loan impairment charges also reduced, by 59% to US\$58m, due to lower lending balances and a significant improvement in delinquency rates driven by the repositioning of the loan book, higher quality lending and strengthened collections practices.

Loan impairment charges and other credit risk provisions in Latin America decreased by 8% to US\$820m, primarily in RBWM. This was mainly in the credit card portfolios in Mexico due to the managed decline of riskier portfolios and lower delinquency rates as a result of tightened underwriting criteria, better collections practices and improved credit conditions. In our CMB portfolios, loan impairment charges and other credit risk provisions declined by 3% to US\$180m, principally as improved economic conditions resulted in lower specific impairment charges against commercial real estate exposures in Mexico.

In the Rest of Asia-Pacific region, loan impairment charges decreased by 36%, notably in RBWM as certain unsecured lending portfolios continued to be managed down in India. This reduction was partly offset by the non-recurrence of impairment releases in GB&M that occurred

in the first half of 2010.

In Hong Kong, loan impairment charges and other credit risk provisions fell by 60% to US\$25m, primarily from the non-recurrence of a specific impairment charge in GB&M along with higher recoveries and a reduction in the level of collective loan impairment allowances in the first half of 2011. Despite the low level of impairment charges in the region, we remained vigilant on maintaining underwriting standards and continued to focus on maintaining high levels of asset quality.

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Interim Management Report (continued)**Operating expenses**

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| By expense category | | | |
| Employee compensation and benefits | 10,521 | 9,806 | 10,030 |
| Premises and equipment (excluding depreciation and impairment) | 2,196 | 2,089 | 2,259 |
| General and administrative expenses | 6,223 | 4,925 | 5,883 |
| Administrative expenses | 18,940 | 16,820 | 18,172 |
| Depreciation and impairment of property, plant and equipment | 805 | 834 | 879 |
| Amortisation and impairment of intangible assets | 765 | 457 | 526 |
| Operating expenses | 20,510 | 18,111 | 19,577 |

| | 30 June | At 30 June | 31 December |
|---|----------------|---------------|-------------|
| | 2011 | 2010 | 2010 |
| Staff numbers (full-time equivalent) | | | |
| Europe | 76,879 | 73,431 | 75,698 |
| Hong Kong | 30,214 | 28,397 | 29,171 |
| Rest of Asia-Pacific | 91,924 | 88,605 | 91,607 |
| Middle East and North Africa | 8,755 | 8,264 | 8,676 |
| North America | 32,605 | 33,988 | 33,865 |
| Latin America | 55,618 | 54,886 | 56,044 |
| Staff numbers | 295,995 | 287,571 | 295,061 |

Cost efficiency ratios

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | | | |

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| | % | % | % |
|--|-------------|------|------|
| HSBC | 57.5 | 50.9 | 59.9 |
| Geographical regions | | | |
| Europe | 70.7 | 60.6 | 77.2 |
| Hong Kong | 43.2 | 40.2 | 46.4 |
| Rest of Asia-Pacific | 53.0 | 53.7 | 57.6 |
| Middle East and North Africa | 46.4 | 43.7 | 45.7 |
| North America | 55.8 | 44.0 | 54.2 |
| Latin America | 65.3 | 63.9 | 67.4 |
| Customer groups and global businesses | | | |
| Retail Banking and Wealth Management ¹⁶ | 61.2 | 56.5 | 59.7 |
| Commercial Banking | 45.1 | 48.5 | 50.3 |
| Global Banking and Markets ¹⁶ | 50.2 | 44.6 | 53.8 |
| Global Private Banking | 66.1 | 62.7 | 68.9 |

For footnote, see page 81.

Operating expenses increased by 13% to US\$20.5bn on a reported basis. On an underlying basis, they increased by 10% and 2% compared with the first and second halves of 2010, respectively. There were a number of significant items during the first half of 2011, notably US\$611m of provisions relating to customer redress programmes in the UK, including a provision of US\$455m in respect of the adverse judgement in the Judicial Review relating to sales of PPI. Litigation costs increased in the US. This was offset by a credit of US\$587m resulting from a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred

pensions. In the first half of 2010, payroll and bonus taxes in the UK and France amounting in aggregate to US\$398m (US\$367m as reported) and the US pension curtailment, which generated accounting credits of US\$148m, were recorded.

The growth in business volumes, which was primarily in Hong Kong, Rest of Asia-Pacific and Latin America and was partly driven by expansion during 2010 and the first half of 2011, was supported by a rise in staff numbers as we recruited selectively. Overall average staff numbers (expressed in full-time equivalents) grew by 3% over the comparable

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period and by 2% over the second half of 2010. Higher wages and salaries reflected the rising demand for talent in certain countries, union-agreed salary increases and an acceleration in the expense recognition for deferred bonus awards of US\$138m as employees now have a better understanding of the likely nature of their deferred awards. (See page 80).

GB&M continued to develop the operational capabilities of their Prime Services and equity market products and expanded their Rates and Foreign Exchange e-commerce platforms, which resulted in higher costs.

Marketing and advertising costs increased, primarily in support of the Group brand through the sponsorship of various activities.

In order to improve cost efficiency and organisational effectiveness we initiated a Group-wide review during the period which resulted in restructuring costs of US\$477m, primarily in the US, Latin America and Europe, which included impairments on certain software projects now deferred or cancelled.

Share of profit in associates and joint ventures

| | 30 June | Half-year to 30 June | 31 December |
|---|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Associates | | | |
| Bank of Communications Co., Limited | 642 | 467 | 520 |
| Ping An Insurance (Group) Company of China, Limited | 469 | 377 | 471 |
| Industrial Bank Co., Limited | 199 | 146 | 181 |
| The Saudi British Bank | 171 | 101 | 60 |
| Other | 56 | 84 | 72 |
| Share of profit in associates | 1,537 | 1,175 | 1,304 |
| Share of profit in joint ventures | 19 | 12 | 26 |
| Share of profit in associates and joint ventures | 1,556 | 1,187 | 1,330 |

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The share of profit in associates and joint ventures was US\$1.6bn, an increase of 31% compared with the first half of 2010 on a reported basis and 27% on an underlying basis. This increase was driven by higher contributions from the mainland China associates as they capitalised on the robust economic conditions in the country.

Our share of profits from the Bank of Communications Co., Limited (Bank of

Communications) was 32% higher than in the first half of 2010 from strong loan growth, an improvement in deposit spreads as base rates increased and expanding fee-based revenue streams. Profits from Ping An also rose, driven by strong sales growth and the performance of the insurance, banking and wealth management business. Profits from Industrial Bank Co., Limited (Industrial Bank) similarly increased as a result of continued strong loan growth.

Tax expense

| | 30 June | Half-year to 30 June | 31 December |
|--------------------|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Profit before tax | 11,474 | 11,104 | 7,933 |
| Tax expense | (1,712) | (3,856) | (990) |
| | | | |
| Profit after tax | 9,762 | 7,248 | 6,943 |
| | | | |
| Effective tax rate | 14.9% | 34.7% | 12.5% |

Our tax charge in the first half of 2011 was 55.6% lower than in the first half of 2010 on a reported basis. The lower tax charge in the first half of 2011 included the benefit of deferred tax now eligible to be recognised in respect of foreign tax credits, partly offset by a current period tax charge in respect of prior periods.

The tax charge in the first half of 2010 included US\$1.6bn attributable to a taxable gain arising from an internal reorganisation within our North American operations. The resulting reported effective tax rate for the first half of 2011 was 14.9% compared with 34.7% for the first half of 2010.

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Interim Management Report (continued)**Consolidated balance sheet***Summary consolidated balance sheet*

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--|--------------------------------|--------------------------------|------------------------------------|
| ASSETS | | | |
| Cash and balances at central banks | 68,218 | 71,576 | 57,383 |
| Trading assets | 474,950 | 403,800 | 385,052 |
| Financial assets designated at fair value | 39,565 | 32,243 | 37,011 |
| Derivatives | 260,672 | 288,279 | 260,757 |
| Loans and advances to banks | 226,043 | 196,296 | 208,271 |
| Loans and advances to customers ²⁹ | 1,037,888 | 893,337 | 958,366 |
| Financial investments | 416,857 | 385,471 | 400,755 |
| Other assets | 166,794 | 147,452 | 147,094 |
| | | | |
| Total assets | 2,690,987 | 2,418,454 | 2,454,689 |
| | | | |
| LIABILITIES AND EQUITY | | | |
| Liabilities | | | |
| Deposits by banks | 125,479 | 127,316 | 110,584 |
| Customer accounts | 1,318,987 | 1,147,321 | 1,227,725 |
| Trading liabilities | 385,824 | 274,836 | 300,703 |
| Financial liabilities designated at fair value | 98,280 | 80,436 | 88,133 |
| Derivatives | 257,025 | 287,014 | 258,665 |
| Debt securities in issue | 149,803 | 153,600 | 145,401 |
| Liabilities under insurance contracts | 64,451 | 52,516 | 58,609 |
| Other liabilities | 123,601 | 152,092 | 109,954 |
| | | | |
| Total liabilities | 2,523,450 | 2,275,131 | 2,299,774 |

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| | | | |
|--|------------------|-----------|-----------|
| Equity | | | |
| Total shareholders' equity | 160,250 | 135,943 | 147,667 |
| Non-controlling interests | 7,287 | 7,380 | 7,248 |
| Total equity | 167,537 | 143,323 | 154,915 |
| Total equity and liabilities | 2,690,987 | 2,418,454 | 2,454,689 |
| <i>Selected financial information</i> | | | |
| Called up share capital | 8,909 | 8,755 | 8,843 |
| Capital resources ^{30,31} | 173,784 | 154,886 | 167,555 |
| Undated subordinated loan capital | 2,782 | 2,780 | 2,781 |
| Preferred securities and dated subordinated loan capital ³² | 53,659 | 48,118 | 54,421 |
| Risk-weighted assets and capital ratios³⁰ | | | |
| Risk-weighted assets | 1,168,529 | 1,075,264 | 1,103,113 |
| | % | % | % |
| Core tier 1 ratio | 10.8 | 9.9 | 10.5 |
| Tier 1 ratio | 12.2 | 11.5 | 12.1 |
| Financial statistics | | | |
| Loans and advances to customers as a percentage of customer accounts | 78.7 | 77.9 | 78.1 |
| Average total shareholders' equity to average total assets | 5.7 | 5.5 | 5.5 |
| Net asset value per ordinary share at period-end ³³ (US\$) | 8.59 | 7.35 | 7.94 |
| Number of US\$0.50 ordinary shares in issue (millions) | 17,818 | 17,510 | 17,686 |
| Closing foreign exchange translation rates to US\$: | | | |
| US\$1: £ | 0.625 | 0.667 | 0.644 |
| US\$1: | 0.690 | 0.815 | 0.748 |
| <i>For footnotes, see page 81.</i> | | | |

A more detailed consolidated balance sheet is contained in the Financial Statements on page 173.

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Movement from 31 December 2010 to 30 June 2011

Total reported assets were US\$2.7 trillion, 10% higher than at 31 December 2010. Underlying assets, excluding the effect of currency movements, increased by 7%. Strong deposit gathering activities across all regions led to significant growth in customer accounts, which enabled us to support our customers' borrowing requirements. Growth in trading assets reflected an improvement in trading activity in the first half of 2011 and an increase in our share of global bond issuances for clients. We remain well capitalised and strongly liquid.

The following commentary is on an underlying basis, compared with the balance sheet at 31 December 2010.

Assets

Cash and balances at central banks rose by 16% due to higher overnight balances with central banks in North America and Asia. This was partly offset by lower residual cash from daily operations placed with central banks in Europe.

Trading assets grew by 20%. Holdings of debt securities, including government and government agency debt securities, increased, reflecting both our role as primary market maker and customer demand. Settlement account balances, which vary considerably in proportion to the level of trading activity, also grew significantly. Higher reverse repo balances were attributable to an increase in client trading and the development of repo products across the regions.

Financial assets designated at fair value were broadly in line with 31 December 2010 levels.

Derivative assets fell by 4%, largely driven by a reduction in the fair value of interest rate contracts in Europe as the euro yield curve moved upwards, coupled with higher netting as we increased our trading through clearing houses. This was partly offset by an increase in the fair value of foreign exchange contracts due to higher levels of client demand.

Loans and advances to banks increased by 5% due to a rise in term placements with commercial and central banks, particularly in Asia.

Loans and advances to customers rose by 6% with increases in all regions except North America. This reflected targeted customer lending growth in CMB and GB&M, mainly in Europe, Hong Kong and Rest of Asia-Pacific, as the economic environment improved and trade flows rose. Mortgage balances increased in Hong Kong and the

UK as we continued to reposition RBWM towards higher quality secured lending and focus on target markets. This was partly offset by the planned decline in lending balances in the run-off portfolios in North America, coupled with a reduction in credit card advances as our customers continued to pay down their credit card debt.

Financial investments rose by 2% due to purchases of government, government agency and highly rated corporate debt securities, in line with the growth in deposit balances.

Other assets increased by 13% due to a rise in items in the course of collection, reflecting increased activity within the central clearing system, notably in Hong Kong.

Liabilities

Deposits by banks increased by 9% due to a rise in funds placed with HSBC by other financial institutions including higher balances relating to our Payments and Cash Management business.

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Customer accounts were 5% higher. Strong growth was seen across most customer groups and regions, reflecting an increase in customer numbers and the success of promotional deposit campaigns. Repo balances also rose in Europe, driven by higher customer activity.

Trading liabilities grew by 24% due to an increase in settlement account balances which vary in proportion to the volume of trading activity. Repo balances increased to finance a rise in long inventory and client-driven trading positions. Short bond positions also rose, in line with the growth in the Rates portfolio.

Financial liabilities designated at fair value rose by 9% due to debt issuances by HSBC entities in Europe in the first half of 2011. This was partly offset by debt maturities that were not replaced in North America due to lower funding requirements as the consumer finance portfolios continued to decline.

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

Debt securities in issue remained in line with 31 December 2010 levels as new issuances in Europe and Latin America were largely offset by lower funding requirements in North America in line with the reduction in lending balances.

Liabilities under insurance contracts grew by 6%, driven by higher sales and renewals of life insurance products in Hong Kong.

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Interim Management Report (continued)

Other liabilities rose by 10% due to an increase in items in the course of transmission to other banks in Hong Kong, corresponding with the increase in items in the course of collection above.

Equity

Total shareholders equity increased by 6%, driven by profits generated during the period and a reduction in the negative balance of the available-for-sale reserve reflecting a rise in market prices.

Reconciliation of reported and underlying changes in assets and liabilities

| | 30 June 2011 compared with 31 December 2010 | | | | | | |
|---|---|---------------------------|--------------|------------|-----------|----------|--------|
| | 31 Dec 10 | | 31 Dec 10 | | 30 Jun 11 | | |
| | as | Currency | at 30 Jun 11 | | as | Reported | Under- |
| | reported | translation ³⁴ | exchange | Underlying | reported | change | lying |
| US\$m | US\$m | US\$m | change | US\$m | % | % | |
| | | | US\$m | | | | |
| HSBC | | | | | | | |
| Cash and balances at central banks | 57,383 | 1,621 | 59,004 | 9,214 | 68,218 | 19 | 16 |
| Trading assets | 385,052 | 12,279 | 397,331 | 77,619 | 474,950 | 23 | 20 |
| Financial assets designated at fair value | 37,011 | 1,541 | 38,552 | 1,013 | 39,565 | 7 | 3 |
| Derivative assets | 260,757 | 10,881 | 271,638 | (10,966) | 260,672 | | (4) |
| Loans and advances to banks | 208,271 | 7,330 | 215,601 | 10,442 | 226,043 | 9 | 5 |
| Loans and advances to customers | 958,366 | 24,619 | 982,985 | 54,903 | 1,037,888 | 8 | 6 |
| Financial investments | 400,755 | 6,983 | 407,738 | 9,119 | 416,857 | 4 | 2 |
| Other assets | 147,094 | 704 | 147,798 | 18,996 | 166,794 | 13 | 13 |
| | | | | | | | |
| Total assets | 2,454,689 | 65,958 | 2,520,647 | 170,340 | 2,690,987 | 10 | 7 |
| | 110,584 | 4,188 | 114,772 | 10,707 | 125,479 | 13 | 9 |

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| | | | | | | | |
|--|-----------|--------|-----------|----------|-----------|-----|-----|
| Deposits by banks | | | | | | | |
| Customer accounts | 1,227,725 | 27,220 | 1,254,945 | 64,042 | 1,318,987 | 7 | 5 |
| Trading liabilities | 300,703 | 9,627 | 310,330 | 75,494 | 385,824 | 28 | 24 |
| Financial liabilities designated at fair value | 88,133 | 2,041 | 90,174 | 8,106 | 98,280 | 12 | 9 |
| Derivative liabilities | 258,665 | 10,844 | 269,509 | (12,484) | 257,025 | (1) | (5) |
| Debt securities in issue | 145,401 | 3,778 | 149,179 | 624 | 149,803 | 3 | |
| Liabilities under insurance contracts | 58,609 | 2,377 | 60,986 | 3,465 | 64,451 | 10 | 6 |
| Other liabilities | 109,954 | 1,929 | 111,883 | 11,718 | 123,601 | 12 | 10 |
| | | | | | | | |
| Total liabilities | 2,299,774 | 62,004 | 2,361,778 | 161,672 | 2,523,450 | 10 | 7 |
| | | | | | | | |
| Total shareholders' equity | 147,667 | 3,895 | 151,562 | 8,688 | 160,250 | 9 | 6 |
| Non-controlling interests | 7,248 | 59 | 7,307 | (20) | 7,287 | 1 | |
| | | | | | | | |
| Total equity | 154,915 | 3,954 | 158,869 | 8,668 | 167,537 | 8 | 5 |
| | | | | | | | |
| Total equity and liabilities | 2,454,689 | 65,958 | 2,520,647 | 170,340 | 2,690,987 | 10 | 7 |

For footnote, see page 81.

In the first half of 2011, the effect of acquisitions and disposals was not significant.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Economic profit/(loss)**

Our internal performance measures include economic profit/(loss), a calculation which compares the return on financial capital invested in HSBC by our shareholders with the cost of that capital. We price our cost of capital internally and the difference between that cost and the post-tax profit attributable to ordinary shareholders represents the amount of economic profit/(loss) generated. In order to concentrate on external factors rather than measurement bases, we emphasise the trend in economic profit/(loss) ahead of absolute amounts.

Our long-term cost of capital is reviewed annually and is 11% for 2011; this remains unchanged from 2010. We use the Capital Asset Pricing Model to determine our cost of capital. The following commentary is on a reported basis.

Economic profit/(loss)

The return on invested capital increased by 2.0 percentage points to 11.4%, which is broadly in line with our benchmark cost of capital. Our economic profit was US\$0.3bn, an increase of US\$1.5bn compared with a loss at 30 June 2010, due to an increase in profit attributable to shareholders. This was predominantly driven by a lower tax charge as well as an increase in reported profit before tax due to lower loan impairment charges across all regions, notably in the US, partly offset by an increase in costs.

The increase in average invested capital reflected higher retained earnings and an increase in the average foreign exchange reserves primarily due to the effect of euro and sterling rate movements on our underlying assets.

| | 30 June 2011 | | Half-year to 30 June 2010 | | 31 December 2010 | |
|--|--------------|-----------------|------------------------------|-----------------|------------------|-----------------|
| | US\$m | % ³⁵ | US\$m | % ³⁵ | US\$m | % ³⁵ |
| Average total shareholders' equity | 153,312 | | 131,198 | | 143,712 | |
| Adjusted by: | | | | | | |
| Goodwill previously amortised or written off | 8,123 | | 8,123 | | 8,123 | |
| Property revaluation reserves | (916) | | (786) | | (820) | |
| Reserves representing unrealised losses on effective cash flow hedges | 384 | | 25 | | 155 | |
| Reserves representing unrealised losses on available-for-sale securities | 3,699 | | 7,590 | | 4,298 | |
| Preference shares and other equity instruments | (7,256) | | (3,661) | | (7,256) | |
| Average invested capital ³⁶ | 157,346 | | 142,489 | | 148,212 | |
| Return on invested capital ³⁷ | 8,929 | 11.4 | 6,629 | 9.4 | 6,117 | 8.2 |
| Benchmark cost of capital | (8,583) | (11.0) | (7,772) | (11.0) | (8,320) | (11.0) |
| Economic profit/(loss) and spread | 346 | 0.4 | (1,143) | (1.6) | (2,203) | (2.8) |



For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Ratios of earnings to combined fixed charges (and preference share dividends)**

| | Half-year to 30 June 2011 | 2010 | Year ended 31 December | | | 2006 |
|---|--|------|------------------------|------|------|------|
| | | | 2009 | 2008 | 2007 | |
| Ratios of earnings to combined fixed charges and preference share dividends: ¹ | | | | | | |
| excluding interest on deposits | 6.36 | 5.89 | 2.64 | 2.97 | 6.96 | 7.22 |
| including interest on deposits | | | | | | |
| Ratios of earnings to combined fixed charges: ¹ | 1.71 | 1.69 | 1.20 | 1.13 | 1.34 | 1.40 |
| excluding interest on deposits | 7.79 | 7.10 | 2.99 | 3.17 | 7.52 | 7.93 |
| including interest on deposits | 1.76 | 1.73 | 1.22 | 1.14 | 1.34 | 1.41 |

¹ For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and non controlling interest plus fixed charges and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, preference share dividends, as applicable, and the proportion of rental expense deemed representative of the interest factor.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Customer accounts by country**

Europe

| | At 30 June 2011 | At 30 June 2010 | At 31 December 2010 |
|----------------------|-----------------------|--------------------|------------------------|
| | US\$m | US\$m | US\$m |
| UK | 366,134 | 335,493 | 351,522 |
| France ⁵⁶ | 101,032 | 68,942 | 65,407 |
| Germany | 9,046 | 7,698 | 7,063 |
| Malta | 6,200 | 5,084 | 5,968 |
| Switzerland | 46,790 | 41,556 | 43,098 |
| Turkey | 7,583 | 5,888 | 6,602 |
| Other | 12,026 | 12,597 | 11,903 |
| | 548,811 | 477,258 | 491,563 |
| Hong Kong | 305,726 | 274,112 | 297,484 |
| Rest of Asia-Pacific | | | |
| Australia | 18,780 | 12,641 | 16,640 |
| India | 11,732 | 11,269 | 12,143 |
| Indonesia | 5,982 | 5,599 | 5,572 |
| Japan | 5,378 | 4,432 | 5,575 |
| Mainland China | 28,481 | 21,893 | 27,007 |
| Malaysia | 16,962 | 13,751 | 15,257 |
| Singapore | 40,906 | 34,696 | 38,951 |
| South Korea | 5,278 | 4,258 | 4,303 |
| Taiwan | 11,968 | 10,385 | 12,131 |
| Vietnam | 1,543 | 1,358 | 1,255 |
| Other | 21,579 | 16,679 | 19,321 |
| | 168,589 | 138,319 | 158,155 |

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| | | | |
|------------------------------|----------------|---------|---------|
| Middle East and North Africa | | | |
| Egypt | 7,103 | 6,666 | 6,881 |
| Qatar | 3,319 | 3,192 | 3,069 |
| United Arab Emirates | 18,558 | 16,136 | 16,332 |
| Other | 8,139 | 6,983 | 7,229 |
| | 37,119 | 32,977 | 33,511 |
| North America | | | |
| US | 104,749 | 97,804 | 103,007 |
| Canada | 47,049 | 42,438 | 45,772 |
| Bermuda | 10,835 | 9,196 | 9,707 |
| | 162,633 | 149,438 | 158,486 |
| Latin America | | | |
| Argentina | 4,403 | 3,505 | 3,983 |
| Brazil | 52,285 | 41,001 | 49,253 |
| Mexico | 25,326 | 18,160 | 21,295 |
| Panama | 7,535 | 7,083 | 7,429 |
| Other | 6,560 | 5,468 | 6,566 |
| | 96,109 | 75,217 | 88,526 |

For footnote, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Customer groups and global businesses**

| | |
|---|-----|
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| <u>Other</u> | 37 |
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Summary

HSBC's senior management reviews operating activity on a number of bases, including by geographical region and by customer group and global business. Capital resources are allocated and performance is assessed primarily by geographical region, as presented on page 41.

In addition to utilising information by geographical region, management assesses performance through two customer groups, Retail Banking and Wealth Management (RBWM),

(formerly Personal Financial Services (PFS)) and Commercial Banking (CMB), and two global businesses, Global Banking and Markets (GB&M) and Global Private Banking (GPB). RBWM incorporates the Group's consumer finance businesses.

With effect from 1 March 2011, our Global Asset Management business was moved from GB&M to RBWM. This resulted in a reallocation between the two of US\$181m and US\$140m in profit before tax in the first and second halves of 2010, respectively, and in total assets of US\$3bn and US\$3.3bn at 30 June 2010 and 31 December 2010, respectively. All periods presented have been adjusted accordingly.

The commentaries below present customer groups and global businesses followed by geographical regions. Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region. All commentaries are on an underlying basis (see page 10) unless stated otherwise.

Profit/(loss) before tax

30 June 2011

Half-year to
30 June 2010

31 December 2010

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| | US\$m | % | US\$m | % | US\$m | % |
|--|---------|--------|-------|------|---------|--------|
| Retail Banking and Wealth Management ¹⁶ | 3,126 | 27.3 | 1,352 | 12.1 | 2,487 | 31.4 |
| Commercial Banking | 4,189 | 36.5 | 3,204 | 28.9 | 2,886 | 36.4 |
| Global Banking and Markets ¹⁶ | 4,811 | 41.9 | 5,452 | 49.1 | 3,763 | 47.4 |
| Global Private Banking | 552 | 4.8 | 556 | 5.0 | 498 | 6.3 |
| Other ³⁸ | (1,204) | (10.5) | 540 | 4.9 | (1,701) | (21.5) |

| | | | | | | |
|--|---------------|--------------|--------|-------|-------|-------|
| | 11,474 | 100.0 | 11,104 | 100.0 | 7,933 | 100.0 |
|--|---------------|--------------|--------|-------|-------|-------|

*Total assets*³⁹

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|--|------------------|--------------|-----------------|--------|---------------------|--------|
| | US\$m | % | US\$m | % | US\$m | % |
| Retail Banking and Wealth Management ¹⁶ | 557,952 | 20.7 | 510,092 | 21.1 | 530,970 | 21.6 |
| Commercial Banking | 336,094 | 12.5 | 264,077 | 10.9 | 296,797 | 12.1 |
| Global Banking and Markets ¹⁶ | 1,942,835 | 72.2 | 1,774,639 | 73.4 | 1,755,043 | 71.5 |
| Global Private Banking | 122,888 | 4.6 | 108,499 | 4.5 | 116,846 | 4.8 |
| Other | 189,912 | 7.0 | 189,153 | 7.8 | 161,458 | 6.6 |
| Intra-HSBC items | (458,694) | (17.0) | (428,006) | (17.7) | (406,425) | (16.6) |
| | 2,690,987 | 100.0 | 2,418,454 | 100.0 | 2,454,689 | 100.0 |

*Risk-weighted assets*⁴⁰

| | At 30 June 2011 | | At 31 December 2010 | |
|--------------------------------------|-----------------|--------------|---------------------|-------|
| | US\$bn | % | US\$bn | % |
| Total | 1,168.5 | 100.0 | 1,103.1 | 100.0 |
| Retail Banking and Wealth Management | 365.0 | 31.2 | 357.0 | 32.4 |
| Commercial Banking | 363.3 | 31.1 | 334.4 | 30.3 |
| Global Banking and Markets | 385.4 | 33.0 | 353.2 | 32.0 |
| Global Private Banking | 23.9 | 2.1 | 24.9 | 2.3 |
| Other | 30.9 | 2.6 | 33.6 | 3.0 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Retail Banking and Wealth Management**

RBWM provides 85 million individual and self-employed customers with financial services in over 60 markets worldwide.

| | 30 Jun | Half-year to ¹⁶ 30 Jun | 31 Dec |
|--|-----------------|--------------------------------------|----------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 12,086 | 12,194 | 11,972 |
| Net fee income | 4,212 | 4,060 | 4,337 |
| Other income | 1,274 | 299 | 749 |
| Net operating income⁴¹ | 17,572 | 16,553 | 17,058 |
| Impairment charges ⁴² | (4,270) | (6,318) | (4,941) |
| Net operating income | 13,302 | 10,235 | 12,117 |
| Total operating expenses | (10,746) | (9,349) | (10,190) |
| Operating profit | 2,556 | 886 | 1,927 |
| Income from associates ⁴³ | 570 | 466 | 560 |
| Profit before tax | 3,126 | 1,352 | 2,487 |
| RoRWA ⁴⁴ | 1.8% | 0.8% | 1.4% |

Significant growth in

insurance and investments

Run-off portfolio balances reduced by

US\$4.9bn

**Best retail bank
in Hong Kong**
(The Asian Banker)

**Best foreign bank
in China**
(The Asian Banker)

Strategic direction

RBWM's aim is to provide consistent and high quality retail banking and wealth management services to our customers. We will provide retail banking services in markets where we already have scale or where scale can be built over time and we will implement standardised distribution and service models to ensure we can deliver them more efficiently. As wealth creation continues to grow in both developed and emerging markets, we will leverage our global propositions such as Premier and our bancassurance and asset management capabilities to deepen our existing customer relationships and the penetration of our wealth management services.

We focus on three strategic imperatives:

developing world class wealth management for retail customers;

leveraging global expertise in retail banking; and

portfolio management to drive superior returns.

For footnotes, see page 81.

Review of performance

As announced last year, RBWM was created with effect from 1 March 2011, bringing together the PFS, insurance and Global Asset Management businesses under a unified management structure. This will enable us to drive our strategy of streamlining our retail banking businesses and developing world class wealth management services for retail customers.

RBWM reported a profit before tax of US\$3.1bn in the first half of 2011, more than double that in the first half of 2010. This was largely attributable to a decline in loan impairment charges, particularly in the US, where delinquency trends continued to improve following the managed reduction in the run-off portfolios.

We continued to rebalance revenue and profit contribution with growth in our priority markets, offsetting declines in run-off portfolios in the US.

Revenue increased by 3%, as income rose in Hong Kong and Rest of Asia-Pacific from an increase in the sales of wealth management products. In Europe, revenue rose as a result of increased lending, notably in mortgages, and net insurance income, driven by successful targeted sales campaigns, particularly in France. Net interest income increased in Rest of Asia-Pacific and Latin America from higher volumes. Deposit spreads increased in parts of Rest of Asia-Pacific due to increases in interest rates, particularly in mainland China, India and Malaysia. This was partly offset by reductions in North America due to lower lending balances in both the run-off portfolio and in the Card and Retail Services business. In a number of markets, particularly Mexico, India and the UAE, we continued to reposition our lending portfolio to lower risk, lower yielding assets. Europe, Hong Kong and Rest of Asia-Pacific benefited from an increase in PVIF due to refinement to the calculation of the PVIF asset (see footnote 27).

Loan impairment charges fell by 34%, reflecting the managed decline of riskier portfolios, and enhanced collection processes and underwriting practices. The loan book continued to decline in the US, and some high risk portfolios in Latin America, Rest of Asia-Pacific and Middle East and North Africa were managed down.

Operating expenses increased by 10% to US\$10.7bn. The rise in costs resulted mainly from increases in front office headcount in Hong Kong, Rest of Asia-Pacific and Brazil as we

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Interim Management Report (continued)

invested in these key growth markets, coupled with wage inflation in certain markets. Operating expenses included US\$589m of provisions relating to customer redress programmes in the UK, including a provision in respect of the adverse judgement in the Judicial Review relating to sales of PPI. Litigation provisions increased in the US. Operating costs also rose as we wrote off certain previously capitalised software development expenses and incurred other restructuring costs as part of our new strategic priorities. This was partly offset by a credit of US\$264m resulting from a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred pensions.

The share of profits from associates increased by 18%, mainly in Ping An due to an increase in profits driven by strong sales growth and the performance of its wealth management businesses and banking business.

Developing world class wealth management for retail customers

Our World Selection global investment offering continued to grow and total assets under management were US\$9.0bn at 30 June 2011, compared with US\$7.2bn at 31 December 2010.

Our insurance operations performed strongly in the first half of 2011, with increased net earned premiums compared with 2010. This was driven by a growing demand for life insurance products. The improved outlook for investment markets in 2011 generated increased demand for wealth products in Asia and a rise in new business sales in Hong Kong. In Latin America, increased premium income reflected an improving economic environment and investment in the sales network, notably in Brazil. The contribution from our investment in Ping An also increased, driven by growth in its life insurance business.

Global Asset Management increased management fees by 6% on the first half of 2010, most notably in Europe, Hong Kong and Latin America. Funds under management (FuM) reached a record period-end high of US\$449bn of which emerging markets FuM were US\$135bn. This represented growth in total FuM of 10% and emerging markets FuM of 14% compared with the first half of 2010. The increasing focus on our wealth management proposition generated US\$4.4bn of net inflows in the first half of 2011 compared with US\$1.3bn in 2010.

Leveraging global expertise in retail banking

We enhanced our services with a number of innovative developments, including the launch of renminbi-denominated deposits in an additional seven markets across Asia in the first half of 2011, and extended our mobile banking solution to Canada, Malaysia and Singapore.

We continued to grow mortgage lending in the UK and in Asia, particularly in Hong Kong where our volume growth in mortgages enabled us to maintain our market leadership. In Australia, Singapore and Malaysia we increased mortgage balances through targeted marketing campaigns. Customer account balances also grew in Rest of Asia-Pacific, reflecting an increase in customer numbers, and in Europe due to competitive pricing and acquisition campaigns.

Portfolio management to drive superior returns

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During the first half of 2011, we continued to reposition our operations and optimise our businesses. In line with this, in April, we announced the sale of HSBC Afore, our pension administration business in Mexico, which is expected to be completed in the third quarter of 2011. Also in April, following a strategic review of our operations in Russia, we announced our withdrawal from the retail business, and have now agreed the sale of some elements of this business.

In May 2011, we sold our Insurance Captive Management business which provided third party property and third party insurance claim administration services. This is part of our strategy to focus our insurance business on connectivity to core banking customers and wealth management product offerings.

In July, we announced the sale of our UK motor insurance portfolio and the closure of retail banking operations in Poland.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Commercial Banking**

CMB offers a full range of commercial financial services to 3.6m customers ranging from sole proprietors to publicly quoted companies in 65 countries.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|----------------|------------------------|---------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 4,814 | 4,024 | 4,463 |
| Net fee income | 2,131 | 1,935 | 2,029 |
| Other income | 735 | 781 | 602 |
| Net operating income⁴¹ | 7,680 | 6,740 | 7,094 |
| Impairment charges ⁴² | (642) | (705) | (1,100) |
| Net operating income | 7,038 | 6,035 | 5,994 |
| Total operating expenses | (3,465) | (3,266) | (3,565) |
| Operating profit | 3,573 | 2,769 | 2,429 |
| Income from associates ⁴³ | 616 | 435 | 457 |
| Profit before tax | 4,189 | 3,204 | 2,886 |
| RoRWA ⁴⁴ | 2.4% | 2.2% | 1.8% |

Revenue growth of

12%

ahead of cost growth of 3%

on an underlying basis

Trade revenue grew

26%

compared with world GDP growth of 3%

Strong revenue growth from

the sale of GB&M products

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 focus on four strategic imperatives:

focus on faster-growing markets while connecting revenue and investment flows with developed markets;

enhance collaboration with GB&M, providing capital market access and a wider range of sophisticated risk management and liquidity products to the growing mid-market corporates;

capture growth in international small and medium-sized enterprises; and

drive efficiency gains through adopting a global operating model.

For footnotes, see page 81.

Review of performance

In the first half of 2011, CMB reported a profit before tax of US\$4.2bn, US\$1.0bn or 31% higher than in the first half of 2010. On an underlying basis, profit before tax also increased by 31%, reflecting higher lending balances and an expansion in world trade, in particular in the faster-growing markets. Income from our associate, Bank of Communications, also increased reflecting strong loan growth and wider spreads. Profit before tax grew in all regions except North America where we are investing in areas of strong international connectivity.

Customer lending balances rose from the end of 2010 by 9% to US\$268bn, primarily in Asia, Europe and Latin America, driven by the expanding trade flows and increased business activity. Demand for credit remained strong in Hong Kong, Malaysia and Brazil. Lending balances also increased in the UK by 2% to US\$69.9bn.

Credit quality improved as our exposure to higher risk portfolios was managed down and the economic environment generally improved. As a result, loan impairment charges and other credit risk provisions declined by 14%. In the first half of 2011, there was a marked decline in loan impairment charges against specific exposures in Europe while, in North America, there were notable falls in loan impairment charges.

In the first half of 2011, CMB grew customer account balances by 3% to US\$301bn, with significant growth in Asia and Latin America driven partly by new customer acquisitions.

Shift towards faster-growing markets while connecting with developed markets

Revenue increased by 12%, primarily in Latin America (specifically Brazil, Mexico and Argentina), Hong Kong and the Rest of Asia-Pacific region (specifically mainland China, India and Singapore). This was driven by lending to meet higher credit demand as a result of improved trade and business volumes, and deposit balance growth. Net fee income also increased from rising sales of trade, payments and cash management, investment and Global Markets products.

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In line with our aspiration to double our trade revenue over the medium term, we merged our Trade and Supply Chain and Receivables Finance businesses, allowing us to build on the scale of our trade business to expand our receivables

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HSBC HOLDINGS PLC

Interim Management Report (continued)

finance offerings from the existing base of 23 countries.

In the first half of 2011, our trade revenue was US\$1bn, an increase of 26% compared with the first half of 2010. Significantly, growth in our trade revenue was more than eight times that of world GDP growth, reflecting our concentration in the faster growing markets.

Our geographic presence across both mature and faster-growing markets allowed us to capitalise on the rising levels of international trade and investment flows. We achieved a significant number of mandates to provide cross-border payments and cash management solutions for our corporate customers, reinforcing the importance of our geographic network to this customer segment.

In the first half of 2011, the number of successful cross-border referrals increased by 43% compared with the first half of 2010, with a transaction value of over US\$12bn. Notably, 66% of this increase came from mainland China, demonstrating its significance to CMB.

We continued to strengthen our position as a leading international bank for renminbi product offerings through product innovation in over 50 locations on six continents. In the first half of 2011, we were the first international bank to provide commercial banking customers with a dedicated renminbi Business Card in Hong Kong, minimising their foreign exchange risk, and in Singapore we expanded our renminbi capabilities, including an e-platform for payments in the currency.

Enhance collaboration with GB&M

Our customers benefit from the diversity of products and services available from a universal bank. This includes Global Markets products provided to CMB customers with more complex requirements, as well as GPB and Premier services for our business customers' personal wealth requirements.

CMB revenue generated from the sale of Global Markets products grew strongly compared with the first half of 2010, with strong momentum in Asia and Latin America.

Capture growth in international SMEs

We are focusing our Business Banking propositions on attracting the growing number of internationally aspirant small and medium-sized enterprises (SMEs). 82% of SMEs in Hong Kong rate us as the best bank for international business and in the UK we have over 130 International Commercial Managers to support the Business Banking segment.

In the Middle East and North Africa, we pledged a second US\$100m during the period to SME customers in the UAE engaged in cross-border business and the amount has been fully utilised.

In Mexico, we launched the HSBC Business Card to facilitate working capital requirements and more effectively service the needs of our SME client base. Despite muted demand, CMB increased gross new lending to UK SMEs by 20% as we continued to support this important

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sector and assist new business start-ups. We are in line with our targets as set out in the Merlin Agreement between the major UK banks and the UK government.

Drive efficiency gains through adopting a global operating model

We continue to enhance and tailor CMB's direct banking solutions to improve our customer experience. We recognise our customers are increasingly more technologically oriented and CMB will continue to invest in and expand the transactional functionality and information services we offer. For example, in the UK, we were one of the first international financial institutions to offer a dedicated Business Mobile Banking iApp, achieving almost 70,000 downloads in the first month. For our corporate segment customers, HSBCnet for Mobile was piloted in 40 countries in the first half of 2011, with a further 25 countries due to go live by the end of 2011, subject to regulatory approvals.

Operating expenses rose by 3% to US\$3.5bn. Excluding a credit of US\$212m resulting from a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred pensions, they increased by 9% to US\$3.7bn. On the same basis, after adjusting for this credit, our cost efficiency ratio improved from 49.2% to 47.8%, reflecting a disciplined approach to managing the cost base. In the Rest of Asia-Pacific region, the cost efficiency ratio improved by 2 percentage points to 47.2% despite inflationary pressures and the addition of almost 200 new staff as we expanded our business in this strategically important market.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Global Banking and Markets**

GB&M is a global business which provides tailored financial solutions to major government, corporate and institutional clients worldwide.

| | 30 Jun | Half-year to ¹⁶ 30 Jun | 31 Dec |
|--|--------------|--------------------------------------|---------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 3,603 | 3,724 | 3,619 |
| Net fee income | 1,730 | 1,879 | 1,785 |
| Net trading income ⁴⁵ | 3,827 | 3,754 | 2,076 |
| Other income | 529 | 963 | 1,112 |
| Net operating income⁴¹ | 9,689 | 10,320 | 8,592 |
| Impairment charges ⁴² | (334) | (499) | (491) |
| Net operating income | 9,355 | 9,821 | 8,101 |
| Total operating expenses | (4,860) | (4,607) | (4,621) |
| Operating profit | 4,495 | 5,214 | 3,480 |
| Income from associates ⁴³ | 316 | 238 | 283 |
| Profit before tax | 4,811 | 5,452 | 3,763 |
| RoRWA ⁴⁴ | 2.6% | 2.9% | 2.0% |

**Significant contribution from
faster-growing markets with
particularly strong performances
in Latin America and Rest of Asia-Pacific**

| | |
|--|---|
| Best Global Risk Management House | Best Domestic Equity House Hong Kong |
| Best Debt House: in Asia in Middle East | <i>(Asiamoney Best Bank 2011 Awards)</i> |
| <i>(Euromoney Awards for Excellence 2011)</i> | Best Investment Bank in Hong Kong |
| | <i>(FinanceAsia Country Awards)</i> |

Strategic direction

GB&M continues to pursue its well established emerging markets-led and financing-focused strategy, with the objective of being a leading global wholesale bank. This strategy has evolved to include a greater emphasis on connectivity, leveraging the Group's extensive distribution network.

We focus on four strategic imperatives:

reinforce client coverage and client-led solutions for major government, corporate and institutional clients;

continue to defend core, enhance existing and build new capabilities in major hubs to support the delivery of an integrated suite of products and services;

enhance collaboration with other customer groups, particularly CMB, to deliver incremental revenues; and

focus on business re-engineering to ensure the efficiency of our platform.

For footnotes, see page 81.

Review of performance

GB&M reported profit before tax of US\$4.8bn, 12% lower than in the first half of 2010 as a result of the challenging trading environment, which was dominated by uncertainty around eurozone sovereign debt. On an underlying basis, profit before tax declined by 16% as a result of lower revenues in legacy Credit, and in Balance Sheet Management, coupled with the cost of continued strategic investment. These factors were partly offset by higher revenues in Global Banking, Equities and Securities Services and a significant decrease in loan impairment charges.

We continued to leverage our unique geographical franchise and global connectivity, particularly focused on South-South trade corridors, to capitalise on opportunities presented by growing international trade flows. We also focused on connecting with other areas of HSBC, notably CMB, where gross revenues from the cross-sale of GB&M products increased, and GPB through the Family Office partnership. Investment in people and infrastructure continued during the first half of 2011 to enhance our product offerings. These strategic initiatives include the development of Prime Services and equity market capabilities together with the expansion of the Rates and Foreign Exchange e-commerce platforms which remain key to supporting our customer-focused strategy over the long term through enhanced competitive positioning.

Net operating income before loan impairment charges and other credit risk provisions decreased by 9%. This was primarily due to lower income in Balance Sheet Management, reflecting the continuing effect of prevailing low interest rates and flattening yield curves. Legacy Credit was affected by lower recoveries generated from the securities investment conduits, a reduction in effective yields and lower holdings of legacy assets. Revenues in Credit were also affected by the re-emergence of uncertainty in the eurozone sovereign credit markets in the

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second quarter of 2011. Trading income from structured liabilities declined, mainly in Rates, due to lower favourable fair value movements as credit spreads widened to a lesser extent than a year ago; a gain of US\$60m compared with a reported gain of US\$255m in the first half of 2010.

Loan impairment charges and other credit risk provisions were significantly lower than both halves of 2010. Loan impairment charges were US\$70m compared with the US\$233m in the

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Management view of total operating income*

| | 30 Jun | Half-year to ¹⁶ 30 Jun | 31 Dec |
|--|---------------|--------------------------------------|--------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Global Markets ⁴⁶ | 5,146 | 5,542 | 3,631 |
| Credit | 530 | 1,043 | 606 |
| Rates | 1,355 | 1,529 | 523 |
| Foreign Exchange | 1,517 | 1,513 | 1,239 |
| Equities | 612 | 479 | 276 |
| Securities Services ⁴⁷ | 854 | 718 | 793 |
| Asset and Structured Finance | 278 | 260 | 194 |
| Global Banking | 2,670 | 2,288 | 2,333 |
| Financing and Equity Capital Markets | 1,664 | 1,420 | 1,432 |
| Payments and Cash Management ⁴⁸ | 695 | 542 | 591 |
| Other transaction services ⁴⁹ | 311 | 326 | 310 |
| Balance Sheet Management | 1,765 | 2,269 | 1,833 |
| Principal Investments | 175 | 126 | 193 |
| Other ⁵⁰ | (67) | 95 | 602 |
| Total operating income | 9,689 | 10,320 | 8,592 |

For footnotes, see page 81.

first half of 2010, driven by a general improvement in the credit environment and the non-recurrence of significant impairment charges taken against a small number of clients in 2010. Credit risk provisions fell by US\$29m to US\$263m, despite a US\$65m charge recorded in respect of Greek sovereign debt in the first half of 2011. Asset-backed securities accounted for US\$238m of US\$263m, compared with impairments of US\$256m reported in the first half of 2010.

Operating expenses increased, reflecting continued investment in GB&M platforms to deliver revenue growth and improved process automation in light of increasing competition and changing regulatory demands. Performance costs rose due to increased amortisation charges for previous years' performance shares and accelerated expense recognition for future deferred bonus awards. Offsetting these factors was a credit of US\$111m in the first half of 2011 arising from a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred pensions. In addition, the first half of 2010 included the cost of payroll and bonus taxes in the UK and

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France on certain bonuses paid in respect of 2009. The cost efficiency ratio, at 50.2%, was 6.2 percentage points higher than in the first half of 2010 reflecting both our investment in the business and the effect of prevailing market conditions on income.

Global Markets delivered first half revenues in excess of US\$5bn for the third consecutive year in a very uncertain trading environment. The decrease compared with the first half of 2010 was mainly due to a decline in legacy Credit, as noted above. Credit revenues were also affected by the re-emergence of eurozone sovereign debt concerns in the second quarter of 2011, resulting in a decline in client activity and a general widening of credit spreads. These were partly offset by improved performance in primary markets as HSBC increased its market share of global bond issuance volumes. Revenues in Rates declined due to lower favourable fair value movements on structured liabilities, partly offset by higher customer demand for structured products. Equities revenues rose as improved competitive positioning helped capture increasing client flows, particularly during the global rally in the first quarter of 2011. Securities Services revenues increased by 14%, benefiting from balance growth in Europe, higher spreads in Asia and Latin America and increased transaction volumes.

Global Banking revenues rose by 12% as it maintained its focus on deepening key client relationships. This growth was led by continued momentum in project and export finance. Lending revenues were broadly in line, as higher income fuelled by asset growth in Asia, was offset by narrower spreads and limited demand in Europe and North America as clients in developed markets focused on refinancing existing facilities. Payments and Cash Management revenue rose by 24%, driven by Asia, with higher net interest income reflecting strong growth in deposit balances and wider spreads following interest rate rises in certain markets; fee income also benefited from growth in transaction volumes.

Revenues in Balance Sheet Management continued to reduce as higher-yielding positions matured and the opportunity for maintaining yields on reinvestment was limited by the prevailing low interest rate environment. Gains on disposal of securities in the available-for-sale portfolio also fell from the high level of realised gains primarily in Hong Kong and Rest of Asia-Pacific in the first half of 2010.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Global Private Banking**

GPB works with high net worth clients to manage and preserve their wealth while connecting them to global opportunities.

| | 30 Jun 2011 US\$m | Half-year to 30 Jun 2010 US\$m | 31 Dec 2010 US\$m |
|--|-------------------------|---|-------------------------|
| Net interest income | 729 | 646 | 699 |
| Net fee income | 731 | 643 | 656 |
| Other income | 229 | 254 | 195 |
| Net operating income⁴¹ | 1,689 | 1,543 | 1,550 |
| Impairment (charges)/ recoveries ⁴² | (22) | | 12 |
| Net operating income | 1,667 | 1,543 | 1,562 |
| Total operating expenses | (1,117) | (967) | (1,068) |
| Operating profit | 550 | 576 | 494 |
| Income from associates ⁴³ | 2 | (20) | 4 |
| Profit before tax | 552 | 556 | 498 |
| RoRWA ⁴⁴ | 4.5% | 4.3% | 3.9% |

Client assets 7% up at

US\$416bn

US\$13bn **net new money**

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Best Private Bank in Asia

(Euromoney 2011 Private Banking Survey)

Best Private Bank

in Hong Kong

(FinanceAsia Country

Awards 2010)

Outstanding Private Bank Middle East

(Private Banker International Awards

2010)

Strategic direction

GPB serves high-net worth customers with complex and international needs. We focus on four strategic imperatives:

further expand our business in the domestic and faster-growing markets through the recruitment of front office staff and the delivery of faster-growing market products to clients in developed markets;

continue to leverage our intra-Group strengths, including referrals with CMB and RBWM and our Family Office Partnership with GB&M;

increase our managed assets, through building on our expertise in alternative investments, faster-growing markets and foreign exchange; and

continue to invest in front-office systems with strong data security, while maintaining a focus on risk management and cost control.

For footnotes, see page 81.

Review of performance

Reported profit before tax was US\$552m, marginally lower than in the first half of 2010 on both a reported and an underlying basis, as strong revenue growth, driven by increases in client assets under management and activity levels, was offset by a rise in costs and impairment charges.

Although clients remained cautious in the prevailing market environment, risk appetite showed signs of improvement. Net fee income rose as a result of higher transaction volumes and growth in average client assets under management, driven by net new money inflows and our focus on faster growing markets. Demand for lending continued to recover which, together with improved spreads, led to higher net interest income.

The increase in operating expenses was primarily driven by the strengthening of the Swiss franc (see footnote 51), which accounts for a significant proportion of our cost base, together with higher costs incurred as a result of the developing regulatory environment, the hiring of front office staff to cover faster growing markets and an acceleration in the expense recognition for deferred bonus awards. A restructuring programme started in the first half of 2011, the benefits of which are expected in future reporting periods.

Loan impairment charges and other credit risk provisions increased, due to the impairment of available-for-sale debt securities.

Client assets

| | Half-year to | |
|--------|--------------|--------|
| | 30 Jun | 31 Dec |
| 30 Jun | | |
| 2011 | 2010 | 2010 |
| US\$bn | US\$bn | US\$bn |

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| | | | |
|------------------------|------------|------|-----|
| At beginning of period | 390 | 367 | 354 |
| Net new money | 13 | 7 | 6 |
| Value change | 1 | (4) | 17 |
| Exchange/other | 12 | (16) | 13 |
| At end of period | 416 | 354 | 390 |

Reported client assets, which include funds under management and cash deposits, increased due to US\$13bn of net new money inflows, together with favourable foreign exchange and market movements. Net new money continued to benefit from intra-Group referrals and strong inflows from Asia and Latin America. As a result, reported Total client assets, the equivalent to many industry definitions of assets under management which includes some non-financial assets held in client trusts, increased by 11% since 31 December 2010 to US\$556bn.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Other**

Other contains the results of certain property transactions, unallocated investment activities, centrally held investment companies, movements in fair value of own debt, HSBC's holding company and financing operations.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|----------------|------------------------|---------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest expense | (481) | (537) | (461) |
| Net trading income/ (expense) | (222) | (572) | 261 |
| Net income/(expense) from financial instruments designated at fair value | (286) | 1,178 | (1,394) |
| Other income | 3,017 | 3,163 | 3,022 |
| Net operating income⁴¹ | 2,028 | 3,232 | 1,428 |
| Impairment (charges)/ recoveries ⁴² | 2 | (1) | 4 |
| Net operating income | 2,030 | 3,231 | 1,432 |
| Total operating expenses | (3,286) | (2,759) | (3,159) |
| Operating profit/(loss) | (1,256) | 472 | (1,727) |
| Income from associates ⁴³ | 52 | 68 | 26 |
| Profit/(loss) before tax | (1,204) | 540 | (1,701) |

US\$1.2bn

reduction in profit before tax**due to fair value movements****on own debt****Increase in operating expenses due to restructuring costs**

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in Latin America and centralisation of processes

For footnotes, see page 81.

Notes

Reported loss before tax of US\$1.2bn compared with a profit before tax of US\$540m in the first half of 2010. This included losses of US\$143m on the fair value of HSBC's own debt attributable to a narrowing in credit spreads compared with gains of US\$1.1bn in the first half of 2010. In addition, reported profits included a gain of US\$62m on the reclassification of Bao Viet as an associate in the first half of 2010 and accounting gains of US\$188m and US\$181m in the first halves of 2010 and 2011, respectively, arising from the dilution of our shareholding in Ping An following its issue of share capital to third parties. On an underlying basis, the loss before tax increased by 57% to US\$1.2bn. For a description of the main items reported under 'Other', see footnote 38.

Net interest expense substantially comprised interest expense on long-term debt issued by HSBC Holdings.

Net trading expense fell by US\$350m, primarily driven by lower adverse fair value movements on non-qualifying hedges, mainly cross-currency swaps used to economically hedge fixed rate long-term debt issued by HSBC Holdings. This was the result of a less pronounced decrease in long-term US interest rates relative to sterling and euro interest rates than in the first half of 2010.

Net expense from financial instruments designated at fair value of US\$143m compared with income of US\$112m in the first half of 2010 due to adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt designated at fair value issued by HSBC Holdings and our European and North American subsidiaries.

Other operating income reduced as gains of US\$250m recognised from the sale and leaseback of our Paris and New York headquarters did not recur.

Operating expenses increased by 18% to US\$3.3bn driven by restructuring costs in Latin America of US\$149m as we took measures to improve efficiencies and processes in order to reduce the future cost base of our operations. The increasing number of centralised operational and migrated activities also contributed to higher costs in the period. These costs were previously incurred directly by customer groups, but are now recorded in 'Other' and charged to customer groups through a recharge mechanism with income reported as 'Other operating income'.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Reconciliation of reported and underlying profit/(loss) before tax****Retail Banking and Wealth Management***30 June 2011 compared with 30 June 2010*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|---------------------------------------|------------|--|---------------|--------------------|---------------|----------------------|----------------------|
| | 1H10 | Currency | | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | translation ¹⁰ | | | as | adjust- | under- | ported | lying |
| | reported | 1H10 adjust- ments ⁹ | US\$m | at 1H11 exchange rates ¹¹ | reported | ments ⁹ | lying | change ¹² | change ¹² |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| Net interest income | 12,194 | | 382 | 12,576 | 12,086 | | 12,086 | (1) | (4) |
| Net fee income | 4,060 | (2) | 138 | 4,196 | 4,212 | | 4,212 | 4 | |
| Other income ¹⁴ | 299 | (3) | 37 | 333 | 1,274 | | 1,274 | 326 | 283 |
| Net operating income¹⁵ | 16,553 | (5) | 557 | 17,105 | 17,572 | | 17,572 | 6 | 3 |
| Loan impairment charges and other credit risk provisions | (6,318) | | (105) | (6,423) | (4,270) | | (4,270) | 32 | 34 |
| Net operating income | 10,235 | (5) | 452 | 10,682 | 13,302 | | 13,302 | 30 | 25 |
| Operating expenses | (9,349) | 2 | (386) | (9,733) | (10,746) | | (10,746) | (15) | (10) |
| Operating profit | 886 | (3) | 66 | 949 | 2,556 | | 2,556 | 188 | 169 |
| Share of profit in associates and joint ventures | 466 | | 19 | 485 | 570 | | 570 | 22 | 18 |
| Profit before tax | 1,352 | (3) | 85 | 1,434 | 3,126 | | 3,126 | 131 | 118 |

30 June 2011 compared with 31 December 2010

| 2H10 | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | |
|------|---|----------|------|------|------|------|---------|--------|
| | 2H10 | Currency | 2H10 | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | adjust- | | | | | | adjust- | |

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| | as reported | adjustments ⁹ US\$m | translation ¹⁰ US\$m | at 1H11 exchange rates ¹⁷ US\$m | as reported | adjust- ments ⁹ US\$m | under- lying US\$m | ported change ¹² % | lying change ¹² % |
|---|----------------|-----------------------------------|------------------------------------|---|----------------|--|--------------------------|-------------------------------------|------------------------------------|
| Net interest income | 11,972 | | 235 | 12,207 | 12,086 | | 12,086 | 1 | (1) |
| Net fee income | 4,337 | | 88 | 4,425 | 4,212 | | 4,212 | (3) | (5) |
| Other income ¹⁴ | 749 | | 18 | 767 | 1,274 | | 1,274 | 70 | 66 |
| Net operating income ¹⁵ | 17,058 | | 341 | 17,399 | 17,572 | | 17,572 | 3 | 1 |
| Loan impairment charges and other credit risk provisions | (4,941) | | (55) | (4,996) | (4,270) | | (4,270) | 14 | 15 |
| Net operating income | 12,117 | | 286 | 12,403 | 13,302 | | 13,302 | 10 | 7 |
| Operating expenses | (10,190) | | (249) | (10,439) | (10,746) | | (10,746) | (5) | (3) |
| Operating profit | 1,927 | | 37 | 1,964 | 2,556 | | 2,556 | 33 | 31 |
| Share of profit in associates and joint ventures | 560 | | 14 | 574 | 570 | | 570 | 2 | (1) |
| Profit/(loss) before tax | 2,487 | | 51 | 2,538 | 3,126 | | 3,126 | 26 | 23 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Commercial Banking

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|-------------------------------|------------------------------------|--------------------------------------|--------------|--------------------------|--------------|--------------------------------|-------------|
| | 1H10 | | 1H10 | | 1H11 | | 1H11 | | Under-lying |
| | as reported | 1H10 adjustments ⁹ | Currency translation ¹⁰ | at 1H11 exchange rates ¹¹ | as reported | adjustments ⁹ | under-lying | Re-ported change ¹² | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest income | 4,024 | (1) | 172 | 4,195 | 4,814 | | 4,814 | 20 | 15 |
| Net fee income | 1,935 | (37) | 82 | 1,980 | 2,131 | | 2,131 | 10 | 8 |
| Other income ¹⁴ | 781 | (116) | 22 | 687 | 735 | | 735 | (6) | 7 |
| Net operating income¹⁵ | 6,740 | (154) | 276 | 6,862 | 7,680 | | 7,680 | 14 | 12 |
| Loan impairment charges and other credit risk provisions | (705) | | (43) | (748) | (642) | | (642) | 9 | 14 |
| Net operating income | 6,035 | (154) | 233 | 6,114 | 7,038 | | 7,038 | 17 | 15 |
| Operating expenses | (3,266) | 38 | (146) | (3,374) | (3,465) | | (3,465) | (6) | (3) |
| Operating profit | 2,769 | (116) | 87 | 2,740 | 3,573 | | 3,573 | 29 | 30 |
| Share of profit in associates and joint ventures | 435 | | 12 | 447 | 616 | | 616 | 42 | 38 |
| Profit before tax | 3,204 | (116) | 99 | 3,187 | 4,189 | | 4,189 | 31 | 31 |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | | |
|-------|---|--------------------------|------------------------------------|--------------------------------------|-------------|--------------------------|-------------|--------------------------------|-------------|
| | 2H10 | | 2H10 | | 1H11 | | 1H11 | | Under-lying |
| | as reported | adjustments ⁹ | Currency translation ¹⁰ | at 1H11 exchange rates ¹⁷ | as reported | adjustments ⁹ | under-lying | Re-ported change ¹² | |
| US\$m | US\$m | US\$m | | US\$m | US\$m | US\$m | US\$m | % | % |
| | | | | | | | | | |

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| | US\$m | | | US\$m | US\$m | US\$m | US\$m | % | % |
|--|---------|-----|-------|---------|---------|-------|---------|----|----|
| Net interest income | 4,463 | 1 | 121 | 4,585 | 4,814 | | 4,814 | 8 | 5 |
| Net fee income | 2,029 | | 55 | 2,084 | 2,131 | | 2,131 | 5 | 2 |
| Other income ¹⁴ | 602 | (3) | 9 | 608 | 735 | | 735 | 22 | 21 |
| Net operating income ¹⁵ | 7,094 | (2) | 185 | 7,277 | 7,680 | | 7,680 | 8 | 6 |
| Loan impairment charges and other credit risk provisions | (1,100) | | (35) | (1,135) | (642) | | (642) | 42 | 43 |
| Net operating income | 5,994 | (2) | 150 | 6,142 | 7,038 | | 7,038 | 17 | 15 |
| Operating expenses | (3,565) | (1) | (104) | (3,670) | (3,465) | | (3,465) | 3 | 6 |
| Operating profit | 2,429 | (3) | 46 | 2,472 | 3,573 | | 3,573 | 47 | 45 |
| Share of profit in associates and joint ventures | 457 | | 8 | 465 | 616 | | 616 | 35 | 32 |
| Profit before tax | 2,886 | (3) | 54 | 2,937 | 4,189 | | 4,189 | 45 | 43 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Global Banking and Markets**

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|---------------------------|------------|---------------|--------------------|--------------|----------------------|----------------------|--------|
| | 1H10 | 1H10 | | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | Currency | at 1H11 | as | adjust- | under- | ported | lying | |
| | reported | translation ¹⁰ | exchange | reported | ments ⁹ | lying | change ¹² | change ¹² | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| Net interest income | 3,724 | 18 | 159 | 3,901 | 3,603 | 3,603 | (3) | (8) | |
| Net fee income | 1,879 | (11) | 59 | 1,927 | 1,730 | 1,730 | (8) | (10) | |
| Other income ¹⁴ | 4,717 | (35) | 189 | 4,871 | 4,356 | 4,356 | (8) | (11) | |
| Net operating income¹⁵ | 10,320 | (28) | 407 | 10,699 | 9,689 | 9,689 | (6) | (9) | |
| Loan impairment charges and other credit risk provisions | (499) | | (27) | (526) | (334) | (334) | 33 | 37 | |
| Net operating income | 9,821 | (28) | 380 | 10,173 | 9,355 | 9,355 | (5) | (8) | |
| Operating expenses | (4,607) | 108 | (204) | (4,703) | (4,860) | (4,860) | (5) | (3) | |
| Operating profit | 5,214 | 80 | 176 | 5,470 | 4,495 | 4,495 | (14) | (18) | |
| Share of profit in associates and joint ventures | 238 | | 7 | 245 | 316 | 316 | 33 | 29 | |
| Profit before tax | 5,452 | 80 | 183 | 5,715 | 4,811 | 4,811 | (12) | (16) | |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | | |
|-------|---|---------------------------|---------------------|----------|--------------------|--------|----------------------|----------------------|--------|
| | 2H10 | 2H10 | | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | Currency | at 1H11 | as | adjust- | under- | ported | lying | |
| | reported | translation ¹⁰ | exchange | reported | ments ⁹ | lying | change ¹² | change ¹² | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| | | | rates ¹⁷ | | | | | | |

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| | US\$m | | | US\$m | US\$m | US\$m | US\$m | % | % |
|--|---------|-------|-------|---------|---------|-------|---------|-----|-----|
| Net interest income | 3,619 | | 83 | 3,702 | 3,603 | | 3,603 | | (3) |
| Net fee income | 1,785 | 1 | 44 | 1,830 | 1,730 | | 1,730 | (3) | (5) |
| Other income ¹⁴ | 3,188 | (332) | 84 | 2,940 | 4,356 | | 4,356 | 37 | 48 |
| Net operating income ¹⁵ | 8,592 | (331) | 211 | 8,472 | 9,689 | | 9,689 | 13 | 14 |
| Loan impairment charges and other credit risk provisions | (491) | | (23) | (514) | (334) | | (334) | 32 | 35 |
| Net operating income | 8,101 | (331) | 188 | 7,958 | 9,355 | | 9,355 | 15 | 18 |
| Operating expenses | (4,621) | | (126) | (4,747) | (4,860) | | (4,860) | (5) | (2) |
| Operating profit | 3,480 | (331) | 62 | 3,211 | 4,495 | | 4,495 | 29 | 40 |
| Share of profit in associates and joint ventures | 283 | | 3 | 286 | 316 | | 316 | 12 | 10 |
| Profit before tax | 3,763 | (331) | 65 | 3,497 | 4,811 | | 4,811 | 28 | 38 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Balance sheet data significant to Global Banking and Markets¹⁶*

| | Rest of | | | | | | Total US\$m |
|-------------------------------------|-----------------|-----------------------|---------------------------|---------------|---------------------------|---------------------------|----------------|
| | Europe US\$m | Hong Kong US\$m | Asia- Pacific US\$m | MENA US\$m | North America US\$m | Latin America US\$m | |
| At 30 June 2011 | | | | | | | |
| Trading assets ¹ | 299,734 | 29,105 | 17,686 | 1,138 | 106,329 | 13,286 | 467,278 |
| Derivative assets ² | 215,099 | 24,324 | 16,490 | 1,087 | 65,681 | 4,381 | 327,062 |
| Trading liabilities | 232,676 | 12,700 | 4,372 | 522 | 111,927 | 5,262 | 367,459 |
| Derivative liabilities ² | 197,486 | 24,447 | 17,225 | 1,075 | 67,225 | 3,835 | 311,293 |
| At 30 June 2010 | | | | | | | |
| Trading assets ¹ | 265,958 | 26,406 | 19,976 | 733 | 76,015 | 6,786 | 395,874 |
| Derivative assets ² | 227,337 | 18,858 | 17,268 | 827 | 71,490 | 3,268 | 339,048 |
| Trading liabilities | 162,471 | 9,838 | 5,131 | 48 | 81,118 | 4,616 | 263,222 |
| Derivative liabilities ² | 227,156 | 19,159 | 16,744 | 849 | 71,874 | 3,545 | 339,327 |
| At 31 December 2010 | | | | | | | |
| Trading assets ¹ | 232,918 | 32,023 | 18,256 | 958 | 87,120 | 6,459 | 377,734 |
| Derivative assets ² | 199,654 | 21,644 | 17,135 | 832 | 65,153 | 3,955 | 308,373 |
| Trading liabilities | 178,861 | 8,650 | 3,846 | 122 | 91,980 | 2,702 | 286,161 |
| Derivative liabilities ² | 199,751 | 22,622 | 17,121 | 845 | 66,323 | 3,913 | 310,575 |

1 Trading assets, financial instruments designated at fair value and financial investments held in Europe, and by GB&M in North America, include financial assets which may be repledged or resold by counterparties.

2 Derivative assets and derivative liabilities of GB&M include derivative transactions between different regions of GB&M.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Global Private Banking***30 June 2011 compared with 30 June 2010*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | |
|--|---|---------------------------|--------------|--------------|--------------------|--------------|----------------------|----------------------|
| | 1H10 | 1H10 | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | Currency | at 1H11 | as | adjust- | under- | ported | lying |
| | reported | translation ¹⁰ | exchange | reported | ments ⁹ | lying | change ¹² | change ¹² |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest income | 646 | 9 | 655 | 729 | | 729 | 13 | 11 |
| Net fee income | 643 | 12 | 655 | 731 | | 731 | 14 | 12 |
| Other income ¹⁴ | 254 | 3 | 257 | 229 | | 229 | (10) | (11) |
| Net operating income¹⁵ | 1,543 | 24 | 1,567 | 1,689 | | 1,689 | 9 | 8 |
| Loan impairment charges and other credit risk provisions | | (1) | (1) | (22) | | (22) | | (2,100) |
| Net operating income | 1,543 | 23 | 1,566 | 1,667 | | 1,667 | 8 | 6 |
| Operating expenses | (967) | (18) | (985) | (1,117) | | (1,117) | (16) | (13) |
| Operating profit | 576 | 5 | 581 | 550 | | 550 | (5) | (5) |
| Share of profit in associates and joint ventures | (20) | | (20) | 2 | | 2 | | |
| Profit before tax | 556 | 5 | 561 | 552 | | 552 | (1) | (2) |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | |
|-------|---|--------------------|---------------------------|----------|--------------------|--------|----------------------|----------------------|
| | 2H10 | 2H10 | 2H10 | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | adjust- | Currency | as | adjust- | under- | ported | lying |
| | reported | ments ⁹ | translation ¹⁰ | at 1H11 | ments ⁹ | lying | change ¹² | change ¹² |
| US\$m | US\$m | US\$m | exchange | reported | US\$m | US\$m | US\$m | US\$m |
| | | | rates ¹⁷ | | | | | |
| | | | | | | | | |

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| | US\$m | | US\$m | US\$m | US\$m | US\$m | % | % |
|---|---------|-----|---------|---------|-------|---------|------|------|
| Net interest income | 699 | 6 | 705 | 729 | | 729 | 4 | 3 |
| Net fee income | 656 | 6 | 662 | 731 | | 731 | 11 | 10 |
| Other income ¹⁴ | 195 | | 195 | 229 | | 229 | 17 | 17 |
| | | | | | | | | |
| Net operating income ¹⁵ | 1,550 | 12 | 1,562 | 1,689 | | 1,689 | 9 | 8 |
| Loan impairment (charges)/recoveries and other credit risk provisions | 12 | | 12 | (22) | | (22) | | |
| | | | | | | | | |
| Net operating income | 1,562 | 12 | 1,574 | 1,667 | | 1,667 | 7 | 6 |
| Operating expenses | (1,068) | (9) | (1,077) | (1,117) | | (1,117) | (5) | (4) |
| | | | | | | | | |
| Operating profit | 494 | 3 | 497 | 550 | | 550 | 11 | 11 |
| Share of profit in associates and joint ventures | 4 | | 4 | 2 | | 2 | (50) | (50) |
| | | | | | | | | |
| Profit before tax | 498 | 3 | 501 | 552 | | 552 | 11 | 10 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Other***30 June 2011 compared with 30 June 2010*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|---------------------------------------|---------------------------------------|--|------------------------|---------------------------------------|-------------------------|---------------------------------------|---|
| | 1H10 as reported | 1H10 adjust- ments ⁹ | Currency translation ¹⁰ | at 1H11 exchange rates ¹¹ | 1H11 as reported | 1H11 adjust- ments ⁹ | 1H11 under- lying | Re- ported change ¹² | Under- lying change ¹² |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest expense | (537) | | (4) | (541) | (481) | | (481) | 10 | 11 |
| Net fee income | 1 | | (3) | (2) | 3 | | 3 | 200 | (250) |
| Changes in fair value ¹³ | 1,074 | (1,074) | | | (143) | 143 | | | |
| Other income ¹⁴ | 2,694 | (250) | 31 | 2,475 | 2,649 | (180) | 2,467 | (2) | (0) |
| Net operating income¹⁵ | 3,232 | (1,324) | 24 | 1,932 | 2,028 | (37) | 1,989 | (37) | 3 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (1) | | | (1) | 2 | | 1 | | |
| Net operating income | 3,231 | (1,324) | 24 | 1,931 | 2,030 | (37) | 1,990 | (37) | 3 |
| Operating expenses | (2,759) | | (31) | (2,790) | (3,286) | | (3,285) | (19) | (18) |
| Operating profit/(loss) | 472 | (1,324) | (7) | (859) | (1,256) | (37) | (1,295) | | (51) |
| Share of profit in associates and joint ventures | 68 | | 3 | 71 | 52 | | 52 | (24) | (27) |
| Profit/(loss) before tax | 540 | (1,324) | (4) | (788) | (1,204) | (37) | (1,243) | | (58) |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | |
|------|---|----------|------|------|------|------|-----|--------|
| 2H10 | 2H10 | Currency | 2H10 | 1H11 | 1H11 | 1H11 | Re- | Under- |

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| | as reported US\$m | adjust- ments ⁹ US\$m | translation ¹⁰ US\$m | at 1H11 exchange rates ¹⁷ US\$m | as reported US\$m | adjust- ments ⁹ US\$m | under- lying US\$m | ported change ¹² % | lying change ¹² % |
|---|-------------------------|--|------------------------------------|---|-------------------------|--|--------------------------|-------------------------------------|------------------------------------|
| Net interest expense | (461) | | (39) | (500) | (481) | | (481) | (4) | 4 |
| Net fee income | 30 | (1) | 2 | 31 | 3 | | 3 | (90) | (90) |
| Changes in fair value ¹³ | (1,137) | 1,137 | | | (143) | 143 | | 87 | 87 |
| Other income ¹⁴ | 2,996 | 1 | 70 | 3,067 | 2,649 | (180) | 2,469 | (12) | (20) |
| Net operating income ¹⁵ | 1,428 | 1,137 | 33 | 2,598 | 2,028 | (37) | 1,991 | 42 | (23) |
| Loan impairment (charges)/recoveries and other credit risk provisions | 4 | | (3) | 1 | 2 | | 2 | (50) | 100 |
| Net operating income | 1,432 | 1,137 | 30 | 2,599 | 2,030 | (37) | 1,993 | 42 | (23) |
| Operating expenses | (3,159) | 1 | (23) | (3,181) | (3,286) | | (3,286) | 4 | (3) |
| Operating loss | (1,727) | 1,138 | 7 | (582) | (1,256) | (37) | (1,293) | (27) | (122) |
| Share of profit in associates and joint ventures | 26 | (1) | 2 | 27 | 52 | | 52 | 100 | 93 |
| Loss before tax | (1,701) | 1,137 | 9 | (555) | (1,204) | (37) | (1,271) | (29) | 129 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Analysis by customer group and global business***HSBC profit/(loss) before tax and balance sheet data*

| | Half-year to 30 June 2011 | | | | | | Total |
|--|--|------------------------------|-------------------------------------|------------------------------|----------------------------|--|---------------------------------|
| | Retail Banking and Wealth Management | Commercial Banking | Global Banking and Markets | Global Private Banking | Other ³⁸ | Inter- segment elimination ⁵² | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Net interest income/(expense) | 12,086 | 4,814 | 3,603 | 729 | (481) | (516) | 20,235 |
| Net fee income | 4,212 | 2,131 | 1,730 | 731 | 3 | | 8,807 |
| Trading income/(expense) excluding net interest income | 166 | 280 | 2,830 | 198 | (243) | | 3,231 |
| Net interest income on trading activities | 22 | 16 | 997 | 9 | 21 | 516 | 1,581 |
| Net trading income/(expense) ⁴⁵ | 188 | 296 | 3,827 | 207 | (222) | 516 | 4,812 |
| Net income/(expense) from financial instruments designated at fair value | 343 | 55 | (212) | | (286) | | (100) |
| Gains less losses from financial investments | 70 | 2 | 414 | (3) | 2 | | 485 |
| Dividend income | 14 | 8 | 39 | 4 | 22 | | 87 |
| Net earned insurance premiums | 5,698 | 985 | 23 | | (6) | | 6,700 |
| Other operating income | 688 | 263 | 280 | 21 | 2,997 | (2,964) | 1,285 |
| Total operating income | 23,299 (5,727) | 8,554 (874) | 9,704 (15) | 1,689 | 2,029 (1) | (2,964) | 42,311 (6,617) |

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| | | | | | | | |
|---|---------------|--------------|--------------|--------------|----------------|----------------|---------------|
| Net insurance claims ⁵³ | | | | | | | |
| Net operating income⁴¹ | 17,572 | 7,680 | 9,689 | 1,689 | 2,028 | (2,964) | 35,694 |
| Loan impairment (charges)/recoveries and other credit risk provisions | (4,270) | (642) | (334) | (22) | 2 | | (5,266) |
| Net operating income | 13,302 | 7,038 | 9,355 | 1,667 | 2,030 | (2,964) | 30,428 |
| Employee expenses ⁵⁴ | (3,169) | (1,210) | (2,396) | (688) | (3,058) | | (10,521) |
| Other operating expenses | (7,577) | (2,255) | (2,464) | (429) | (228) | 2,964 | (9,989) |
| Total operating expenses | (10,746) | (3,465) | (4,860) | (1,117) | (3,286) | 2,964 | (20,510) |
| Operating profit/(loss) | 2,556 | 3,573 | 4,495 | 550 | (1,256) | | 9,918 |
| Share of profit in associates and joint ventures | 570 | 616 | 316 | 2 | 52 | | 1,556 |
| Profit/(loss) before tax | 3,126 | 4,189 | 4,811 | 552 | (1,204) | | 11,474 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 27.3 | 36.5 | 41.9 | 4.8 | (10.5) | | 100.0 |
| Cost efficiency ratio | 61.2 | 45.1 | 50.2 | 66.1 | 162.0 | | 57.5 |
| <i>Balance sheet data³⁹</i> | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 400,944 | 268,037 | 321,061 | 44,612 | 3,234 | | 1,037,888 |
| Total assets | 557,952 | 336,094 | 1,942,835 | 122,888 | 189,912 | (458,694) | 2,690,987 |
| Customer accounts | 541,998 | 301,169 | 359,757 | 115,245 | 818 | | 1,318,987 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 30 June 2010 | | | | | | Total US\$m |
|---|---|-----------------------|---|------------------------------|--|---------|-------------------|
| | Retail | | Global | | Inter- segment elimination ⁵² | Total | |
| | Banking and Wealth Management ¹⁶ | Commercial Banking | Banking and Markets ¹⁶ | Global Private Banking | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| Net interest income/(expense) | 12,194 | 4,024 | 3,724 | 646 | (537) | (294) | 19,757 |
| Net fee income | 4,060 | 1,935 | 1,879 | 643 | 1 | | 8,518 |
| Trading income/(expense) excluding net interest income | (391) | 222 | 2,866 | 209 | (597) | | 2,309 |
| Net interest income on trading activities | 15 | 11 | 888 | 10 | 25 | 294 | 1,243 |
| Net trading income/(expense) ⁴⁵ | (376) | 233 | 3,754 | 219 | (572) | 294 | 3,552 |
| Net income/(expense) from financial instruments designated at fair value | (127) | 26 | 8 | | 1,178 | | 1,085 |
| Gains less losses from financial investments | 1 | 3 | 507 | 11 | 35 | | 557 |
| Dividend income | 14 | 5 | 22 | 3 | 15 | | 59 |
| Net earned insurance premiums | 4,954 | 696 | 21 | | (5) | | 5,666 |
| Other operating income | 405 | 355 | 420 | 21 | 3,114 | (2,837) | 1,478 |
| Total operating income | 21,125 | 7,277 | 10,335 | 1,543 | 3,229 | (2,837) | 40,672 |
| Net insurance claims ⁵³ | (4,572) | (537) | (15) | | 3 | | (5,121) |
| Net operating income ⁴¹ | 16,553 (6,318) | 6,740 (705) | 10,320 (499) | 1,543 | 3,232 (1) | (2,837) | 35,551 (7,523) |

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Loan impairment charges and other credit risk provisions

| | | | | | | | |
|---|---------|---------|-----------|---------|---------|-----------|-----------|
| Net operating income | 10,235 | 6,035 | 9,821 | 1,543 | 3,231 | (2,837) | 28,028 |
| Employee expenses ⁵⁴ | (2,757) | (1,063) | (2,347) | (609) | (3,030) | | (9,806) |
| Other operating (expenses)/income | (6,592) | (2,203) | (2,260) | (358) | 271 | 2,837 | (8,305) |
| | | | | | | | |
| Total operating expenses | (9,349) | (3,266) | (4,607) | (967) | (2,759) | 2,837 | (18,111) |
| | | | | | | | |
| Operating profit | 886 | 2,769 | 5,214 | 576 | 472 | | 9,917 |
| | | | | | | | |
| Share of profit/(loss) in associates and joint ventures | 466 | 435 | 238 | (20) | 68 | | 1,187 |
| | | | | | | | |
| Profit before tax | 1,352 | 3,204 | 5,452 | 556 | 540 | | 11,104 |
| | | | | | | | |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 12.1 | 28.9 | 49.1 | 5.0 | 4.9 | | 100.0 |
| Cost efficiency ratio | 56.5 | 48.5 | 44.6 | 62.7 | 85.4 | | 50.9 |
| | | | | | | | |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 377,478 | 207,763 | 268,495 | 36,590 | 3,011 | | 893,337 |
| Total assets | 510,092 | 264,077 | 1,774,639 | 108,499 | 189,153 | (428,006) | 2,418,454 |
| Customer accounts | 488,251 | 263,616 | 290,672 | 104,025 | 757 | | 1,147,321 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*HSBC profit/(loss) before tax and balance sheet data (continued)*

| | Half-year to 31 December 2010 | | | | | | |
|--|--|------------------|------------------------------|--------------------|---------------------|---------------------------|-------------------|
| | Retail | | Global | | | Inter- | Total |
| | Banking | Commercial | Banking | Global | segment | | |
| | and Wealth Management ¹⁶ | Banking | and Markets ¹⁶ | Private Banking | Other ³⁸ | elimination ⁵² | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| Net interest income/(expense) | 11,972 | 4,463 | 3,619 | 699 | (461) | (608) | 19,684 |
| Net fee income | 4,337 | 2,029 | 1,785 | 656 | 30 | | 8,837 |
| Trading income excluding net interest income | 285 | 205 | 1,460 | 182 | 239 | | 2,371 |
| Net interest income on trading activities | 13 | 17 | 616 | 11 | 22 | 608 | 1,287 |
| Net trading income ⁴⁵ | 298 | 222 | 2,076 | 193 | 261 | 608 | 3,658 |
| Net income/(expense) from financial instruments designated at fair value | 1,337 | 164 | 28 | | (1,394) | | 135 |
| Gains less losses from financial investments | (25) | (4) | 356 | (17) | 101 | | 411 |
| Dividend income | 13 | 7 | 26 | 2 | 5 | | 53 |
| Net earned insurance premiums | 4,783 | 683 | 20 | | (6) | | 5,480 |
| Other operating income | 279 | 230 | 693 | 17 | 2,891 | (3,026) | 1,084 |
| Total operating income | 22,994 | 7,794 | 8,603 | 1,550 | 1,427 | (3,026) | 39,342 |
| Net insurance claims ⁵³ | (5,936) | (700) | (11) | | 1 | | (6,646) |
| Net operating income ⁴¹ | 17,058 (4,941) | 7,094 (1,100) | 8,592 (491) | 1,550 12 | 1,428 4 | (3,026) | 32,696 (6,516) |

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Loan impairment (charges)/recoveries and other credit risk provisions

| | | | | | | | |
|--|----------|---------|-----------|---------|---------|-----------|-----------|
| Net operating income | 12,117 | 5,994 | 8,101 | 1,562 | 1,432 | (3,026) | 26,180 |
| Employee expenses ⁵⁴ | (3,013) | (1,090) | (2,006) | (628) | (3,293) | | (10,030) |
| Other operating (expenses)/income | (7,177) | (2,475) | (2,615) | (440) | 134 | 3,026 | (9,547) |
| | | | | | | | |
| Total operating expenses | (10,190) | (3,565) | (4,621) | (1,068) | (3,159) | 3,026 | (19,577) |
| | | | | | | | |
| Operating profit/(loss) | 1,927 | 2,429 | 3,480 | 494 | (1,727) | | 6,603 |
| | | | | | | | |
| Share of profit in associates and joint ventures | 560 | 457 | 283 | 4 | 26 | | 1,330 |
| | | | | | | | |
| Profit/(loss) before tax | 2,487 | 2,886 | 3,763 | 498 | (1,701) | | 7,933 |
| | | | | | | | |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 31.4 | 36.4 | 47.4 | 6.3 | (21.5) | | 100.0 |
| Cost efficiency ratio | 59.7 | 50.3 | 53.8 | 68.9 | 221.2 | | 59.9 |
| | | | | | | | |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 390,963 | 239,286 | 284,497 | 40,665 | 2,955 | | 958,366 |
| Total assets | 530,970 | 296,797 | 1,755,043 | 116,846 | 161,458 | (406,425) | 2,454,689 |
| Customer accounts | 525,221 | 286,007 | 308,416 | 107,130 | 951 | | 1,227,725 |
| <i>For footnotes, see page 81.</i> | | | | | | | |

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Interim Management Report (continued)**Geographical regions**

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| Summary | |

In the analysis of profit and loss by geographical region that follows, operating income and operating expenses include intra-HSBC items of US\$1,567m (first half of 2010: US\$1,467m; second half of 2010: US\$1,658m).

Profit/(loss) before tax

| | 30 June 2011 | | Half-year to 30 June 2010 | | 31 December 2010 | |
|------------------------------|---------------|--------------|------------------------------|--------------|------------------|--------------|
| | US\$m | % | US\$m | % | US\$m | % |
| Europe | 2,147 | 18.7 | 3,521 | 31.7 | 781 | 9.8 |
| Hong Kong | 3,081 | 26.9 | 2,877 | 25.9 | 2,815 | 35.5 |
| Rest of Asia-Pacific | 3,742 | 32.6 | 2,985 | 26.9 | 2,917 | 36.8 |
| Middle East and North Africa | 747 | 6.5 | 346 | 3.1 | 546 | 6.9 |
| North America | 606 | 5.3 | 492 | 4.4 | (38) | (0.5) |
| Latin America | 1,151 | 10.0 | 883 | 8.0 | 912 | 11.5 |
| | 11,474 | 100.0 | 11,104 | 100.0 | 7,933 | 100.0 |

*Total assets*³⁹

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| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|------------------------------|------------------|--------------|-----------------|-------|---------------------|-------|
| | US\$m | % | US\$m | % | US\$m | % |
| Europe | 1,379,308 | 51.2 | 1,280,698 | 52.9 | 1,249,527 | 50.9 |
| Hong Kong | 474,044 | 17.6 | 410,991 | 17.0 | 429,565 | 17.5 |
| Rest of Asia-Pacific | 298,590 | 11.1 | 244,624 | 10.1 | 278,062 | 11.3 |
| Middle East and North Africa | 58,038 | 2.2 | 49,637 | 2.1 | 52,757 | 2.1 |
| North America | 529,386 | 19.7 | 495,408 | 20.5 | 492,487 | 20.1 |
| Latin America | 163,611 | 6.1 | 121,885 | 5.0 | 139,938 | 5.7 |
| Intra-HSBC items | (211,990) | (7.9) | (184,789) | (7.6) | (187,647) | (7.6) |
| | 2,690,987 | 100.0 | 2,418,454 | 100.0 | 2,454,689 | 100.0 |

*Risk-weighted assets*⁵⁵

| | At 30 June 2011 | | At 31 December 2010 | |
|------------------------------|-----------------|------|---------------------|------|
| | US\$bn | % | US\$bn | % |
| Total | 1,168.5 | | 1,103.1 | |
| Europe | 315.7 | 26.9 | 301.6 | 27.2 |
| Hong Kong | 110.8 | 9.5 | 106.9 | 9.7 |
| Rest of Asia-Pacific | 241.1 | 20.6 | 217.5 | 19.6 |
| Middle East and North Africa | 58.1 | 5.0 | 54.1 | 4.9 |
| North America | 335.8 | 28.6 | 330.7 | 29.9 |
| Latin America | 110.5 | 9.4 | 95.9 | 8.7 |

For footnotes, see page 81.

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Interim Management Report (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) S.A. and HSBC Trinkaus & Burkhardt AG. Through these operations we provide a wide range of banking, treasury and financial services to personal, commercial and corporate customers across Europe.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|-----------------------|------------------------|---------------|
| | 2011 US\$m | 2010 US\$m | 2010 US\$m |
| Net interest income | 5,566 | 5,802 | 5,448 |
| Net fee income | 3,131 | 3,177 | 3,194 |
| Net trading income | 2,007 | 1,604 | 1,259 |
| Other income/(expense) | 636 | 2,138 | 128 |
| Net operating income⁴¹ | 11,340 | 12,721 | 10,029 |
| Impairment charges ⁴² | (1,173) | (1,501) | (1,519) |
| Net operating income | 10,167 | 11,220 | 8,510 |
| Total operating expenses | (8,014) | (7,704) | (7,741) |
| Operating profit | 2,153 | 3,516 | 769 |
| Income from associates ⁴³ | (6) | 5 | 12 |
| Profit before tax | 2,147 | 3,521 | 781 |
| Cost efficiency ratio | 70.7% | 60.6% | 77.2% |
| RoRWA ⁴⁴ | 1.4% | 2.2% | 0.5% |
| Period-end staff numbers | 76,879 | 73,431 | 75,698 |

Reduction in reported**loan impairment charges⁴²**

22%

Market share of new

UK mortgage lending

11%

Strong trade revenue growth

For footnotes, see page 81.

The commentary on Europe is on an underlying basis unless stated otherwise.

Economic background

The UK's economic recovery remained disappointingly lacklustre in the first half of 2011. In the first quarter, the level of real Gross Domestic Product (GDP) rose by 0.5%, having fallen by 0.5% in the previous quarter. The unemployment rate edged down to 7.7% in the three months to April as modest job shedding in the public sector, in reaction to ongoing fiscal austerity, was offset by job gains in the private sector. The level of turnover in the housing market remained subdued. The Bank of England left interest rates unchanged at 0.5% and the Asset Purchase Facility remained steady at £200bn. CPI inflation was well above the Bank of England's 2% target throughout the period, reaching 4.5% in May, partly from the rise in VAT at the start of the year, and increases in commodity prices.

The eurozone recovery continued to be uneven, with countries in the north of the region demonstrating strong growth while economies in the south, particularly those focused on fiscal consolidation, saw more modest levels of activity. In part because of rising commodity prices, eurozone inflation rose above the European Central Bank's (ECB's) target, reaching 2.7% in June, and the ECB began to tighten monetary policy, raising the refi rate in April and July, taking it to 1.5%. For certain countries, particularly Greece, concerns in sovereign bond markets intensified. As it became clear that Greece would be unable to return to the private capital markets in the first half of 2012, the eurozone heads of state arranged in July 2011 for further medium-term financial assistance to be provided to the country.

Review of performance

Our European operations reported a pre-tax profit of US\$2.1bn, compared with US\$3.5bn in the first half of 2010, a decrease of 39%. Included within these results were adverse fair value movements of US\$71m in the first half of 2011 due to the change in credit spreads on the Group's own debt held at fair value, compared with favourable fair value movements of US\$574m in the first half of 2010. The first half of 2010 included a gain of US\$107m on the disposal of the HSBC Insurance Brokers business along with the operating results of Eversholt Rail Group which was sold in December 2010. Excluding these items, underlying pre-tax profits decreased by 28%, mainly due to lower revenues in GB&M.

In GB&M, we are investing in the business by expanding our capabilities across the region and further enhancing our product offering in areas such as Payments and Cash Management, Securities

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

| | Retail Banking and Wealth Management¹⁶ | Commercial Banking | Global Banking and Markets¹⁶ | Global Private Banking | Other | Total |
|--------------------------------------|--|-------------------------------|--|---------------------------------------|----------------|--------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | |
| UK | 634 | 761 | 483 | 108 | (862) | 1,124 |
| France ⁵⁶ | 139 | 111 | 274 | 10 | (89) | 445 |
| Germany | 23 | 38 | 121 | 21 | 6 | 209 |
| Malta | 31 | 34 | 6 | | | 71 |
| Switzerland | | (5) | | 122 | | 117 |
| Turkey | 11 | 42 | 31 | | | 84 |
| Other | (69) | 63 | 87 | 54 | (38) | 97 |
| | 769 | 1,044 | 1,002 | 315 | (983) | 2,147 |
| Half-year to 30 June 2010 | | | | | | |
| UK | 483 | 500 | 1,356 | 116 | (366) | 2,089 |
| France ⁵⁶ | 87 | 83 | 401 | 6 | 157 | 734 |
| Germany | 19 | 17 | 127 | 18 | (4) | 177 |
| Malta | 21 | 28 | 7 | | | 56 |
| Switzerland | | | | 161 | | 161 |
| Turkey | 35 | 47 | 58 | | | 140 |
| Other | (46) | 34 | 99 | 58 | 19 | 164 |
| | 599 | 709 | 2,048 | 359 | (194) | 3,521 |
| Half-year to 31 December 2010 | | | | | | |
| UK | 698 | 327 | 416 | 107 | (1,239) | 309 |
| France ⁵⁶ | 51 | 52 | (25) | 12 | (131) | (41) |
| Germany | 17 | 15 | 104 | 12 | 8 | 156 |
| Malta | 16 | 28 | 10 | | | 54 |
| Switzerland | | (5) | | 104 | | 99 |
| Turkey | 29 | 33 | 47 | 1 | | 110 |
| Other | (98) | 46 | 103 | 45 | (2) | 94 |
| | 713 | 496 | 655 | 281 | (1,364) | 781 |

For footnotes, see page 81.

Services, Prime Services and Equities. Lower revenues compared with the first half of 2010 were driven by reductions in Balance Sheet Management and legacy Credit.

In the UK CMB business, income from UK based customers using products to support international activity grew by 16% compared with the first half of 2010. We remain on track to achieve our lending goals under the Merlin Agreement with the UK government, having made available total new facilities of £22.7bn (US\$36.3bn) in the first half of 2011, compared with a full year target of £38.8bn (US\$62.1bn), with capacity to increase this to £44.1bn (US\$70.6bn) if there is sufficient demand on commercial terms. For UK SMEs, we have provided gross new facilities of £5.6bn (US\$9.0bn), compared with a goal of £11.7bn (US\$18.7bn) for the full year, with committed capacity for additional facilities of at least £1.2bn (US\$1.9bn) if required.

In the UK personal sector, we delivered further growth in mortgage balances and increased our market share of new lending to 11% while maintaining a conservative new lending loan-to-value ratio of 53%. The investment business

continued to grow and we increased our assets under management of HSBC World Selection by 20% to US\$3.9bn in the first half of the year.

Within Continental Europe, there was a continued focus on selected markets where we have scale and opportunities for growth, particularly in wealth management, CMB and GB&M.

In GPB, the focus remained on enhancing client experience through the delivery of bespoke services and global connections. Client assets increased due to net new money inflows, together with favourable market and foreign exchange movements.

Across the region there was a drive to improve efficiency and rationalise the portfolio and, to that end, we announced the closure of our retail businesses in Russia and Poland, as well as initiatives to improve operational efficiency in France and the UK. We continued to monitor our portfolio against strict targets, and keep our cost base under review.

Net interest income decreased by 9% as Balance Sheet Management revenues reduced. This was due to higher-yielding positions maturing and

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Interim Management Report (continued)

opportunities for reinvestment at similar yields being limited by the prevailing low interest rate environment and flatter yield curves. It was partly offset by growth in mortgage and commercial lending balances and wider lending spreads. We continued to build on our strong deposit base in the UK despite fierce competition for customer deposits.

Net fee income decreased by 4%. The increases in GPB from growth in assets under management and higher levels of client activity, along with an increase in domestic and international payments in the UK, did not offset lower fee income in GB&M for management services as the comparable period in 2010 benefited from higher fees generated from the securities investment conduits.

Net trading income increased by 7%. There were lower adverse fair value movements on non-qualifying hedges used to economically hedge fixed-rate long-term debt issued by HSBC Holdings. These were driven by a less pronounced decrease in long-term US interest rates relative to sterling and euro interest rates than those experienced in the first half of 2010. In addition, there were favourable foreign exchange movements on trading assets held as economic hedges of foreign currency debt designated at fair value. These offset adverse foreign exchange movements on the foreign currency debt which is reported in *Net expense from financial instruments designated at fair value*.

Excluding the above items, net trading income decreased. This reflected lower favourable fair value movements on structured liabilities, mainly in Rates. Credit trading revenues were affected by the re-emergence of eurozone sovereign debt concerns in the second quarter of 2011 which resulted in a reduction in client activity and a general widening of credit spreads. In addition, foreign exchange revenues were constrained by continued spread compression due to increased competition. Benefiting from recent investment spending, higher revenues in Equities reflected an improved competitive positioning which helped capture increasing client flows, particularly during the rally in global equity markets in the first quarter of 2011.

Net expense from financial instruments designated at fair value increased by US\$143m. There were adverse foreign exchange movements on foreign currency debt designated at fair value, issued as part of our overall funding strategy, with an offset reported in *Net trading income*. These adverse movements were partly mitigated by gains on the fair value of assets held to meet liabilities under insurance and investment contracts that were recognised as equity markets rose, compared with

losses experienced in the first half of 2010. To the extent that these gains accrued to policyholders holding unit-linked insurance policies and insurance or investment contracts with DPF, there was a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments increased by US\$62m, driven by gains on certain securitised debt portfolios.

Net earned insurance premiums increased by 6% reflecting successful targeted sales campaigns in RBWM, notably for investment contracts with DPF in France, and higher sales of unit-linked products in the UK. This was partly offset by a reduction in premiums resulting from the non-renewal and transfer to third parties of certain contracts in our Irish business, and the run-off of the legacy motor book in the UK.

Other operating income decreased by 23%, largely reflecting the non-recurrence of a gain on the sale and leaseback of our Paris headquarters in the first half of 2010, partly offset by the benefit from a refinement of the calculation of the PVIF asset during the period (see footnote 27 on page 81).

Net insurance claims incurred and movement in liabilities to policyholders increased by 23%. Investment gains, which contrasted with investment losses in the first half of 2010, led to an increase in the movement in liabilities to policyholders. Additional reserves were also established for new business written, consistent with the increase in net earned insurance premiums. The non-renewal and transfer to third parties of certain contracts in the Irish business and the run-off of the legacy motor book in the UK resulted in a decrease in net insurance claims incurred and movement in liabilities to policyholders, partly offsetting the above.

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Loan impairment charges and other credit risk provisions decreased by 26% to US\$1.2bn, reflecting an improved credit environment in the region and successful risk mitigation by management in RBWM. The decline in loan impairment charges was also attributable to lower delinquency rates across both the secured and unsecured lending portfolios in the UK as a result of better collections capability and enhanced credit risk management practices. In CMB, loan impairment charges fell in the UK across a range of industry sectors. In GB&M, loan impairment charges and other credit risk provisions declined despite recording a charge of US\$65m to write down to market value available-for-sale Greek sovereign debt now judged to be

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Interim Management Report (continued)

impaired. In addition, impairments of US\$40m were included in our GPB and insurance businesses in relation to Greek available-for-sale debt securities.

Operating expenses in the first half of 2011 included US\$611m of provisions relating to UK customer redress programmes, including a provision in respect of the adverse judgement in the Judicial Review relating to sales of PPI in the UK. This was offset by a credit of US\$587m resulting from a change in the inflation measure used to calculate the defined benefit obligation in the UK for deferred

pensions. The first half of 2010 included one-off payroll and bonus taxes of US\$398m (US\$367m as reported) in the UK and France. Excluding these items, operating expenses increased by 6%. This included an acceleration in the expense recognition of deferred bonus awards. We also continued to invest in strategic initiatives in GB&M, including the development of Prime Services and equity market capabilities and the expansion of the Rates and Foreign Exchange e-commerce platforms.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Europe*

| | Half-year to 30 June 2011 | | | | | | Total US\$m |
|--|--|-----------------------|---------------------------|------------------------------|-------------------|------------|----------------|
| | Retail | Global | | | Inter- segment | Total | |
| | Banking and Wealth Management | Commercial Banking | Banking and Markets | Global Private Banking | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 2,861 | 1,522 | 1,107 | 476 | (271) | (129) | 5,566 |
| Net fee income/(expense) | 1,323 | 813 | 516 | 496 | (17) | | 3,131 |
| Trading income/(expense) excluding net interest income | 36 | 6 | 1,268 | 84 | (196) | | 1,198 |
| Net interest income on trading activities | 6 | 8 | 636 | 9 | 21 | 129 | 809 |
| Net trading income/(expense) ⁴⁵ | 42 | 14 | 1,904 | 93 | (175) | 129 | 2,007 |
| Net income/(expense) from financial instruments designated at fair value | 105 | 25 | (211) | | (159) | | (240) |
| Gains less losses from financial investments | 56 | 1 | 254 | (4) | 5 | | 312 |
| Dividend income | 1 | 1 | 19 | 3 | 1 | | 25 |
| Net earned insurance premiums | 2,201 | 191 | | | (6) | | 2,386 |
| Other operating income | 142 | 40 | 96 | 8 | 264 | 102 | 652 |
| Total operating income/(expense) | 6,731 | 2,607 | 3,685 | 1,072 | (358) | 102 | 13,839 |
| Net insurance claims ⁵³ | (2,316) | (180) | | | (3) | | (2,499) |

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| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|------------|---------------|
| Net operating income/(expense)⁴¹ | 4,415 | 2,427 | 3,685 | 1,072 | (361) | 102 | 11,340 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (394) | (369) | (382) | (34) | 6 | | (1,173) |
| Net operating income/(expense) | 4,021 | 2,058 | 3,303 | 1,038 | (355) | 102 | 10,167 |
| Operating expenses | (3,249) | (1,013) | (2,299) | (723) | (628) | (102) | (8,014) |
| Operating profit/(loss) | 772 | 1,045 | 1,004 | 315 | (983) | | 2,153 |
| Share of profit/(loss) in associates and joint ventures | (3) | (1) | (2) | | | | (6) |
| Profit/(loss) before tax | 769 | 1,044 | 1,002 | 315 | (983) | | 2,147 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 6.7 | 9.1 | 8.7 | 2.8 | (8.6) | | 18.7 |
| Cost efficiency ratio | 73.6 | 41.7 | 62.4 | 67.4 | (173.5) | | 70.7 |
| <i>Balance sheet data³⁹</i> | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 154,055 | 100,140 | 200,498 | 30,354 | 1,284 | | 486,331 |
| Total assets | 221,095 | 123,446 | 1,075,148 | 80,073 | 72,488 | (192,942) | 1,379,308 |
| Customer accounts | 178,819 | 101,195 | 207,891 | 60,906 | | | 548,811 |

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Interim Management Report (continued)

| | Half-year to 30 June 2010 | | | | | | | |
|--|---------------------------|-----------------------|--------------|------------|--------------|------------|---------------------------|-------|
| | Retail | Global | | | | | Inter- | Total |
| | Banking | Banking | Global | Other | | segment | | |
| | and Wealth | and | Private | | | | elimination ⁵² | |
| Management ¹⁶ | Commercial | Markets ¹⁶ | Banking | Other | US\$m | US\$m | | |
| US\$m | Banking US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | | |
| Net interest income/(expense) | 2,706 | 1,324 | 1,648 | 424 | (292) | (8) | 5,802 | |
| Net fee income/(expense) | 1,221 | 796 | 719 | 444 | (3) | | 3,177 | |
| Trading income/(expense) excluding net interest income | (19) | 14 | 1,342 | 105 | (570) | | 872 | |
| Net interest income on trading activities | | 7 | 700 | 10 | 7 | 8 | 732 | |
| Net trading income/ (expense) ⁴⁵ | (19) | 21 | 2,042 | 115 | (563) | 8 | 1,604 | |
| Net income/(expense) from financial instruments designated at fair value | (121) | (26) | (31) | | 751 | | 573 | |
| Gains less losses from financial investments | (1) | | 241 | 1 | (4) | | 237 | |
| Dividend income | | | 12 | 2 | | | 14 | |
| Net earned insurance premiums | 2,012 | 130 | | | (5) | | 2,137 | |
| Other operating income | 104 | 125 | 303 | 4 | 479 | 126 | 1,141 | |
| Total operating income | 5,902 | 2,370 | 4,934 | 990 | 363 | 126 | 14,685 | |
| Net insurance claims ⁵³ | (1,882) | (81) | | | (1) | | (1,964) | |
| Net operating income⁴¹ | 4,020 | 2,289 | 4,934 | 990 | 362 | 126 | 12,721 | |
| Loan impairment charges and other credit risk provisions | (686) | (410) | (394) | (11) | | | (1,501) | |
| Net operating income | 3,334 | 1,879 | 4,540 | 979 | 362 | 126 | 11,220 | |
| Operating expenses | (2,738) | (1,171) | (2,493) | (620) | (556) | (126) | (7,704) | |
| Operating profit/(loss) | 596 | 708 | 2,047 | 359 | (194) | | 3,516 | |
| Share of profit in associates and joint ventures | 3 | 1 | 1 | | | | 5 | |
| Profit/(loss) before tax | 599 | 709 | 2,048 | 359 | (194) | | 3,521 | |

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| | % | % | % | % | % | % |
|---|---------|---------|-----------|--------|--------|-----------|
| Share of HSBC's profit before tax | 5.4 | 6.3 | 18.5 | 3.2 | (1.7) | 31.7 |
| Cost efficiency ratio | 68.1 | 51.2 | 50.5 | 62.6 | 153.6 | 60.6 |
| <i>Balance sheet data</i> ³⁹ | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Loans and advances to customers (net) | 135,746 | 82,822 | 163,020 | 24,717 | 921 | 407,226 |
| Total assets | 193,060 | 105,134 | 1,019,364 | 70,116 | 74,744 | 1,280,698 |
| Customer accounts | 156,581 | 95,558 | 170,695 | 54,423 | 1 | 477,258 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Europe (continued)*

| | Half-year to 31 December 2010 | | | | | | Total US\$m |
|---|--|--------------------------------|--|---------------------------------------|----------------|---|----------------|
| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Inter- segment elimination ⁵² US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/ (expense) | 2,831 | 1,450 | 1,287 | 447 | (362) | (205) | 5,448 |
| Net fee income | 1,338 | 774 | 601 | 439 | 42 | | 3,194 |
| Trading income/(expense) excluding net interest income | 13 | (11) | 199 | 80 | 308 | | 589 |
| Net interest income on trading activities | (1) | 12 | 427 | 11 | 16 | 205 | 670 |
| Net trading income ⁴⁵ | 12 | 1 | 626 | 91 | 324 | 205 | 1,259 |
| Net income/(expense) from financial instruments designated at fair value | 617 | 139 | 8 | | (1,055) | | (291) |
| Gains less losses from financial investments | (35) | | 284 | (8) | 8 | | 249 |
| Dividend income | | 1 | 4 | | 1 | | 6 |
| Net earned insurance premiums | 1,788 | 148 | | | (6) | | 1,930 |
| Other operating income | 83 | 38 | 514 | 3 | 275 | 63 | 976 |
| Total operating income/ (expense) | 6,634 | 2,551 | 3,324 | 972 | (773) | 63 | 12,771 |
| Net insurance claims ⁵³ | (2,482) | (261) | | | 1 | | (2,742) |
| Net operating income/ (expense) ⁴¹ | 4,152 | 2,290 | 3,324 | 972 | (772) | 63 | 10,029 |

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| | | | | | | | |
|--|---------|---------|---------|--------|---------|-----------|-----------|
| Loan impairment (charges)/ recoveries and other credit risk provisions | (531) | (587) | (389) | (15) | 3 | | (1,519) |
| Net operating income/ (expense) | 3,621 | 1,703 | 2,935 | 957 | (769) | 63 | 8,510 |
| Operating expenses | (2,909) | (1,207) | (2,291) | (676) | (595) | (63) | (7,741) |
| Operating profit/(loss) | 712 | 496 | 644 | 281 | (1,364) | | 769 |
| Share of profit in associates and joint ventures | 1 | | 11 | | | | 12 |
| Profit/(loss) before tax | 713 | 496 | 655 | 281 | (1,364) | | 781 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 9.0 | 6.3 | 8.3 | 3.5 | (17.3) | | 9.8 |
| Cost efficiency ratio | 70.1 | 52.7 | 68.9 | 69.5 | (77.1) | | 77.2 |
| <i>Balance sheet data</i> ³⁹ | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 145,069 | 91,744 | 170,369 | 27,629 | 988 | | 435,799 |
| Total assets | 205,032 | 111,356 | 962,861 | 76,631 | 65,824 | (172,177) | 1,249,527 |
| Customer accounts | 169,016 | 96,597 | 169,836 | 56,114 | | | 491,563 |

For footnotes, see page 81.

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Interim Management Report (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 approximately 65% by value of banknotes in circulation in the first half of 2011.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|----------------|------------------------|---------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 2,249 | 1,994 | 2,252 |
| Net fee income | 1,612 | 1,395 | 1,567 |
| Net trading income | 669 | 688 | 624 |
| Other income | 884 | 819 | 863 |
| Net operating income⁴¹ | 5,414 | 4,896 | 5,306 |
| Impairment charges ⁴² | (25) | (63) | (51) |
| Net operating income | 5,389 | 4,833 | 5,255 |
| Total operating expenses | (2,339) | (1,968) | (2,463) |
| Operating profit | 3,050 | 2,865 | 2,792 |
| Income from associates ⁴³ | 31 | 12 | 23 |
| Profit before tax | 3,081 | 2,877 | 2,815 |
| Cost efficiency ratio | 43.2% | 40.2% | 46.4% |
| RoRWA ⁴⁴ | 5.6% | 5.1% | 5.0% |
| Period-end staff numbers | 30,214 | 28,397 | 29,171 |

Best Bank in Hong Kong*(FinanceAsia Country Awards 2011)*

**Market leadership in mortgages,
cards, life insurance
and deposits
More than 50%
increase in the number of CMB
cross-border referrals between
Hong Kong and mainland China**

For footnotes, see page 81.

The commentary on Hong Kong is on an underlying basis unless stated otherwise.

Economic background

Hong Kong continued to demonstrate robust growth in economic activity, helped by strong demand from mainland China and low interest rates, with the Hong Kong Monetary Authority (HKMA) maintaining rates at 0.5% since April 2008. Inflationary pressures built during the period, spurred by rapid gains in the price of food and property. CPI inflation rose to 5.3% in May 2011, compared with 2.9% in December 2010.

Review of performance

Our operations in Hong Kong reported pre-tax profits of US\$3.1bn compared with US\$2.9bn in the first half of 2010, an increase of 7%. On an underlying basis, profit before tax increased by 9%.

The increase in profitability was driven by strong balance sheet growth from 2010 onwards, higher sales of wealth management products, increased underwriting fees and higher sales of trade-related products. There was also a gain from the refinement of the calculation of the PVIF asset. Staff and support costs rose, driven by the increase in business volumes and the need to maintain our strong competitive position.

We successfully retained market leadership in Hong Kong in mortgages, deposits, credit cards and life insurance. Robust growth in lending balances continued, increasing by 13% compared with 31 December 2010, while deposit balances continued to grow.

We remained ideally positioned to capture cross-border opportunities, particularly with mainland China. The number of CMB cross-border referrals between Hong Kong and mainland China increased by more than 50% and Premier referrals rose by 47%.

Collaboration between CMB and GB&M continued to meet the demands of fast growing mid-market companies by providing foreign exchange and derivatives products as well as access to debt and equity markets to fund business growth.

We continued to bolster our position as a leading international renminbi bank. We were appointed as joint lead arranger for Hong Kong's first renminbi-denominated equity initial public offering, and led the market in offshore renminbi bond issuance. We were the first international bank to offer CMB customers a dedicated renminbi Business Card in Hong Kong.

Net interest income was 13% higher than in the first half of 2010, primarily due to strong loan

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Interim Management Report (continued)*Profit/(loss) before tax by customer group and global business*

| | 30 June | Half-year to | |
|--|----------------|--------------|-------------|
| | | 30 June | 31 December |
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Retail Banking and Wealth Management ¹⁶ | 1,599 | 1,462 | 1,539 |
| Commercial Banking | 825 | 672 | 680 |
| Global Banking and Markets ¹⁶ | 631 | 690 | 657 |
| Global Private Banking | 130 | 119 | 108 |
| Other | (104) | (66) | (169) |
| | | | |
| Profit before tax | 3,081 | 2,877 | 2,815 |

For footnote, see page 81.

growth, particularly in CMB and GB&M, partly offset by lower asset spreads in RBWM and CMB resulting from competitive pressures. Balance Sheet Management results remained strong.

The targeted expansion of our lending book reflected our balance sheet strength, together with continued strong economic growth and trade flows. The resultant increase in demand for credit saw significant increases in lending balances in CMB, notably in trade-related lending, and in GB&M. Average personal lending balances rose, primarily in residential mortgage lending as a result of the strong property market and our leadership in new mortgage business. The continued strength of the Hong Kong property market led the HKMA to introduce further prudential measures on loan-to-value ratios in June 2011, following similar measures taken in 2010 designed to calm upward property price movement. We continued to lend prudently and average loan-to-value ratios were 51% on new residential mortgage draw-downs and an estimated 35% on the portfolio as a whole.

Asset spreads narrowed relative to the same period in 2010 as a result of competitive pressures, particularly in trade-related and term lending and HIBOR-linked residential mortgages.

Balance Sheet Management income rose due to the increased duration in the overall portfolio.

Momentum continued in the growth of deposit balances in GB&M and in CMB, reflecting increased customer numbers.

Net fee income increased by 16%, primarily from increased sales of wealth management products in the low interest rate environment, particularly unit trusts, driven by improved investor sentiment and supported by an increase in sales staff in our wealth management business. In addition, fees from funds under management grew as a result of higher net inflows including the launch of two new funds in 2011. Underwriting fees increased from our involvement in several significant IPOs, and trade-

related fees and remittances also rose as transaction volumes increased, driven by economic growth.

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Net trading income reduced by 3%. Revenue from foreign exchange trading increased due to higher levels of customer-driven activity and the successful capture of market volatility. The Rates and Equities businesses also performed well. This was offset by lower revenue in credit trading as credit spreads widened in some markets.

Net income from financial instruments designated at fair value rose by US\$51m due to investment gains in the first half of 2011 on assets held by the insurance business as equity markets improved, compared with revaluation losses in the same period in 2010. To the extent that these gains were attributed to policyholders, there was an offsetting change in *Net insurance claims incurred and movement in liabilities to policyholders* .

Net earned insurance premiums increased by 15% from the rise in sales of unit-linked insurance and deferred annuity products, reflecting the increased demand. This growth in insurance sales resulted in a related increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were 63% lower, primarily due to the non-recurrence of significant gains on the sale of debt securities in the first half of 2010 in Balance Sheet Management.

Other operating income increased by 41% to US\$911m, primarily in insurance due to the refinement of the calculation of the PVIF asset during the period of US\$135m (see footnote 27 on page 81), and higher life insurance sales in the first half of 2011.

Loan impairment charges and other credit risk provisions decreased from US\$63m to US\$25m, driven by releases and recoveries in GB&M compared with a specific impairment charge in the same period in 2010. Though impairment charges were low, we remained cautious on the outlook for

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Interim Management Report (continued)

credit and continued to focus on maintaining high levels of asset quality.

Operating expenses rose by 19% as business volumes grew. Staff costs increased due to wage inflation in the competitive marketplace, increased headcount, particularly in front office functions to strengthen our sales capacity, and higher sales incentives which reflected our strong business performance in the first half of 2011. Staff costs also rose due to an acceleration in the expense recognition of deferred bonus awards.

We continued to invest in developing our key capabilities, most notably in equities, Prime Services and commodities, to drive future revenue growth. Marketing and support costs also increased in line with higher business volumes and product development. Although our cost efficiency ratio is already relatively low in Hong Kong, we continue to focus on improving operational efficiency while maintaining market leadership and strong growth.

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Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Hong Kong*

| | Half-year to 30 June 2011 | | | | | | Total US\$m |
|--|--|--------------------------------|------------------------------------|-----------------------------|---|--------------|----------------|
| | Retail Banking and Wealth Management | Commercial Banking US\$m | Global | Global | Inter- segment elimination ⁵² US\$m | | |
| | | | Banking and Markets US\$m | Private Banking US\$m | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 1,249 | 625 | 501 | 88 | (234) | 20 | 2,249 |
| Net fee income | 908 | 356 | 241 | 97 | 10 | | 1,612 |
| Trading income/(expense) excluding net interest income | 89 | 86 | 320 | 69 | (9) | | 555 |
| Net interest income on trading activities | 4 | | 124 | | 6 | (20) | 114 |
| Net trading income/(expense) ⁴⁵ | 93 | 86 | 444 | 69 | (3) | (20) | 669 |
| Net income/(expense) from financial instruments designated at fair value | 50 | (27) | 2 | | 1 | | 26 |
| Gains less losses from financial investments | | | 20 | | (2) | | 18 |
| Dividend income | | 1 | 11 | | 19 | | 31 |
| Net earned insurance premiums | 2,193 | 390 | 5 | | | | 2,588 |
| Other operating income | 375 | 83 | 22 | 6 | 556 | (131) | 911 |
| Total operating income | 4,868 | 1,514 | 1,246 | 260 | 347 | (131) | 8,104 |
| Net insurance claims ⁵³ | (2,344) | (342) | (5) | | 1 | | (2,690) |

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| | | | | | | | |
|--|--------------|--------------|--------------|------------|--------------|--------------|--------------|
| Net operating income⁴¹ | 2,524 | 1,172 | 1,241 | 260 | 348 | (131) | 5,414 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (38) | (7) | 22 | (1) | (1) | | (25) |
| Net operating income | 2,486 | 1,165 | 1,263 | 259 | 347 | (131) | 5,389 |
| Operating expenses | (889) | (342) | (633) | (129) | (477) | 131 | (2,339) |
| Operating profit/(loss) | 1,597 | 823 | 630 | 130 | (130) | | 3,050 |
| Share of profit in associates and joint ventures | 2 | 2 | 1 | | 26 | | 31 |
| Profit/(loss) before tax | 1,599 | 825 | 631 | 130 | (104) | | 3,081 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 13.9 | 7.2 | 5.5 | 1.1 | (0.8) | | 26.9 |
| Cost efficiency ratio | 35.2 | 29.2 | 51.0 | 49.6 | 137.1 | | 43.2 |
| <i>Balance sheet data³⁹</i> | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 53,999 | 58,529 | 39,124 | 5,949 | 1,769 | | 159,370 |
| Total assets | 82,184 | 66,563 | 232,057 | 21,545 | 81,316 | (9,621) | 474,044 |
| Customer accounts | 175,641 | 74,760 | 34,348 | 20,378 | 599 | | 305,726 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 30 June 2010 | | | | | | |
|--|---|--------------------------------|--|---|--------------------------|---|----------------|
| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Banking and Private Banking US\$m | Global Other US\$m | Inter- segment elimination ⁵² US\$m | Total US\$m |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 1,279 | 504 | 437 | 77 | (247) | (56) | 1,994 |
| Net fee income | 761 | 305 | 242 | 78 | 9 | | 1,395 |
| Trading income excluding net interest income | 108 | 53 | 367 | 59 | 4 | | 591 |
| Net interest income on trading activities | 1 | | 34 | | 6 | 56 | 97 |
| Net trading income ⁴⁵ | 109 | 53 | 401 | 59 | 10 | 56 | 688 |
| Net income/(expense) from financial instruments designated at fair value | (110) | 23 | 42 | | 15 | | (30) |
| Gains less losses from financial investments | | | 63 | 8 | 40 | | 111 |
| Dividend income | | | | | 13 | | 13 |
| Net earned insurance premiums | 1,874 | 369 | 5 | | | | 2,248 |
| Other operating income | 228 | 27 | 24 | 5 | 499 | (139) | 644 |
| Total operating income | 4,141 | 1,281 | 1,214 | 227 | 339 | (139) | 7,063 |
| Net insurance claims ⁵³ | (1,853) | (309) | (5) | | | | (2,167) |

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| | | | | | | | |
|--|---------|--------|---------|--------|--------|----------|---------|
| Net operating income ⁴¹ | 2,288 | 972 | 1,209 | 227 | 339 | (139) | 4,896 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (42) | (2) | (20) | | 1 | | (63) |
| Net operating income | 2,246 | 970 | 1,189 | 227 | 340 | (139) | 4,833 |
| Operating expenses | (786) | (298) | (499) | (108) | (416) | 139 | (1,968) |
| Operating profit/(loss) | 1,460 | 672 | 690 | 119 | (76) | | 2,865 |
| Share of profit in associates and joint ventures | 2 | | | | 10 | | 12 |
| Profit/(loss) before tax | 1,462 | 672 | 690 | 119 | (66) | | 2,877 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 13.2 | 6.1 | 6.2 | 1.1 | (0.7) | | 25.9 |
| Cost efficiency ratio | 34.4 | 30.7 | 41.3 | 47.6 | 122.7 | | 40.2 |
| <i>Balance sheet data</i> ³⁹ | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 45,121 | 37,184 | 25,501 | 4,353 | 1,916 | | 114,075 |
| Total assets | 69,187 | 44,409 | 213,956 | 19,919 | 92,165 | (28,645) | 410,991 |
| Customer accounts | 165,238 | 63,562 | 26,142 | 18,559 | 611 | | 274,112 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Hong Kong (continued)*

| | Half-year to 31 December 2010 | | | | | | | Total US\$m |
|--|--|--------------------------------|--------------------------------|---|-------|--|--|------------------|
| | Retail Banking and Wealth Management ¹⁶ | Commercial Banking US\$m | Global | Global | Other | Inter- segment elimination ⁵² | | |
| | US\$m | | Markets ¹⁶ US\$m | Banking and Private Banking US\$m | | | | |
| <i>Profit/(loss) before tax</i> | | | | | | | | |
| Net interest income/(expense) | 1,325 | 602 | 478 | 96 | (216) | (33) | | 2,252 |
| Net fee income | 895 | 329 | 253 | 85 | 5 | | | 1,567 |
| Trading income/(expense) excluding net interest income | 90 | 68 | 313 | 61 | (16) | | | 516 |
| Net interest income on trading activities | 3 | | 66 | | 6 | 33 | | 108 |
| Net trading income/ (expense) ⁴⁵ | 93 | 68 | 379 | 61 | (10) | 33 | | 624 |
| Net income/(expense) from financial instruments designated at fair value | 438 | (33) | 19 | | (16) | | | 408 |
| Gains less losses from financial investments | | | (7) | (7) | 1 | | | (13) |
| Dividend income | | 1 | 12 | | 4 | | | 17 |
| Net earned insurance premiums | 1,781 | 296 | 7 | | | | | 2,084 |
| Other operating income | 285 | 41 | 132 | 7 | 641 | (144) | | 962 |
| Total operating income | 4,817 (2,340) | 1,304 (250) | 1,273 (5) | 242 | 409 | (144) | | 7,901 (2,595) |

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Net insurance claims⁵³

| | | | | | | | |
|--|---------|--------|---------|--------|--------|---------|---------|
| Net operating income ⁴¹ | 2,477 | 1,054 | 1,268 | 242 | 409 | (144) | 5,306 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (34) | (26) | 10 | | (1) | | (51) |
| Net operating income | 2,443 | 1,028 | 1,278 | 242 | 408 | (144) | 5,255 |
| Operating expenses | (907) | (355) | (625) | (134) | (586) | 144 | (2,463) |
| Operating profit/(loss) | 1,536 | 673 | 653 | 108 | (178) | | 2,792 |
| Share of profit in associates and joint ventures | 3 | 7 | 4 | | 9 | | 23 |
| Profit/(loss) before tax | 1,539 | 680 | 657 | 108 | (169) | | 2,815 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 19.4 | 8.6 | 8.3 | 1.4 | (2.2) | | 35.5 |
| Cost efficiency ratio | 36.6 | 33.7 | 49.3 | 55.4 | 143.3 | | 46.4 |
| <i>Balance sheet data³⁹</i> | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 50,983 | 48,670 | 34,491 | 4,760 | 1,787 | | 140,691 |
| Total assets | 76,871 | 55,030 | 223,286 | 20,598 | 62,486 | (8,706) | 429,565 |
| Customer accounts | 176,960 | 71,209 | 29,388 | 19,241 | 686 | | 297,484 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (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 four associates.

Outside Hong Kong and mainland China, we conduct business in 22 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.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|-----------------------|------------------------|---------------|
| | 2011 US\$m | 2010 US\$m | 2010 US\$m |
| Net interest income | 2,381 | 1,822 | 2,006 |
| Net fee income | 1,117 | 934 | 998 |
| Net trading income | 862 | 780 | 838 |
| Other income | 988 | 962 | 892 |
| Net operating income⁴¹ | 5,348 | 4,498 | 4,734 |
| Impairment charges ⁴² | (100) | (147) | (292) |
| Net operating income | 5,248 | 4,351 | 4,442 |
| Total operating expenses | (2,836) | (2,417) | (2,726) |
| Operating profit | 2,412 | 1,934 | 1,716 |
| | 1,330 | 1,051 | 1,201 |

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| | | | |
|--------------------------------------|-----|---------------|--------|
| Income from associates ⁴³ | | | |
| Profit before tax | | 3,742 | 2,985 |
| | | | 2,917 |
| Cost efficiency ratio | | 53.0% | 53.7% |
| | | | 57.6% |
| RoRWA ⁴⁴ | | 3.3% | 3.3% |
| | | | 2.8% |
| Period-end staff numbers | | 91,924 | 88,605 |
| | 25% | | 91,607 |

growth in reported pre-tax profit

Best foreign Commercial Bank

in mainland China

(FinanceAsia)

Best International Trade Bank

in mainland China

(Trade Finance)

For footnotes, see page 81.

The commentary on Rest of Asia-Pacific is on an underlying basis unless stated otherwise.

Economic background

In mainland China, strong inflationary pressures caused the People's Bank of China to continue raising interest rates and the Reserve Requirement Ratio on bank deposits during the first half of 2011, and GDP growth began to show signs of slowing as a result. The deceleration was modest, however, with activity in the second quarter of 2011 9.5% higher than a year ago. Investment spending remained particularly strong, growing by 26% in the first half of the year compared with the same period in 2010. Inflation reached 6.4% in June.

Economic conditions deteriorated sharply in Japan during the first quarter of 2011, following the earthquake and tsunami in March 2011. By 30 June, economic activity was beginning to accelerate. Having fallen by more than 15% in March, industrial output recovered by 7.9% in the two months to May, despite electricity shortages. The Bank of Japan kept the target unsecured overnight call rate at 0.1% and introduced measures to ensure credit and liquidity were made available.

GDP was particularly strong in Singapore in the first quarter of 2011 but fell sharply in the second quarter, with the pharmaceutical sector accounting for much of this volatility. GDP was 0.5% higher than in 2010 with inflation remaining relatively high. The annual pace of GDP growth in India slowed to 7.8% in the first quarter of 2011 from 8.3% in the final quarter of 2010, in part due to the tightening of monetary policy, with a further slowdown expected in the second quarter. Wholesale price inflation of 9.4% in June 2011 remained above the Reserve Bank of India's range. In other parts of Asia-Pacific growth showed signs of slowing. The South Korean economy continued to perform well. Exports slowed in the second quarter, but domestic demand held up well. Employment remained robust and the Bank of Korea raised interest rates by 75 basis points in the first half of the year. GDP continued to grow in the Philippines and Vietnam, though there was some evidence of a slowdown in the second quarter. CPI inflation remained a major concern in Vietnam, reaching 20% in May. In Indonesia, domestic consumption continued to support GDP growth but, like elsewhere in the region, inflation was uncomfortably high. In Malaysia and Taiwan, exports were adversely affected by supply chain disruptions following the Japanese tsunami, but domestic consumption helped support overall GDP growth. In Thailand, the recent election brought political stability and the outlook for domestic consumption and investment improved.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Total US\$m |
|----------------------------------|---|--------------------------------|--|---------------------------------------|----------------|----------------|
| Half-year to 30 June 2011 | | | | | | |
| Australia | 36 | 33 | 70 | | (4) | 135 |
| India | (4) | 78 | 292 | 3 | 82 | 451 |
| Indonesia | (1) | 47 | 68 | | | 114 |
| Japan | 4 | | 27 | 2 | (8) | 25 |
| Mainland China | 490 | 617 | 472 | (2) | 194 | 1,771 |
| Associates | 524 | 539 | 248 | | 181 | 1,492 |
| Other mainland China | (34) | 78 | 224 | (2) | 13 | 279 |
| Malaysia | 77 | 56 | 114 | | 4 | 251 |
| Singapore | 95 | 62 | 126 | 46 | (2) | 327 |
| South Korea | 6 | | 118 | | 20 | 144 |
| Taiwan | 33 | 11 | 67 | | 6 | 117 |
| Vietnam | 1 | 26 | 40 | | 15 | 82 |
| Other | 29 | 131 | 146 | | 19 | 325 |
| | 766 | 1,061 | 1,540 | 49 | 326 | 3,742 |
| Half-year to 30 June 2010 | | | | | | |
| Australia | 23 | 42 | 68 | | 3 | 136 |
| India | (49) | 39 | 244 | 3 | 103 | 340 |
| Indonesia | (3) | 48 | 60 | | (3) | 102 |
| Japan | (9) | | 39 | | (2) | 28 |
| Mainland China | 364 | 390 | 297 | (4) | 234 | 1,281 |
| Associates | 415 | 356 | 215 | | 192 | 1,178 |
| Other mainland China | (51) | 34 | 82 | (4) | 42 | 103 |
| | 54 | 45 | 96 | | 6 | 201 |

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| | | | | | | |
|-------------------------------|------|-----|-------|-----|------|-------|
| Malaysia | | | | | | |
| Singapore | 85 | 42 | 91 | 43 | 3 | 264 |
| South Korea | 8 | (4) | 180 | | 29 | 213 |
| Taiwan | 26 | 32 | 37 | | (9) | 86 |
| Vietnam | (9) | 21 | 22 | | 4 | 38 |
| Other | 34 | 102 | 124 | 1 | 35 | 296 |
| | 524 | 757 | 1,258 | 43 | 403 | 2,985 |
| | | | | | | |
| Half-year to 31 December 2010 | | | | | | |
| Australia | 36 | 54 | 27 | | 5 | 122 |
| India | (34) | 32 | 264 | 1 | 76 | 339 |
| Indonesia | 15 | 46 | 56 | | | 117 |
| Japan | (24) | | 37 | (1) | (4) | 8 |
| Mainland China | 475 | 443 | 386 | (3) | (17) | 1,284 |
| Associates | 558 | 390 | 228 | | (4) | 1,172 |
| Other mainland China | (83) | 53 | 158 | (3) | (13) | 112 |
| | | | | | | |
| Malaysia | 66 | 43 | 98 | | (7) | 200 |
| Singapore | 84 | 45 | 9 | 41 | 81 | 260 |
| South Korea | (6) | | 125 | | 21 | 140 |
| Taiwan | 5 | 4 | 50 | | 2 | 61 |
| Vietnam | 2 | 29 | 39 | | 3 | 73 |
| Other | 19 | 103 | 139 | | 52 | 313 |
| | 638 | 799 | 1,230 | 38 | 212 | 2,917 |

For footnote, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Review of performance

Our operations in the Rest of Asia-Pacific region reported pre-tax profits of US\$3.7bn compared with US\$3.0bn in the first half of 2010, an increase of 25%. Reported profits included accounting gains arising from the dilution of HSBC's shareholding in Ping An following its issue of share capital to third parties in both 2010 (US\$188m) and 2011 (US\$181m). On an underlying basis, which excludes these dilution gains, pre-tax profit rose by 21%.

The growth in profitability in the region in the first half of 2011 reflected strong lending and deposit growth coupled with widening deposit spreads, higher trade volumes and a growing demand for wealth management products. The contribution from our associates in mainland China also grew. Costs increased, although to a lesser extent than revenues, to support business growth and maintain our competitive position in the region.

We continued building a domestic franchise in mainland China where we remained a leading foreign bank. Asset balances grew by 9% over the first six months of 2011, and our ratio of advances to deposits in mainland China remained conservative at 74%. We now have 108 outlets, 16 rural bank outlets and 38 Hang Seng Bank outlets in our branch network. We were awarded the Best International Trade Bank by *Trade Finance* and the Best Foreign Commercial Bank by *FinanceAsia*, reinforcing our strong corporate brand in mainland China. We expanded our renminbi services and now offer trade products in over 50 countries worldwide and renminbi services to RBWM customers in 11 countries in Asia.

We utilised our international connectivity to capture trade, capital and wealth flows across the region, in particular with mainland China. As cross-border referrals between mainland China and the rest of the world increased by more than 50%, we continued to facilitate outbound and inbound flows, particularly with Hong Kong, but also with Singapore, Latin America and the Middle East.

We continued to invest and build scale in the other key strategic markets of India, Singapore, Malaysia, Indonesia and Australia. In India, we made progress in RBWM with our deposit-led strategy and focus on secured lending. In Malaysia, we are the leading foreign bank by total assets and size of branch network and HSBC Amanah was named the world's number one Sukuk underwriter.

Net interest income increased by 23% due to strong loan and deposit growth coupled with wider deposit spreads as base rates rose in certain countries, partly offset by lower asset spreads than in the first half of 2010 from increased competition.

Average lending balances increased primarily in trade and term lending in GB&M and CMB due to a higher demand for credit as a result of improved trade and business volumes in the region. RBWM lending balances also rose, mainly in residential mortgages, most notably in Australia and Singapore, driven by local marketing campaigns and increased demand for credit.

Asset spreads narrowed compared with the same period in 2010, primarily due to increased market competition.

Customer deposit balances grew in CMB, GB&M and RBWM, principally in mainland China, Singapore and Australia, reflecting an increase in customer numbers and strong economic conditions across the region.

Deposit spreads increased as interest rates rose in certain countries, primarily in mainland China, India and Malaysia. Balance Sheet Management income was higher than in the comparative period, notably in mainland China and Singapore. In the former, this was driven by profit opportunities in the interbank market and the widening of onshore US dollar lending spreads. In Singapore, results reflected the higher return from short-term lending and balance sheet growth.

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Net fee income rose by 11%. Trade-related fees and fees arising on Payments and Cash Management increased in CMB and GB&M, reflecting higher trade and transaction volumes in the region. Securities Services fee income increased, as equity market performance drove higher volumes and growth in assets under custody. Fee income in RBWM also rose as a result of the increased demand for investment products, notably in unit trusts, reflecting successful sales activity, improved investor sentiment and the expansion of the structured products business in mainland China.

Net trading income increased by 4%, primarily from higher Foreign Exchange trading revenues. This was most notable in mainland China, Taiwan and India as the increased market volatility led to higher client volumes and wider spreads.

Net income from financial instruments designated at fair value increased by US\$7m due to higher valuation gains on assets held by the insurance business, primarily in Singapore. To the extent that these higher investment gains were attributed to policyholders, there was a corresponding increase in Net insurance claims

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HSBC HOLDINGS PLC

Interim Management Report (continued)

incurred and movement in liabilities to policyholders .

Losses from financial investments were US\$22m compared with gains of US\$41m in the first half of 2010, due to losses on disposals of debt securities, notably government bonds, coupled with an impairment loss on an equity investment in 2011.

Net earned insurance premiums increased by 57% to US\$340m, largely due to higher sales of insurance products in the region, most notably in Singapore and Malaysia. This was driven by successful sales initiatives and increased demand for wealth products as economic conditions improved strongly. The growth in the insurance business resulted in a related increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating income increased by 4% to US\$752m, including a favourable movement due to the refinement of the calculation of the PVIF asset during the period (see footnote 27 on page 81) and higher life insurance sales in the region.

Loan impairment charges and other credit risk provisions decreased by 36% to US\$100m as credit conditions throughout the region continued to improve. Loan impairment charges fell in RBWM, particularly in India, as certain unsecured lending portfolios were managed down. We remained cautious on the outlook for credit and sustained our focus on maintaining high levels of underwriting and asset quality.

Operating expenses increased by 10% as volumes grew due to the continued strong economic growth in the region. We hired more sales staff to support our continued business expansion in our key strategic markets and average wages rose, reflecting the increased demand for talent in the region.

Share of profit from associates and joint ventures increased by 21%. A higher contribution from Bank of Communications was driven by strong loan growth, an improvement in spreads and an increase in fee-based revenue streams. Income from Industrial Bank similarly rose as a result of loan growth, while strong sales growth in insurance, banking and wealth management business drove an increased contribution from Ping An.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit before tax and balance sheet data Rest of Asia-Pacific*

| | Half-year to 30 June 2011 | | | | | | Total US\$m |
|--|-------------------------------------|-----------------------|-------------------------------------|------------------------------|----------------|--------------------------------------|----------------|
| | Retail | | | | | Inter- | |
| | Banking and Wealth Management | Commercial Banking | Global Banking and Markets | Global Private Banking | Other US\$m | segment elimination ⁵² | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit before tax</i> | | | | | | | |
| Net interest income | 891 | 580 | 900 | 58 | 59 | (107) | 2,381 |
| Net fee income | 463 | 259 | 359 | 32 | 4 | | 1,117 |
| Trading income/(expense) excluding net interest income | 50 | 75 | 583 | 30 | (29) | | 709 |
| Net interest income/(expense) on trading activities | | | 51 | | (5) | 107 | 153 |
| Net trading income/ (expense) ⁴⁵ | 50 | 75 | 634 | 30 | (34) | 107 | 862 |
| Net income/(expense) from financial instruments designated at fair value | 7 | 2 | 1 | | (7) | | 3 |
| Gains less losses from financial investments | | 1 | (23) | 1 | (1) | | (22) |
| Dividend income | | | 1 | | | | 1 |
| Net earned insurance premiums | 225 | 115 | | | | | 340 |
| Other operating income | 71 | 33 | 35 | 1 | 877 | (85) | 932 |
| Total operating income | 1,707 | 1,065 | 1,907 | 122 | 898 | (85) | 5,614 |
| Net insurance claims ⁵³ | (173) | (94) | | | 1 | | (266) |
| Net operating income⁴¹ | 1,534 | 971 | 1,907 | 122 | 899 | (85) | 5,348 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (112) | 7 | 4 | 2 | (1) | | (100) |
| Net operating income | 1,422 | 978 | 1,911 | 124 | 898 | (85) | 5,248 |
| Operating expenses | (1,188) | (458) | (626) | (75) | (574) | 85 | (2,836) |
| Operating profit | 234 | 520 | 1,285 | 49 | 324 | | 2,412 |
| Share of profit in associates and joint ventures | 532 | 541 | 255 | | 2 | | 1,330 |
| Profit before tax | 766 | 1,061 | 1,540 | 49 | 326 | | 3,742 |

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| | % | % | % | % | % | | % |
|---|--------|--------|---------|--------|--------|----------|---------|
| Share of HSBC's profit before tax | 6.7 | 9.2 | 13.4 | 0.4 | 2.8 | | 32.6 |
| Cost efficiency ratio | 77.4 | 47.2 | 32.8 | 61.5 | 63.8 | | 53.0 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 41,707 | 36,128 | 39,569 | 3,846 | 179 | | 121,429 |
| Total assets | 54,326 | 47,028 | 181,947 | 12,802 | 15,215 | (12,728) | 298,590 |
| Customer accounts | 59,352 | 39,922 | 56,262 | 13,014 | 39 | | 168,589 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit before tax and balance sheet data Rest of Asia-Pacific (continued)*

| | Half-year to 30 June 2010 | | | | | | Total US\$m |
|--|---|-----------------------|---|------------------------------|----------------|--------------------------------------|----------------|
| | Retail | | Global | | | Inter- | |
| | Banking and Wealth Management ¹⁶ | Commercial Banking | Banking and Markets ¹⁶ | Global Private Banking | Other US\$m | segment elimination ⁵² | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit before tax</i> | | | | | | | |
| Net interest income | 754 | 431 | 662 | 40 | 30 | (95) | 1,822 |
| Net fee income/(expense) | 399 | 204 | 306 | 30 | (5) | | 934 |
| Trading income/(expense) excluding net interest income | 36 | 61 | 462 | 35 | (8) | | 586 |
| Net interest income on trading activities | | | 98 | | 1 | 95 | 194 |
| Net trading income/ (expense) ⁴⁵ | 36 | 61 | 560 | 35 | (7) | 95 | 780 |
| Net income/(expense) from financial instruments designated at fair value | 2 | 1 | | | (5) | | (2) |
| Gains less losses from financial investments | | 3 | 31 | 2 | 3 | | 39 |
| Dividend income | | | 1 | | | | 1 |
| Net earned insurance premiums | 172 | 26 | | | | | 198 |
| Other operating income | 53 | 53 | 19 | | 826 | (74) | 877 |
| Total operating income | 1,416 | 779 | 1,579 | 107 | 842 | (74) | 4,649 |
| Net insurance claims ⁵³ | (133) | (18) | | | | | (151) |
| Net operating income ⁴¹ | 1,283 | 761 | 1,579 | 107 | 842 | (74) | 4,498 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (175) | 18 | 10 | | | | (147) |
| Net operating income | 1,108 | 779 | 1,589 | 107 | 842 | (74) | 4,351 |
| Operating expenses | (1,028) | (376) | (533) | (64) | (490) | 74 | (2,417) |
| Operating profit | 80 | 403 | 1,056 | 43 | 352 | | 1,934 |

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| | | | | | | | |
|--|--------|--------|---------|--------|--------|---------|---------|
| Share of profit in associates and joint ventures | 444 | 354 | 202 | | 51 | | 1,051 |
| Profit before tax | 524 | 757 | 1,258 | 43 | 403 | | 2,985 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 4.7 | 6.8 | 11.3 | 0.4 | 3.6 | | 26.9 |
| Cost efficiency ratio | 80.1 | 49.4 | 33.8 | 59.8 | 58.2 | | 53.7 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 31,317 | 26,284 | 30,718 | 3,181 | 172 | | 91,672 |
| Total assets | 42,334 | 34,810 | 153,639 | 12,013 | 10,393 | (8,565) | 244,624 |
| Customer accounts | 48,890 | 31,046 | 46,089 | 12,262 | 32 | | 138,319 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 31 December 2010 | | | | | | Total US\$m |
|--|--|--------------------------------|---|---------------------------------------|-------|--|----------------|
| | Retail Banking and Wealth Management ¹⁶ | Commercial Banking US\$m | Global Banking and Markets ¹⁶ | Global Private Banking US\$m | Other | Inter- segment elimination ⁵² | |
| | US\$m | | US\$m | US\$m | US\$m | US\$m | |
| | | | | | | | |
| <i>Profit before tax</i> | | | | | | | |
| Net interest income | 827 | 507 | 773 | 51 | 25 | (177) | 2,006 |
| Net fee income/(expense) | 435 | 238 | 305 | 25 | (5) | | 998 |
| Trading income/(expense) excluding net interest income | 44 | 68 | 505 | 34 | (30) | | 621 |
| Net interest income/(expense) on trading activities | | | 40 | | | 177 | 217 |
| Net trading income/ (expense) ⁴⁵ | 44 | 68 | 545 | 34 | (30) | 177 | 838 |
| Net income/(expense) from financial instruments designated at fair value | 39 | 1 | (1) | | (13) | | 26 |
| Gains less losses on financial investments | | | 20 | (2) | 89 | | 107 |
| Dividend income | | | | | | | |
| Net earned insurance premiums | 214 | 36 | | | | | 250 |
| Other operating income | 56 | 33 | 36 | 1 | 673 | (78) | 721 |
| Total operating income | 1,615 | 883 | 1,678 | 109 | 739 | (78) | 4,946 |
| Net insurance claims ⁵³ | (191) | (21) | | | | | (212) |
| Net operating income ⁴¹ | 1,424 | 862 | 1,678 | 109 | 739 | (78) | 4,734 |
| Loan impairment charges and other credit risk provisions | (123) | (37) | (132) | | | | (292) |
| Net operating income | 1,301 | 825 | 1,546 | 109 | 739 | (78) | 4,442 |
| Operating expenses | (1,205) | (423) | (561) | (71) | (544) | 78 | (2,726) |
| Operating profit | 96 | 402 | 985 | 38 | 195 | | 1,716 |
| Share of profit in associates and joint ventures | 542 | 397 | 245 | | 17 | | 1,201 |
| Profit before tax | 638 | 799 | 1,230 | 38 | 212 | | 2,917 |

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| | % | % | % | % | % | % |
|-----------------------------------|------|------|------|------|------|------|
| Share of HSBC's profit before tax | 8.0 | 10.1 | 15.5 | 0.5 | 2.7 | 36.8 |
| Cost efficiency ratio | 84.6 | 49.1 | 33.4 | 65.1 | 73.6 | 57.6 |

Balance sheet data³⁹

| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
|---------------------------------------|--------|--------|---------|--------|--------|------------------|
| Loans and advances to customers (net) | 37,831 | 31,423 | 35,810 | 3,489 | 178 | 108,731 |
| Total assets | 49,758 | 41,588 | 166,710 | 12,126 | 19,450 | (11,570) 278,062 |
| Customer accounts | 54,741 | 36,943 | 53,752 | 12,620 | 99 | 158,155 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (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 Middle East and North Africa. Our associate in Saudi Arabia, The Saudi British Bank (40% owned), is the Kingdom's sixth largest bank by total assets.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|---------------|------------------------|--------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 673 | 667 | 700 |
| Net fee income | 327 | 356 | 321 |
| Net trading income | 237 | 194 | 176 |
| Other income/(expense) | (1) | (29) | 25 |
| Net operating income⁴¹ | 1,236 | 1,188 | 1,222 |
| Impairment charges ⁴² | (99) | (438) | (189) |
| Net operating income | 1,137 | 750 | 1,033 |
| Total operating expenses | (574) | (519) | (559) |
| Operating profit | 563 | 231 | 474 |
| Income from associates ⁴³ | 184 | 115 | 72 |
| Profit before tax | 747 | 346 | 546 |
| Cost efficiency ratio | 46.4% | 43.7% | 45.7% |
| RoRWA ⁴⁴ | 2.7% | 1.3% | 2.0% |
| Period-end staff numbers | 8,755 | 8,264 | 8,676 |

Underlying profits nearly doubled despite political

unrest and economic pressures

Loan impairment charges declined to their lowest levels

since 1H08

Best International Islamic Bank

(Euromoney Islamic

Finance Awards 2011)

Best Risk Advisor in

Middle East

(Euromoney Awards for Excellence 2011)

For footnotes, see page 81.

The commentary on the Middle East and North Africa is on an

underlying basis unless stated otherwise.

Economic background

Political unrest weighed heavily on economic performance in the Middle East and North Africa in the first half of 2011. Those economies that saw the most pronounced turmoil fell into recession as production was disrupted, consumption scaled back and investor confidence compromised. While in economies such as Egypt there were early signs of economic activity normalising as political conditions improved, in others where unrest continued, output losses were substantial and ongoing. Continued high oil prices allowed the region's key energy exporters to increase public spending, providing a significant boost to domestic demand. Access to domestic credit improved as the effect of the 2008/09 downturn continued to fade and interest rates remained at historic lows. Inflation was subdued region-wide.

Review of performance

Our operations in the Middle East and North Africa reported a profit before tax of US\$747m. On an underlying basis, pre-tax profits increased by 94%, largely driven by the non-recurrence of significant loan impairment charges. This was partly offset by higher operating expenses as we continued to invest in distribution and marketing initiatives to drive future revenue growth.

The increase in profits reflected strong risk management practices, and was achieved despite political unrest and economic pressures in 10 of the 14 countries in which we operate in the region. The overall resilience of the oil-based regional economies and the strength of the HSBC brand were evidenced by a robust growth in deposits during the volatile conditions experienced in the region in the first half of 2011. Except when instructed to close by the central bank in Egypt and the one day of closure in Bahrain, our branch network in the region remained open for business throughout the period, reflecting our commitment to serve our customers.

In RBWM, we continued to build long-term relationships through our Premier and Advance customer offerings, focusing on wealth management and secured lending for affluent expatriates in the region.

We also strengthened our position as the leading international trade and business bank and achieved strong synergies by connecting our CMB and GB&M businesses, with CMB revenues from GB&M products increasing compared with the first half of 2010. As part of our continued

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

| | Retail Banking and Wealth Management¹⁶ | Commercial Banking US\$m | Global Banking and Markets¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Total US\$m |
|----------------------------------|--|---|--|---|------------------------|------------------------|
| Half-year to 30 June 2011 | | | | | | |
| Egypt | 15 | 32 | 67 | | (1) | 113 |
| Qatar | (1) | 23 | 39 | | | 61 |
| United Arab Emirates | 40 | 120 | 119 | (3) | (11) | 265 |
| Other | 10 | 62 | 53 | | | 125 |
| MENA (excluding Saudi Arabia) | 64 | 237 | 278 | (3) | (12) | 564 |
| Saudi Arabia | 37 | 59 | 61 | 2 | 24 | 183 |
| | 101 | 296 | 339 | (1) | 12 | 747 |
| Half-year to 30 June 2010 | | | | | | |
| Egypt | 18 | 41 | 19 | | | 78 |
| Qatar | 10 | 28 | 33 | | | 71 |
| United Arab Emirates | 7 | 98 | 24 | (2) | (1) | 126 |
| Other | 14 | 15 | (64) | (1) | | (36) |
| MENA (excluding Saudi Arabia) | 49 | 182 | 12 | (3) | (1) | 239 |
| Saudi Arabia | 16 | 76 | 30 | (20) | 5 | 107 |
| | 65 | 258 | 42 | (23) | 4 | 346 |

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| | | | | | | |
|-------------------------------|----|-----|-----|---|-----|-----|
| Half-year to 31 December 2010 | | | | | | |
| Egypt | 20 | 41 | 58 | | (2) | 117 |
| Qatar | 9 | 24 | 34 | | | 67 |
| United Arab Emirates | 10 | 88 | 97 | 3 | | 198 |
| Other | 5 | 42 | 45 | 1 | | 93 |
| | | | | | | |
| MENA (excluding Saudi Arabia) | 44 | 195 | 234 | 4 | (2) | 475 |
| Saudi Arabia | 9 | 31 | 23 | 4 | 4 | 71 |
| | | | | | | |
| | 53 | 226 | 257 | 8 | 2 | 546 |

For footnote see page 81.

support to local internationally-focused businesses, we pledged a second US\$100m fund to UAE SME customers engaged in cross-border business during the period, and the amount has been fully utilised.

In GB&M, we won a number of awards, including Best Overall Primary Debt Provider and Best for Middle East Currencies from *Euromoney* and Best Middle East House in the *EuroWeek* Bond Market Awards.

Net interest income rose marginally, driven by higher trade balances in CMB as we saw increased opportunities to support global and intra-regional trade flows. This was partly offset by lower average lending balances and narrower spreads in RBWM as unsecured lending portfolios continued to be managed down and new lending was directed to higher quality but lower yielding lending.

Net fee income decreased by 8% despite higher trade volumes in CMB as institutional equity activity receded in the challenging political and economic environment. In addition, card fee income decreased due to a decline in the number of credit cards in

issue in RBWM as certain portfolios were managed down.

Trading income benefited from higher local currency Rates trading due to a combination of new customer trades along with valuation gains on trading positions in relation to Middle East currency derivatives.

Loan impairment charges and other credit risk provisions declined to their lowest levels since the first half of 2008, driven by an overall improvement in credit conditions. Repositioning of the loan book towards higher quality lending, and strengthened collection practices contributed to a significant improvement in delinquency rates in RBWM. In CMB, loan impairment charges and other credit risk provisions remained broadly in line with the first half of 2010 and included specific impairments in relation to a few corporate customers reflecting economic uncertainty in the region. Loan impairment charges and other credit risk provisions in GB&M reduced markedly as loan impairment charges which followed restructuring activity for a

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HSBC HOLDINGS PLC

Interim Management Report (continued)

small number of large UAE corporate customers in the first half of 2010 did not recur.

Operating expenses increased by 11%, mainly as a result of higher staff costs driven by a rise in staff numbers, as the branch network was expanded, and wage inflation. The increase included restructuring costs of US\$16m across the region as initiatives taken as a result of the strategic review of costs to drive future revenue growth were implemented. Marketing and advertising costs also

rose as we increased investment in the promotion of the HSBC brand, including at the Abu Dhabi International and Dubai International airports. Excluding restructuring costs, expenses were broadly in line with the second half of 2010.

Profit from associates and joint ventures increased by 60%, mainly from the Saudi British Bank, driven by strong revenues, good cost control and a decline in loan impairment charges as operating conditions improved.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Middle East and North Africa*

| | Half-year to 30 June 2011 | | | | | | 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 ⁵² US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income | 253 | 243 | 174 | 1 | 3 | (1) | 673 |
| Net fee income/(expense) | 90 | 135 | 96 | 8 | (2) | | 327 |
| Trading income/(expense) excluding net interest income | 30 | 48 | 129 | | (1) | | 206 |
| Net interest income on trading activities | 1 | 7 | 22 | | | 1 | 31 |
| Net trading income/(expense) ⁴⁵ | 31 | 55 | 151 | | (1) | 1 | 237 |
| Net expense from financial instruments designated at fair value | | | | | (6) | | (6) |
| Gains less losses from financial investments | | | (6) | | | | (6) |
| Dividend income | | | 1 | | 1 | | 2 |
| Other operating income | 10 | 7 | 3 | | 43 | (54) | 9 |
| Total operating income | 384 | 440 | 419 | 9 | 38 | (54) | 1,236 |
| Net insurance claims ⁵³ | | | | | | | |
| Net operating income⁴¹ | 384 | 440 | 419 | 9 | 38 | (54) | 1,236 |
| Loan impairment (charges)/recoveries and other credit risk provisions | (58) | (48) | 6 | | 1 | | (99) |
| Net operating income | 326 | 392 | 425 | 9 | 39 | (54) | 1,137 |
| Operating expenses | (263) | (155) | (148) | (12) | (50) | 54 | (574) |
| Operating profit/(loss) | 63 | 237 | 277 | (3) | (11) | | 563 |
| Share of profit in associates and joint ventures | 38 | 59 | 62 | 2 | 23 | | 184 |
| Profit/(loss) before tax | 101 | 296 | 339 | (1) | 12 | | 747 |

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| | % | % | % | % | % | % |
|---|--------|--------|--------|-------|-------|--------|
| Share of HSBC's profit before tax | 0.9 | 2.6 | 3.0 | | | 6.5 |
| Cost efficiency ratio | 68.5 | 35.2 | 35.3 | 133.3 | 131.6 | 46.4 |
| <i>Balance sheet data</i> ³⁹ | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Loans and advances to customers (net) | 4,861 | 13,189 | 7,611 | 31 | 2 | 25,694 |
| Total assets | 6,383 | 14,950 | 34,306 | 73 | 4,958 | 58,038 |
| Customer accounts | 19,301 | 11,101 | 6,275 | 363 | 79 | 37,119 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Middle East and North Africa (continued)*

| | Half-year to 30 June 2010 | | | | | | Total US\$m |
|---|--|--------------------------------|--|---------------------------------------|---|-------|----------------|
| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Inter- segment Other elimination ⁵² US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income | 287 | 214 | 163 | 1 | 5 | (3) | 667 |
| Net fee income | 103 | 134 | 113 | 6 | | | 356 |
| Trading income/(expense) excluding net interest income | 30 | 44 | 113 | | (3) | | 184 |
| Net interest income/(expense) on trading activities | 1 | 3 | 5 | | (2) | 3 | 10 |
| Net trading income/(expense) ⁴⁵ | 31 | 47 | 118 | | (5) | 3 | 194 |
| Gains less losses from financial investments | 1 | | (1) | | (1) | | (1) |
| Dividend income | 2 | 1 | 2 | | | | 5 |
| Other operating income/(expense) | 11 | (20) | (11) | | 16 | (29) | (33) |
| | 435 | 376 | 384 | 7 | 15 | (29) | 1,188 |

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Total operating income

Net insurance claims⁵³

| | | | | | | | |
|------------------------------------|-----|-----|-----|---|----|------|-------|
| Net operating income ⁴¹ | 435 | 376 | 384 | 7 | 15 | (29) | 1,188 |
|------------------------------------|-----|-----|-----|---|----|------|-------|

| | | | | | | | |
|--|-------|------|-------|--|--|--|-------|
| Loan impairment charges and other credit risk provisions | (141) | (47) | (250) | | | | (438) |
|--|-------|------|-------|--|--|--|-------|

| | | | | | | | |
|----------------------|-----|-----|-----|---|----|------|-----|
| Net operating income | 294 | 329 | 134 | 7 | 15 | (29) | 750 |
|----------------------|-----|-----|-----|---|----|------|-----|

| | | | | | | | |
|--------------------|-------|-------|-------|------|------|----|-------|
| Operating expenses | (245) | (150) | (127) | (10) | (16) | 29 | (519) |
|--------------------|-------|-------|-------|------|------|----|-------|

| | | | | | | | |
|-------------------------|----|-----|---|-----|-----|--|-----|
| Operating profit/(loss) | 49 | 179 | 7 | (3) | (1) | | 231 |
|-------------------------|----|-----|---|-----|-----|--|-----|

| | | | | | | | |
|---|----|----|----|------|---|--|-----|
| Share of profit/(loss) in associates and joint ventures | 16 | 79 | 35 | (20) | 5 | | 115 |
|---|----|----|----|------|---|--|-----|

| | | | | | | | |
|--------------------------|----|-----|----|------|---|--|-----|
| Profit/(loss) before tax | 65 | 258 | 42 | (23) | 4 | | 346 |
|--------------------------|----|-----|----|------|---|--|-----|

| | | | | | | | |
|--|---|---|---|---|---|--|---|
| | % | % | % | % | % | | % |
|--|---|---|---|---|---|--|---|

| | | | | | | | |
|-----------------------------------|-----|-----|-----|-------|-----|--|-----|
| Share of HSBC's profit before tax | 0.6 | 2.3 | 0.3 | (0.2) | 0.1 | | 3.1 |
|-----------------------------------|-----|-----|-----|-------|-----|--|-----|

| | | | | | | | |
|-----------------------|------|------|------|-------|-------|--|------|
| Cost efficiency ratio | 56.3 | 39.9 | 33.1 | 142.9 | 106.7 | | 43.7 |
|-----------------------|------|------|------|-------|-------|--|------|

*Balance sheet data*³⁹

| | | | | | | | |
|---------------------------------------|--------|--------|--------|-------|-------|---------|--------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 5,443 | 11,541 | 6,389 | 18 | 3 | | 23,394 |
| Total assets | 6,266 | 13,892 | 29,078 | (267) | 4,247 | (3,579) | 49,637 |
| Customer accounts | 16,449 | 10,482 | 5,359 | 641 | 46 | | 32,977 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 31 December 2010 | | | | | | Total US\$m |
|--|---|--------------------------------|-----------------------|---------------------------------------|----------------|------------------------------------|----------------|
| | Retail | | Global | | Inter- | | |
| | Banking | | Banking | | segment | | |
| | and Wealth Management ¹⁶ | Commercial Banking US\$m | Markets ¹⁶ | Global Private Banking US\$m | Other US\$m | elimination ⁵² US\$m | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 266 | 259 | 171 | (1) | 9 | (4) | 700 |
| Net fee income | 97 | 124 | 89 | 11 | | | 321 |
| Trading income/(expense) excluding net interest income | 29 | 41 | 92 | 1 | (4) | | 159 |
| Net interest income/(expense) on trading activities | | 4 | 13 | | (4) | 4 | 17 |
| Net trading income/(expense) ⁴⁵ | 29 | 45 | 105 | 1 | (8) | 4 | 176 |
| Gains less losses from financial investments | | | (2) | | | | (2) |
| Dividend income | | | 2 | | | | 2 |
| Other operating income | 16 | 12 | 10 | 1 | 24 | (38) | 25 |
| Total operating income | 408 | 440 | 375 | 12 | 25 | (38) | 1,222 |
| Net insurance claims ⁵³ | | | | | | | |

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| | | | | | | | |
|--|--------|--------|--------|-------|-------|---------|--------|
| Net operating income ⁴¹ | 408 | 440 | 375 | 12 | 25 | (38) | 1,222 |
| Loan impairment charges and other credit risk provisions | (86) | (98) | (5) | | | | (189) |
| Net operating income | 322 | 342 | 370 | 12 | 25 | (38) | 1,033 |
| Operating expenses | (279) | (147) | (136) | (8) | (27) | 38 | (559) |
| Operating profit/(loss) | 43 | 195 | 234 | 4 | (2) | | 474 |
| Share of profit in associates and joint ventures | 10 | 31 | 23 | 4 | 4 | | 72 |
| Profit before tax | 53 | 226 | 257 | 8 | 2 | | 546 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 0.7 | 2.8 | 3.2 | 0.1 | 0.1 | | 6.9 |
| Cost efficiency ratio | 68.4 | 33.4 | 36.3 | 66.7 | 108.0 | | 45.7 |
| <i>Balance sheet data</i> ³⁹ | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 5,063 | 12,293 | 7,247 | 21 | 2 | | 24,626 |
| Total assets | 6,286 | 13,991 | 31,253 | 59 | 4,129 | (2,961) | 52,757 |
| Customer accounts | 17,538 | 10,319 | 5,306 | 290 | 58 | | 33,511 |
| <i>For footnotes, see page 81.</i> | | | | | | | |

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HSBC HOLDINGS PLC

Interim Management Report (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., which is concentrated in New York State, and HSBC Finance, a national consumer finance company based near Chicago. 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.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|----------------|------------------------|---------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 5,849 | 6,353 | 6,086 |
| Net fee income | 1,718 | 1,801 | 1,863 |
| Net trading income/ (expense) | 448 | (67) | 381 |
| Other income/(expense) | 225 | 913 | (283) |
| Net operating income⁴¹ | 8,240 | 9,000 | 8,047 |
| Impairment charges ⁴² | (3,049) | (4,554) | (3,741) |
| Net operating income | 5,191 | 4,446 | 4,306 |
| Total operating expenses | (4,602) | (3,957) | (4,365) |
| Operating profit/(loss) | 589 | 489 | (59) |
| Income from associates ⁴³ | 17 | 3 | 21 |
| Profit/(loss) before tax | 606 | 492 | (38) |
| Cost efficiency ratio | 55.8% | 44.0% | 54.2% |
| RoRWA ⁴⁴ | 0.4% | 0.3% | |
| Period-end staff numbers | 32,605 | 33,988 | 33,865 |

Card and Retail Services**pre-tax profit 1H11**

US\$1.0bn

Continued improvement in

loan impairment charges

Operations in Canada contributed

US\$520m

to North America profit before tax

For footnotes, see page 81.

The commentary on North America is on an underlying basis

unless stated otherwise.

Economic background

The process of reducing debt levels following the credit boom of the past decade continued to restrain growth in the US as households saved more and the rise in consumer spending was subdued. High oil prices made the process of reducing debt more difficult. In the first quarter, the growth of real consumer spending was only 2.2% higher than the level a year ago, compared with a long-run average annual growth rate of 3.3%. This depressed overall growth in GDP to a 2.8% annual rate since the recession ended in mid-2009. Reductions in spending among state and local governments also constrained economic activity. Slow GDP growth kept the unemployment rate high, at 9.2% in June, down only slightly from the peak of 10.1% in 2010. In response to slow growth and low inflation, the Federal Reserve maintained the Fed funds rate in the range of zero to 0.25% and undertook large-scale purchases of fixed-income securities.

Canadian GDP rose by 2.9% in the year ended 31 March 2011, up from 2.1% the year before. Labour market conditions improved with the unemployment rate dropping to 7.4% in June from 7.9% in June 2010. Steep increases in crude oil and gasoline prices drove the headline rate of inflation up to 3.7% in May 2011 from 1.4% a year earlier. However, the core rate of inflation followed by the Bank of Canada (BoC) was steady at 1.8%. In response to these conditions, the BoC maintained its overnight lending rate at 1.0% throughout the period.

Review of performance

In North America, we reported a profit before tax of US\$606m in the first half of 2011, compared with a profit before tax of US\$492m in the first half of 2010. Our results included movements on our own debt designated at fair value resulting from changes in credit spreads, while 2010 also included a US\$66m gain from the sale of our stake in the Wells Fargo HSBC Trade Bank. On an underlying basis, which excludes these items, the pre-tax profit was US\$672m in the first half of 2011, compared with a pre-tax loss of US\$51m. This improvement in performance resulted from a significant decline in loan impairment charges, partly offset by a reduction in revenue, both reflecting lower lending balances in HSBC Finance.

During the first half of 2011, we continued to evaluate the strategic options for elements within our US operations and remained focused on managing down our run-off assets sensitively and effectively. In addition, we continued to work closely with our regulators to ensure full compliance with new and existing frameworks and policies.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

| | Retail Banking and Wealth Management¹⁶ | Commercial Banking | Global Banking and Markets¹⁶ | Global Private Banking | Other | Total |
|--------------------------------------|--|-------------------------------|--|---------------------------------------|--------------|--------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | |
| US | (568) | 177 | 599 | 47 | (244) | 11 |
| Canada | 95 | 297 | 134 | | (6) | 520 |
| Bermuda | 28 | 14 | 23 | 2 | 8 | 75 |
| Other | | | | | | |
| | (445) | 488 | 756 | 49 | (242) | 606 |
| Half-year to 30 June 2010 | | | | | | |
| US | (1,576) | 265 | 840 | 55 | 342 | (74) |
| Canada | 82 | 289 | 124 | | 7 | 502 |
| Bermuda | 27 | 18 | 16 | (2) | 7 | 66 |
| Other | 1 | | | 1 | (4) | (2) |
| | (1,466) | 572 | 980 | 54 | 352 | 492 |
| Half-year to 31 December 2010 | | | | | | |
| US | (729) | 137 | 444 | 58 | (381) | (471) |
| Canada | 49 | 216 | 103 | | (3) | 365 |
| Bermuda | 31 | 14 | 22 | (1) | | 66 |
| Other | (1) | | | | 3 | 2 |
| | (650) | 367 | 569 | 57 | (381) | (38) |

For footnotes, see page 81.

The North American economies continue to represent a significant share of international trade, and in our CMB and GB&M businesses we remain focused on expanding our business further into areas with strong international connectivity. In CMB, we expanded our operations in the West Coast of the US and in Texas and Florida as well as in eastern Canada to attract the growing number of businesses that trade

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internationally. Successful cross-border referrals from North America to other HSBC sites increased by 11% from the first half of 2010.

In GB&M, profit before tax fell in the first half of 2011 due to lower releases of collective loan impairment allowances, an increase in compliance costs and a change in the expense recognition of bonus awards. We successfully utilised our established platform in New York to interconnect more closely our GB&M businesses across the Americas and, in the first half of 2011, we syndicated several significant financing transactions for customers in Latin America.

The region represents a significant wealth management market and we continued to direct resources towards the expansion of wealth services and Premier, and remain focused on providing differentiated premium services to internationally minded, upwardly mobile customers.

Net interest income decreased by 9% to US\$5.8bn, primarily due to lower lending balances in our Consumer Lending and Mortgage Services portfolios due to continued run-off, and in our Card and Retail Services portfolio as customers continued to pay down outstanding debt. In addition, balances declined following the sale of the vehicle finance portfolio in 2010. This was partly offset by wider asset spreads in our Consumer Lending and Mortgage Services portfolios as the cost of funds fell.

Average customer deposit balances increased in CMB in both the US and Canada as we continued to expand on the West Coast, Texas, Florida and Eastern Canada, and in RBWM due to growth in branch-based deposit products driven by our Premier strategy. In GB&M, increased deposit balances reflected a rise in repurchase transactions.

Net fee income declined by 6% to US\$1.7bn, as a result of lower late and overlimit fees in our Card and Retail Services business, reflecting lower volumes and delinquency rates, customers actively seeking to reduce their credit card debt and changes required by the CARD Act.

In December 2010, we exited the Taxpayer Financial Services business, further reducing our fee income compared with the first half of 2010.

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Net trading income increased by US\$511m to US\$448m, driven by fair value movements on non-qualifying hedges which reflected fluctuations in long-term US interest rates. In the first half of 2011, these rates declined, but to a lesser extent than in the corresponding period in 2010, resulting in lower adverse fair value movements in non-qualifying hedges.

In addition, in the first half of 2011 loss provisions for loan repurchase obligations relating to loans previously sold were lower while, in our GB&M business, trading income remained broadly flat. This reflected higher deal volumes in foreign exchange, metals and interest rate and emerging markets derivatives, and improved revenue on structured credit products which was broadly offset by the non-recurrence of a gain in the first half of 2010 associated with a settlement relating to certain loans previously purchased for re-sale from a third party.

Net expense from financial instruments designated at fair value of US\$53m was 42% less than in the first half of 2010. This was due to lower adverse fair value movements from interest rate ineffectiveness in the economic hedging of our long-term debt designated at fair value, reflecting the decrease in long-term US interest rates.

Gains less losses from financial investments declined by 7% to US\$110m, mainly due to lower gains on the disposal of private equity investments.

Other operating income declined by 29% to US\$168m due to higher losses on foreclosed properties, reflecting an increase in the number of such properties sold and declines in house prices in the first half of 2011 and the non-recurrence of a US\$56m gain on the sale of our New York headquarters. This was partly offset by the non-recurrence of a US\$77m loss on the sale of the vehicle finance loan portfolio and servicing operation in the first half of 2010.

Loan impairment charges and other credit risk provisions decreased by 33% to US\$3.0bn, primarily due to lower lending balances in our run-off Consumer Lending and Mortgage Services portfolios and in our Card and Retail Services portfolio. The decline also reflected an overall improvement in credit quality resulting in lower delinquency levels and reduced write-offs. In our Consumer Lending and Mortgage Services

business, the improvement was partly offset by an incremental charge resulting from adverse changes to economic assumptions on the pace of recovery in home prices and delays in the timing of expected cash flows, mainly as a result of the suspension of foreclosure activity that began in late 2010.

Loan impairment charges and other credit risk provisions in CMB declined by 58% to US\$45m, driven by lower impairment allowances relating to commercial real estate and middle market exposures and lower write-offs in business banking, reflecting improved credit quality and lower delinquency. This was partially offset by a specific loan impairment charge associated with the downgrade of an individual commercial real estate loan.

In GB&M, net recoveries of loan impairment charges and other credit risk provisions were 85% lower than in the first half of 2010 as a reduction in higher-risk balances and a stabilisation of credit quality resulted in a reduced release of collective loan impairment allowances in the first half of 2011.

Further commentary on delinquency trends in the US RBWM portfolios is provided in *Areas of special interest* US personal lending on page 107.

Operating expenses increased by 15%. This included a charge of US\$144m relating to the impairment of certain previously capitalised software development costs in the first half of 2011 and the non-recurrence of a pension curtailment gain in the first half of 2010. Excluding these items, operating expenses grew by 8%, mainly due to an increase in litigation provisions and, in GB&M, an increase in amortisation charges for previous years performance shares and accelerated expense recognition for future deferred bonus awards. In addition, legal and compliance costs were higher and marketing expenses in Card and Retail Services rose, driven by an increase in direct mail volumes, albeit at lower than

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historical levels. Also notable in the first half of 2011 were severance costs of US\$46m resulting from a planned reduction in staff numbers. Partly offsetting these increases were lower costs following the sale of the vehicle finance servicing operation and closure of the Taxpayer Financial Services business.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data North America*

| | Half-year to 30 June 2011 | | | | | | Total US\$m |
|---|--|--------------------------------|------------------------------------|---------------------------------------|----------------|---|----------------|
| | Retail Banking and Wealth Management US\$m | Global | | | | Inter- segment elimination ⁵² US\$m | |
| | | Commercial Banking US\$m | Banking and Markets US\$m | Global Private Banking US\$m | Other US\$m | | |
| | | | | | | | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 4,617 | 748 | 465 | 94 | (37) | (38) | 5,849 |
| Net fee income | 936 | 276 | 420 | 79 | 7 | | 1,718 |
| Trading income/(expense) excluding net interest income | (68) | 16 | 344 | 13 | (11) | | 294 |
| Net interest income/(expense) on trading activities | 10 | 1 | 106 | | (1) | 38 | 154 |
| Net trading income/(expense) ⁴⁵ | (58) | 17 | 450 | 13 | (12) | 38 | 448 |
| Net expense from financial instruments designated at fair value | | | (4) | | (115) | | (119) |
| Gains less losses from financial investments | 14 | | 96 | | | | 110 |
| Dividend income | 8 | 4 | 7 | 1 | 1 | | 21 |
| Net earned insurance premiums | 118 | | | | | | 118 |
| Other operating income/ (expense) | (28) | 60 | 100 | 5 | 1,130 | (1,099) | 168 |
| Total operating income | 5,607 | 1,105 | 1,534 | 192 | 974 | (1,099) | 8,313 |
| Net insurance claims ⁵³ | (73) | | | | | | (73) |

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| | | | | | | | |
|---|--------------|--------------|--------------|--------------|--------------|----------------|--------------|
| Net operating income⁴¹ | 5,534 | 1,105 | 1,534 | 192 | 974 | (1,099) | 8,240 |
| Loan impairment (charges)/recoveries and other credit risk provisions | (3,035) | (45) | 23 | 11 | (3) | | (3,049) |
| Net operating income | 2,499 | 1,060 | 1,557 | 203 | 971 | (1,099) | 5,191 |
| Operating expenses | (2,945) | (587) | (801) | (154) | (1,214) | 1,099 | (4,602) |
| Operating profit/(loss) | (446) | 473 | 756 | 49 | (243) | | 589 |
| Share of profit in associates and joint ventures | 1 | 15 | | | 1 | | 17 |
| Profit/(loss) before tax | (445) | 488 | 756 | 49 | (242) | | 606 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | (3.9) | 4.3 | 6.6 | 0.4 | (2.1) | | 5.3 |
| Cost efficiency ratio | 53.2 | 53.1 | 52.2 | 80.2 | 124.6 | | 55.8 |
| <i>Balance sheet data³⁹</i> | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 123,891 | 31,015 | 19,988 | 4,368 | | | 179,262 |
| Total assets | 153,098 | 42,971 | 341,246 | 6,831 | 13,009 | (27,769) | 529,386 |
| Customer accounts | 76,266 | 46,940 | 25,579 | 13,747 | 101 | | 162,633 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data North America (continued)*

| | Half-year to 30 June 2010 | | | | | | Total US\$m |
|--|--|--------------------------------|--|---------------------------------------|----------------|---|----------------|
| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Inter- segment elimination ⁵² US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/(expense) | 5,190 | 758 | 425 | 94 | (86) | (28) | 6,353 |
| Net fee income/(expense) | 1,084 | 252 | 400 | 71 | (6) | | 1,801 |
| Trading income/(expense) excluding net interest income | (567) | 12 | 401 | 9 | (16) | | (161) |
| Net interest income on trading activities | 13 | 1 | 40 | | 12 | 28 | 94 |
| Net trading income/(expense) ⁴⁵ | (554) | 13 | 441 | 9 | (4) | 28 | (67) |
| Net income/(expense) from financial instruments designated at fair value | | | (3) | | 417 | | 414 |
| Gains less losses from financial investments | | | 121 | | (3) | | 118 |
| Dividend income | 9 | 3 | 6 | 1 | 2 | | 21 |
| Net earned insurance premiums | 126 | | | | | | 126 |
| Other operating income/(expense) | (8) | 160 | 83 | 11 | 1,213 | (1,153) | 306 |
| Total operating income | 5,847 | 1,186 | 1,473 | 186 | 1,533 | (1,153) | 9,072 |
| Net insurance claims ⁵³ | (76) | | | | 4 | | (72) |

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| | | | | | | | |
|---|---------|--------|---------|--------|---------|----------|---------|
| Net operating income ⁴¹ | 5,771 | 1,186 | 1,473 | 186 | 1,537 | (1,153) | 9,000 |
| Loan impairment (charges)/recoveries and other credit risk provisions | (4,613) | (104) | 152 | 11 | | | (4,554) |
| Net operating income | 1,158 | 1,082 | 1,625 | 197 | 1,537 | (1,153) | 4,446 |
| Operating expenses | (2,624) | (511) | (645) | (143) | (1,187) | 1,153 | (3,957) |
| Operating profit/(loss) | (1,466) | 571 | 980 | 54 | 350 | | 489 |
| Share of profit in associates and joint ventures | | 1 | | | 2 | | 3 |
| Profit/(loss) before tax | (1,466) | 572 | 980 | 54 | 352 | | 492 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | (13.2) | 5.1 | 8.8 | 0.5 | 3.2 | | 4.4 |
| Cost efficiency ratio | 45.5 | 43.1 | 43.8 | 76.9 | 77.2 | | 44.0 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 140,501 | 30,498 | 32,861 | 4,281 | | | 208,141 |
| Total assets | 164,600 | 38,525 | 299,300 | 5,608 | 7,290 | (19,915) | 495,408 |
| Customer accounts | 74,475 | 42,853 | 19,229 | 12,814 | 67 | | 149,438 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 31 December 2010 | | | | | | |
|--|-------------------------------|-----------------------|---------|--------|---------|---------------------------|---------------|
| | Retail | | Global | | | Inter- | Total |
| | Banking | | Banking | | segment | | |
| | and | Commercial | and | Global | | elimination ⁵² | |
| Wealth | Banking | Markets ¹⁶ | Private | Other | | | |
| Management ¹⁶ | Banking | Markets ¹⁶ | Banking | Other | US\$m | US\$m | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income | 4,722 | 767 | 527 | 96 | 15 | (41) | 6,086 |
| Net fee income | 1,058 | 282 | 445 | 78 | | | 1,863 |
| Trading income excluding net interest income | 95 | 5 | 162 | 4 | 4 | | 270 |
| Net interest income on trading activities | 11 | 1 | 53 | | 5 | 41 | 111 |
| Net trading income ⁴⁵ | 106 | 6 | 215 | 4 | 9 | 41 | 381 |
| Net income/(expense) from financial instruments designated at fair value | 6 | | 1 | | (310) | | (303) |
| Gains less losses from financial investments | 5 | (6) | 20 | | 6 | | 25 |
| Dividend income | 9 | 4 | 6 | 2 | | | 21 |
| Net earned insurance premiums | 119 | | | | | | 119 |
| Other operating income/(expense) | (242) | 82 | (12) | 4 | 1,138 | (1,043) | (73) |
| Total operating income | 5,783 (72) | 1,135 | 1,202 | 184 | 858 | (1,043) | 8,119 (72) |

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Net insurance claims⁵³

| | | | | | | | |
|---|---------|--------|---------|--------|---------|----------|---------|
| Net operating income ⁴¹ | 5,711 | 1,135 | 1,202 | 184 | 858 | (1,043) | 8,047 |
| Loan impairment (charges)/recoveries and other credit risk provisions | (3,581) | (219) | 32 | 27 | | | (3,741) |
| Net operating income | 2,130 | 916 | 1,234 | 211 | 858 | (1,043) | 4,306 |
| Operating expenses | (2,784) | (570) | (665) | (154) | (1,235) | 1,043 | (4,365) |
| Operating profit/(loss) | (654) | 346 | 569 | 57 | (377) | | (59) |
| Share of profit/(loss) in associates and joint ventures | 4 | 21 | | | (4) | | 21 |
| Profit/(loss) before tax | (650) | 367 | 569 | 57 | (381) | | (38) |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | (8.2) | 4.6 | 7.2 | 0.7 | (4.8) | | (0.5) |
| Cost efficiency ratio | 48.7 | 50.2 | 55.3 | 83.7 | 143.9 | | 54.2 |
| <i>Balance sheet data</i> ³⁹ | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 131,194 | 30,277 | 24,338 | 4,723 | | | 190,532 |
| Total assets | 154,204 | 39,213 | 306,298 | 5,824 | 9,373 | (22,425) | 492,487 |
| Customer accounts | 76,817 | 46,425 | 22,324 | 12,812 | 108 | | 158,486 |
| <i>For footnotes, see page 81.</i> | | | | | | | |

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Latin America**

Our operations in Latin America principally comprise HSBC Bank Brasil S.A.-Banco Múltiplo, HSBC México, S.A., HSBC Bank Argentina S.A. and HSBC Bank (Panama) S.A. In addition to banking services, we operate insurance businesses in Brazil, Mexico, Argentina, Panama and a range of smaller markets.

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|----------------|------------------------|----------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Net interest income | 3,517 | 3,119 | 3,192 |
| Net fee income | 902 | 855 | 894 |
| Net trading income | 589 | 353 | 380 |
| Other income | 675 | 388 | 550 |
| Net operating income⁴¹ | 5,683 | 4,715 | 5,016 |
| Impairment charges ⁴² | (820) | (820) | (724) |
| Net operating income | 4,863 | 3,895 | 4,292 |
| Total operating expenses | (3,712) | (3,013) | (3,381) |
| Operating profit | 1,151 | 882 1 | 911 1 |

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| | | | |
|--------------------------------------|---------------|--------|--------|
| Income from associates ⁴³ | | | |
| Profit before tax | 1,151 | 883 | 912 |
| Cost efficiency ratio | 65.3% | 63.9% | 67.4% |
| RoRWA ⁴⁴ | 2.2% | 2.1% | 2.0% |
| Period-end staff numbers | 55,618 | 54,886 | 56,044 |

30%

increase in profit before tax

13%

increase in lending balances

since the end of 2010

8%

reduction in impairment charges on an underlying basis

For footnotes, see page 81.

The commentary on Latin America is on an underlying basis unless stated otherwise.

Economic background

After a very strong 2010, Latin American growth slowed in the first half of 2011 due to a combination of weaker global demand and a downturn in domestic demand following a considerable tightening of monetary conditions in the period. Monetary policy rates rose by 2% in Chile, 1.5% in Brazil and Uruguay, and 1.25% in Colombia and Peru. In Brazil, the annual pace of GDP growth eased to 4.2% in the first quarter of 2011 from 7.5% in the comparable period in 2010.

The slowdown in activity, coupled with some easing in the rate of growth of food prices, helped to moderate inflation in the region, although it remained above the mid-point target of most countries that had adopted explicit inflation targets. Inflationary risks continued in Argentina, Brazil, Chile and Uruguay, where very high employment put upward pressure on wage growth.

Given its close ties to the US, Mexico suffered more immediately from the reduction in the growth of US demand. Some easing in global commodity prices and the strength of the Mexican peso helped restrain inflation and, accordingly, Banco de México left the monetary policy rate unchanged at 4.5% in the period.

Review of performance

Our operations in Latin America reported a profit before tax of US\$1.2bn for the first half of 2011, representing an increase of 30% over the same period in 2010. On an underlying basis, pre-tax profits increased by 23% due to increased revenues in CMB and RBWM and lower loan impairment charges, partly offset by higher costs as a result of inflationary pressures, strategic business growth and restructuring costs.

Several strategic measures were implemented, focusing on organic growth and improving efficiency. We increased the number of relationship managers in Brazil, mainly in RBWM and CMB, to leverage on the strong economic environment and, in Mexico, to grow our CMB business. We consolidated the branch network in Mexico, reducing it by 66 during the first half of 2011, and restructured the regional and country support

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functions, thereby improving the efficiency of the business. To ensure the strategic alignment of our portfolios, we entered into a sale agreement for HSBC Afore (the Mexican pension business) which is expected to be completed in the second half of 2011. Also, in RBWM we continued to reposition our lending portfolio to higher quality customers, achieving a better risk-adjusted return.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax by country within customer groups and global businesses*

| | Retail Banking and Wealth Management¹⁶ | Commercial Banking | Global Banking and Markets¹⁶ | Global Private Banking | Other | Total |
|--------------------------------------|---|-------------------------------|--|---------------------------------------|--------------|--------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | |
| Argentina | 49 | 46 | 67 | | (8) | 154 |
| Brazil | 136 | 294 | 250 | 7 | (50) | 637 |
| Mexico | 169 | 103 | 171 | 2 | (142) | 303 |
| Panama | 17 | 27 | 26 | 1 | (2) | 69 |
| Other | (35) | 5 | 29 | | (11) | (12) |
| | 336 | 475 | 543 | 10 | (213) | 1,151 |
| Half-year to 30 June 2010 | | | | | | |
| Argentina | 39 | 41 | 53 | | | 133 |
| Brazil | 60 | 160 | 227 | 2 | 29 | 478 |
| Mexico | 95 | (2) | 112 | 1 | 18 | 224 |
| Panama | 18 | 26 | 15 | 1 | | 60 |
| Other | (44) | 11 | 27 | | (6) | (12) |
| | 168 | 236 | 434 | 4 | 41 | 883 |
| Half-year to 31 December 2010 | | | | | | |
| Argentina | 50 | 49 | 52 | | | 151 |
| Brazil | 91 | 222 | 203 | 4 | 35 | 555 |
| Mexico | 79 | 26 | 98 | 3 | (29) | 177 |
| Panama | 30 | 31 | 18 | 1 | | 80 |
| Other | (56) | (10) | 24 | (2) | (7) | (51) |
| | 194 | 318 | 395 | 6 | (1) | 912 |

For footnote, see page 81.

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Net interest income increased by 5% compared with the first half of 2010, driven by higher lending balances in the stronger economic environment. Net interest income in CMB grew by 29%, supported by strong asset growth of 33% with moderate spread compression in the competitive environment. In RBWM, lending grew in personal loans, mortgages, overdrafts and cards in Brazil and, in Argentina, on strong consumer demand. In Mexico, net interest income in RBWM fell by 15% as we continued to shift our portfolio to lower risk, lower yielding assets. This fall was partly offset by strong balance growth in personal and payroll lending.

In Balance Sheet Management, results were affected by higher funding costs, in line with an increase in interest rates, and higher yielding deals maturing.

Fee income fell marginally compared with the first half of 2010. Higher card transaction volumes, current accounts and Payments and Cash Management revenues in Brazil were offset by a decline in the volumes of cards and fewer account services and automated teller machine (ATM) transactions in Mexico, where increased regulatory charges to non-HSBC customers led to a change in customer behaviour.

Net trading income of US\$589m was 56% higher than in the first half of 2010, primarily due to a rise in volumes, mainly in Brazil; the cost of internally funding these assets also increased, but this interest expense is reported under *Net interest income* . Revenue in Brazil further benefited from a significant growth in sales of GB&M products across customer groups. In Mexico, revenue increased due to a limited number of large derivative transactions.

Net income on financial instruments designated at fair value increased by 70% due to growth of a unit-linked product in Brazil, where new money received was invested in assets designated at fair value, and an increase was registered in the value of policyholder assets supporting these contracts. An offsetting increase was recorded in *Net insurance claims incurred and movement in liabilities to policyholders* .

Gains less losses from financial investments increased by US\$17m, mainly due to a gain on the sale of shares in a Mexican listed company.

Other operating income increased by US\$168m, primarily due to the gain on sale of buildings including the sale and leaseback of branches in Mexico.

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Net earned insurance premiums increased by 24% to US\$1.3bn, driven by increased sales in Brazil of both credit-related products and term life insurance, and higher contributions on a unit-linked product which reflected the improved economic environment and an increase in the sales force. Premiums also rose in Argentina, mainly from repricing initiatives in the motor insurance segment. This growth resulted in an increase in *Net insurance claims and movement in liabilities to policyholders*.

Loan impairment charges and other credit risk provisions declined by 8%, mainly in RBWM, where riskier portfolios of credit cards in Mexico were managed down and collections and underwriting processes were tightened. The decline in loan impairment charges also reflected an improvement in the economic environment. In CMB, loan impairment charges increased by 3%. This increase

occurred mainly in Brazil following a significant expansion in lending since the first half of 2010, and was partly offset by the non-recurrence of individual loan impairment charges booked in the first half of 2010 in the real estate portfolio in Mexico.

Operating expenses increased by 15%, in part due to restructuring costs of US\$149m recognised in the first half of 2011 as we took measures to improve the efficiency of our processes in order to lower the future cost base of our operations. This included charges relating to certain regional projects, restructuring regional and country support functions and consolidating the branch network in Mexico. Costs also rose due to inflationary pressures, union-agreed wage increases in Brazil and Argentina, increased front office staffing levels in Brazil and Mexico to support strategic growth and volume-driven transactional taxes in Brazil and Argentina.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Latin America*

| | Half-year to 30 June 2011 | | | | | | 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 ⁵² US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income/ (expense) | 2,215 | 1,096 | 456 | 12 | (1) | (261) | 3,517 |
| Net fee income | 492 | 292 | 98 | 19 | 1 | | 902 |
| Trading income excluding net interest income | 29 | 49 | 186 | 2 | 3 | | 269 |
| Net interest income on trading activities | 1 | | 58 | | | 261 | 320 |
| Net trading income ⁴⁵ | 30 | 49 | 244 | 2 | 3 | 261 | 589 |
| Net income from financial instruments designated at fair value | 181 | 55 | | | | | 236 |
| Gains less losses from financial investments | | | 73 | | | | 73 |
| Dividend income | 5 | 2 | | | | | 7 |
| Net earned insurance premiums | 961 | 289 | 18 | | | | 1,268 |
| Other operating income | 118 | 40 | 24 | 1 | 127 | (130) | 180 |
| Total operating income | 4,002 | 1,823 | 913 | 34 | 130 | (130) | 6,772 |
| Net insurance claims ⁵³ | (821) | (258) | (10) | | | | (1,089) |
| Net operating income⁴¹ | 3,181 | 1,565 | 903 | 34 | 130 | (130) | 5,683 |
| Loan impairment charges and other credit risk provisions | (633) | (180) | (7) | | | | (820) |
| Net operating income | 2,548 | 1,385 | 896 | 34 | 130 | (130) | 4,863 |
| Operating expenses | (2,212) | (910) | (353) | (24) | (343) | 130 | (3,712) |
| Operating profit/(loss) | 336 | 475 | 543 | 10 | (213) | | 1,151 |
| Share of profit in associates and joint ventures | | | | | | | |

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| | | | | | | | |
|---|---------------|---------------|---------------|--------------|--------------|----------------|----------------|
| Profit/(loss) before tax | 336 | 475 | 543 | 10 | (213) | | 1,151 |
| | <i>%</i> | <i>%</i> | <i>%</i> | <i>%</i> | <i>%</i> | | <i>%</i> |
| Share of HSBC's profit before tax | 2.9 | 4.1 | 4.7 | 0.1 | (1.8) | | 10.0 |
| Cost efficiency ratio | 69.5 | 58.1 | 39.1 | 70.6 | 263.8 | 100 | 65.3 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 22,431 | 29,036 | 14,271 | 64 | | | 65,802 |
| Total assets | 40,866 | 41,136 | 78,131 | 1,564 | 2,926 | (1,012) | 163,611 |
| Customer accounts | 32,619 | 27,251 | 29,402 | 6,837 | | | 96,109 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Profit/(loss) before tax and balance sheet data Latin America (continued)*

| | Half-year to 30 June 2010 | | | | | | Total US\$m |
|--|---|--------------------------------|--|---------------------------------------|----------------|---|----------------|
| | Retail Banking and Wealth Management ¹⁶ US\$m | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Inter- segment elimination ⁵² US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income | 1,978 | 793 | 389 | 10 | 53 | (104) | 3,119 |
| Net fee income | 492 | 244 | 99 | 14 | 6 | | 855 |
| Trading income/(expense) excluding net interest income | 21 | 38 | 181 | 1 | (4) | | 237 |
| Net interest income on trading activities | | | 11 | | 1 | 104 | 116 |
| Net trading income/ (expense) ⁴⁵ | 21 | 38 | 192 | 1 | (3) | 104 | 353 |
| Net income from financial instruments designated at fair value | 102 | 28 | | | | | 130 |
| Gains less losses from financial investments | 1 | | 52 | | | | 53 |
| Dividend income | 3 | 1 | 1 | | | | 5 |
| Net earned insurance premiums | 770 | 171 | 16 | | | | 957 |
| Other operating income | 17 | 10 | 2 | 1 | 81 | (101) | 10 |
| Total operating income | 3,384 | 1,285 | 751 | 26 | 137 | (101) | 5,482 |
| Net insurance claims ⁵³ | (628) | (129) | (10) | | | | (767) |
| Net operating income ⁴¹ | 2,756 | 1,156 | 741 | 26 | 137 | (101) | 4,715 |
| Loan impairment (charges)/ recoveries and other credit risk provisions | (661) | (160) | 3 | | (2) | | (820) |
| Net operating income | 2,095 | 996 | 744 | 26 | 135 | (101) | 3,895 |
| Operating expenses | (1,928) | (760) | (310) | (22) | (94) | 101 | (3,013) |
| Operating profit | 167 | 236 | 434 | 4 | 41 | | 882 |

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| | | | | | | | |
|--|--------|--------|--------|-------|-------|-------|---------|
| Share of profit in associates and joint ventures | 1 | | | | | | 1 |
| Profit before tax | 168 | 236 | 434 | 4 | 41 | | 883 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 1.5 | 2.2 | 3.9 | | 0.4 | | 8.0 |
| Cost efficiency ratio | 70.0 | 65.7 | 41.8 | 84.6 | 68.6 | | 63.9 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 19,350 | 19,434 | 10,006 | 39 | | | 48,829 |
| Total assets | 34,645 | 27,307 | 59,302 | 1,110 | 314 | (793) | 121,885 |
| Customer accounts | 26,618 | 20,115 | 23,158 | 5,326 | | | 75,217 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 31 December 2010 | | | | | | Total US\$m |
|---|---|--------------------------------|--|---------------------------------------|----------------|---|----------------|
| | Retail Banking and Wealth Management ¹⁶ | Commercial Banking US\$m | Global Banking and Markets ¹⁶ US\$m | Global Private Banking US\$m | Other US\$m | Inter- segment elimination ⁵² US\$m | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| <i>Profit/(loss) before tax</i> | | | | | | | |
| Net interest income | 2,001 | 878 | 383 | 10 | 68 | (148) | 3,192 |
| Net fee income/(expense) | 514 | 282 | 92 | 18 | (12) | | 894 |
| Trading income/(expense) excluding net interest income | 14 | 34 | 189 | 2 | (23) | | 216 |
| Net interest income/(expense) on trading activities | | | 17 | | (1) | 148 | 164 |
| Net trading income/(expense) ⁴⁵ | 14 | 34 | 206 | 2 | (24) | 148 | 380 |
| Net income from financial instruments designated at fair value | 237 | 57 | 1 | | | | 295 |
| Gains less losses from financial investments | 5 | 2 | 41 | | (3) | | 45 |
| Dividend income | 4 | 1 | 2 | | | | 7 |
| Net earned insurance premiums | 881 | 203 | 13 | | | | 1,097 |
| Other operating income | 81 | 24 | 13 | 1 | 140 | (128) | 131 |
| Total operating income | 3,737 | 1,481 | 751 | 31 | 169 | (128) | 6,041 |
| Net insurance claims ⁵³ | (851) | (168) | (6) | | | | (1,025) |
| Net operating income ⁴¹ | 2,886 (586) | 1,313 (133) | 745 (7) | 31 | 169 2 | (128) | 5,016 (724) |

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Loan impairment (charges)/ recoveries and other
credit risk provisions

| | | | | | | | |
|--|---------|--------|--------|-------|-------|-------|---------|
| Net operating income | 2,300 | 1,180 | 738 | 31 | 171 | (128) | 4,292 |
| Operating expenses | (2,106) | (863) | (343) | (25) | (172) | 128 | (3,381) |
| Operating profit/(loss) | 194 | 317 | 395 | 6 | (1) | | 911 |
| Share of profit in associates and joint ventures | | 1 | | | | | 1 |
| Profit/(loss) before tax | 194 | 318 | 395 | 6 | (1) | | 912 |
| | % | % | % | % | % | | % |
| Share of HSBC's profit before tax | 2.5 | 4.0 | 5.0 | | | | 11.5 |
| Cost efficiency ratio | 73.0 | 65.7 | 46.0 | 80.6 | 101.8 | | 67.4 |
| <i>Balance sheet data</i> ³⁹ | | | | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | | US\$m |
| Loans and advances to customers (net) | 20,823 | 24,879 | 12,242 | 43 | | | 57,987 |
| Total assets | 38,819 | 35,619 | 64,635 | 1,608 | 196 | (939) | 139,938 |
| Customer accounts | 30,149 | 24,514 | 27,810 | 6,053 | | | 88,526 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Reconciliation of reported and underlying profit/(loss) before tax****Europe***30 June 2011 compared with 30 June 2010*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|--------------------------------|------------------------------------|--------------------------------------|------------------|-------------------------------|-----------------|----------------------------------|---------------------------------|
| | 1H10 | 1H10 | Currency translation ¹⁰ | at 1H11 exchange rates ¹¹ | 1H11 as reported | 1H11 adjustments ⁹ | 1H11 underlying | Re-reported change ¹² | Underlying change ¹² |
| | as reported US\$m | adjustments ⁹ US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest income | 5,802 | 17 | 312 | 6,131 | 5,566 | | 5,566 | (4) | (9) |
| Net fee income | 3,177 | (50) | 139 | 3,266 | 3,131 | | 3,131 | (1) | (4) |
| Changes in fair value ¹³ | 574 | (574) | | | (71) | 71 | | | |
| Other income ¹⁴ | 3,168 | (135) | 156 | 3,189 | 2,714 | | 2,714 | (14) | (15) |
| Net operating income¹⁵ | 12,721 | (742) | 607 | 12,586 | 11,340 | 71 | 11,411 | (11) | (9) |
| Loan impairment charges and other credit risk provisions | (1,501) | | (93) | (1,594) | (1,173) | | (1,173) | 22 | 26 |
| Net operating income | 11,220 | (742) | 514 | 10,992 | 10,167 | 71 | 10,238 | (9) | (7) |
| Operating expenses | (7,704) | 148 | (368) | (7,924) | (8,014) | | (8,014) | (4) | (1) |
| | 3,516 | (594) | 146 | 3,068 | 2,153 | 71 | 2,224 | (39) | (28) |

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| | | | | | | | | | |
|--|--------------|--------------|------------|--------------|--------------|-----------|--------------|-------------|-------------|
| Operating profit | | | | | | | | | |
| Share of profit in associates and joint ventures | 5 | | (6) | (1) | (6) | | (6) | | (500) |
| Profit before tax | 3,521 | (594) | 140 | 3,067 | 2,147 | 71 | 2,218 | (39) | (28) |

30 June 2011 compared with 31 December 2010

Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10)

| | 2H10 | | | at 1H11 | | | Re-ported change ¹² | Under-lying change ¹² |
|--|-------------------|--------------------------------------|--|------------------------------------|------------------------|--------------------------------------|--------------------------------|----------------------------------|
| | as reported US\$m | 2H10 adjust-ments ⁹ US\$m | Currency translation ¹⁰ US\$m | exchange rates ¹⁷ US\$m | 1H11 as reported US\$m | 1H11 adjust-ments ⁹ US\$m | | |
| Net interest income | 5,448 | 1 | 176 | 5,625 | 5,566 | 5,566 | 2 | (1) |
| Net fee income | 3,194 | | 98 | 3,292 | 3,131 | 3,131 | (2) | (5) |
| Changes in fair value ¹³ | (773) | 773 | | | (71) | 71 | 91 | |
| Other income ¹⁴ | 2,160 | (255) | 56 | 1,961 | 2,714 | 2,714 | 26 | 38 |
| Net operating income¹⁵ | 10,029 | 519 | 330 | 10,878 | 11,340 | 11,411 | 13 | 5 |
| Loan impairment charges and other credit risk provisions | (1,519) | | (53) | (1,572) | (1,173) | (1,173) | 23 | 25 |
| Net operating income | 8,510 | 519 | 277 | 9,306 | 10,167 | 10,238 | 19 | 10 |
| Operating expenses | (7,741) | | (220) | (7,961) | (8,014) | (8,014) | (4) | (1) |
| Operating profit | 769 | 519 | 57 | 1,345 | 2,153 | 2,224 | 180 | 65 |
| Share of profit in associates and joint ventures | 12 | (1) | (5) | 6 | (6) | (6) | | |
| Profit before tax | 781 | 518 | 52 | 1,351 | 2,147 | 2,218 | 175 | 64 |

For footnotes, see page 81.

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Interim Management Report (continued)**Hong Kong**

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | |
|--|---|-------------|---------------------------|--------------|--------------|--------------------|----------------------|----------------------|
| | 1H10 | 1H10 | | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | as | adjust- | Currency | at 1H11 | as | adjust- | ported | lying |
| | reported | ments | translation ¹⁰ | exchange | reported | ments ⁹ | change ¹² | change ¹² |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest income | 1,994 | | 1 | 1,995 | 2,249 | 2,249 | 13 | 13 |
| Net fee income | 1,395 | | | 1,395 | 1,612 | 1,612 | 16 | 16 |
| Changes in fair value ¹³ | (6) | 6 | | | | | 100 | |
| Other income ¹⁴ | 1,513 | (62) | (3) | 1,448 | 1,553 | 1,553 | 3 | 7 |
| Net operating income¹⁵ | 4,896 | (56) | (2) | 4,838 | 5,414 | 5,414 | 11 | 12 |
| Loan impairment charges and other credit risk provisions | (63) | | | (63) | (25) | (25) | 60 | 60 |
| Net operating income | 4,833 | (56) | (2) | 4,775 | 5,389 | 5,389 | 11 | 13 |
| Operating expenses | (1,968) | | (1) | (1,969) | (2,339) | (2,339) | (19) | (19) |
| Operating profit | 2,865 | (56) | (3) | 2,806 | 3,050 | 3,050 | 6 | 9 |
| Share of profit in associates and joint ventures | 12 | | | 12 | 31 | 31 | 158 | 158 |

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| | | | | | | | | | |
|--------------------------|--------------|-------------|------------|--------------|--------------|--|--------------|----------|----------|
| Profit before tax | 2,877 | (56) | (3) | 2,818 | 3,081 | | 3,081 | 7 | 9 |
|--------------------------|--------------|-------------|------------|--------------|--------------|--|--------------|----------|----------|

30 June 2011 compared with 31 December 2010

Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10)

| | 2H10 | | at 1H11 | 1H11 | 1H11 | | Re- | Under- |
|--|----------|--|---------------------|----------|--------------------|----------------|----------------------|----------------------|
| | as | Currency | exchange | as | adjust- | 1H11 | ported | lying |
| | reported | 2H10 | rates ¹⁷ | reported | ments ⁹ | under- | change ¹² | change ¹² |
| | US\$m | adjust- ments ⁹ US\$m | US\$m | US\$m | US\$m | lying US\$m | % | % |
| Net interest income | 2,252 | | (2) | 2,250 | 2,249 | 2,249 | | |
| Net fee income | 1,567 | | (2) | 1,565 | 1,612 | 1,612 | 3 | 3 |
| Other income ¹⁴ | 1,487 | (74) | (4) | 1,409 | 1,553 | 1,553 | 4 | 10 |
| Net operating income ¹⁵ | 5,306 | (74) | (8) | 5,224 | 5,414 | 5,414 | 2 | 4 |
| Loan impairment charges and other credit risk provisions | (51) | | (1) | (52) | (25) | (25) | 51 | 52 |
| Net operating income | 5,255 | (74) | (9) | 5,172 | 5,389 | 5,389 | 3 | 4 |
| Operating expenses | (2,463) | | 3 | (2,460) | (2,339) | (2,339) | 5 | 5 |
| Operating profit | 2,792 | (74) | (6) | 2,712 | 3,050 | 3,050 | 9 | 12 |
| Share of profit in associates and joint ventures | 23 | | 1 | 24 | 31 | 31 | 35 | 29 |
| Profit before tax | 2,815 | (74) | (5) | 2,736 | 3,081 | 3,081 | 9 | 13 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Rest of Asia-Pacific**

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|-------------------------------|---------------------------|--|----------------|-------------------------------|-----------------|--------------------------------|-------------------------------|
| | 1H10 | 1H10 | Currency | 1H11 | 1H11 | 1H11 | Re- | Under- | |
| | as reported | adjust- ments ⁹ | translation ¹⁰ | at 1H11 exchange rates ¹¹ | as reported | adjust- ments ⁹ | under- lying | ported change ¹² | lying change ¹² |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| Net interest income | 1,822 | | 116 | 1,938 | 2,381 | | 2,381 | 31 | 23 |
| Net fee income | 934 | | 68 | 1,002 | 1,117 | | 1,117 | 20 | 11 |
| Changes in fair value ¹³ | | | | | (2) | 2 | | | |
| Other income ¹⁴ | 1,742 | (188) | 81 | 1,635 | 1,852 | (180) | 1,672 | 6 | 2 |
| Net operating income¹⁵ | 4,498 | (188) | 265 | 4,575 | 5,348 | (178) | 5,170 | 19 | 13 |
| Loan impairment charges and other credit risk provisions | (147) | | (10) | (157) | (100) | | (100) | 32 | 36 |
| Net operating income | 4,351 | (188) | 255 | 4,418 | 5,248 | (178) | 5,070 | 21 | 15 |
| Operating expenses | (2,417) | | (151) | (2,568) | (2,836) | | (2,836) | (17) | (10) |
| Operating profit | 1,934 | (188) | 104 | 1,850 | 2,412 | (178) | 2,234 | 25 | 21 |
| Share of profit in associates and joint ventures | 1,051 | | 47 | 1,098 | 1,330 | | 1,330 | 27 | 21 |
| Profit before tax | 2,985 | (188) | 151 | 2,948 | 3,742 | (178) | 3,564 | 25 | 21 |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | | |
|--|---|------|----------|------|------|------|--------|-----|--------|
| | 2H10 | 2H10 | Currency | 2H10 | 1H11 | 1H11 | 1H11 | Re- | Under- |
| | | | | | | | under- | | |

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| | as reported US\$m | adjust- ments ⁹ US\$m | translation ¹⁰ US\$m | at 1H11 exchange rates ¹⁷ US\$m | as reported US\$m | adjust- ments ⁹ US\$m | lying US\$m | ported change ¹² % | lying change ¹² % |
|--|-------------------------|--|------------------------------------|---|-------------------------|--|----------------|-------------------------------------|------------------------------------|
| Net interest income | 2,006 | | 68 | 2,074 | 2,381 | | 2,381 | 19 | 15 |
| Net fee income | 998 | | 39 | 1,037 | 1,117 | | 1,117 | 12 | 8 |
| Changes in fair value ¹³ | (1) | 1 | | | (2) | 2 | | (100) | |
| Other income ¹⁴ | 1,731 | | 51 | 1,782 | 1,852 | (180) | 1,672 | 7 | 6 |
| Net operating income ¹⁵ | 4,734 | 1 | 158 | 4,893 | 5,348 | (178) | 5,170 | 13 | 6 |
| Loan impairment charges and other credit risk provisions | (292) | | (12) | (304) | (100) | | (100) | 66 | 67 |
| Net operating income | 4,442 | 1 | 146 | 4,589 | 5,248 | (178) | 5,070 | 18 | 10 |
| Operating expenses | (2,726) | | (94) | (2,820) | (2,836) | | (2,836) | (4) | (1) |
| Operating profit | 1,716 | 1 | 52 | 1,769 | 2,412 | (178) | 2,234 | 41 | 26 |
| Share of profit in associates and joint ventures | 1,201 | | 31 | 1,232 | 1,330 | | 1,330 | 11 | 8 |
| Profit before tax | 2,917 | 1 | 83 | 3,001 | 3,742 | (178) | 3,564 | 28 | 19 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Middle East and North Africa***30 June 2011 compared with 30 June 2010*

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | Re- ported change ¹² | Under- lying change ¹² |
|--|---|--|------------------------------------|---|-------------------------|--|--------------------------|---------------------------------------|---|
| | 1H10 | 1H10 | Currency | 1H10 | 1H11 | 1H11 | 1H11 | | |
| | as reported US\$m | adjust- ments ⁹ US\$m | translation ¹⁰ US\$m | at 1H11 exchange rates ¹¹ US\$m | as reported US\$m | adjust- ments ⁹ US\$m | under- lying US\$m | | |
| | | | | | | | % | % | |
| Net interest income | 667 | | (7) | 660 | 673 | | 673 | 1 | 2 |
| Net fee income | 356 | | (2) | 354 | 327 | | 327 | (8) | (8) |
| Other income ¹⁴ | 165 | 47 | (2) | 210 | 236 | 4 | 240 | 45 | 14 |
| Net operating income¹⁵ | 1,188 | 47 | (11) | 1,224 | 1,236 | 4 | 1,240 | 4 | 1 |
| Loan impairment charges and other credit risk provisions | (438) | | 2 | (436) | (99) | | (99) | 77 | 77 |
| Net operating income | 750 | 47 | (9) | 788 | 1,137 | 4 | 1,141 | 52 | 45 |
| Operating expenses | (519) | | 4 | (515) | (574) | | (574) | (11) | (11) |
| Operating profit | 231 | 47 | (5) | 273 | 563 | 4 | 567 | 144 | 108 |
| Share of profit in associates and joint ventures | 115 | | | 115 | 184 | | 184 | 60 | 60 |
| Profit before tax | 346 | 47 | (5) | 388 | 747 | 4 | 751 | 116 | 94 |

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | Re- under- lying | Under- lying |
|--|---|------|----------|------|------|------|------|------------------------|-----------------|
| | 2H10 | 2H10 | Currency | 2H10 | 1H11 | 1H11 | 1H11 | | |
| | | | | | | | | | |

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| | as reported US\$m | adjust- ments ⁹ US\$m | translation ¹⁰ US\$m | at 1H11 exchange rates ¹⁷ US\$m | as reported US\$m | adjust- ments ⁹ US\$m | US\$m | ported change ¹² % | lying change ¹² % |
|---|----------------------|--|------------------------------------|---|----------------------|--|-------|-------------------------------------|------------------------------------|
| Net interest income | 700 | | (4) | 696 | 673 | | 673 | (4) | (3) |
| Net fee income | 321 | | (2) | 319 | 327 | | 327 | 2 | 3 |
| Other income ¹⁴ | 201 | (5) | | 196 | 236 | 4 | 240 | 17 | 22 |
| Net operating income ¹⁵ | 1,222 | (5) | (6) | 1,211 | 1,236 | 4 | 1,240 | 1 | 2 |
| Loan impairment charges and other credit risk provisions | (189) | | | (189) | (99) | | (99) | 48 | 48 |
| Net operating income | 1,033 | (5) | (6) | 1,022 | 1,137 | 4 | 1,141 | 10 | 12 |
| Operating expenses | (559) | | 3 | (556) | (574) | | (574) | (3) | (3) |
| Operating profit | 474 | (5) | (3) | 466 | 563 | 4 | 567 | 19 | 22 |
| Share of profit in associates and joint ventures | 72 | | (1) | 71 | 184 | | 184 | 156 | 159 |
| Profit before tax | 546 | (5) | (4) | 537 | 747 | 4 | 751 | 37 | 40 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**North America**

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|--------------------|---------------------------|--------------|--------------|--------------------|--------------|--|--|
| | 1H10 as reported US\$m | 1H10 | | 1H11 | | 1H11 | | Re- ported change ¹² % | Under- lying change ¹² % |
| | | adjust- | Currency | at 1H11 | as | adjust- | under- | | |
| | | ments ⁹ | translation ¹⁰ | exchange | reported | ments ⁹ | lying | | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % | |
| Net interest income | 6,353 | | 45 | 6,398 | 5,849 | | 5,849 | (8) | (9) |
| Net fee income | 1,801 | | 19 | 1,820 | 1,718 | | 1,718 | (5) | (6) |
| Changes in fair value ¹³ | 506 | (506) | | | (66) | 66 | | | |
| Other income ¹⁴ | 340 | (66) | 4 | 278 | 739 | | 739 | 117 | 166 |
| Net operating income¹⁵ | 9,000 | (572) | 68 | 8,496 | 8,240 | 66 | 8,306 | (8) | (2) |
| Loan impairment charges and other credit risk provisions | (4,554) | | (8) | (4,562) | (3,049) | | (3,049) | 33 | 33 |
| Net operating income | 4,446 | (572) | 60 | 3,934 | 5,191 | 66 | 5,257 | 17 | 34 |
| Operating expenses | (3,957) | | (32) | (3,989) | (4,602) | | (4,602) | (16) | (15) |
| Operating profit | 489 | (572) | 28 | (55) | 589 | 66 | 655 | 20 | |
| Share of profit in associates and joint ventures | 3 | | 1 | 4 | 17 | | 17 | 467 | 325 |

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Profit before tax

492 (572) 29 (51) 606 66 672 23

30 June 2011 compared with 31 December 2010

Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10)

| | 2H10 | 2H10 | at 1H11 | 1H11 | 1H11 | | Re- | Under- |
|--|----------|--------------------|---------------------------|---------------------|----------|--------------------|----------------------|----------------------|
| | as | adjust- | Currency | exchange | as | adjust- | ported | lying |
| | reported | ments ⁹ | translation ¹⁰ | rates ¹⁷ | reported | ments ⁹ | change ¹² | change ¹² |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| | | | | | | 1H11 | | |
| | | | | | | under- | | |
| | | | | | | lying | | |
| | | | | | | US\$m | | |
| Net interest income | 6,086 | | 40 | 6,126 | 5,849 | 5,849 | (4) | (5) |
| Net fee income | 1,863 | | 18 | 1,881 | 1,718 | 1,718 | (8) | (9) |
| Changes in fair value ¹³ | (363) | 363 | | | (66) | 66 | 82 | |
| Other income ¹⁴ | 461 | | 2 | 462 | 739 | 739 | 61 | 60 |
| Net operating income ¹⁵ | 8,047 | 363 | 59 | 8,469 | 8,240 | 66 | 8,306 | 2 (2) |
| Loan impairment charges and other credit risk provisions | (3,741) | | (11) | (3,752) | (3,049) | (3,049) | 18 | 19 |
| Net operating income | 4,306 | 363 | 48 | 4,717 | 5,191 | 66 | 5,257 | 21 11 |
| Operating expenses | (4,365) | | (30) | (4,395) | (4,602) | (4,602) | (5) | (5) |
| Operating profit/(loss) | (59) | 363 | 18 | 322 | 589 | 66 | 655 | 103 |
| Share of profit in associates and joint ventures | 21 | | 1 | 22 | 17 | 17 | (19) | (23) |
| Profit/(loss) before tax | (38) | 363 | 19 | 344 | 606 | 66 | 672 | 95 |

For footnotes, see page 81.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Latin America**

30 June 2011 compared with 30 June 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 30 June 2010 (1H10) | | | | | | | | |
|--|---|---------------------------------------|---------------------------------------|--|------------------------|---------------------------------------|-------------------------|---------------------------------------|---|
| | 1H10 as reported | 1H10 adjust- ments ⁹ | Currency translation ¹⁰ | 1H10 at 1H11 exchange rates ¹¹ | 1H11 as reported | 1H11 adjust- ments ⁹ | 1H11 under- lying | Re- ported change ¹² | Under- lying change ¹² |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | % | % |
| Net interest income | 3,119 | | 231 | 3,350 | 3,517 | | 3,517 | 13 | 5 |
| Net fee income | 855 | | 64 | 919 | 902 | | 902 | 6 | (2) |
| Other income ¹⁴ | 741 | | 49 | 790 | 1,264 | | 1,264 | 71 | 60 |
| Net operating income¹⁵ | 4,715 | | 344 | 5,059 | 5,683 | | 5,683 | 21 | 12 |
| Loan impairment charges and other credit risk provisions | (820) | | (67) | (887) | (820) | | (820) | | 8 |
| Net operating income | 3,895 | | 277 | 4,172 | 4,863 | | 4,863 | 25 | 17 |
| Operating expenses | (3,013) | | (220) | (3,233) | (3,712) | | (3,712) | (23) | (15) |
| Operating profit | 882 | | 57 | 939 | 1,151 | | 1,151 | 31 | 23 |
| Share of profit in associates and joint ventures | 1 | | (1) | | | | (100) | | |
| | 883 | | 56 | 939 | 1,151 | | 1,151 | 30 | 23 |

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Profit before tax

30 June 2011 compared with 31 December 2010

| | Half-year to 30 June 2011 (1H11) compared with half-year to 31 December 2010 (2H10) | | | | | | | | |
|---|---|--|--|---|---------------------------------|--|----------------------------------|--|--|
| | 2H10 as reported US\$m | 2H10 adjust- ments ⁹ US\$m | Currency translation ¹⁰ US\$m | at 1H11 exchange rates ¹⁷ US\$m | 1H11 as reported US\$m | 1H11 adjust- ments ⁹ US\$m | 1H11 under- lying US\$m | Re- ported change ¹² % | Under- lying change ¹² % |
| Net interest income | 3,192 | | 146 | 3,338 | 3,517 | | 3,517 | 10 | 5 |
| Net fee income | 894 | | 44 | 938 | 902 | | 902 | 1 | (4) |
| Other income ¹⁴ | 930 | | 44 | 974 | 1,264 | | 1,264 | 36 | 30 |
| Net operating income ¹⁵ | 5,016 | | 234 | 5,250 | 5,683 | | 5,683 | 13 | 8 |
| Loan impairment charges and other credit risk provisions | (724) | | (39) | (763) | (820) | | (820) | (13) | (7) |
| Net operating income | 4,292 | | 195 | 4,487 | 4,863 | | 4,863 | 13 | 8 |
| Operating expenses | (3,381) | | (158) | (3,539) | (3,712) | | (3,712) | (10) | (5) |
| Operating profit | 911 | | 37 | 948 | 1,151 | | 1,151 | 26 | 21 |
| Share of profit in associates and joint ventures | 1 | | | 1 | | | | (100) | (100) |
| Profit before tax | 912 | | 37 | 949 | 1,151 | | 1,151 | 26 | 21 |

For footnotes, see page 81.

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Interim Management Report (continued)**Other information****Funds under management and assets held in custody**

| | 30 June 2011 US\$bn | Half-year to 30 June 2010 US\$bn | 31 December 2010 US\$bn |
|---|------------------------------------|---|-------------------------------|
| Funds under management | | | |
| At beginning of period | 925 | 857 | 828 |
| Net new money | 16 | 25 | 17 |
| Value change | 3 | (16) | 49 |
| Exchange and other | 4 | (38) | 31 |
| At end of period | 948 | 828 | 925 |
| Funds under management by business | | | |
| HSBC Global Asset Management | 449 | 407 | 439 |
| Global Private Banking | 297 | 245 | 277 |
| Affiliates | 3 | 3 | 3 |
| Other | 199 | 173 | 206 |
| | 948 | 828 | 925 |

Funds under management (FuM) at 30 June 2011 amounted to US\$948bn, an increase of 2% when compared with 31 December 2010. Both Global Asset Management and GPB fund holdings increased.

Global Asset Management funds, including emerging market funds, increased by 2% to US\$449bn. The increase in FuM was primarily driven by favourable foreign exchange movements together with net inflows in Europe and Latin America. We remain one of the world's largest emerging market asset managers with FuM of US\$135bn at 30 June 2011 in countries outside North America, Western Europe, Japan and Australia.

GPB FuM increased by 7% compared with 31 December 2010 to US\$297bn, driven by strong net inflows, which benefited from cross-business referrals and the hiring of relationship managers, together with favourable foreign exchange movements. Client assets, which include FuM and cash deposits and provide an indicator of overall GPB volumes, increased by US\$26bn to US\$416bn due to the growth in FuM.

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Other FuM decreased marginally to US\$199bn primarily due to the disposal of real estate and infra-structure fund management activity during the year.

Assets held in custody and under administration

Custody is the safekeeping and servicing of securities and other financial assets on behalf of clients. At 30 June 2011, we held assets as custodian of US\$5.9 trillion, 3% higher than the US\$5.7 trillion held at 31 December 2010. This was mainly driven by favourable foreign exchange and market movements.

Our assets under administration business, which includes the provision of various support function activities including the valuation of portfolios of securities and other financial assets on behalf of clients, complements the custody business. At 30 June 2011, the value of assets held under administration by the Group amounted to US\$2.8 trillion, an increase from US\$2.7 trillion at 31 December 2010 primarily due to favourable foreign exchange movements.

Review of transactions with related parties

The Financial Services Authority's (FSA) Disclosure Rules and Transparency Rules require the disclosure of related party transactions that have taken place in the first six months of the current financial year and any changes in the related party transactions described in the *Annual Report and Accounts 2010*, that have or could have materially affected the financial position or performance of HSBC. A fair review has been undertaken and any such related party transactions have been disclosed in the Notes on the Financial Statements.

Accounting for deferred bonus arrangements

Recent regulatory and best practice guidance has clarified the required structure and terms of deferred bonus arrangements awarded to employees, who now have a better understanding of the likely nature of awards to be granted in respect of a particular financial year. As a result, the vesting period in respect of deferred awards expected to be granted in March 2012 is therefore determined to have started on 1 January 2011. An additional expense of US\$138m in respect of these deferred awards was recognised in Operating expenses in the first half of 2011.

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Interim Management Report (continued)

Footnotes to pages 2 to 80

Financial highlights

- 1 *Dividends recorded in the financial statements are dividends per ordinary share declared in the first six months of 2011 and are not dividends in respect of, or for, the period.*
- 2 *Return on invested capital is based on the profit attributable to ordinary shareholders. Average invested capital is measured as average total shareholders equity after adding back goodwill previously written-off directly to reserves, deducting average equity preference shares issued by HSBC Holdings and deducting/(adding) average reserves for unrealised gains/(losses) on effective cash flow hedges and available-for-sale securities. This measure reflects capital initially invested and subsequent profit.*
- 3 *The return on average ordinary shareholders' equity is defined as profit attributable to shareholders of the parent company divided by average ordinary shareholders' equity.*
- 4 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*
- 5 *Each ADS represents five ordinary shares.*
- 6 *Total shareholder return is defined on page 84 of the Annual Report and Accounts 2010.*
- 7 *The Financial Times Stock Exchange 100 Index.*
- 8 *The Morgan Stanley Capital International World Index and the Morgan Stanley Capital International World Banks Index.*

Reconciliations of reported and underlying profit before tax

- 9 *These columns comprise the net increments or decrements in profits in the current half-year (compared with the previous half-years) which are attributable to acquisitions or disposals of subsidiaries, gains arising on the dilution of interests in associates and/or movements in fair value of own debt designated at fair value attributable to credit spread. The inclusion of acquisitions and disposals is determined in the light of events in each period.*
- 10 *Currency translation is the effect of translating the results of subsidiaries and associates for the previous half-years at the average rates of exchange applicable in the current half-year.*
- 11 *Excluding adjustments in the first half of 2010.*
- 12 *Positive numbers are favourable; negative numbers are unfavourable.*
- 13 *Changes in fair value due to movements in own credit spread on long-term debt issued. This does not include the fair value changes due to own credit spread on structured notes issued and other hybrid instruments included within trading liabilities.*
- 14 *Other income in this context comprises net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, dividend income, net earned insurance premiums and other operating income less net insurance claims incurred and movement in liabilities to policyholders.*
- 15 *Net operating income before loan impairment charges and other credit risk provisions.*
- 16 *With effect from 1 March 2011, our Global Asset Management business was moved from GB&M to RBWM. Comparative data have been adjusted accordingly.*
- 17 *Excluding adjustments and disposals in the second half of 2010.*

Financial summary

- 18 *Net interest income includes the cost of funding trading assets, while the related external revenues are reported in trading income. In HSBC's customer group results, the cost of funding trading assets is included within Global Banking and Markets' net trading income as an interest expense.*
- 19 *Gross interest yield is the average annualised interest rate earned on average interest-earning assets (AIEA).*
- 20 *Net interest spread is the difference between the average annualised interest rate earned on AIEA, net of amortised premiums and loan fees, and the average annualised interest rate payable on average interest-bearing funds.*
- 21 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*

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The cost of internal funding of trading assets was US\$516m (first half of 2010: US\$294m; second half of 2010: US\$608m) and is excluded from the reported Net trading income line and included in Net interest income. However, this cost is reinstated in Net trading income in HSBC's customer group and global business reporting.

- 23 *Net trading income includes an income of US\$60m (first half of 2010: income of US\$255m; second half of 2009: expense of US\$232m) associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities derived from movements in HSBC issuance spreads.*
- 24 *The change in fair value related to movements in the Group's credit spread on long-term debt resulted in an expense of US\$143m in the first half of 2011 (first half of 2010: income of US\$1.1bn; second half of 2010: expense of US\$1.1bn).*
- 25 *Includes gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with HSBC's long-term debt issued.*
- 26 *Discretionary participation features.*
- 27 *The calculation of the PVIF asset was refined during the period to bring greater comparability and consistency across the Group's insurance operations. This was achieved by incorporating explicit margins and allowances for certain risks and uncertainties in place of implicit adjustments to the discount rate. The change in calculation reflected explicit risk margins for non-economic risks in the projection assumptions, and explicit allowances for financial options and guarantees using stochastic methods. Discount rates have been reduced as a result of removing the implicit adjustments. In certain circumstances, the implicit adjustments were different from the explicit amounts, resulting in a gain of US\$243m which was included in Other operating income.*
- 28 *Net insurance claims incurred and movement in liabilities to policyholders arise from both life and non-life insurance business. For non-life business, amounts reported represent the cost of claims paid during the year and the estimated cost of notified claims. For life business, the main element of claims is the liability to policyholders created on the initial underwriting of the policy and any subsequent movement in the liability that arises, primarily from the attribution of investment performance to savings-related policies. Consequently, claims rise in line with increases in sales of savings-related business and with investment market growth.*

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Consolidated balance sheet

- 29 *Net of impairment allowances.*
- 30 *The calculation of capital resources, capital ratios and risk-weighted assets is on a Basel II basis.*
- 31 *Capital resources are total regulatory capital, the calculation of which is set out on page 161.*
- 32 *Includes perpetual preferred securities.*
- 33 *The definition of net asset value per share is total shareholders' equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue.*
- 34 *Currency translation is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current period-end.*

Economic profit

- 35 *Expressed as a percentage of average invested capital.*
- 36 *Average invested capital is measured as average total shareholders' equity after: adding back the average balance of goodwill amortised before the transition to IFRSs or subsequently written off directly to reserves (less goodwill previously amortised in respect of the French regional banks sold in 2008); deducting the average balance of HSBC's revaluation surplus relating to property held for own use. This reserve was generated when determining the deemed cost of such properties on transition to IFRSs and will run down as the properties are sold; deducting average preference shares and other equity instruments issued by HSBC Holdings; and deducting average reserves for unrealised gains/(losses) on effective cash flow hedges and available-for-sale securities.*
- 37 *Return on invested capital is based on the profit attributable to ordinary shareholders of the parent company.*

Analyses by customer group and global business and by geographical region

- 38 *The main items reported under 'Other' are certain property activities, unallocated investment activities, centrally held investment companies, gains arising from the dilution of interests in associates, movements in the fair value of own debt designated at fair value (the remainder of the Group's gain on own debt is included in GB&M), and HSBC's holding company and financing operations. The results also include net interest earned on free capital held centrally, operating costs incurred by the Group Management Office operations in providing stewardship and central management services to HSBC, and costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries.*
- 39 *Assets by geographical region and customer group include intra-HSBC items. These items are eliminated, where appropriate, under the headings 'Intra-HSBC items' or 'Inter-segment elimination'.*
- 40 *RWAs from associates have been reallocated in order to properly align with the classification of income. RWAs from Global Asset Management have been reallocated to RBWM, principally from GB&M. Both items represent a reclassification from the basis used in HSBC's 2010 Pillar 3 disclosures. Comparative data have been adjusted accordingly.*
- 41 *Net operating income before loan impairment charges and other credit risk provisions.*
- 42 *Loan impairment charges and other credit risk provisions.*
- 43 *Share of profit in associates and joint ventures.*
- 44 *Pre-tax return on average risk-weighted assets.*
- 45 *In the analysis of customer groups and global businesses, net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, related external and internal interest income and interest expense, and dividends received; in the statutory presentation internal interest income and expense are eliminated.*
- 46 *In the first half of 2011, Global Markets included a favourable fair value movement of US\$60m on the widening of credit spreads on structured liabilities (first half of 2010: favourable fair value movement of US\$255m; second half of 2010: adverse fair value movement of US\$232m).*
- 47 *Total income earned on Securities Services products in the Group amounted to US\$0.9bn (first half of 2010: US\$0.7bn; second half of 2010: US\$0.8bn), of which US\$0.9bn was in GB&M (first half of 2010: US\$0.7bn; second half of 2010: US\$0.8bn) and US\$19m was in CMB (first half of 2010: US\$11m; second half of 2010: US\$18m).*

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- 48 *Total income earned on Payments and Cash Management products in the Group amounted to US\$2.6bn (first half of 2010: US\$2.1bn; second half of 2010: US\$2.3bn), of which US\$1.9bn was in CMB (first half of 2010: US\$1.6bn; second half of 2010: US\$1.7bn) and US\$0.7bn was in GB&M (first half of 2010: US\$0.5bn; second half of 2010: US\$0.6bn).*
- 49 *Total income earned on other transaction services in the Group amounted to US\$1.3bn (first half of 2010: US\$1.1bn; second half of 2010: US\$1.2bn). Of this US\$1.0bn was in CMB relating to trade and supply chain (first half of 2010: US\$0.8bn; second half of 2010: US\$0.8bn) and US\$0.3bn was in GB&M of which US\$0.3bn related to trade and supply chain (first half of 2010: US\$0.3bn; second half of 2010: US\$0.2bn) and US\$20m related to banknotes and other (first half of 2010: US\$71m; second half of 2010: US\$42m).*
- 50 *Other in GB&M includes net interest earned on free capital held in the global business not assigned to products.*
- 51 *The foreign exchange effect is not eliminated on an underlying basis as the reporting currency of the principal business within GPB is US dollars.*
- 52 *Inter-segment elimination comprises (i) the costs of shared services and Group Service Centres included within Other which are recovered from customer groups, and (ii) the intra-segment funding costs of trading activities undertaken within GB&M. HSBC's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M's net trading income on a fully funded basis, Net interest income/(expense) and Net interest income/(expense) on trading activities are grossed up to reflect internal funding transactions prior to their elimination in the inter-segment column.*
- 53 *Net insurance claims incurred and movement in liabilities to policyholders.*
- 54 *Employee expenses comprises costs directly incurred by each customer group. The reallocation and recharging of employee and other expenses directly incurred in the Other customer group is shown in Other operating expenses .*
- 55 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*
- 56 *France primarily comprises the domestic operations of HSBC France, HSBC Assurances Vie and the Paris branch of HSBC Bank plc.*

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Interim Management Report (continued)

Risk

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| Risk Profile | |

Managing our risk profile

A strong balance sheet is core to our philosophy.

We ensured that our portfolios remain aligned to our risk appetite and strategy.

We actively managed our risks, supported by strong forward looking risk identification.

Maintaining capital strength and strong liquidity position

Our core tier 1 capital ratio remains strong at 10.8%.

We have sustained our strong liquidity position throughout the first half of 2011.

The ratio of customer advances to deposits remains below 80%.

Strong governance

Robust risk governance and accountability is embedded across the Group.

The Board, advised by the Group Risk Committee, approves our risk appetite.

A new global operating model has been developed and adopted for the Risk function.

Our top and emerging risks

Challenges to our business operations.

Challenges to our governance and internal control systems.

Macro-economic and geopolitical risk.

Macro-prudential and regulatory risks.

Managing risk

The continued growth in our business in the first half of 2011 was achieved while ensuring risks were assumed in a measured manner and in line with our risk appetite.

Balance sheet assets grew by 10% compared with the end of 2010, while our credit risk-weighted assets increased by 6% during the period.

During the first six months of 2011 financial markets were dominated by concerns over sovereign debt default risk and its contagion effects, Middle East turmoil, and the perception that the world economic recovery remained fragile. This created volatility in financial markets, and inflationary pressures affected emerging markets. Within an ever-changing economic and financial environment, we maintained our conservative risk profile by reducing exposure to the most likely areas of stress. Stress tests are run regularly to evaluate the potential impact of emerging scenarios. Where applicable and necessary we have adjusted our risk appetite.

We continued to manage selectively our exposure to sovereign debt, with the overall quality of the portfolio remaining strong. We regularly updated our assessment of higher risk countries and adjusted our risk appetite and exposures to reflect the updates.

The diversification of our lending portfolio across the regions, together with our broad range of customer groups and products, ensured that we were not overly dependent on a few countries or markets to generate income and growth. Our geographical diversification also supported our strategies for growth in faster-growing markets and those with international connectivity.

We continued to increase lending in all regions except North America. All regions experienced an improvement in loan impairment charges and other credit risk provisions as we reduced our portfolio risk and improved collections. On a constant currency basis, in the first half of 2011 our loan impairment charges and other credit risk provisions fell by 32% compared with the first half of 2010, to US\$5.3bn. The US accounted for a significant proportion of the decline due to lower lending balances in the run-off Consumer Lending and Mortgage Services portfolios and in the Card and Retail Services portfolio, combined with lower delinquencies.

For details of HSBC's policies and practices regarding risk management and governance see the Appendix to Risk on page 148.

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Capital and liquidity

Preserving our strong capital position has long been, and will remain, a key priority for HSBC. We are well equipped to respond to the capital requirements imposed by Basel III, which are discussed further on page 162, and to sustain future growth. We utilise an enterprise-wide approach to testing the sensitivities of our capital plans against a number of scenarios; our approach to scenario stress testing analysis is discussed on page 148.

We continue to maintain a very strong liquidity position and are well positioned for the emerging new regulatory landscape.

Challenges and uncertainties

The top and emerging risks identified through our risk management processes and outlined on page 9 give rise to challenges and uncertainties as we carry out our activities. These are considered in further detail below.

Challenges to our business operations

Challenges to our operating model in an economic downturn (in developed countries) and rapid growth (in emerging markets)

Internet crime and fraud

Economic volatility heightens the degree of operational risk that we face.

We are exposed to many types of operational risk, including fraudulent and criminal activities, in particular a growing threat from internet crime. We also face breakdowns in processes or procedures and systems failure or unavailability and are subject to the risk of disruption to our business arising from events that are wholly or partially beyond our control such as natural disasters, acts of terrorism, epidemics and transport or utility failures. These may give rise to losses in service to customers and/or economic loss to HSBC. All of these risks also apply when we rely on external suppliers or vendors to provide services to us and our customers.

Challenges to our governance and internal control systems

Level of change creating operational complexity

Information security risk

The global financial services industry is facing several changes which increase the complexity of carrying out business.

The reliability and security of our information and technology infrastructure and customer databases and their ability, for example, to combat internet fraud are crucial to maintaining our banking applications and processes and to protecting the HSBC brand. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause

serious damage to our ability to serve our clients, breach regulations under which we operate and cause long-term damage to our business and brand. Information security and the management of an increasingly complex operating infrastructure remain two of the key emerging operational risks that we face.

Macro-economic and geopolitical

Eurozone crisis, US deficit and elevated risk from potential overheating economies in emerging markets

Increased geopolitical risk in the Middle East and North Africa region

Prevailing economic and market conditions may adversely affect our results

Our earnings are affected by global and local economic and market conditions. Following the problems experienced in financial markets in 2007-8, concerted government action paved the way for a general improvement in the economic environment, though recovery was variable between regions. The peripheral eurozone economies came under increasing pressure in the first half of 2011, the dominant concern being over the sustainability of their sovereign debt. In the US, the large budget deficit, growing government indebtedness and failure to increase the Federal debt ceiling are generating concerns about the impact this will have on the US, the global economy and the financial services sector.

With unemployment remaining high and consumer confidence weak in developed markets, and amid signs of inflationary pressures in emerging markets, economic conditions remain fragile and volatile. Most emerging markets are growing rapidly but sluggish global demand and efficient monetary tightening should help in controlling imbalances. Moreover, domestic demand in many major emerging markets grew strongly, contributing to an output gap and reducing the risk of overheating. The global economy will remain volatile and subject to

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HSBC HOLDINGS PLC

Interim Management Report (continued)

shocks and this could have an adverse effect on our results. In particular, we may face the following challenges to our operations and operating model in connection with these events:

the demand for borrowing from creditworthy customers may diminish if economic activity slows or remains subdued;

the elevated risk of overheating economies in emerging markets in recent years is giving rise to concerns that asset and credit bubbles may be created, leading to volatility and losses;

European banks may come under stress if the sovereign debt crisis in the region increases the need to recapitalise parts of the sector;

trade and capital flows may contract as a result of protectionist measures being introduced in certain markets or on the emergence of geopolitical risks;

a prolonged period of modest interest rates will constrain, for example, through margin compression and low returns on assets, the interest income we earn on our excess deposits;

our ability to borrow from other financial institutions or to engage in funding transactions may be adversely affected by market disruption, for example in the event of contagion from stress in the eurozone sovereign and financial sectors; and

market developments may depress consumer and business confidence. If growth in the US or the UK remains subdued, for example, asset prices and payment patterns may be adversely affected, leading to increases in delinquencies and default rates, write-offs and loan impairment charges beyond our expectations.

We are subject to political and economic risks in the countries in which we operate

We continue to manage carefully our response to the aftermath of the financial crisis, events in the Middle East and the sovereign debt problems within the eurozone. During the first half of the year, we also played a positive role in maintaining credit and liquidity supply.

As an organisation which operates in 87 countries and territories, however, our results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on such matters as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which we operate.

The ability of our subsidiaries and affiliates to pay dividends could be restricted by changes in official banking measures, exchange controls and other requirements. We present our consolidated financial statements in US dollars but, because a portion of our assets, liabilities, revenues and expenses are denominated in other currencies, changes in foreign exchange rates affect our reported income, cash flows and shareholders' equity.

Macro-prudential and regulatory

Regulatory and legislative requirements affecting conduct of business

Regulatory change impacting our business model and Group profitability

We face a number of challenges in regulation and supervision

Financial services providers face increasingly stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, the conduct of business, the structure of our operations and the integrity of financial services delivery. Increased government intervention and control over financial institutions, together with measures to reduce systemic risk, may significantly alter the competitive landscape. These measures may be introduced as formal requirements in a super-equivalent manner and to differing timetables across regulatory regimes. This may result in Group and some of our operating entities in effect having to implement requirements ahead of some of its international peers and be potentially placed at a competitive disadvantage as a result.

In relation to capital management the FSA supervises HSBC on a consolidated basis, as well as HSBC Bank directly. This is explained on page 158.

Prudential measures aimed at increasing resilience in the financial system

In July 2011, the European Commission published proposals to implement the Basel III capital and liquidity standards within Europe. The proposals which consist of a new Regulation and a Directive, collectively known as **CRD IV**, will incorporate the current Capital Requirements Directive including changes already introduced to increase weightings risk for the trading book and for re-securitisations (due to take effect from 31 December 2011), and new risk-based remuneration rules. The measures are subject to agreement by EU member state governments and the European Parliament, a process that could take 12-18 months.

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Interim Management Report (continued)

New elements of CRD IV include:

Quality of capital: a further strengthening and harmonisation of the criteria for eligibility of capital instruments with an emphasis on common equity as the principal component of tier 1 capital, a minimum common equity requirement of 4.5% and increased deductions from shareholders' equity to determine the level of regulatory capital. The new minimum requirements for common equity tier 1 and tier 1 capital are to be implemented gradually between 2013 and 2015. The new prudential adjustments are also to be introduced gradually, at a rate of 20% per annum from 2014, reaching 100% in 2018, with grandfathering of certain capital instruments over a 10-year period.

Capital buffers: proposals comprise a capital conservation buffer of 2.5% of risk-weighted assets to be built up during periods of economic growth, aimed at ensuring the capacity to absorb losses in stressed periods that may span a number of years; and a countercyclical capital buffer of up to an additional 2.5% to be built up in periods in which credit growth exceeds GDP growth. Capital buffers would be composed of tier 1 common equity. Banks whose capital falls below the buffers would be subject to restrictions on the distribution of profits, payments on non-equity capital instruments and the award of variable remuneration and discretionary pension benefits. It is not yet clear how these buffers may operate in practice and there is some doubt whether either supervisors or the market would support the release of a buffer as the economic cycle turns.

Counterparty credit risk: requirements for managing and capitalising counterparty credit risk are to be strengthened, with an additional capital charge for potential losses associated with the deterioration in the creditworthiness of individual counterparties.

Leverage: the Commission proposes to introduce a non-risk based leverage ratio, not as a binding prudential requirement but as an instrument for supervisory review (pillar 2). The implications of this ratio will be monitored prior to it potentially becoming a directly applicable prudential (pillar 1) requirement from 2018.

Liquidity and funding: a new minimum standard, the liquidity coverage ratio, designed to improve the short-term resilience of a bank's liquidity risk profile, will be introduced after an observation and review period in 2015. To address funding problems arising from asset-liability maturity mismatches, the European Commission will consider proposing a net stable funding ratio after an observation and review period in 2018.

Single rule book: the proposal harmonises divergent national supervisory approaches by removing options and discretions.

Enhanced governance: new rules aim to increase the effectiveness of risk oversight by boards, improve the status of the risk management function and ensure effective monitoring by supervisors of risk governance.

Sanctions: supervisors will be able to apply sanctions where prudential requirements are breached, such as imposing administrative fines of up to 10% of a bank's annual turnover, or temporary bans on members of a bank's management committee.

Enhanced supervision: supervisors will be required to ensure the annual preparation of a supervisory programme for each supervised bank on the basis of a risk assessment; greater and more systematic use of on-site supervisory examinations; more robust standards; and more intrusive and forward-looking supervisory assessments.

The Financial Stability Board and the Basel Committee are currently consulting on an approach to define Global Systemically Important Financial Institutions (G-SIFIs), introduce more rigorous oversight and co-ordinated assessment of their risks through international supervisory colleges, provide for higher levels of capital and liquidity resilience, and require mandatory recovery and resolution plans with institution-specific crisis co-operation agreements between cross-border crisis management groups. Final recommendations will be submitted to the G20 group of countries in November 2011.

The European Commission is expected to introduce legislative proposals before the end of 2011 which will establish a cross-border crisis management framework encompassing recovery and resolution planning; early intervention tools; resolution tools including bridge banks, asset transfers and bail-in; resolution funds; and the conditions under which resolution will be applied.

A strong capital position has long been, and will remain, a key priority for HSBC.

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Interim Management Report (continued)

Other measures

Taxation of the financial sector: the European Commission is actively considering specific taxes for the financial sector following a consultation in the first three months of 2011.

Bank levy: legislation in respect of the UK bank levy was substantively enacted on 5 July 2011, after the balance sheet date. We estimate that the cost of the UK bank levy will be approximately US\$600m for the full year 2011. No charge for the UK bank levy has been recognised in the first half of 2011. Other countries, including France, Germany and South Korea have also introduced bank levies. These do not have the same global basis as the UK bank levy and do not have a material impact on the Group at present.

Deposit Guarantee Schemes Directive: new EU rules, currently in negotiation, propose that deposit guarantee schemes will be required to pre-fund a percentage of covered deposits after a transitional period of 15 years. The final agreed level of pre-funding is likely to be in the 0.5-1.5% range.

The Volcker Rule : the rulemaking to implement those provisions of the Dodd-Frank Act limiting the ability of banking organisations with operations in the US to sponsor or invest in private equity or hedge funds and engage in certain types of proprietary trading in the US, is ongoing. It is expected that there will be a number of exceptions allowing an entity significant leeway to engage in client-serving trading, such as market-making and underwriting, and risk-mitigating hedging activities.

Derivatives and central counterparties regulation: Measures have been introduced to give effect to the G20 commitments designed to reduce systemic risk and volatility relating to derivatives trading. The G20 agreed that all standardised over-the-counter (OTC) derivatives were to be exchange traded where appropriate, reported to trade repositories and centrally cleared by the end of 2012. Higher capital requirements (under Basel III) will be imposed for bilateral (uncleared) transactions to incentivise use of clearing. In the US, rulemaking by the authorities is underway to implement the Dodd-Frank Act. The Act provides an extensive regulatory framework for OTC derivatives in addition to the mandatory clearing, exchange trading and reporting of certain swaps and security-based swaps. On 14 June 2011, the Commodity Futures Trading Commission unanimously voted to delay aspects of the Act that were scheduled to take effect on 16 July 2011 until as late as 31 December 2011. These include defining a swap trade, clearing exemptions for companies that use swaps to hedge everyday business risks, real-time reporting of derivatives trades, and capital and margin requirements for trades. The EU Commission proposals on central clearing and reporting of OTC derivatives launched in September 2010 are currently under negotiation. Exemptions for foreign exchange swaps and forwards have been proposed in the US and are currently being considered in the EU.

Retail Distribution Review: In 2006, the FSA initiated a fundamental review of how retail investment products are distributed in the market. In March 2010, it published rules with which firms must comply by January 2013. The rules introduce a system of adviser charging , requiring firms providing investment advice to set their own charges and to agree them with customers. They also ban product providers from offering commission.

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Markets in financial instruments: the European Commission has conducted a major review of the Markets in Financial Instruments Directive and formal legislative proposals are expected during 2011. These potentially extend its scope beyond equities to other asset classes including bonds, exchange-traded funds and other equity-like and non-equity instruments, and promotes their trading on exchanges and other markets that will be subject to regulation. It also proposes giving additional powers to regulators to ban trading in products that are eligible to be cleared but for which no clearing arrangements are currently available.

The UK Independent Commission on Banking (ICB) published its Interim Report on 11 April 2011. The Commission's reform proposals could have wide ranging implications for the structure of the UK banking industry. In particular, the Commission is considering, *inter alia*, whether a separation of the retail and investment banking operations, through the creation of a ring-fenced retail bank, could make banks more stable. The Commission is further considering whether the ring-fenced retail bank should be required to have a ratio of, at least, 10% equity capital to risk-weighted assets calculated under the Basel III agreement, together with a level of loss-absorbent (bail-inable) debt. Were separation required,

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given the current legal frameworks, it is most likely that the ring-fenced retail bank would be spun-out from the existing UK incorporated universal bank.

We maintain that HSBC's existing model of universal banking, protected by geographic ring-fencing through subsidiarisation, is already achieving the main goals pursued by the ICB. However, while the Commission will not publish its final recommendations until September 2011, there is a strong possibility that it could recommend changes to the UK banking sector which may require us to make major changes to HSBC's corporate structure and business activities conducted in the UK through our major banking subsidiary, HSBC Bank plc. These changes would take an extended period to implement with a significant impact on costs to both implement the changes and run the ongoing operations as restructured. The nature, impact and timing of any such changes remains unclear, as is the effect of changes on the ratings afforded to the debt of HSBC Bank plc, which would be the most affected subsidiary.

The Chancellor of the Exchequer has indicated that the UK Government endorses in principle the proposals for bail-inable debt and the ring-fencing of retail banking operations, but the Government is not bound to adopt the Commission's recommendations.

Accounting standards: in working towards convergence to a single set of high-quality, global, independent accounting standards, the IASB has issued five significant new and revised accounting standards in 2011 and is continuing to work on projects on financial instruments, insurance, leasing and revenue recognition. The new and revised accounting standards, including IFRS 9 on the classification and measurement of financial instruments, are yet to be endorsed by the EU. These standards represent substantial accounting changes which will require implementation from 2013 and over which there remains uncertainty about the content and timing of the final requirements as well as EU endorsement. In the event of non-endorsement by the EU, this would result in additional reporting costs in order to produce two sets of financial statements in order to meet SEC requirements to comply with IFRSs as issued by the IASB and UK legal requirements to comply with EU-endorsed IFRSs.

Implementation risks

Both the current regulatory environment and the extensive programme of regulatory change carry significant implementation risks for authorities and industry participants alike, including:

disparities in implementation: many official measures are proposals in development and negotiation, and have yet to be enacted into regional and national legislation. Linked to this, some regulators are adopting or considering changes in applying existing rules relating to capital requirements. These processes could result in differing, fragmented and overlapping implementation around the world, leading to risks of regulatory arbitrage, a far from level competitive playing-field and increased compliance costs (including the risks of disparate capital requirements and differences in timing for new measures or changes), especially for global financial institutions such as HSBC. This could also affect our business model and profitability.

timetable and market expectations: while the Basel Committee has announced the timetable for its core proposals in Basel III, it remains uncertain how these and other measures will play out in practice, for instance with regard to differences in approach between Basel III and the Dodd-Frank Act in the US. Meanwhile, market expectations will exert pressure on institutions to assess and effect compliance well in advance of official timetables.

wider economic impact and unforeseen consequences: while the conclusions of official and industry studies have diverged, the measures proposed and other changes that may be made will clearly impact on financial and economic activity in ways that cannot yet be clearly

foreseen. For example, higher capital requirements may seriously restrict the availability of funds for lending to support economic recovery.

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Credit risk

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Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and derivatives, and from the Group's holdings of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

There have been no material changes to our policies and practices for the management of credit risk as described in the *Annual Report and Accounts 2010*.

Total gross loans and advances increased by 8% to US\$1,283bn primarily due to growth in Asia.

Impairment allowances decreased by 7% largely from the continued run-off of the Customer Lending and Mortgage Services portfolios in North America.

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A summary of our current policies and practices regarding credit risk is provided in the Appendix to Risk on page 148.

Credit risk in the first half of 2011

Exposure, impairment allowances and charges

| | At 30 Jun 2011 US\$bn | At 30 Jun 2010 US\$bn | At 31 Dec 2010 US\$bn |
|---|--------------------------------|--------------------------------|--------------------------------|
| Total gross loans and advances (A) | 1,282.8 | 1,111.8 | 1,186.9 |
| Impairment allowances as a percentage of A | 18.9 1.47% | 22.2 2.00% | 20.2 1.70% |
| Impairment charges | 5.0 | 7.2 | 6.3 |

Loss experience

| | 30 Jun 2011 US\$m | Half-year to 30 Jun 2010 US\$m | 31 Dec 2010 US\$m |
|--|-------------------------|---|-------------------------|
| Loan impairment charges and other credit risk provisions | 5,266 | 7,523 | 6,516 |
| | % | % | % |
| RBWM | 81 | 84 | 76 |
| GB&M | 6 | 7 | 7 |
| CMB | 12 | 9 | 17 |
| Other | 1 | | |
| | 100 | 100 | 100 |

In the first half of 2011, the Group increased its maximum exposure to credit risk, mainly from growth in gross loans and advances to customers and a rise in trading assets. Gross loans and advances increased by 8% from 31 December 2010, mainly in corporate and commercial lending, reflecting continued growth in trade and business activity in Asia.

On a constant currency basis, corporate and commercial lending increased by 7% from 31 December 2010 to US\$491bn and was the Group's largest lending category at 47% of gross loans and advances to customers. Despite this strong growth, loan impairment charges in CMB and GB&M declined compared with the first half of 2010.

On a constant currency basis, the Group's personal lending was US\$439bn at 30 June 2011, reflecting a small increase compared with 31 December 2010 as growth in mortgage lending, particularly in the UK and Hong Kong, where lending remained well secured, was partly offset by the continued run-off of the Consumer Lending and Mortgage Services portfolios in the US. Personal lending balances in the US declined by 7% from 31 December 2010 to US\$102bn as balances in our run-off portfolios continued to diminish, although in the first half the rate of reduction was adversely

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affected by the temporary suspension of foreclosure activity.

In the first half of 2011 the eurozone demonstrated signs of economic recovery, though there were regular periods of significant market volatility related to a number of sovereigns, notably Greece, Ireland, Portugal, Italy and Spain. We continued to closely monitor our exposure to sovereign debt during the first half of 2011. At 30 June 2011, our on-balance sheet exposure to the sovereign and agency debt of Greece, Ireland, Portugal, Italy and Spain was US\$8.2bn. During the first half of 2011, an impairment charge of US\$105m was recognised in respect of Greek sovereign and agency exposures classified as available for sale.

Overall credit quality improved during the first half of 2011. Loan impairment charges and other credit risk provisions were US\$5.3bn, 32% lower than in the first half of 2010, with 65% of the overall decline attributable to RBWM in North America. In addition, both loan impairment allowances and impaired loans declined at 30 June 2011 compared with the end of 2010, mainly reflecting the continued run-off of the Consumer Lending and Mortgage Services portfolios and the reduction in balances in the Card and Retail Services portfolios.

For securitisation exposures and structured products the financial impact of the recent market disruption remained modest with net write-downs to the income statement of US\$0.2bn (first half of 2010: US\$0.1bn net write-backs) and a reduction in the available-for-sale ABSs reserve deficit of US\$1.6bn to US\$4.8bn.

Credit exposure

Maximum exposure to credit risk

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments. In the first half of 2011, our exposure to credit risk remained well diversified across asset classes. While we increased our overall exposure to credit risk in the period, the balance of exposure has remained broadly stable.

Our exposure to corporate and commercial lending also increased, mainly in Asia reflecting strong growth in trade and business activity. Exposure to personal lending remained significant as we grew mortgage lending balances, notably in the UK and Hong Kong where our portfolios are well secured. This growth partly offset the decline in the US reflecting the continued run-off of selected

portfolios. For further commentary on personal lending, see *Areas of special interest* personal lending on page 101.

In the first half of 2011, we increased our exposure to trading assets. Our holdings of debt securities rose reflecting our role as primary market-maker, as well as increased customer demand for government and government agency debt securities. In addition, settlement accounts, which vary in proportion to levels of trading activity, grew significantly, while our reverse repo exposure also rose reflecting increased client trading and the development of repo products.

Loss experience continued to be concentrated in the personal lending portfolios, with some 81% of our loan impairment charges and other credit risk provisions reported in RBWM, the majority of which related to US personal lending.

The table on page 92 presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

Collateral and other credit enhancements

The nature of collateral held against financial instruments presented in the Maximum exposure to credit risk table on page 92 is described in the Appendix to Risk on page 149.

Offsets

Loans and advances

The loans and advances offset adjustment in the table on page 92 primarily relates to customer loans and deposits, and balances arising from repo and reverse repo transactions. The offset relates to balances where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk management purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

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Derivatives

The derivative offset amount in the table overleaf relates to exposures where the counterparty has an offsetting derivative exposure with HSBC, a master netting arrangement is in place and the credit risk exposure is managed on a net basis, or the position is specifically collateralised, normally in the form of cash. At 30 June 2011, the total amount of such offsets was US\$208.5bn (30 June 2010: US\$219.2bn; 31 December 2010: US\$197.5bn), of which US\$188.2bn (30 June 2010: US\$198.5bn; 31 December 2010: US\$178.3bn) were offsets under a master netting arrangement, US\$20.1bn (30 June 2010: US\$20.5bn; 31 December 2010: US\$19.0bn) was collateral received in cash and US\$0.2bn (30 June 2010: US\$0.2bn; 31 December 2010: US\$0.2bn) was other collateral. These amounts do not qualify for net presentation for accounting purposes, as settlement may not actually be made on a net basis.

Concentration of exposure

Concentrations of credit risk are described in the Appendix to Risk on page 149.

Securities held for trading

Total securities held for trading within trading assets were US\$269bn at 30 June 2011 (30 June 2010: US\$244bn; 31 December 2010: US\$235bn). The largest concentration of these assets was to government and government agency securities. A detailed analysis of securities held for trading is set out in Note 7 on the Financial Statements and an analysis of credit quality is provided on page 111.

Debt securities, treasury and other eligible bills

Our holdings of corporate debt, ABSs and other securities were spread across a wide range of issuers and geographical regions, with 24% invested in securities issued by banks and other financial institutions. A more detailed analysis of financial investments is set out in Note 13 on the Financial Statements and an analysis by credit quality is provided on page 111.

At 30 June 2011, our insurance businesses held diversified portfolios of debt and equity securities designated at fair value of US\$31bn (30 June 2010: US\$23bn; 31 December 2010: US\$28bn) and debt securities classified as financial investments of US\$42bn (30 June 2010: US\$36bn; 31 December 2010: US\$38bn). A more detailed analysis of securities held by the insurance businesses is set out on page 142.

Derivatives

On a reported basis, derivative assets at 30 June 2011 were US\$261bn, in line with 31 December 2010. Our single largest exposure was to interest rate derivatives, and this balance was largely unchanged compared with the end of 2010, as a small increase in gross exposure, driven by an increased notional value of outstanding contracts, was offset by higher netting from increased trading with clearing houses.

Loans and advances

On a reported basis, gross loans and advances to customers (excluding the financial sector) at 30 June 2011 increased by US\$60bn or 7% from 31 December 2010. On a constant currency basis the increase was 4%. The rise was primarily due to strong growth in Asia and Europe.

Summary of gross loans and advances to customers

The following commentary is on a constant currency basis:

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Personal lending of US\$439bn in the first half of 2011 was slightly higher than at 31 December 2010 as growth in residential mortgage lending was substantially offset by lower other personal lending balances. Personal lending represented 42% of our total lending to customers. At US\$282bn, residential mortgage lending constituted the Group's largest concentration in a single exposure type, the most significant balances being in the UK, the US and Hong Kong.

Corporate and commercial lending was 47% of gross lending to customers at 30 June 2011, comprising our largest lending category. Commercial, industrial and international trade was the biggest portion of this category, increasing by 11% compared with 31 December 2010 as business and trade activity, particularly in Asia, grew. Commercial real estate lending, which represented 7% of total gross lending to customers, was broadly in line with 31 December 2010.

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Interim Management Report (continued)*Maximum exposure to credit risk*

| | At 30 June 2011 | | | At 30 June 2010 | | | At 31 December 2010 | | |
|--|------------------------|--------------|-------------------------------------|------------------------|--------------|-------------------------------------|------------------------|--------------|-------------------------------------|
| | Maximum exposure US\$m | Offset US\$m | Exposure to credit risk (net) US\$m | Maximum exposure US\$m | Offset US\$m | Exposure to credit risk (net) US\$m | Maximum exposure US\$m | Offset US\$m | Exposure to credit risk (net) US\$m |
| Cash and balances at central banks | 68,218 | | 68,218 | 71,576 | | 71,576 | 57,383 | | 57,383 |
| Items in the course of collection from other banks | 15,058 | | 15,058 | 11,195 | | 11,195 | 6,072 | | 6,072 |
| Hong Kong Government certificates of indebtedness | 19,745 | | 19,745 | 18,364 | | 18,364 | 19,057 | | 19,057 |
| Trading assets | 438,232 | (10,491) | 427,741 | 376,440 | (17,890) | 358,550 | 343,966 | (4,189) | 339,777 |
| Treasury and other eligible bills | 23,899 | | 23,899 | 22,236 | | 22,236 | 25,620 | | 25,620 |
| Debt securities | 208,805 | | 208,805 | 194,390 | | 194,390 | 168,268 | | 168,268 |
| Loans and advances: | | | | | | | | | |
| to banks | 100,134 | | 100,134 | 77,434 | | 77,434 | 70,456 | | 70,456 |
| to customers | 105,394 | (10,491) | 94,903 | 82,380 | (17,890) | 64,490 | 79,622 | (4,189) | 75,433 |
| Financial assets designated at fair value | 19,977 | | 19,977 | 18,350 | | 18,350 | 19,593 | | 19,593 |
| Treasury and other eligible bills | 207 | | 207 | 249 | | 249 | 159 | | 159 |
| Debt securities | 18,496 | | 18,496 | 16,153 | | 16,153 | 18,248 | | 18,248 |
| Loans and advances: | | | | | | | | | |
| to banks | 355 | | 355 | 1,149 | | 1,149 | 315 | | 315 |
| to customers | 919 | | 919 | 799 | | 799 | 871 | | 871 |
| Derivatives | 260,672 | (208,471) | 52,201 | 288,279 | (219,180) | 69,099 | 260,757 | (197,501) | 63,256 |
| Loans and advances held at amortised cost: | | | | | | | | | |
| to banks | 1,263,931 | (103,876) | 1,160,055 | 1,089,633 | (89,301) | 1,000,332 | 1,166,637 | (91,966) | 1,074,671 |
| to customers | 226,043 | (3,173) | 222,870 | 196,296 | (330) | 195,966 | 208,271 | (3,099) | 205,172 |
| | 1,037,888 | (100,703) | 937,185 | 893,337 | (88,971) | 804,366 | 958,366 | (88,867) | 869,499 |
| Financial investments | 408,650 | | 408,650 | 376,642 | | 376,642 | 392,772 | | 392,772 |

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| | | | | | | | | | |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Treasury and other similar bills | 61,664 | | 61,664 | 61,275 | | 61,275 | 57,129 | | 57,129 |
| Debt securities | 346,986 | | 346,986 | 315,367 | | 315,367 | 335,643 | | 335,643 |
| Other assets | 36,789 | (3) | 36,786 | 30,643 | (15) | 30,628 | 30,371 | (29) | 30,342 |
| Endorsements and acceptances | 11,338 | (3) | 11,335 | 9,573 | (15) | 9,558 | 10,116 | (29) | 10,087 |
| Other | 25,451 | | 25,451 | 21,070 | | 21,070 | 20,255 | | 20,255 |
| Financial guarantees and similar contracts | 52,232 | | 52,232 | 46,120 | | 46,120 | 49,436 | | 49,436 |
| Loan and other credit-related commitments ¹ | 660,175 | | 660,175 | 548,710 | | 548,710 | 602,513 | | 602,513 |
| | 3,243,679 | (322,841) | 2,920,838 | 2,875,952 | (326,386) | 2,549,566 | 2,948,557 | (293,685) | 2,654,872 |

For footnote, see page 146.

In the financial category, our largest exposure was to non-bank financial institutions which increased by 13% to US\$118bn; this mainly comprised secured lending on trading accounts, mainly reverse-repo facilities.

Loans and advances to banks were widely distributed across major institutions in the first half of 2011 and increased by 5% as placements with commercial and central banks rose, particularly in

Hong Kong and Rest of Asia-Pacific.

The following tables analyse loans by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the lending branch.

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Interim Management Report (continued)*Gross loans and advances by industry sector*

| | At | At | | |
|--|----------------|-----------------|-------------------|----------------|
| | 31 December | Currency | | 30 June |
| | 2010 US\$m | effect US\$m | Movement US\$m | 2011 US\$m |
| Personal | 425,320 | 8,471 | 5,559 | 439,350 |
| Residential mortgages ² | 268,681 | 5,579 | 7,831 | 282,091 |
| Other personal ³ | 156,639 | 2,892 | (2,272) | 157,259 |
| Corporate and commercial | 445,512 | 11,993 | 33,842 | 491,347 |
| Commercial, industrial and international trade | 237,694 | 6,458 | 26,457 | 270,609 |
| Commercial real estate | 71,880 | 1,995 | (543) | 73,332 |
| Other property-related | 34,838 | 403 | 1,816 | 37,057 |
| Government | 8,594 | 187 | 644 | 9,425 |
| Other commercial ⁴ | 92,506 | 2,950 | 5,468 | 100,924 |
| Financial | 101,725 | 4,347 | 14,187 | 120,259 |
| Non-bank financial institutions | 100,163 | 4,311 | 13,482 | 117,956 |
| Settlement accounts | 1,562 | 36 | 705 | 2,303 |
| Asset-backed securities reclassified | 5,892 | 164 | (392) | 5,664 |
| Total gross loans and advances to customers (TGLAC ⁵) | 978,449 | 24,975 | 53,196 | 1,056,620 |
| Gross loans and advances to banks | 208,429 | 7,329 | 10,447 | 226,205 |
| Total gross loans and advances | 1,186,878 | 32,304 | 63,643 | 1,282,825 |
| Impaired loans and advances to customers as a percentage of TGLAC | 28,091 2.9% | 594 | (2,703) | 25,982 2.5% |
| Impairment allowances on loans and advances to customers as a percentage of TGLAC | 20,083 2.1% | 356 | (1,707) | 18,732 1.8% |
| Charge for impairment losses to 30 June 2010 | 7,234 | (772) | (1,489) | 4,973 |
| New allowances net of allowance releases | 7,687 | (818) | (1,166) | 5,703 |
| Recoveries | (453) | 46 | (323) | (730) |

*For footnotes, see page 146.**Gross loans and advances to customers by industry sector and by geographical region***Gross loans and advances to customers**

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| | Rest of | | | | | | Total US\$m | As a % of total gross loans |
|--|-----------------|-----------------------|---------------------------|---------------|---------------------------|---------------------------|----------------|--------------------------------------|
| | Europe US\$m | Hong Kong US\$m | Asia- Pacific US\$m | MENA US\$m | North America US\$m | Latin America US\$m | | |
| At 30 June 2011 | | | | | | | | |
| Personal Residential mortgages ² | 172,383 | 61,704 | 44,300 | 5,196 | 131,676 | 24,091 | 439,350 | 41.6 |
| Other personal ³ | 52,390 | 16,208 | 12,076 | 3,405 | 54,986 | 18,194 | 157,259 | 14.9 |
| Corporate and commercial | 221,361 | 94,566 | 74,726 | 20,786 | 38,761 | 41,147 | 491,347 | 46.5 |
| Commercial, industrial and international trade | 125,668 | 42,587 | 46,128 | 12,316 | 16,766 | 27,144 | 270,609 | 25.6 |
| Commercial real estate | 31,066 | 20,379 | 9,728 | 1,037 | 7,673 | 3,449 | 73,332 | 6.9 |
| Other property-related | 7,189 | 16,097 | 5,643 | 1,897 | 5,391 | 840 | 37,057 | 3.5 |
| Government | 2,126 | 3,252 | 430 | 1,251 | 311 | 2,055 | 9,425 | 0.9 |
| Other commercial ⁴ | 55,312 | 12,251 | 12,797 | 4,285 | 8,620 | 7,659 | 100,924 | 9.6 |
| Financial Non-bank financial institutions | 92,799 | 3,673 | 3,231 | 1,281 | 16,563 | 2,712 | 120,259 | 11.4 |
| Settlement accounts | 91,636 | 3,042 | 2,794 | 1,267 | 16,563 | 2,654 | 117,956 | 11.2 |
| Asset-backed securities reclassified | 1,163 | 631 | 437 | 14 | | 58 | 2,303 | 0.2 |
| TGLAC ⁵ | 491,663 | 159,943 | 122,257 | 27,263 | 187,544 | 67,950 | 1,056,620 | 100.0 |
| Percentage of TGLAC by geographical region | 46.6% | 15.1% | 11.6% | 2.6% | 17.7% | 6.4% | 100.0% | |
| Impaired loans as a percentage of TGLAC | 10,202 2.1% | 510 0.3% | 1,208 1.0% | 2,195 8.1% | 9,346 5.0% | 2,521 3.7% | 25,982 2.5% | |
| Total impairment allowances as a percentage of TGLAC | 5,332 1.1% | 573 0.4% | 828 0.7% | 1,569 5.8% | 8,282 4.4% | 2,148 3.2% | 18,732 1.8% | |

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| | Gross loans and advances to customers | | | | | | | As a % of total gross loans |
|--|---------------------------------------|-----------------------|--------------------------------------|---------------|---------------------------|---------------------------|----------------|--------------------------------------|
| | Europe US\$m | Hong Kong US\$m | Rest of Asia- Pacific US\$m | MENA US\$m | North America US\$m | Latin America US\$m | Total US\$m | |
| At 30 June 2010 | | | | | | | | |
| Personal Residential mortgages ² | 150,801 | 50,734 | 33,637 | 5,763 | 148,869 | 20,248 | 410,052 | 44.8 |
| Other personal ³ | 103,485 | 37,394 | 23,289 | 1,789 | 81,811 | 5,080 | 252,848 | 27.6 |
| Corporate and commercial | 47,316 | 13,340 | 10,348 | 3,974 | 67,058 | 15,168 | 157,204 | 17.2 |
| Commercial, industrial and international trade | 186,547 | 60,728 | 56,394 | 17,670 | 39,021 | 28,230 | 388,590 | 42.4 |
| Commercial real estate | 100,043 | 23,363 | 35,051 | 9,952 | 13,406 | 18,043 | 199,858 | 21.8 |
| Other property-related | 29,723 | 16,722 | 7,153 | 1,044 | 9,874 | 2,457 | 66,973 | 7.3 |
| Government | 5,571 | 12,179 | 4,186 | 1,751 | 9,220 | 578 | 33,485 | 3.7 |
| Other commercial ⁴ | 1,664 | 357 | 660 | 1,533 | 406 | 1,774 | 6,394 | 0.7 |
| Financial Non-bank financial institutions | 49,546 | 8,107 | 9,344 | 3,390 | 6,115 | 5,378 | 81,880 | 8.9 |
| Settlement accounts | 70,520 | 3,344 | 2,497 | 1,548 | 30,179 | 2,468 | 110,556 | 12.1 |
| Asset-backed securities reclassified | 69,909 | 2,523 | 2,196 | 1,539 | 29,845 | 2,390 | 108,402 | 11.9 |
| TGLAC ⁵ | 611 | 821 | 301 | 9 | 334 | 78 | 2,154 | 0.2 |
| Percentage of TGLAC by geographical region | 5,193 | | | | 979 | | 6,172 | 0.7 |
| Impaired loans as a percentage of TGLAC | 413,061 | 114,806 | 92,528 | 24,981 | 219,048 | 50,946 | 915,370 | 100.0 |
| Total impairment allowances | 45.1% | 12.6% | 10.1% | 2.7% | 23.9% | 5.6% | 100.0% | |
| | 10,257 | 814 | 1,146 | 1,978 | 11,119 | 2,573 | 27,887 | |
| | 2.5% | 0.7% | 1.2% | 7.9% | 5.1% | 5.1% | 3.0% | |
| | 5,835 | 731 | 856 | 1,587 | 10,907 | 2,117 | 22,033 | |

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| as a percentage of TGLAC | 1.4% | 0.6% | 0.9% | 6.4% | 5.0% | 4.2% | 2.4% | |
|--|---------|---------|---------|--------|---------|--------|---------|-------|
| At 31 December 2010 | | | | | | | | |
| Personal | 161,717 | 57,308 | 40,184 | 5,371 | 139,117 | 21,623 | 425,320 | 43.4 |
| Residential mortgages ² | 111,618 | 42,488 | 28,724 | 1,751 | 78,842 | 5,258 | 268,681 | 27.4 |
| Other personal ³ | 50,099 | 14,820 | 11,460 | 3,620 | 60,275 | 16,365 | 156,639 | 16.0 |
| Corporate and commercial ⁶ | 203,804 | 80,823 | 67,247 | 19,560 | 38,707 | 35,371 | 445,512 | 45.6 |
| Commercial, industrial and international trade | 111,980 | 33,451 | 41,274 | 11,173 | 16,737 | 23,079 | 237,694 | 24.3 |
| Commercial real estate | 30,629 | 19,678 | 8,732 | 1,085 | 8,768 | 2,988 | 71,880 | 7.3 |
| Other property-related | 6,401 | 15,232 | 5,426 | 1,785 | 5,109 | 885 | 34,838 | 3.6 |
| Government | 2,289 | 2,339 | 415 | 1,345 | 89 | 2,117 | 8,594 | 0.9 |
| Other commercial ⁴ | 52,505 | 10,123 | 11,400 | 4,172 | 8,004 | 6,302 | 92,506 | 9.5 |
| Financial Non-bank financial institutions | 70,725 | 3,189 | 2,259 | 1,347 | 21,202 | 3,003 | 101,725 | 10.4 |
| Settlement accounts | 70,019 | 2,824 | 2,058 | 1,335 | 21,109 | 2,818 | 100,163 | 10.2 |
| Asset-backed securities reclassified | 706 | 365 | 201 | 12 | 93 | 185 | 1,562 | 0.2 |
| | 5,216 | | | | 676 | | 5,892 | 0.6 |
| TGLAC ⁵ | 441,462 | 141,320 | 109,690 | 26,278 | 199,702 | 59,997 | 978,449 | 100.0 |
| Percentage of TGLAC by geographical region | 45.2% | 14.4% | 11.2% | 2.7% | 20.4% | 6.1% | 100.0% | |
| Impaired loans as a percentage of TGLAC | 10,557 | 660 | 1,324 | 2,433 | 10,727 | 2,390 | 28,091 | |
| | 2.4% | 0.5% | 1.2% | 9.3% | 5.4% | 4.0% | 2.9% | |
| Total impairment allowances as a percentage of TGLAC | 5,663 | 629 | 959 | 1,652 | 9,170 | 2,010 | 20,083 | |
| | 1.3% | 0.4% | 0.9% | 6.3% | 4.6% | 3.4% | 2.1% | |

For footnotes, see page 146.

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Interim Management Report (continued)*Gross loans and advances to customers by country*

| | Residential mortgages US\$m | Other personal US\$m | Property- related US\$m | Commercial, international trade and other US\$m | Total US\$m |
|--|-----------------------------------|----------------------------|-------------------------------|--|----------------|
| At 30 June 2011 | | | | | |
| Europe | 119,993 | 52,390 | 38,255 | 281,025 | 491,663 |
| UK | 110,768 | 25,666 | 26,486 | 189,926 | 352,846 |
| France | 3,864 | 10,233 | 9,316 | 66,192 | 89,605 |
| Germany | 11 | 339 | 51 | 4,929 | 5,330 |
| Malta | 1,850 | 645 | 585 | 1,740 | 4,820 |
| Switzerland | 1,502 | 12,043 | 165 | 2,250 | 15,960 |
| Turkey | 858 | 3,053 | 253 | 3,799 | 7,963 |
| Other | 1,140 | 411 | 1,399 | 12,189 | 15,139 |
| Hong Kong | 45,496 | 16,208 | 36,476 | 61,763 | 159,943 |
| Rest of Asia-Pacific | 32,224 | 12,076 | 15,371 | 62,586 | 122,257 |
| Australia | 9,418 | 1,384 | 2,375 | 5,192 | 18,369 |
| India | 949 | 446 | 732 | 3,989 | 6,116 |
| Indonesia | 84 | 511 | 112 | 4,283 | 4,990 |
| Japan | 244 | 193 | 1,163 | 1,922 | 3,522 |
| Mainland China | 2,441 | 307 | 4,332 | 14,115 | 21,195 |
| Malaysia | 4,158 | 2,125 | 1,344 | 6,289 | 13,916 |
| Singapore | 7,799 | 4,035 | 3,700 | 9,155 | 24,689 |
| South Korea | 2,312 | 205 | 96 | 3,015 | 5,628 |
| Taiwan | 3,261 | 578 | 129 | 3,997 | 7,965 |
| Vietnam | 45 | 211 | 78 | 1,457 | 1,791 |
| Other | 1,513 | 2,081 | 1,310 | 9,172 | 14,076 |
| Middle East and North Africa (excluding Saudi Arabia) | 1,791 | 3,405 | 2,934 | 19,133 | 27,263 |
| Egypt | 3 | 407 | 135 | 2,644 | 3,189 |
| Qatar | 9 | 455 | 417 | 1,323 | 2,204 |
| UAE | 1,500 | 1,915 | 1,451 | 11,386 | 16,252 |
| Other | 279 | 628 | 931 | 3,780 | 5,618 |

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| | | | | | |
|----------------------|----------------|----------------|----------------|----------------|------------------|
| North America | 76,690 | 54,986 | 13,064 | 42,804 | 187,544 |
| US | 55,118 | 46,396 | 7,865 | 26,443 | 135,822 |
| Canada | 19,824 | 8,095 | 4,674 | 15,864 | 48,457 |
| Bermuda | 1,748 | 495 | 525 | 497 | 3,265 |
| Latin America | 5,897 | 18,194 | 4,289 | 39,570 | 67,950 |
| Argentina | 30 | 1,140 | 119 | 2,405 | 3,694 |
| Brazil | 1,554 | 12,156 | 1,781 | 20,219 | 35,710 |
| Mexico | 2,214 | 2,650 | 1,424 | 9,600 | 15,888 |
| Panama | 1,186 | 1,011 | 669 | 4,389 | 7,255 |
| Other | 913 | 1,237 | 296 | 2,957 | 5,403 |
| | | | | | |
| | | | | | |
| Total | 282,091 | 157,259 | 110,389 | 506,881 | 1,056,620 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Gross loans and advances to customers by country (continued)*

| | Residential mortgages US\$m | Other personal US\$m | Property- related US\$m | Commercial, international trade and other US\$m | Total US\$m |
|---|-----------------------------------|----------------------------|-------------------------------|--|----------------|
| At 30 June 2010 | | | | | |
| Europe | 103,485 | 47,316 | 35,294 | 226,966 | 413,061 |
| UK | 95,525 | 25,569 | 25,478 | 167,553 | 314,125 |
| France | 3,590 | 8,588 | 7,711 | 41,414 | 61,303 |
| Germany | 9 | 340 | 88 | 3,531 | 3,968 |
| Malta | 1,508 | 514 | 551 | 1,393 | 3,966 |
| Switzerland | 1,198 | 9,316 | 63 | 1,457 | 12,034 |
| Turkey | 773 | 2,650 | 223 | 2,676 | 6,322 |
| Other | 882 | 339 | 1,180 | 8,942 | 11,343 |
| Hong Kong | 37,394 | 13,340 | 28,901 | 35,171 | 114,806 |
| Rest of Asia-Pacific | 23,289 | 10,348 | 11,339 | 47,552 | 92,528 |
| Australia | 6,176 | 966 | 1,942 | 3,734 | 12,818 |
| India | 855 | 635 | 564 | 4,160 | 6,214 |
| Indonesia | 67 | 549 | 104 | 2,563 | 3,283 |
| Japan | 163 | 156 | 820 | 2,193 | 3,332 |
| Mainland China | 1,770 | 307 | 3,068 | 10,218 | 15,363 |
| Malaysia | 3,374 | 1,839 | 1,064 | 4,489 | 10,766 |
| Singapore | 5,380 | 3,204 | 2,676 | 6,379 | 17,639 |
| South Korea | 2,063 | 299 | 29 | 2,539 | 4,930 |
| Taiwan | 2,315 | 473 | 78 | 2,565 | 5,431 |
| Vietnam | 27 | 129 | 54 | 1,364 | 1,574 |
| Other | 1,099 | 1,791 | 940 | 7,348 | 11,178 |
| Middle East and North Africa (excluding Saudi Arabia) | 1,789 | 3,974 | 2,795 | 16,423 | 24,981 |
| Egypt | 4 | 360 | 95 | 2,314 | 2,773 |

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| | | | | | |
|---------------|---------|---------|---------|---------|---------|
| Qatar | 9 | 541 | 510 | 779 | 1,839 |
| UAE | 1,531 | 2,436 | 1,359 | 9,933 | 15,259 |
| Other | 245 | 637 | 831 | 3,397 | 5,110 |
| | | | | | |
| North America | 81,811 | 67,058 | 19,094 | 51,085 | 219,048 |
| | | | | | |
| US | 61,339 | 58,731 | 8,635 | 37,910 | 166,615 |
| Canada | 18,829 | 7,791 | 9,953 | 12,442 | 49,015 |
| Bermuda | 1,643 | 536 | 506 | 733 | 3,418 |
| | | | | | |
| Latin America | 5,080 | 15,168 | 3,035 | 27,663 | 50,946 |
| | | | | | |
| Argentina | 29 | 743 | 56 | 2,034 | 2,862 |
| Brazil | 806 | 9,998 | 1,164 | 12,853 | 24,821 |
| Mexico | 2,217 | 2,423 | 995 | 6,767 | 12,402 |
| Panama | 1,150 | 963 | 474 | 3,445 | 6,032 |
| Other | 878 | 1,041 | 346 | 2,564 | 4,829 |
| | | | | | |
| Total | 252,848 | 157,204 | 100,458 | 404,860 | 915,370 |

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Interim Management Report (continued)

| | Residential mortgages US\$m | Other personal US\$m | Property- related US\$m | Commercial, international trade and other US\$m | Total US\$m |
|---|-----------------------------------|----------------------------|-------------------------------|--|----------------|
| At 31 December 2010 | | | | | |
| Europe | 111,618 | 50,099 | 37,030 | 242,715 | 441,462 |
| UK | 103,037 | 25,636 | 26,002 | 165,283 | 319,958 |
| France | 3,749 | 9,550 | 8,737 | 56,613 | 78,649 |
| Germany | 11 | 356 | 79 | 4,015 | 4,461 |
| Malta | 1,656 | 599 | 563 | 1,643 | 4,461 |
| Switzerland | 1,358 | 10,708 | 114 | 1,837 | 14,017 |
| Turkey | 809 | 2,817 | 210 | 2,783 | 6,619 |
| Other | 998 | 433 | 1,325 | 10,541 | 13,297 |
| Hong Kong | 42,488 | 14,820 | 34,910 | 49,102 | 141,320 |
| Rest of Asia-Pacific | 28,724 | 11,460 | 14,158 | 55,348 | 109,690 |
| Australia | 8,405 | 1,267 | 2,346 | 4,867 | 16,885 |
| India | 920 | 526 | 680 | 4,583 | 6,709 |
| Indonesia | 74 | 531 | 115 | 3,374 | 4,094 |
| Japan | 226 | 199 | 1,214 | 2,503 | 4,142 |
| Mainland China | 2,046 | 310 | 3,836 | 12,932 | 19,124 |
| Malaysia | 3,833 | 2,053 | 1,361 | 4,845 | 12,092 |
| Singapore | 6,571 | 3,661 | 3,262 | 7,846 | 21,340 |
| South Korea | 2,295 | 248 | 58 | 2,494 | 5,095 |
| Taiwan | 3,002 | 527 | 135 | 2,832 | 6,496 |
| Vietnam | 35 | 162 | 59 | 1,255 | 1,511 |
| Other | 1,317 | 1,976 | 1,092 | 7,817 | 12,202 |
| Middle East and North Africa (excluding Saudi Arabia) | 1,751 | 3,620 | 2,870 | 18,037 | 26,278 |
| Egypt | 3 | 396 | 111 | 2,484 | 2,994 |
| Qatar | 8 | 491 | 404 | 918 | 1,821 |
| UAE | 1,477 | 2,099 | 1,359 | 11,043 | 15,978 |
| Other | 263 | 634 | 996 | 3,592 | 5,485 |
| | 78,842 | 60,275 | 13,877 | 46,708 | 199,702 |

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North America

| | | | | | |
|---------|--------|--------|-------|--------|---------|
| US | 57,630 | 51,686 | 8,269 | 31,496 | 149,081 |
| Canada | 19,505 | 8,070 | 5,079 | 14,711 | 47,365 |
| Bermuda | 1,707 | 519 | 529 | 501 | 3,256 |

| | | | | | |
|---------------|-------|--------|-------|--------|--------|
| Latin America | 5,258 | 16,365 | 3,873 | 34,501 | 59,997 |
|---------------|-------|--------|-------|--------|--------|

| | | | | | |
|-----------|-------|--------|-------|--------|--------|
| Argentina | 30 | 918 | 103 | 2,172 | 3,223 |
| Brazil | 1,111 | 10,979 | 1,816 | 17,093 | 30,999 |
| Mexico | 2,097 | 2,365 | 1,146 | 8,622 | 14,230 |
| Panama | 1,155 | 982 | 489 | 3,794 | 6,420 |
| Other | 865 | 1,121 | 319 | 2,820 | 5,125 |

| | | | | | |
|-------|---------|---------|---------|---------|---------|
| Total | 268,681 | 156,639 | 106,718 | 446,411 | 978,449 |
|-------|---------|---------|---------|---------|---------|

Loans and advances to banks by geographical region

| | Hong Kong | Rest of Asia- Pacific | MENA US\$m | North America US\$m | Latin America US\$m | Total US\$m | Impair- ment allowances US\$m |
|------------------------------------|---------------|-----------------------------|---------------|---------------------------|---------------------------|----------------|--|
| At 30 June 2011⁷ | 83,153 | 37,334 | 50,331 | 7,786 | 19,865 | 226,205 | (162) |
| At 30 June 2010 | 82,119 | 31,633 | 35,338 | 8,644 | 17,132 | 196,461 | (165) |
| At 31 December 2010 | 78,239 | 33,585 | 40,437 | 9,335 | 19,479 | 208,429 | (158) |

For footnote, see page 146.

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Interim Management Report (continued)

Areas of special interest

Wholesale lending

Wholesale lending covers the range of credit facilities granted to sovereign borrowers, banks, non-bank financial institutions and corporate entities. Our wholesale portfolios are well diversified across geographical and industry sectors, with certain exposures subject to specific portfolio controls. Loan impairment charges fell during the first half of 2011, as economies generally demonstrated signs of recovery.

We continued to closely manage our exposure to sovereign debt in the first half of 2011. The overall quality of the portfolio was strong with most in-country and cross-border limits extended to countries with high-grade internal credit risk ratings. We regularly update our assessment of higher risk countries and adjust our risk appetite accordingly.

Exposures to countries in the eurozone

The eurozone as a whole retained substantial economic and financial strength and demonstrated positive signs of economic recovery in the first half of 2011, despite the stresses from the financial crisis.

However, the transfer of private sector liabilities to sovereign bodies which started after the 2007 financial crisis continued to put pressure on government balance sheets. The resulting fiscal imbalance in some industrialised economies led to intensified market concerns about sovereign credit risk in these countries.

In the first half of 2011, there were periods of significant market volatility related to a number of sovereigns in the eurozone, notably Greece, Ireland, Portugal, Italy and Spain. Sovereign spreads remained high and the lack of market access eventually resulted in Portugal joining Greece and Ireland in seeking bailout funding amounting to 78bn (US\$113bn) from the European Financial Stability Facility (EFSF) and International Monetary Fund (IMF) in early April 2011. Political instability in Greece, Ireland and Portugal also exacerbated the situation and all three countries were downgraded by major credit rating agencies during the period. Italy and Spain made progress in implementing fiscal adjustments and banking reforms but still experienced volatility in credit spreads.

The tables overleaf summarise our exposures to selected eurozone countries, including:

governments and central banks of selected eurozone countries along with near/quasi government agencies;

banks; and

other financial institutions and other corporates.

Exposures to banks, other financial institutions and other corporates are based on the country of domicile of the counterparty.

The countries presented were selected because during the period they exhibited levels of market volatility which exceeded other eurozone countries and demonstrated fiscal or political uncertainty which may persist through the second half of 2011. In addition, certain of these countries exhibit high sovereign debt to GDP ratios and short to medium-term maturity concentration of those liabilities. An analysis of loans and advances to customers by significant countries is provided on page 95.

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Off-balance sheet exposures mainly relate to commitments to lend and the amount shown in the tables represents the maximum amount that could be drawn down by the counterparty.

Eurozone sovereigns and agencies

Concerns remained over the capacity of certain sovereign borrowers to refinance given the problems with market liquidity and the uncertainty surrounding support arrangements in the longer term.

In July 2011, the second Greek support package was formalised as EU leaders announced a 3-year programme that included 109bn (US\$158bn) of new loans and a target of 37bn (US\$54bn) in bondholder commitments. In addition, EFSF rules were changed to allow EFSF to buy bonds on the secondary market, finance the recapitalisation of banks and provide pre-emptive credit lines to eurozone countries under pressure in debt markets. This is intended to help contain the fears of contagion to other eurozone countries. HSBC in principle supports this programme, which is expected to trigger a selective default as predicted by two of the three major rating agencies.

In the second half of 2011, we expect that the ECB and eurozone countries will continue to focus on resolving intra-eurozone imbalances, rebuilding public finances, improving fiscal discipline, strengthening the banking system and managing cross-border risk. Concerns of contagion of the debt crisis in Greece, Ireland and Portugal to other peripheral countries, notably Italy and Spain, may persist, causing the risk premium on most European countries to remain high.

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Interim Management Report (continued)

At 30 June 2011, our exposure to the sovereign and agency debt of Greece, Ireland, Italy, Portugal and Spain was US\$8.2bn. Of the total financial investments available for sale, approximately 43% matures within one year, 27% between one and three years and 30% in excess of three years.

During the first half of 2011, an impairment charge of US\$105m was recognised in respect of Greek sovereign and agency exposures classified as available for sale, reflecting the further deterioration in Greece's fiscal position and the recently announced support measures. The amount of the

impairment charge represented the cumulative fair value loss on these securities as at 30 June 2011, and does not necessarily represent the expectation of future cash losses. The impairment charge was recycled from the available-for-sale reserve to the income statement. Our sovereign exposures to Ireland, Portugal, Italy and Spain are not considered to be impaired at 30 June 2011 because, despite financial difficulties in these countries, the situation is not severe enough to conclude that loss events have occurred which will have an impact on the future cash flows of these countries' sovereign securities.

Exposures to selected eurozone countries – sovereigns and agencies

| | Greece US\$bn | Ireland US\$bn | Italy US\$bn | Portugal US\$bn | Spain US\$bn | Total US\$bn |
|---|------------------|-------------------|-----------------|--------------------|-----------------|-----------------|
| At 30 June 2011 | | | | | | |
| Cash and balances at central banks | 0.1 | | | | 0.1 | 0.2 |
| Assets held at amortised cost | | | 0.1 | | | 0.1 |
| Financial investments available for sale ⁸ | 0.2 | 0.1 | 1.5 | 0.1 | 1.0 | 2.9 |
| cumulative impairment | 0.1 | | | | | 0.1 |
| Net trading assets ⁹ | 0.7 | 0.2 | 3.0 | 0.4 | 0.3 | 4.6 |
| Derivatives ¹⁰ | 0.1 | 0.1 | | | 0.2 | 0.4 |
| Total | 1.1 | 0.4 | 4.6 | 0.5 | 1.6 | 8.2 |
| Off-balance sheet exposures | | | | | 0.7 | 0.7 |
| CDS asset positions | 0.9 | 0.2 | 0.2 | 0.2 | 0.2 | 1.7 |
| CDS liability positions | (0.7) | (0.2) | (0.2) | (0.2) | (0.2) | (1.5) |
| CDS asset notionals | 2.1 | 0.9 | 4.6 | 1.1 | 2.5 | 11.2 |
| CDS liability notionals | 1.8 | 1.0 | 4.5 | 1.0 | 2.6 | 10.9 |

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Exposures to selected eurozone countries – banks

| | Italy | | | | | |
|---|------------------|-------------------|------------|--------------------|-----------------|-----------------|
| | Greece US\$bn | Ireland US\$bn | US\$bn | Portugal US\$bn | Spain US\$bn | Total US\$bn |
| At 30 June 2011 | | | | | | |
| Loans and advances | 0.1 | 0.7 | 1.9 | 0.3 | 0.8 | 3.8 |
| Financial investments held to maturity | | 0.3 | 0.2 | | | 0.5 |
| Financial investments available for sale ⁸ | | 0.1 | 1.0 | 0.2 | 0.6 | 1.9 |
| Net trading assets ⁹ | | 0.8 | 0.4 | 0.1 | 1.6 | 2.9 |
| Derivatives ¹⁰ | 0.3 | 0.3 | 0.1 | | 0.5 | 1.2 |
| Total | 0.4 | 2.2 | 3.6 | 0.6 | 3.5 | 10.3 |
| Off-balance sheet exposures | 0.2 | | 0.4 | | | 0.6 |
| CDS asset positions | | 0.1 | 0.2 | 0.1 | 0.1 | 0.5 |
| CDS liability positions | | (0.1) | (0.2) | (0.1) | (0.1) | (0.5) |
| CDS asset notionals | | 0.3 | 4.3 | 0.7 | 1.5 | 6.8 |
| CDS liability notionals | | 0.3 | 4.0 | 0.9 | 2.0 | 7.2 |

For footnote, see page 146.

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Interim Management Report (continued)*Eurozone banks*

The banking sector in the eurozone remained under stress, mainly as a result of governments having to finance large budget deficits, weaknesses in property markets and slow credit growth. The size of the financial sector's exposure to sovereign debt in some eurozone countries rendered the re-capitalisation of European banks critical.

Concerns about the size and quality of eurozone banks' exposure to weaker eurozone countries were entwined with concerns about their ability to obtain funding. It is estimated that European banks share over three quarters of the banks' public and private sector debt in Greece, Ireland, Portugal, Italy and Spain, with regional and local banks in the eurozone considered to be more vulnerable than the diversified global banks. The second Greek rescue package announced in July 2011 involves the private sector sharing some economic loss. This is likely to put a strain on the banks with significant holdings of Greek bonds. The details of the plan, level of take-up and application will become clear in the second half of the year.

We expect that the pace of reforms outlined by various policymakers will gather speed in the second half of 2011, most notably the Basel III proposals. These regulations will require banks to hold more capital and a higher quality of capital and implement new liquidity rules, and are likely to result in a rise in the cost of funding and put pressure on credit pricing. The European Banking Authority published the results of this year's stress test on 15 July 2011. We successfully passed these tests with a core tier 1 ratio of 8.5% under the modelled adverse scenario, exceeding the post-stress minimum core tier 1 capital requirement of 5% used in this exercise.

Our overall exposure within the eurozone is largely to the banks in stronger countries. We continue to closely monitor and manage eurozone bank exposures in the weaker countries, and are cautious in lending to this sector. We regularly update our assessment of higher-risk eurozone banks and adjust our risk appetite accordingly. We also, where possible, seek to play a positive role in maintaining credit and liquidity supply. We have not recognised any impairment in respect of the exposures outlined above.

Exposures to selected eurozone countries – other financial institutions and corporates

| | Greece US\$bn | Ireland US\$bn | Italy US\$bn | Portugal US\$bn | Spain US\$bn | Total US\$bn |
|---|------------------|-------------------|-----------------|--------------------|-----------------|-----------------|
| At 30 June 2011 | | | | | | |
| Loans and advances | 3.5 | 2.4 | 1.1 | 0.1 | 5.4 | 12.5 |
| gross | 3.6 | 2.4 | 1.1 | 0.1 | 5.5 | 12.7 |
| impairment allowances | (0.1) | | | | (0.1) | (0.2) |
| Financial investments available for sale ⁸ | | | 0.3 | 0.1 | 0.2 | 0.6 |
| Net trading assets ⁹ | | | | | 0.1 | 0.1 |
| Derivatives ¹⁰ | | | | | 0.2 | 0.2 |
| Total | 3.5 | 2.4 | 1.4 | 0.2 | 5.9 | 13.4 |

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| Off-balance sheet exposures | 2.1 | 0.1 | 1.0 | | 0.2 |
|-----------------------------|-----|-----|-----|-------|-------|
| CDS asset positions | | 0.1 | | 0.1 | 0.2 |
| CDS liability positions | | | | (0.1) | (0.1) |
| CDS asset notionals | 0.3 | 0.7 | 2.8 | 0.6 | 1.1 |
| CDS liability notionals | 0.3 | 0.3 | 3.8 | 0.9 | 1.5 |
| | | | | | 6.8 |

For footnotes, see page 146.

Other financial institutions and other corporates

The credit quality of the other financial institutions and other corporates portfolios remains strong with no significant impairments recognised in respect of these portfolios. The portfolios largely comprise large multinational corporates and other financial institutions with significant operations outside these countries that mitigate the risk. At 30 June 2011, our exposure to Greek shipping companies amounted to US\$1.8bn. We believe the industry is less sensitive to the Greek economy as it is mainly dependent on international trade.

Personal lending

Our retail activities within these countries are limited, with our only significant exposures in Greece which amounted to US\$1.2bn. Substantially all of this exposure is in the form of residential mortgage lending where the level of delinquencies is low.

US budget deficit

In the US, the large budget deficit, growing government indebtedness and continued failure to reach agreement on raising the Federal debt ceiling

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Interim Management Report (continued)

have resulted in increased scrutiny during the first half of 2011, to the extent that two major rating agencies placed their US sovereign debt rating on negative watch. While the need to build a political consensus around the interplay of budget discipline and an increase in the current sovereign debt ceiling has been the immediate concern, there is an underlying risk that lower growth, fiscal challenges and a general lack of political consensus will result in a deterioration in the US credit standing over the longer term.

While the potential effects of a US downgrade are broad and impossible to accurately predict, they could include a widening of sovereign and corporate credit spreads, devaluation of the US dollar and a general market move away from riskier assets.

We are monitoring events closely and have stress-tested our capital position for potential scenarios.

Elevated risk of overheating in emerging markets

Market concerns emerged during the first half of 2011 about the overheating of certain emerging market countries, mainly due to the inflationary pressures, growth rates, risk of asset bubbles and large potentially volatile capital inflows they are experiencing. The policy makers in countries including mainland China, India and Brazil have taken steps to address these issues including increasing interest rates, restricting capital flows and raising reserve requirements. We regularly perform economic analyses and closely monitor our exposures to these countries.

Middle East and North Africa

Although significant unrest and political change were witnessed in the Middle East and North Africa in the first half of 2011, the majority of the Group's exposures in the region were concentrated in our associate investment in Saudi Arabia and in the UAE, where the respective political landscapes remained stable and economic growth continued to recover. In the remaining countries in which we have a presence and there was unrest or political change (or which exhibited similar socio-economic, political and demographic profiles to countries experiencing unrest), we continued to carefully monitor and respond to developments while assisting our customers in managing their own risks in the volatile environment.

We also continued to work closely with Dubai World and the various entities related to the Government of Dubai to address their prevailing issues. In March 2011, Dubai World signed a final

deal with HSBC and other creditors restructuring US\$25bn of its debt. The arrangement extends loan maturities for five to eight years at discounted rates, allowing Dubai World to sell off its non-core assets while focusing on its core earnings.

Commercial real estate

Our exposure to the commercial real estate sector is concentrated in Hong Kong, the UK and North America. In Hong Kong, the economy continued to grow and the market remained relatively buoyant during the first half of 2011, characterised by continuing demand and credit appetite. While the markets in the UK and North America have been relatively stable, this is in part supported by the continued low levels of interest rates.

On a constant currency basis, the aggregate of our commercial real estate and other property-related lending of US\$110bn at 30 June 2011 was in line with our exposure at 31 December 2010 and represented 10% of total loans and advances to customers. In the first half of 2011, credit quality across this sector was generally stable but there remains risk of stress in certain markets.

Across our portfolios, credit risk is mitigated by long-standing and conservative policies on asset origination which focus on relationships with long-term customers and limited initial leverage. We also set and monitor sector risk appetite limits for the sector at Group and regional levels to detect and prevent higher risk concentrations. While individual regions may differ with regard to local market regulatory and legal structures and

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real estate market characteristics, typically origination loan-to-value ratios would be less than 65% across the Group.

Personal lending

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Given the diverse nature of the markets in which we operate, the range is not standard across all countries but is tailored to meet the demands of individual markets while using appropriate distribution channels and, wherever possible, global IT platforms.

Personal lending includes advances to customers for asset purchases, such as residential property and motor vehicles, where the loans are typically secured by the assets being acquired. We also offer loans secured on existing assets, such as first and second liens on residential property; unsecured lending products such as overdrafts, credit cards and payroll loans; and debt consolidation loans which may be secured or unsecured.

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Interim Management Report (continued)

In the first half of 2011, credit quality in our personal lending portfolios improved, reflecting the continued recovery of economic conditions in most markets. Delinquency levels and loan impairment charges reduced as customer repayments remained strong, lending balances in the US run-off portfolios continued to decline and some higher-risk portfolios in Latin America, Rest of Asia-Pacific and the Middle East and North Africa were managed down.

The commentary that follows is on an underlying basis.

At 30 June 2011, total personal lending was US\$439bn, slightly higher than at 31 December 2010 as growth in the UK and Hong Kong was partly offset by the continued planned decline in personal lending balances in the US. Within our RBWM business, total loan impairment charges and other credit risk provisions of US\$4.3bn were 34% lower than in the first half of 2010 with the most significant fall in the US reflecting the reduction in balances and improved delinquency rates.

Total personal lending in the UK increased by 3% from 31 December 2010 to US\$136bn. The increase was mainly due to growth in mortgage balances following the success of marketing campaigns and high levels of customer retention. (UK mortgage lending is discussed in greater detail on page 104). This was partly offset by a 3% fall in other personal lending balances, reflecting a

reduction in unsecured lending products, specifically the credit cards portfolio.

In Hong Kong, total personal lending grew by 8% to US\$62bn, mainly due to growth in residential mortgage lending as the property market in the region remained strong, and as a result of our leadership in new mortgage business. Personal lending balances in Rest of Asia-Pacific also reflected a strong property sector with residential mortgage lending growth of 8%, most notably in Singapore and Australia.

Total personal lending balances in the US at 30 June 2011 were US\$102bn, a decrease of 7% compared with the end of 2010. The decline reflected lower balances in our Card and Retail Services portfolio due to fewer active accounts, an increased focus by customers on reducing outstanding credit card debt and seasonal improvements in our collection activities as our customers used tax refunds to make repayments. Residential mortgage lending balances in the US continued to fall reflecting the run-off of our Consumer Lending and Mortgage Services portfolios. Based on current experience, we expect these portfolio balances to decline to between 40% and 50% of the 31 December 2010 balance.

For an analysis of loan impairment allowances and impaired loans, see page 115.

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Interim Management Report (continued)*Total personal lending*

| | Rest of | | | | | Total |
|---|----------------|----------------|------------------|---------------|-----------------------------|-----------------|
| | UK | Rest of Europe | US ¹¹ | North America | Other regions ¹² | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | |
| At 30 June 2011 | | | | | | |
| Residential mortgages | 110,768 | 9,225 | 55,118 | 21,572 | 85,408 | 282,091 |
| Other personal lending | 25,666 | 26,724 | 46,396 | 8,590 | 49,883 | 157,259 |
| vehicle finance | | 29 | 60 | 38 | 5,918 | 6,045 |
| credit cards | 11,122 | 2,007 | 30,670 | 1,282 | 14,048 | 59,129 |
| second lien mortgages | 795 | 1 | 8,509 | 553 | 288 | 10,146 |
| other | 13,749 | 24,687 | 7,157 | 6,717 | 29,629 | 81,939 |
| Total personal lending | 136,434 | 35,949 | 101,514 | 30,162 | 135,291 | 439,350 |
| Impairment allowances on personal lending | | | | | | |
| Residential mortgages | (336) | (61) | (3,980) | (24) | (323) | (4,724) |
| Other personal lending | (920) | (475) | (3,299) | (131) | (1,681) | (6,506) |
| vehicle finance | | (4) | | | (233) | (237) |
| credit cards | (237) | (220) | (1,670) | (35) | (466) | (2,628) |
| second lien mortgages | (51) | | (697) | (12) | | (760) |
| other | (632) | (251) | (932) | (84) | (982) | (2,881) |
| Total | (1,256) | (536) | (7,279) | (155) | (2,004) | (11,230) |
| as a percentage of total personal lending | 0.9% | 1.5% | 7.2% | 0.5% | 1.5% | 2.6% |

| | | | | | | |
|-------------------------------|----------------|---------------|----------------|---------------|----------------|----------------|
| At 30 June 2010 | | | | | | |
| Residential mortgages | 95,525 | 7,960 | 61,339 | 20,472 | 67,552 | 252,848 |
| Other personal lending | 25,568 | 21,748 | 58,731 | 8,327 | 42,830 | 157,204 |
| vehicle finance | | 52 | 4,232 | 71 | 5,796 | 10,151 |
| credit cards | 11,066 | 1,777 | 33,844 | 1,304 | 12,442 | 60,433 |
| second lien mortgages | 895 | 1 | 10,373 | 594 | 467 | 12,330 |
| other | 13,607 | 19,918 | 10,282 | 6,358 | 24,125 | 74,290 |
| Total personal lending | 121,093 | 29,708 | 120,070 | 28,799 | 110,382 | 410,052 |

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| | | | | | | |
|---|----------------|---------------|----------------|---------------|----------------|-----------------|
| Impairment allowances on personal lending | | | | | | |
| Residential mortgages | (226) | (47) | (3,695) | (25) | (242) | (4,235) |
| Other personal lending | (1,241) | (538) | (5,970) | (175) | (1,850) | (9,774) |
| vehicle finance | | (6) | (174) | (1) | (302) | (483) |
| credit cards | (492) | (250) | (2,948) | (56) | (618) | (4,364) |
| second lien mortgages | (68) | | (1,212) | (25) | | (1,305) |
| other | (681) | (282) | (1,636) | (93) | (930) | (3,622) |
| Total | (1,467) | (585) | (9,665) | (200) | (2,092) | (14,009) |
| as a percentage of total personal lending | 1.2% | 2.0% | 8.0% | 0.7% | 1.9% | 3.4% |
| | | | | | | |
| At 31 December 2010 | | | | | | |
| Residential mortgages | 103,037 | 8,581 | 57,630 | 21,212 | 78,221 | 268,681 |
| Other personal lending | 25,636 | 24,463 | 51,686 | 8,589 | 46,265 | 156,639 |
| vehicle finance | | 35 | 72 | 55 | 5,886 | 6,048 |
| credit cards | 11,612 | 1,916 | 33,744 | 1,334 | 13,778 | 62,384 |
| second lien mortgages | 846 | 2 | 9,322 | 578 | 422 | 11,170 |
| other | 13,178 | 22,510 | 8,548 | 6,622 | 26,179 | 77,037 |
| Total personal lending | 128,673 | 33,044 | 109,316 | 29,801 | 124,486 | 425,320 |
| | | | | | | |
| Impairment allowances on personal lending | | | | | | |
| Residential mortgages | (275) | (58) | (3,592) | (25) | (297) | (4,247) |
| Other personal lending | (1,348) | (467) | (4,436) | (179) | (1,616) | (8,046) |
| vehicle finance | | (5) | | | (244) | (249) |
| credit cards | (506) | (216) | (2,256) | (62) | (483) | (3,523) |
| second lien mortgages | (58) | | (889) | (19) | | (966) |
| other | (784) | (246) | (1,291) | (98) | (889) | (3,308) |
| Total | (1,623) | (525) | (8,028) | (204) | (1,913) | (12,293) |
| as a percentage of total personal lending | 1.3% | 1.6% | 7.3% | 0.7% | 1.5% | 2.9% |

For footnotes, see page 146.

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Interim Management Report (continued)

Mortgage lending

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only, affordability and offset mortgages. The commentary that follows is on an underlying basis.

US mortgage lending

US mortgage lending balances, comprising residential and second lien lending, were US\$64bn at 30 June 2011, a decline of 5% compared with the end of 2010. Overall, US mortgage lending represented 14% of the Group's total personal lending compared with 16% at the 31 December 2010.

Mortgage lending in HSBC Finance was US\$47bn at 30 June 2011, a decline of 7% from 31 December 2010 due to the continued run-off in the Consumer Lending and Mortgage Services portfolios and the seasonal improvement in collections as some customers used tax refunds to make repayments. The rate at which balances declined slowed in the first half of 2011, as we continued to be affected by the lack of refinancing opportunities available to our customers, improvements in the flow of balances into late stage delinquency and delays in the foreclosure processes. See page 106 for a breakdown of mortgage lending in HSBC Finance.

In HSBC Bank USA, mortgage lending balances were US\$16bn at 30 June 2011, an increase of 2% compared with the end of 2010. We continued to sell the majority of new originations to the secondary market as a means of managing our interest rate risk and improving structural liquidity. Additions to our portfolio primarily comprise Premier relationship products.

Following an industry-wide examination into foreclosure practices in 2010, we temporarily suspended foreclosures while we worked to implement improvements in our processes. We worked closely with the regulators to address these issues quickly and effectively, and made several improvements to enhance our processes. We have now resumed foreclosures on a limited basis in certain states, but it will be a number of months before we fully resume foreclosures in all states as we need to ensure that all necessary enhancements have been satisfactorily implemented.

The effects of the industry-wide slowdown in foreclosures remains highly uncertain, particularly in the long-term, as servicers begin to increase foreclosure activity and sell properties in large numbers, which may result in a significant oversupply. This may lead to a substantial increase in losses on foreclosed properties.

A discussion of credit trends in the US mortgage lending portfolio and the steps taken to mitigate risk is provided in *US personal lending credit quality* on page 107.

Mortgage lending - rest of the world

Mortgage lending in the UK was US\$112bn at 30 June 2011, the Group's largest concentration of this exposure. The balance was 4% higher than at the end of 2010.

Our UK mortgage portfolio remained of high quality with an average loan-to-value ratio for new business of 53%. We restricted lending to purchase residential property for the purpose of rental, and almost all new business was originated through our own salesforce, with the self-certification of income not permitted. The majority of mortgage lending was to existing customers holding current or savings accounts with HSBC.

Loan impairment charges and delinquency levels in our UK mortgage book remained at low levels, reflecting the economic environment and low interest rates which helped to make mortgage repayments more affordable for customers, some of whom were actively reducing their

outstanding debt levels.

In Hong Kong, mortgage lending was US\$45bn, an increase of 7% compared with the end of 2010 as the local property market remained strong. The continued strong growth in the Hong Kong property market led the HKMA to reduce the maximum loan-to-value ratios for new loans in both the second half of 2010 and in June 2011. The quality of our mortgage book was good with an average loan-to-value ratio of 51% on new mortgage sales.

The following table shows the levels of mortgage lending products in the various portfolios in the US, the UK and the rest of the HSBC Group.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Mortgage lending products*

| | Rest | | | | | Total |
|---|----------------|----------------|------------------|------------------|-----------------------------|----------------|
| | UK | Rest of Europe | US ¹¹ | of North America | Other regions ¹² | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | |
| At 30 June 2011 | | | | | | |
| Residential mortgages | 110,768 | 9,225 | 55,118 | 21,572 | 85,408 | 282,091 |
| Second lien mortgages | 795 | 1 | 8,509 | 553 | 288 | 10,146 |
| Total mortgage lending | 111,563 | 9,226 | 63,627 | 22,125 | 85,696 | 292,237 |
| Second lien as percentage of total mortgage lending | 0.7% | | 13.4% | 2.5% | 0.3% | 3.5% |
| Impairment allowances on mortgage lending | (387) | (61) | (4,677) | (36) | (323) | (5,484) |
| Residential mortgages | (336) | (61) | (3,980) | (24) | (323) | (4,724) |
| Second lien mortgages | (51) | | (697) | (12) | | (760) |
| Interest-only (including endowment) mortgages | 45,730 | 54 | | 810 | 1,362 | 47,956 |
| Affordability mortgages, including ARMs | 692 | 572 | 17,789 | 276 | 7,816 | 27,145 |
| Other | 118 | | | | 195 | 313 |
| Total interest-only and affordability mortgages | 46,540 | 626 | 17,789 | 1,086 | 9,373 | 75,414 |
| as a percentage of total mortgage lending | 41.7% | 6.8% | 28.0% | 4.9% | 10.9% | 25.8% |
| Negative equity mortgages ¹³ | 2,365 | | 16,368 | 86 | 317 | 19,136 |
| Other loan-to-value ratios greater than 90% ¹⁴ | 5,925 | 265 | 9,168 | 1,648 | 1,193 | 18,199 |
| Total negative equity and other mortgages | 8,290 | 265 | 25,536 | 1,734 | 1,510 | 37,335 |
| as a percentage of total mortgage lending | 7.4% | 2.9% | 40.1% | 7.8% | 1.8% | 12.8% |
| At 30 June 2010 | | | | | | |
| Residential mortgages | 95,525 | 7,960 | 61,339 | 20,472 | 67,552 | 252,848 |
| Second lien mortgages | 895 | 1 | 10,373 | 594 | 467 | 12,330 |
| Total mortgage lending | 96,420 | 7,961 | 71,712 | 21,066 | 68,019 | 265,178 |

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| | | | | | | |
|---|--------|-------|---------|-------|-------|---------|
| Second lien as percentage of total mortgage lending | 0.9% | | 14.5% | 2.8% | 0.7% | 4.6% |
| Impairment allowances on mortgage lending | (294) | (47) | (4,907) | (50) | (242) | (5,540) |
| Residential mortgages | (226) | (47) | (3,695) | (25) | (242) | (4,235) |
| Second lien mortgages | (68) | | (1,212) | (25) | | (1,305) |
| Interest-only (including endowment) mortgages | 43,001 | 42 | | 1,028 | 1,090 | 45,161 |
| Affordability mortgages, including ARMs | 1,666 | 1,139 | 19,556 | 243 | 5,943 | 28,547 |
| Other | 125 | | | | 143 | 268 |
| | | | | | | |
| Total interest-only and affordability mortgages | 44,792 | 1,181 | 19,556 | 1,271 | 7,176 | 73,976 |
| | | | | | | |
| as a percentage of total mortgage lending | 46.5% | 14.8% | 27.3% | 6.0% | 10.5% | 27.9% |
| Negative equity mortgages ¹³ | 3,263 | | 17,783 | 127 | 496 | 21,669 |
| Other loan-to-value ratios greater than 90% ¹⁴ | 6,618 | | 11,418 | 1,785 | 1,367 | 21,188 |
| | | | | | | |
| Total negative equity and other mortgages | 9,881 | | 29,201 | 1,912 | 1,863 | 42,857 |
| | | | | | | |
| as a percentage of total mortgage lending | 10.2% | | 40.7% | 9.1% | 2.7% | 16.2% |

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Interim Management Report (continued)

| | UK | Rest of Europe | US ¹¹ | Rest of North America | Other regions ¹² | Total |
|---|----------------|----------------|------------------|-----------------------|-----------------------------|----------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 31 December 2010 | | | | | | |
| Residential mortgages | 103,037 | 8,581 | 57,630 | 21,212 | 78,221 | 268,681 |
| Second lien mortgages | 846 | 2 | 9,322 | 578 | 422 | 11,170 |
| Total mortgage lending | 103,883 | 8,583 | 66,952 | 21,790 | 78,643 | 279,851 |
| Second lien as percentage of total mortgage lending | 0.8% | | 13.9% | 2.7% | 0.5% | 4.0% |
| Impairment allowances on mortgage lending | (333) | (58) | (4,481) | (44) | (297) | (5,213) |
| Residential mortgages | (275) | (58) | (3,592) | (25) | (297) | (4,247) |
| Second lien mortgages | (58) | | (889) | (19) | | (966) |
| Interest-only (including endowment) mortgages | 45,039 | 51 | | 908 | 1,282 | 47,280 |
| Affordability mortgages, including ARMs | 1,089 | 326 | 18,494 | 274 | 7,855 | 28,038 |
| Other | 102 | | | | 183 | 285 |
| Total interest-only and affordability mortgages | 46,230 | 377 | 18,494 | 1,182 | 9,320 | 75,603 |
| as a percentage of total mortgage lending | 44.5% | 4.4% | 27.6% | 5.4% | 11.9% | 27.0% |
| Negative equity mortgages ¹³ | 2,436 | | 15,199 | 103 | 291 | 18,029 |
| Other loan-to-value ratios greater than 90% ¹⁴ | 5,802 | 263 | 10,460 | 1,698 | 1,348 | 19,571 |
| Total negative equity and other mortgages | 8,238 | 263 | 25,659 | 1,801 | 1,639 | 37,600 |
| as a percentage of total mortgage lending | 7.9% | 3.1% | 38.3% | 8.3% | 2.1% | 13.4% |

For footnotes, see page 146.

HSBC Finance held approximately US\$47bn of residential mortgage and second lien loans and advances to personal customers secured on real estate at 30 June 2011, 11% of the Group's gross loans and advances to personal customers. For a breakdown of these balances by portfolio, see below.

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HSBC Finance US mortgage lending¹⁵

| | At 30 June 2011 | | | At 30 June 2010 | | | At 31 December 2010 | | |
|---|-------------------------|------------------------|------------------------------|-------------------------|------------------------|------------------------------|-------------------------|------------------------|------------------------------|
| | Mortgage Services US\$m | Consumer Lending US\$m | Other mortgage lending US\$m | Mortgage Services US\$m | Consumer Lending US\$m | Other mortgage lending US\$m | Mortgage Services US\$m | Consumer Lending US\$m | Other mortgage lending US\$m |
| Fixed rate | 10,768 | 29,706 | 80 | 12,436 | 34,523 | 97 | 11,447 | 31,759 | 87 |
| Other | 5,325 | 1,391 | 2 | 7,084 | 1,653 | 5 | 6,122 | 1,517 | 2 |
| Adjustable-rate Interest-only (affordability mortgages) ¹⁶ | 4,445 | 1,391 | 2 | 5,799 | 1,653 | 5 | 5,042 | 1,517 | 2 |
| | 880 | | | 1,285 | | | 1,080 | | |
| | 16,093 | 31,097 | 82 | 19,520 | 36,176 | 102 | 17,569 | 33,276 | 89 |
| First lien | 14,123 | 28,092 | 61 | 16,898 | 32,296 | 77 | 15,300 | 29,950 | 66 |
| Second lien | 1,970 | 3,005 | 21 | 2,622 | 3,880 | 25 | 2,269 | 3,326 | 23 |
| | 16,093 | 31,097 | 82 | 19,520 | 36,176 | 102 | 17,569 | 33,276 | 89 |
| Stated income ¹⁷ | 2,571 | | | 3,360 | | | 2,905 | | |
| Negative equity mortgages ¹³ | 5,326 | 9,770 | | 6,096 | 10,413 | | 5,161 | 8,910 | |
| Impairment allowances as a percentage of total mortgage lending | 1,783 11.1% | 2,721 8.8% | | 1,931 9.9% | 2,695 7.4% | 1 1.0% | 1,837 10.5% | 2,474 7.4% | |

For footnotes, see page 146.

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Interim Management Report (continued)

US personal lending

Credit quality

During the first half of 2011, economic conditions in the US improved marginally, although the pace of the recovery in the second quarter slowed as a result of higher energy costs, supply disruptions in the manufacturing sector and a significant reduction in the pace of job creation. These factors undermined consumer confidence, which continued to be low by historical standards. In addition, uncertainty remained in the housing market resulting in continuing house price declines in many states.

Unemployment rates, which have been a major factor in the deterioration of credit quality and continue to affect our allowance for loan impairments, improved but remained high at 9.2% in June 2011, down from 9.4% in December 2010 and some 40 basis points higher than in March 2011. Unemployment rates were at or above the US national average in 18 states and were at or above 10% in 7 states, including California and Florida where we have lending balances in excess of 5% of HSBC Finance's total loan balance.

An improvement in the US economy depends on a sustained recovery in the housing market, a fall in unemployment rates, the stabilisation of energy prices and improved consumer confidence. Any further weakening in these factors may adversely affect consumer payment patterns and credit quality.

Mortgage lending

In the first half of 2011, we further reduced our mortgage exposure in the US as balances continued to run-off in our Consumer Lending and Mortgage Services portfolios, as discussed on page 104. At 30 June 2011, residential mortgage lending balances were US\$55bn, a decline of 4% compared with the end of 2010.

Real estate markets in the majority of the US have been, and will continue to be, affected by stagnation or declines in property values. As a result, loan-to-value ratios for our real estate secured loans have generally deteriorated since origination. At 30 June 2011, loans in negative equity were US\$16bn, compared with US\$15bn at the end of 2010.

In both our Consumer Lending and Mortgage Services portfolios, despite continued high unemployment levels, two months or more delinquent balances declined compared with the end of 2010 as lending balances continued to run-off and economic conditions continued to recover. We also experienced

seasonal improvements in our collections as some of our customers used tax refunds to repay outstanding debt. The reduction was partly offset by our suspension of foreclosure activities, which resulted in a slowing in the rate at which lending balances were transferred to foreclosed. As a result of these factors, in our Consumer Lending portfolio two months or more delinquency rates improved from 16.2% at 31 December 2010 to 15.7%, while in our Mortgage Services portfolio they improved from 18.0% to 17.2%.

At HSBC Bank USA, two months or more delinquency rates improved from 7.9% to 7.6% at 31 December 2010, reflecting the improved credit quality, partly offset by the effects of higher levels of unemployment, the continued weakness in the housing market and the suspension of foreclosure activities, as discussed above.

Second lien mortgage loans have a risk profile characterised by higher loan-to-value ratios because in the majority of cases the loans were taken out to complete the refinancing of properties. Loss experience on default of second lien loans has typically approached 100% of the amount outstanding, as any equity in the property is initially applied to the first lien loan. In the US, second lien mortgage balances declined by 9% to US\$9bn, representing 13% of the overall US mortgage lending portfolio. Two months or more delinquency rates improved from 9.1% at 31 December 2010 to 7.6% at 30 June 2011.

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As previously reported, beginning in late 2010 we temporarily suspended all new foreclosure proceedings and in early 2011 ceased foreclosures where judgement had yet to be entered while we enhanced our processes. As a result, and together with an increase in sales, the number of foreclosed properties at HSBC Finance at 30 June 2011 decreased compared with the end of December 2010. We expect the number of foreclosed properties added to the inventory to remain low through the remainder of 2011 as the effects of the foreclosure suspension continue to be reflected in our reported numbers.

The average total loss on foreclosed properties increased slightly compared with the end of 2010 as a result of the continued declines in house prices, partly attributable to the high levels of foreclosed properties. The average loss on sale of foreclosed properties decreased compared with the end of 2010, reflecting lower sales of properties located in states that have experienced the greatest deterioration in house prices in the past few years.

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HSBC Finance: geographical concentration of US lending^{15,18}

| | Mortgage lending as a percentage of: | | Other personal lending as a percentage of: | | Percentage of total lending |
|--------------|--------------------------------------|------------------------|--|------------------------------|-----------------------------|
| | total lending | total mortgage lending | total lending | total other personal lending | |
| | % | % | % | % | |
| California | 6 | 10 | 4 | 10 | 10 |
| New York | 4 | 7 | 3 | 7 | 7 |
| Florida | 3 | 6 | 2 | 5 | 6 |
| Texas | 2 | 4 | 3 | 7 | 5 |
| Pennsylvania | 3 | 6 | 2 | 5 | 6 |
| Ohio | 3 | 6 | 2 | 5 | 5 |

For footnotes, see page 146.

HSBC Finance: foreclosed properties in the US

| | Half year | Quarter ended | | | |
|---|------------|---------------|----------|-------------|--------------|
| | to 30 June | 30 June | 31 March | 31 December | 30 September |
| | 2011 | 2011 | 2011 | 2010 | 2010 |
| Number of foreclosed properties at end of period | 6,982 | 6,982 | 10,204 | 10,940 | 9,798 |
| Number of properties added to foreclosed inventory in the half year/quarter | 8,071 | 2,548 | 5,523 | 5,763 | 5,413 |
| Average loss on sale of foreclosed properties ¹⁹ | 14% | 13% | 15% | 15% | 10% |
| Average total loss on foreclosed properties ²⁰ | 55% | 55% | 55% | 54% | 52% |
| Average time to sell foreclosed properties (days) | 168 | 169 | 167 | 165 | 158 |

For footnotes, see page 146.

Credit cards

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In our US credit card business, which comprises both general and private label cards, lending balances declined by 9% from the end of 2010 to US\$31bn despite consumer spending remaining relatively strong. The fall reflected fewer active accounts, an increase in focus by customers on reducing outstanding debt, seasonal improvements in our collections as some customers used tax refunds to repay credit card debt, lower balances in certain segments of the portfolio where we no longer originate new accounts and, in the private label portfolio, the exit of certain merchant relationships. Credit quality continued to improve in the first half of 2011, reflecting improved customer payment patterns which led to a continued fall in delinquency rates. In our credit card portfolio, two months or more delinquency rates declined to 3.3% at 30 June 2011, while in our private label cards portfolio, two months or more delinquency rates decreased to 2.4% at 30 June 2011.

Other personal lending

Unsecured personal lending balances in the US continued to fall, largely due to run-off. Two months or more delinquency rates declined reflecting the run-off and seasonal improvement in collections.

Loan delinquency

The table overleaf sets out the trends in two months and over contractual delinquencies.

Forbearance strategies and renegotiated loans

For a description of current policies and practices regarding forbearance and renegotiated loans, see page 150. There were no significant changes to them in the period.

Renegotiated loans that would otherwise be past due or impaired totalled US\$33bn at 30 June 2011 (30 June 2010: US\$36bn; 31 December 2010: US\$35bn). The largest concentration was in the US and amounted to US\$26bn or 78% (30 June 2010: US\$31bn or 85%; 31 December 2010: US\$28bn or 82%) of our total renegotiated loans, substantially all of which were held by HSBC Finance.

The second largest concentration was in Latin America and amounted to US\$3bn (30 June 2010: US\$1bn; 31 December 2010: US\$2bn), constituting 10% of total renegotiated loans (30 June 2010: 3%; 31 December 2010: 5%). Although, Europe and the UK in particular represented the single largest lending portfolio, forbearance activities remained limited and renegotiated loans in the UK totalled only US\$2bn (30 June 2010: US\$2bn; 31 December 2010: US\$2bn), reflecting the quality of the portfolios including the residential mortgage book.

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Interim Management Report (continued)

Similarly, the continued economic growth in Hong Kong and Rest of Asia-Pacific meant that forbearance activity remained low and renegotiated loans totalled only US\$0.4bn and US\$0.5bn, respectively (30 June 2010: US\$0.4bn and US\$0.5bn; 31 December 2010: US\$0.3bn and US\$0.5bn).

HSBC Finance loan modifications and re-ageing

HSBC Finance maintains customer account management policies and practices, including account modification and re-age programmes. Modification occurs when the terms of a loan are changed either temporarily or permanently. Modification may also lead to a re-ageing of an account, although it may be re-aged without any modification to the original terms and conditions of the loan. In the first half of 2011, HSBC Finance modified 18,700 loans in Consumer Lending and Mortgage Services through its foreclosure avoidance and account modification programmes, with an aggregate balance of US\$2.6bn.

At 30 June 2011, the total balance outstanding on HSBC Finance real estate secured accounts which had been re-aged or modified was US\$25.4bn, compared with US\$26.7bn at the end of 2010. US\$10.4bn related to loans that had been re-aged without modification to the terms (30 June 2010: US\$10.7bn; 31 December 2010: US\$10.6bn), and US\$13.3bn related to loans whose terms had been modified and re-aged (30 June 2010: US\$14.6bn; 31 December 2010: US\$13.9bn). These amounts are included in the renegotiated loans balance disclosed above. In addition, US\$1.7bn of loans had been modified but not re-aged (30 June 2010: US\$3.1bn; 31 December 2010: US\$2.2bn) and as such did not meet the definition of a renegotiated loan as the impairment or past-due status of the loans did not change on modification. At 30 June 2011, 66% of modified or re-aged real estate loans remained up-to-date or past due less than 30 days (30 June 2010: 63%; 31 December 2010: 62%) and 24% were two or more months delinquent (30 June 2010: 25%; 31 December 2010: 26%).

Trends in two months and over contractual delinquency in the US

| | At 30 Jun 2011 US\$m | At 31 Dec 2010 US\$m | At 30 Jun 2010 US\$m |
|--------------------------------------|-------------------------------|-------------------------------|-------------------------------|
| In Personal Lending in the US | | | |
| Residential mortgages | 7,864 | 8,632 | 8,591 |
| Second lien mortgage lending | 646 | 847 | 930 |
| Vehicle finance | | | 152 |
| Credit card | 628 | 957 | 1,201 |
| Private label | 285 | 404 | 478 |
| Personal non-credit card | 517 | 811 | 987 |
| Total | 9,940 | 11,651 | 12,339 |

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| | % | % | % |
|------------------------------|--------------|-------|-------|
| | 21 | 21 | 21 |
| Residential mortgages | 14.28 | 15.00 | 14.02 |
| Second lien mortgage lending | 7.60 | 9.10 | 8.98 |
| Vehicle finance | | | 3.59 |
| Credit card | 3.33 | 4.69 | 5.65 |
| Private label | 2.41 | 3.03 | 3.80 |
| Personal non-credit card | 7.22 | 9.49 | 9.60 |
| Total | 9.80 | 10.67 | 10.28 |

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Interim Management Report (continued)

| | At 30 Jun 2011 US\$m | At 31 Dec 2010 US\$m | At 30 Jun 2010 US\$m |
|---|-------------------------------|-------------------------------|-------------------------------|
| In Mortgage Services and Consumer Lending²² | | | |
| Mortgage Services: | | | |
| first lien | 2,596 | 3,002 | 3,067 |
| second lien | 2,432 | 2,757 | 2,788 |
| | 164 | 245 | 279 |
| Consumer Lending: | | | |
| first lien | 4,734 | 5,284 | 5,278 |
| second lien | 4,420 | 4,861 | 4,795 |
| | 314 | 423 | 483 |
| | % ²¹ | % ²¹ | % ²¹ |
| Mortgage Services: | | | |
| first lien | 17.22 | 18.02 | 16.50 |
| second lien | 8.32 | 10.80 | 10.63 |
| total | 16.13 | 17.09 | 15.71 |
| Consumer Lending: | | | |
| first lien | 15.73 | 16.23 | 14.85 |
| second lien | 10.46 | 12.72 | 12.44 |
| total | 15.22 | 15.88 | 14.59 |

For footnotes, see page 146.

Credit quality of financial instruments

The five classifications describing the credit quality of HSBC's lending, debt securities portfolios and derivatives are set out in the Appendix to Risk on page 150 and defined on page 114 of the *Annual Report and Accounts 2010*. Additional credit quality information in respect of our consolidated holdings of ABSs is provided on page 121.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10 are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Distribution of financial instruments by credit quality*

| | Neither past due nor impaired Satisfactory | | | Past due | | Impair- | | Total |
|--|---|----------------|----------------|---------------|---------------|---------------|--------------------------|------------------|
| | Strong | Good | | Sub- | but not | Impaired | ment | |
| | US\$m | US\$m | US\$m | standard | impaired | US\$m | allowances ²⁵ | US\$m |
| | | | | US\$m | US\$m | | US\$m | |
| At 30 June 2011 | | | | | | | | |
| Cash and balances at central banks | 66,860 | 999 | 229 | 130 | | | | 68,218 |
| Items in the course of collection from other banks | 14,107 | 658 | 291 | 2 | | | | 15,058 |
| Hong Kong Government certificates of indebtedness | 19,745 | | | | | | | 19,745 |
| Trading assets ²⁶ | 318,456 | 51,432 | 62,735 | 5,609 | | | | 438,232 |
| treasury and other eligible bills | 21,488 | 1,197 | 1,214 | | | | | 23,899 |
| debt securities | 173,233 | 10,726 | 22,215 | 2,631 | | | | 208,805 |
| loans and advances: | | | | | | | | |
| to banks | 73,490 | 20,773 | 4,347 | 1,524 | | | | 100,134 |
| to customers | 50,245 | 18,736 | 34,959 | 1,454 | | | | 105,394 |
| Financial assets designated at fair value ²⁶ | 7,856 | 5,356 | 6,700 | 65 | | | | 19,977 |
| treasury and other eligible bills | 207 | | | | | | | 207 |
| debt securities | 6,660 | 5,085 | 6,686 | 65 | | | | 18,496 |
| loans and advances: | | | | | | | | |
| to banks | 70 | 271 | 14 | | | | | 355 |
| to customers | 919 | | | | | | | 919 |
| Derivatives ²⁶ | 211,625 | 34,718 | 11,096 | 3,233 | | | | 260,672 |
| Loans and advances held at amortised cost | 692,926 | 306,987 | 193,916 | 33,765 | 29,052 | 26,179 | (18,894) | 1,263,931 |
| to banks | 182,273 | 35,168 | 7,666 | 785 | 116 | 197 | (162) | 226,043 |
| to customers ²⁷ | 510,653 | 271,819 | 186,250 | 32,980 | 28,936 | 25,982 | (18,732) | 1,037,888 |
| Financial investments | 351,940 | 24,373 | 25,631 | 4,103 | | 2,603 | | 408,650 |
| treasury and other similar bills | 54,771 | 3,370 | 3,479 | 44 | | | | 61,664 |
| debt securities | 297,169 | 21,003 | 22,152 | 4,059 | | 2,603 | | 346,986 |
| Other assets | 11,982 | 7,285 | 15,106 | 1,525 | 637 | 254 | | 36,789 |
| endorsements and acceptances | 1,801 | 4,228 | 4,776 | 499 | 16 | 18 | | 11,338 |
| accrued income and other | 10,181 | 3,057 | 10,330 | 1,026 | 621 | 236 | | 25,451 |
| Total financial instruments | 1,695,497 | 431,808 | 315,704 | 48,432 | 29,689 | 29,036 | (18,894) | 2,531,272 |

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Interim Management Report (continued)*Distribution of financial instruments by credit quality (continued)*

| | Strong US\$m | Neither past due nor impaired Good US\$m | Satisfac- tory US\$m | Sub- standard US\$m | Past due but not impaired US\$m | Impaired US\$m | Impair- ment allowances ²⁵ US\$m | Total US\$m |
|--|-----------------|--|----------------------------|---------------------------|--|-------------------|--|----------------|
| At 30 June 2010 | | | | | | | | |
| Cash and balances at central banks | 67,466 | 1,899 | 1,910 | 301 | | | | 71,576 |
| Items in the course of collection from other banks | 10,200 | 554 | 441 | | | | | 11,195 |
| Hong Kong Government certificates of indebtedness | 18,364 | | | | | | | 18,364 |
| Trading assets ²⁶ | 278,887 | 52,634 | 43,105 | 1,814 | | | | 376,440 |
| treasury and other eligible bills | 20,524 | 1,054 | 473 | 185 | | | | 22,236 |
| debt securities | 173,483 | 7,709 | 12,539 | 659 | | | | 194,390 |
| loans and advances: | | | | | | | | |
| to banks | 50,641 | 21,567 | 4,960 | 266 | | | | 77,434 |
| to customers | 34,239 | 22,304 | 25,133 | 704 | | | | 82,380 |
| Financial assets designated at fair value ²⁶ | 7,722 | 3,600 | 6,988 | 40 | | | | 18,350 |
| treasury and other eligible bills | 215 | | 34 | | | | | 249 |
| debt securities | 6,114 | 3,600 | 6,399 | 40 | | | | 16,153 |
| loans and advances: | | | | | | | | |
| to banks | 594 | | 555 | | | | | 1,149 |
| to customers | 799 | | | | | | | 799 |
| Derivatives ²⁶ | 196,558 | 70,831 | 18,587 | 2,303 | | | | 288,279 |
| Loans and advances held at amortised cost | 585,784 | 234,005 | 188,792 | 40,386 | 34,749 | 28,115 | (22,198) | 1,089,633 |
| to banks | 142,135 | 40,911 | 12,064 | 983 | 140 | 228 | (165) | 196,296 |
| to customer ²⁷ | 443,649 | 193,094 | 176,728 | 39,403 | 34,609 | 27,887 | (22,033) | 893,337 |
| Financial investments | 333,892 | 20,963 | 15,298 | 4,072 | | 2,417 | | 376,642 |
| treasury and other similar bills | 56,193 | 2,289 | 2,353 | 439 | | 1 | | 61,275 |
| debt securities | 277,699 | 18,674 | 12,945 | 3,633 | | 2,416 | | 315,367 |
| Other assets | 9,797 | 5,880 | 12,264 | 1,583 | 660 | 459 | | 30,643 |
| endorsements and acceptances | 1,506 | 2,896 | 4,508 | 639 | 14 | 10 | | 9,573 |
| accrued income and other | 8,291 | 2,984 | 7,756 | 944 | 646 | 449 | | 21,070 |
| Total financial instruments | 1,508,670 | 390,366 | 287,385 | 50,499 | 35,409 | 30,991 | (22,198) | 2,281,122 |

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Interim Management Report (continued)

| | Strong US\$m | Neither past due nor impaired | | Sub- standard US\$m | Past due | | Impair- ment allowances ²⁵ US\$m | Total US\$m |
|--|-----------------|-------------------------------|----------------------------|---------------------------|------------------------------|-------------------|--|----------------|
| | | Good US\$m | Satisfac- tory US\$m | | but not impaired US\$m | Impaired US\$m | | |
| At 31 December 2010 | | | | | | | | |
| Cash and balances at central banks | 51,682 | 3,100 | 2,461 | 140 | | | | 57,383 |
| Items in the course of collection from other banks | 5,631 | 101 | 340 | | | | | 6,072 |
| Hong Kong Government certificates of indebtedness | 19,057 | | | | | | | 19,057 |
| Trading assets ²⁶ | 256,576 | 41,620 | 43,278 | 2,492 | | | | 343,966 |
| treasury and other eligible bills | 23,663 | 1,000 | 957 | | | | | 25,620 |
| debt securities | 141,837 | 8,254 | 17,222 | 955 | | | | 168,268 |
| loans and advances: | | | | | | | | |
| to banks | 55,534 | 9,980 | 4,865 | 77 | | | | 70,456 |
| to customers | 35,542 | 22,386 | 20,234 | 1,460 | | | | 79,622 |
| Financial assets designated at fair value ²⁶ | 8,377 | 4,640 | 6,536 | 40 | | | | 19,593 |
| treasury and other eligible bills | 158 | | 1 | | | | | 159 |
| debt securities | 7,310 | 4,368 | 6,530 | 40 | | | | 18,248 |
| loans and advances: | | | | | | | | |
| to banks | 38 | 272 | 5 | | | | | 315 |
| to customers | 871 | | | | | | | 871 |
| Derivatives ²⁶ | 199,920 | 45,042 | 13,980 | 1,815 | | | | 260,757 |
| Loans and advances held at amortised cost | 653,248 | 251,265 | 186,704 | 37,057 | 30,320 | 28,284 | (20,241) | 1,166,637 |
| to banks | 166,943 | 33,051 | 6,982 | 1,152 | 108 | 193 | (158) | 208,271 |
| to customers ²⁷ | 486,305 | 218,214 | 179,722 | 35,905 | 30,212 | 28,091 | (20,083) | 958,366 |
| Financial investments | 345,265 | 23,253 | 17,168 | 4,479 | 16 | 2,591 | | 392,772 |
| treasury and other similar bills | 52,423 | 2,702 | 1,882 | 115 | | 7 | | 57,129 |
| debt securities | 292,842 | 20,551 | 15,286 | 4,364 | 16 | 2,584 | | 335,643 |
| Other assets | 9,752 | 6,067 | 12,212 | 1,510 | 513 | 317 | | 30,371 |
| endorsements and acceptances | 2,074 | 3,305 | 4,227 | 493 | 9 | 8 | | 10,116 |
| accrued income and other | 7,678 | 2,762 | 7,985 | 1,017 | 504 | 309 | | 20,255 |
| Total financial instruments | 1,549,508 | 375,088 | 282,679 | 47,533 | 30,849 | 31,192 | (20,241) | 2,296,608 |

For footnotes, see page 146.

Financial instruments on which credit quality has been assessed increased by 10% to US\$2,531bn in the first half of 2011, of which US\$1,695bn or 67% was classified as strong. This percentage was in line with 31 December 2010. The proportion of financial instruments classified as good

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and satisfactory remained broadly stable at 17% and 12%, respectively. The proportion of sub-standard financial instruments was 2%.

Loans and advances held at amortised cost on which credit quality has been assessed increased by 8% to US\$1,264bn. The increase in balances was mainly due to growth in corporate and commercial

lending, as economic conditions generally improved and trade flows increased. The proportion of balances classified as strong was broadly in line with the end of 2010 while the portion of balances classified as good increased from 22% to 24%.

Trading assets on which credit quality has been assessed grew by 27% to US\$438bn from 31 December 2010. The rise reflected an increase in our holdings of debt securities, together with a rise in settlement accounts and higher reverse repo balances. The proportion of balances classified as strong declined from 75% to 73%.

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Interim Management Report (continued)

Past due but not impaired gross financial instruments

Examples of exposures past due but not impaired include overdue loans fully secured by cash collateral; mortgages that are individually assessed for impairment and that are in arrears more than

90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

Past due but not impaired gross loans and advances to customers and banks by geographical region

| | Europe US\$m | Hong Kong US\$m | Rest of Asia- Pacific US\$m | MENA US\$m | North America US\$m | Latin America US\$m | Total US\$m |
|------------------------|-----------------|-----------------------|--------------------------------------|---------------|---------------------------|---------------------------|----------------|
| At 30 June 2011 | 2,529 | 1,071 | 2,377 | 1,319 | 18,156 | 3,600 | 29,052 |
| At 30 June 2010 | 2,717 | 1,230 | 2,019 | 1,372 | 23,483 | 3,928 | 34,749 |
| At 31 December 2010 | 2,518 | 1,158 | 2,092 | 1,351 | 20,227 | 2,974 | 30,320 |

Past due but not impaired gross loans and advances to customers and banks by industry sector

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--------------------------|--------------------------------|--------------------------------|------------------------------------|
| Banks | 116 | 140 | 108 |
| Customers | 28,936 | 34,609 | 30,212 |
| Personal | 23,435 | 28,995 | 24,824 |
| Corporate and commercial | 5,187 | 5,451 | 5,292 |
| Financial | 314 | 163 | 96 |
| | 29,052 | 34,749 | 30,320 |

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Ageing analysis of past due but not impaired gross financial instruments

| | Up to 29 days | 30-59 days | 60-89 days | 90-179 days | 180 days and over | Total |
|---|---------------|--------------|--------------|-------------|-------------------|---------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 30 June 2011 | | | | | | |
| Loans and advances held at amortised cost | 19,254 | 6,257 | 3,169 | 235 | 137 | 29,052 |
| to banks | 116 | | | | | 116 |
| to customers | 19,138 | 6,257 | 3,169 | 235 | 137 | 28,936 |
| Other assets | 317 | 166 | 72 | 30 | 52 | 637 |
| endorsements and acceptances | 13 | 1 | | | 2 | 16 |
| other | 304 | 165 | 72 | 30 | 50 | 621 |
| | 19,571 | 6,423 | 3,241 | 265 | 189 | 29,689 |
| At 30 June 2010 | | | | | | |
| Loans and advances held at amortised cost | 22,627 | 8,058 | 3,682 | 238 | 144 | 34,749 |
| to banks | 140 | | | | | 140 |
| to customers | 22,487 | 8,058 | 3,682 | 238 | 144 | 34,609 |
| Other assets | 348 | 164 | 85 | 24 | 39 | 660 |
| endorsements and acceptances | 8 | 3 | 1 | 1 | 1 | 14 |
| other | 340 | 161 | 84 | 23 | 38 | 646 |
| | 22,975 | 8,222 | 3,767 | 262 | 183 | 35,409 |

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Interim Management Report (continued)

| | Up to 29 days | 30-59 days | 60-89 days | 90-179 days | 180 days and over | Total |
|---|------------------|---------------|---------------|----------------|-------------------------|--------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 31 December 2010 | | | | | | |
| Loans and advances held at amortised cost | 19,481 | 6,915 | 3,281 | 482 | 161 | 30,320 |
| to banks | 108 | | | | | 108 |
| to customers | 19,373 | 6,915 | 3,281 | 482 | 161 | 30,212 |
| Financial investments | | | | | | |
| debt securities | 16 | | | | | 16 |
| Other assets | 262 | 123 | 57 | 26 | 45 | 513 |
| endorsements and acceptances | 7 | | | 1 | 1 | 9 |
| other | 255 | 123 | 57 | 25 | 44 | 504 |
| | 19,759 | 7,038 | 3,338 | 508 | 206 | 30,849 |

Impairment of loans and advances

Impaired loans and advances to customers and banks by industry sector

| | Impaired loans and advances | | | Impaired loans and advances | | | Impaired loans and advances | | |
|-----------|-----------------------------|-----------------------------|-------------|-----------------------------|-----------------------------|-------------|-----------------------------|-----------------------------|-------------|
| | at 30 June 2011 | | | at 30 June 2010 | | | at 31 December 2010 | | |
| | Individually assessed US\$m | Collectively assessed US\$m | Total US\$m | Individually assessed US\$m | Collectively assessed US\$m | Total US\$m | Individually assessed US\$m | Collectively assessed US\$m | Total US\$m |
| Banks | 197 | | 197 | 228 | | 228 | 193 | | 193 |
| Customers | 14,806 | 11,176 | 25,982 | 14,462 | 13,425 | 27,887 | 15,201 | 12,890 | 28,091 |

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| | | | | | | | | | |
|--------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| personal | 2,145 | 10,861 | 13,006 | 1,877 | 13,119 | 14,996 | 2,121 | 12,592 | 14,713 |
| corporate and commercial | 11,462 | 315 | 11,777 | 11,663 | 305 | 11,968 | 11,964 | 298 | 12,262 |
| financial | 1,199 | | 1,199 | 922 | 1 | 923 | 1,116 | | 1,116 |
| | | | | | | | | | |
| | 15,003 | 11,176 | 26,179 | 14,690 | 13,425 | 28,115 | 15,394 | 12,890 | 28,284 |

Impairment allowances

The tables below analyse by geographical region the impairment allowances recognised for impaired

loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

Impairment allowances on loans and advances to customers by geographical region

| | Europe US\$m | Hong Kong US\$m | Rest of Asia- Pacific US\$m | MENA US\$m | North America US\$m | Latin America US\$m | Total US\$m |
|--|-----------------|-----------------------|--------------------------------------|---------------|---------------------------|---------------------------|----------------|
| At 30 June 2011 | | | | | | | |
| Gross loans and advances | | | | | | | |
| Individually assessed impaired loans ²⁸ | 8,923 | 489 | 1,081 | 1,896 | 1,553 | 864 | 14,806 |
| Collectively assessed ²⁹ | 482,740 | 159,454 | 121,176 | 25,367 | 185,991 | 67,086 | 1,041,814 |
| impaired loans ²⁸ | 1,279 | 21 | 127 | 299 | 7,793 | 1,657 | 11,176 |
| non-impaired loans ³⁰ | 481,461 | 159,433 | 121,049 | 25,068 | 178,198 | 65,429 | 1,030,638 |
| TGLAC | 491,663 | 159,943 | 122,257 | 27,263 | 187,544 | 67,950 | 1,056,620 |
| Total impairment allowances | 5,332 | 573 | 828 | 1,569 | 8,282 | 2,148 | 18,732 |
| individually assessed | 3,607 | 297 | 518 | 1,098 | 384 | 339 | 6,243 |
| collectively assessed | 1,725 | 276 | 310 | 471 | 7,898 | 1,809 | 12,489 |
| Net loans and advances | 486,331 | 159,370 | 121,429 | 25,694 | 179,262 | 65,802 | 1,037,888 |

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Interim Management Report (continued)

| | Europe | Hong Kong | Rest of Asia-Pacific | MENA | North America | Latin America | Total |
|--|---------|-----------|----------------------|--------|---------------|---------------|---------|
| | % | % | % | % | % | % | % |
| Individually assessed allowances as a percentage of individually assessed impaired loans | 40.4 | 60.7 | 47.9 | 57.9 | 24.7 | 39.2 | 42.2 |
| Collectively assessed allowances as a percentage of collectively assessed loans and advances | 0.4 | 0.2 | 0.3 | 1.9 | 4.2 | 2.7 | 1.2 |
| Total allowances as a percentage of TGLAC | 1.1 | 0.4 | 0.7 | 5.8 | 4.4 | 3.2 | 1.8 |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 30 June 2010 | | | | | | | |
| Gross loans and advances | | | | | | | |
| Individually assessed impaired loans ²⁸ | 8,420 | 782 | 989 | 1,718 | 1,699 | 854 | 14,462 |
| Collectively assessed ²⁹ | | | | | | | |
| impaired loans ²⁸ | 404,641 | 114,024 | 91,539 | 23,263 | 217,349 | 50,092 | 900,908 |
| non-impaired loans ²⁹ | 1,837 | 32 | 157 | 260 | 9,420 | 1,719 | 13,425 |
| | 402,804 | 113,992 | 91,382 | 23,003 | 207,929 | 48,373 | 887,483 |
| TGLAC | 413,061 | 114,806 | 92,528 | 24,981 | 219,048 | 50,946 | 915,370 |
| Total impairment allowances | 5,835 | 731 | 856 | 1,587 | 10,907 | 2,117 | 22,033 |
| individually assessed | 3,647 | 444 | 474 | 1,032 | 434 | 371 | 6,402 |
| collectively assessed | 2,188 | 287 | 382 | 555 | 10,473 | 1,746 | 15,631 |
| Net loans and advances | 407,226 | 114,075 | 91,672 | 23,394 | 208,141 | 48,829 | 893,337 |
| | % | % | % | % | % | % | % |
| Individually assessed allowances as a percentage of individually assessed impaired loans | 43.3 | 56.8 | 47.9 | 60.1 | 25.5 | 43.4 | 44.3 |
| Collectively assessed allowances as a percentage of collectively assessed loans and advances | 0.5 | 0.3 | 0.4 | 2.4 | 4.8 | 3.5 | 1.7 |
| Total allowances as a percentage of TGLAC | 1.4 | 0.6 | 0.9 | 6.4 | 5.0 | 4.2 | 2.4 |

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| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
|--|---------|---------|---------|--------|---------|--------|---------|
| At 31 December 2010 | | | | | | | |
| Gross loans and advances | | | | | | | |
| Individually assessed impaired loans ²⁸ | 8,831 | 637 | 1,185 | 2,137 | 1,632 | 779 | 15,201 |
| Collectively assessed ²⁹ | 432,631 | 140,683 | 108,505 | 24,141 | 198,070 | 59,218 | 963,248 |
| impaired loans ²⁸ | 1,726 | 23 | 139 | 296 | 9,095 | 1,611 | 12,890 |
| non-impaired loans ²⁹ | 430,905 | 140,660 | 108,366 | 23,845 | 188,975 | 57,607 | 950,358 |
| TGLAC | 441,462 | 141,320 | 109,690 | 26,278 | 199,702 | 59,997 | 978,449 |
| Total impairment allowances | 5,663 | 629 | 959 | 1,652 | 9,170 | 2,010 | 20,083 |
| individually assessed | 3,563 | 345 | 629 | 1,163 | 390 | 367 | 6,457 |
| collectively assessed | 2,100 | 284 | 330 | 489 | 8,780 | 1,643 | 13,626 |
| Net loans and advances | 435,799 | 140,691 | 108,731 | 24,626 | 190,532 | 57,987 | 958,366 |
| | % | % | % | % | % | % | % |
| Individually assessed allowances as a percentage of individually assessed impaired loans | 40.3 | 54.2 | 53.1 | 54.4 | 23.9 | 47.1 | 42.5 |
| Collectively assessed allowances as a percentage of collectively assessed loans and advances | 0.5 | 0.2 | 0.3 | 2.0 | 4.4 | 2.8 | 1.4 |
| Total allowances as a percentage of TGLAC | 1.3 | 0.4 | 0.9 | 6.3 | 4.6 | 3.4 | 2.1 |

For footnotes, see page 146.

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Interim Management Report (continued)*Movement in impairment allowances on loans and advances to customers and banks*

| | Banks individually | Customers | | Total US\$m |
|--|---------------------------------------|--|--|------------------------|
| | assessed⁷ US\$m | Individually assessed US\$m | Collectively assessed US\$m | |
| At 1 January 2011 | 158 | 6,457 | 13,626 | 20,241 |
| Amounts written off | | (986) | (5,975) | (6,961) |
| Recoveries of loans and advances previously written off | | 107 | 623 | 730 |
| Charge to income statement | 1 | 637 | 4,335 | 4,973 |
| Exchange and other movements | 3 | 28 | (120) | (89) |
| At 30 June 2011 | 162 | 6,243 | 12,489 | 18,894 |
| Impairment allowances: on loans and advances to customers | | 6,243 | 12,489 | 18,732 |
| personal | | 679 | 10,550 | 11,229 |
| corporate and commercial | | 4,966 | 1,853 | 6,819 |
| financial | | 598 | 86 | 684 |
| as a percentage of loans and advances ^{31,32} | 0.10% | 0.64% | 1.27% | 1.66% |
| | US\$m | US\$m | US\$m | US\$m |
| At 1 January 2010 | 107 | 6,494 | 19,048 | 25,649 |
| Amounts written off | (8) | (675) | (9,678) | (10,361) |
| Recoveries of loans and advances previously written off | 2 | 58 | 393 | 453 |
| Charge to income statement | 12 | 1,057 | 6,165 | 7,234 |
| Exchange and other movements | 52 | (532) | (297) | (777) |
| At 30 June 2010 | 165 | 6,402 | 15,631 | 22,198 |

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| | | | | |
|---|-------|---------|---------|---------|
| Impairment allowances: | | | | |
| on loans and advances to customers | | 6,402 | 15,631 | 22,033 |
| personal | | 544 | 13,465 | 14,009 |
| corporate and commercial | | 5,471 | 2,050 | 7,521 |
| financial | | 387 | 116 | 503 |
| | | | | |
| as a percentage of loans and advances ^{31,32} | 0.13% | 0.76% | 1.86% | 2.29% |
| | US\$m | US\$m | US\$m | US\$m |
| | | | | |
| At 1 July 2010 | 165 | 6,402 | 15,631 | 22,198 |
| Amounts written off | (1) | (1,766) | (7,172) | (8,939) |
| Recoveries of loans and advances previously written off | | 85 | 482 | 567 |
| Charge to income statement | | 1,556 | 4,758 | 6,314 |
| Exchange and other movements | (6) | 180 | (73) | 101 |
| | | | | |
| At 31 December 2010 | 158 | 6,457 | 13,626 | 20,241 |
| | | | | |
| Impairment allowances: | | | | |
| on loans and advances to customers | | 6,457 | 13,626 | 20,083 |
| personal | | 615 | 11,678 | 12,293 |
| corporate and commercial | | 5,274 | 1,863 | 7,137 |
| financial | | 568 | 85 | 653 |
| | | | | |
| as a percentage of loans and advances ^{31,32} | 0.11% | 0.70% | 1.49% | 1.91% |
| <i>For footnotes, see page 146.</i> | | | | |

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Interim Management Report (continued)

Impairment charge

Net loan impairment charge by geographical region

| | Rest of | | | | | | |
|---|-----------|--------------|-------|---------------|---------------|-------|-------|
| | Hong Kong | Asia-Pacific | MENA | North America | Latin America | | Total |
| Europe | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | | |
| Individually assessed impairment allowances | | | | | | | |
| New allowances | 744 | 20 | 78 | 96 | 182 | 89 | 1,209 |
| Release of allowances no longer required | (269) | (23) | (61) | (37) | (41) | (35) | (466) |
| Recoveries of amounts previously written off | (21) | (13) | (11) | (11) | (15) | (34) | (105) |
| | 454 | (16) | 6 | 48 | 126 | 20 | 638 |
| Collectively assessed impairment allowances | | | | | | | |
| New allowances net of allowance releases | 684 | 52 | 188 | 81 | 3,004 | 951 | 4,960 |
| Recoveries of amounts previously written off | (288) | (13) | (90) | (30) | (55) | (149) | (625) |
| | 396 | 39 | 98 | 51 | 2,949 | 802 | 4,335 |
| Total charge for impairment losses | 850 | 23 | 104 | 99 | 3,075 | 822 | 4,973 |
| Banks | | | | | | 1 | 1 |
| Customers | 850 | 23 | 104 | 99 | 3,075 | 821 | 4,972 |
| | % | % | % | % | % | % | % |
| Charge for impairment losses as a percentage of closing gross loans and advances (annualised) | 0.30 | 0.02 | 0.12 | 0.57 | 2.99 | 1.73 | 0.78 |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 30 June 2011 | | | | | | | |

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| | | | | | | | |
|---|---------------|------------|--------------|--------------|--------------|--------------|---------------|
| Impaired loans | 10,309 | 514 | 1,210 | 2,215 | 9,408 | 2,523 | 26,179 |
| Impairment allowances | 5,412 | 573 | 828 | 1,586 | 8,346 | 2,149 | 18,894 |
| Half-year to 30 June 2010 | | | | | | | |
| Individually assessed impairment allowances | | | | | | | |
| New allowances | 782 | 60 | 72 | 388 | 240 | 64 | 1,606 |
| Release of allowances no longer required | (230) | (29) | (52) | (33) | (107) | (26) | (477) |
| Recoveries of amounts previously written off | (11) | (7) | (8) | (5) | (21) | (8) | (60) |
| | 541 | 24 | 12 | 350 | 112 | 30 | 1,069 |
| Collectively assessed impairment allowances | | | | | | | |
| New allowances net of allowance releases | 777 | 52 | 212 | 111 | 4,537 | 869 | 6,558 |
| Recoveries of amounts previously written off | (104) | (13) | (77) | (24) | (73) | (102) | (393) |
| | 673 | 39 | 135 | 87 | 4,464 | 767 | 6,165 |
| Total charge for impairment losses | 1,214 | 63 | 147 | 437 | 4,576 | 797 | 7,234 |
| Banks | 2 | | | 2 | 8 | | 12 |
| Customers | 1,212 | 63 | 147 | 435 | 4,568 | 797 | 7,222 |
| | % | % | % | % | % | % | % |
| Charge for impairment losses as a percentage of closing gross loans and advances (annualised) | 0.49 | 0.09 | 0.23 | 2.62 | 3.91 | 2.22 | 1.31 |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 30 June 2010 | | | | | | | |
| Impaired loans | 10,398 | 818 | 1,147 | 1,998 | 11,181 | 2,573 | 28,115 |
| Impairment allowances | 5,919 | 731 | 856 | 1,605 | 10,970 | 2,117 | 22,198 |

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Interim Management Report (continued)

| | Europe | Hong | Rest of | | North | Latin | |
|---|--------|-------|---------|-------|---------|---------|--------|
| | US\$m | Kong | Asia- | MENA | America | America | Total |
| | US\$m | US\$m | Pacific | US\$m | US\$m | US\$m | US\$m |
| Half-year to 31 December 2010 | | | | | | | |
| Individually assessed impairment allowances | | | | | | | |
| New allowances | 1,092 | 51 | 239 | 173 | 340 | 116 | 2,011 |
| Release of allowances no longer required | (164) | (25) | (32) | (22) | (89) | (38) | (370) |
| Recoveries of amounts previously written off | (24) | (5) | (21) | 1 | (15) | (21) | (85) |
| | 904 | 21 | 186 | 152 | 236 | 57 | 1,556 |
| Collectively assessed impairment allowances | | | | | | | |
| New allowances net of allowance releases | 562 | 67 | 177 | 63 | 3,565 | 806 | 5,240 |
| Recoveries of amounts previously written off | (148) | (14) | (82) | (29) | (73) | (136) | (482) |
| | 414 | 53 | 95 | 34 | 3,492 | 670 | 4,758 |
| Total charge for impairment losses | 1,318 | 74 | 281 | 186 | 3,728 | 727 | 6,314 |
| Customers | 1,318 | 74 | 281 | 186 | 3,728 | 727 | 6,314 |
| | % | % | % | % | % | % | % |
| Charge for impairment losses as a percentage of closing gross loans and advances (annualised) | 0.51 | 0.09 | 0.38 | 1.05 | 3.43 | 1.68 | 1.07 |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 31 December 2010 | | | | | | | |
| Impaired loans | 10,663 | 665 | 1,324 | 2,453 | 10,789 | 2,390 | 28,284 |
| Impairment allowances | 5,741 | 629 | 959 | 1,669 | 9,234 | 2,010 | 20,241 |

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Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region

| | Europe % | Hong Kong % | Rest of Asia- Pacific % | MENA % | North America % | Latin America % | Total % |
|--|-------------|-------------------|----------------------------------|-----------|-----------------------|-----------------------|------------|
| Half-year to 30 June 2011 | | | | | | | |
| New allowances net of allowance releases | 0.57 | 0.07 | 0.36 | 1.04 | 3.27 | 3.20 | 1.20 |
| Recoveries | (0.15) | (0.03) | (0.18) | (0.31) | (0.07) | (0.58) | (0.15) |
| Total charge for impairment losses | 0.42 | 0.04 | 0.18 | 0.73 | 3.20 | 2.62 | 1.05 |
| Amount written off net of recoveries | 0.68 | 0.10 | 0.38 | 0.45 | 3.89 | 2.39 | 1.31 |
| Half-year to 30 June 2010 | | | | | | | |
| New allowances net of allowance releases | 0.71 | 0.17 | 0.51 | 3.85 | 4.34 | 3.64 | 1.81 |
| Recoveries | (0.06) | (0.04) | (0.19) | (0.24) | (0.09) | (0.44) | (0.11) |
| Total charge for impairment losses | 0.65 | 0.13 | 0.32 | 3.61 | 4.25 | 3.20 | 1.70 |
| Amount written off net of recoveries | 0.49 | 0.26 | 0.59 | 1.84 | 6.69 | 4.72 | 2.32 |
| Half-year to 31 December 2010 | | | | | | | |
| New allowances net of allowance releases | 0.77 | 0.13 | 0.80 | 1.65 | 3.71 | 3.24 | 1.53 |
| Recoveries | (0.09) | (0.03) | (0.21) | (0.23) | (0.09) | (0.58) | (0.13) |
| Total charge for impairment losses | 0.68 | 0.10 | 0.59 | 1.42 | 3.62 | 2.66 | 1.40 |
| Amount written off net of recoveries | 0.92 | 0.14 | 0.48 | 0.83 | 5.08 | 3.38 | 1.86 |

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Interim Management Report (continued)*Impaired loans by geographical region*

| | 31 Dec 10 | 31 Dec 10 Constant currency effect US\$m | 31 Dec 10 at 30 Jun 11 exchange rates US\$m | Movement on a constant currency basis US\$m | 30 Jun 11 as reported US\$m | Reported change % | Movement on a constant currency basis % |
|------------------------------|---------------|--|---|--|-----------------------------------|-------------------------|--|
| Europe | 10,663 | 421 | 11,084 | (775) | 10,309 | (3) | (7) |
| Hong Kong | 665 | | 665 | (151) | 514 | (23) | (23) |
| Rest of Asia-Pacific | 1,324 | 33 | 1,357 | (147) | 1,210 | (9) | (11) |
| Middle East and North Africa | 2,453 | (4) | 2,449 | (234) | 2,215 | (10) | (10) |
| North America | 10,789 | 26 | 10,815 | (1,407) | 9,408 | (13) | (13) |
| Latin America | 2,390 | 116 | 2,506 | 17 | 2,523 | 6 | 1 |
| Total | 28,284 | 592 | 28,876 | (2,697) | 26,179 | (7) | (9) |

Impaired loans and net loan impairment allowances

On a reported basis, loan impairment charges to the income statement of US\$5.0bn in the first half of 2011 declined by 31% compared with the first half of 2010 and by 21% compared with the second half of 2010. Reported impaired loans were US\$26.2bn, 7% lower than at 31 December 2010.

The following commentary is on a constant currency basis.

New loan impairment allowances were US\$6.2bn, a decline of 26% compared with the first half of 2010, reflecting an overall improvement in the credit environment and lower lending balances in our US run-off portfolios. Releases and recoveries of US\$1.2bn were 24% higher, mainly in the UK reflecting economic recovery.

Impaired loans were 2% of total gross loans and advances at 30 June 2011, in line with 31 December 2010.

In **Europe**, new loan impairment allowances were US\$1.4bn, 13% lower than in the first half of 2010, reflecting an improved credit environment across the region. Individually assessed new loan impairment allowances decreased, mainly in the UK, as a result of lower loan impairment charges against specific exposures. Collectively assessed new loan impairment allowances also declined, mainly in the UK personal lending book, as a result of improved delinquency rates in both the secured and unsecured portfolios, strengthened risk management practices and improved collections. In addition, lower new loan impairment allowances reflected lower levels of unsecured lending. Impaired loans of US\$10.3bn were 7% lower than at 31 December 2010.

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Releases and recoveries in Europe were US\$580m, an increase of 61% compared with the first half of 2010 due to higher recoveries in the UK.

In **Hong Kong**, new loan impairment allowances fell by 37% compared with the first half of 2010. New individually assessed loan impairment allowances declined, reflecting fewer loan impairment charges against specific exposures, while collectively assessed allowances remained broadly flat. Impaired loans declined by 23% from 31 December 2010, reflecting debt restructuring, repayments and write-offs.

Releases and recoveries in Hong Kong were US\$49m, in line with the first half of 2010.

New loan impairment allowances in **Rest of Asia-Pacific** decreased by 11% to US\$266m. The decline reflected lower collectively assessed new loan impairment allowances, mainly in India, where lending balances fell as certain higher risk unsecured portfolios were managed down. This was partly offset by increases in collectively assessed new loan impairment allowances in other parts of the region. Individually assessed new loan impairment allowances increased, mainly in Australia, due to loan impairment charges raised against a small number of CMB exposures. Impaired loans in the region decreased by 11% from the end of 2010 to US\$1.2bn at 30 June 2011, mainly in India due to the write-off of a previously impaired loan.

Releases and recoveries in the region decreased by 12%, mainly due to lower releases for cards and unsecured products.

In the **Middle East and North Africa**, new loan impairment allowances declined by 65% to US\$177m in the first half of 2011. Individually assessed new loan impairment charges fell, as charges in 2011 were restricted to a small number of corporate exposures and due to the non-recurrence of a significant charge related to a single corporate exposure in the UAE. Collectively assessed new loan impairment allowances also declined, primarily in the UAE due to lower delinquencies as a result of an improvement in the credit environment. Impaired

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Interim Management Report (continued)

loans decreased by 10% from 31 December 2010 to US\$2.2bn due to the derecognition of a previously impaired loan in the UAE following debt restructuring.

Releases and recoveries in the region decreased by 26% to US\$78m from the first half of 2010.

In **North America**, new loan impairment allowances declined markedly, reducing by 33% to US\$3.2bn. In our Consumer Finance portfolios, the fall in new loan impairment allowances reflected a reduction in lending balances and an improvement in credit quality resulting in lower delinquency rates and higher recovery rates. This was partly offset by additional impairment charges as a result of changes in assumptions on the pace of recovery in house prices and delays in the timing of expected cash flows as a result of the temporary foreclosure suspension.

In our corporate and commercial portfolios, new loan impairment allowances also declined in the commercial real estate and middle market sectors, and lower write-offs in business banking reflected improved credit quality and lower delinquency levels. This was partially offset by a specific loan impairment charge associated with the downgrade of an individual commercial real estate loan. Releases and recoveries in North America declined by 45% to US\$111m due to lower levels of payments on loans resulting in lower releases.

Impaired loans decreased by 13% from the end of 2010 to US\$9.4bn, driven by the continued run-off of the Consumer Lending and Mortgage Services portfolios.

In **Latin America**, new loan impairment allowances increased by 3% to US\$1.0bn. The increase in new loan impairment allowances was primarily in Brazil, driven by lending growth and higher delinquency partly offset by lower collective new loan impairment allowances reflecting the reduction in the size of the credit card portfolio in Mexico. Impaired loans were broadly in line with 31 December 2010 as an increase in Brazil reflecting increased delinquency and higher lending balances was broadly offset by a decline in Mexico following settlement of a previously impaired loan, and lower impaired loans in Argentina.

Releases and recoveries in Latin America increased by 51% from the first half of 2010 to US\$218m, primarily in Brazil due to improved collections initiatives.

Securitisation exposures and other structured products

This section contains information about our exposure to the following:

asset-backed securities (ABS s), including mortgage-backed securities (MBS s) and related collateralised debt obligations (CDO s);

direct lending at fair value through profit or loss;

monolines;

credit derivative product companies (CDPC s);

leveraged finance transactions; and

representations and warranties related to mortgage sales and securitisation activities.

Business model

MBSs and other ABSs are held in Balance Sheet Management and as part of our investment portfolios in order to earn net interest income and management fees. Some are also held in the trading portfolio and hedged through credit derivative protection with the intention of earning the spread differential over the life of the instruments.

Our investment portfolios include securities investment conduits (SICs) and money market funds, as described in Note 21 on the Financial Statements. We also originate leveraged finance loans for the purpose of syndicating or selling them down to generate trading profit or holding them to earn interest margin over their lives.

These activities are not a significant part of GB&M's ongoing activities. The purchase and securitisation of US mortgage loans and the secondary trading of US MBSs, which was conducted in our US MBS business, was discontinued in 2007.

Exposure in the first half of 2011

The first half of 2011 and, in particular, the second quarter saw renewed uncertainty and concerns over sovereign credit risk, and a more pessimistic outlook for the US housing market. However, despite these developments, the levels of write-downs and losses on our holdings of structured assets remained modest with net write-downs to the income statement of US\$0.2bn in the first half of 2011 (first half of 2010: US\$0.1bn net write-backs; second half of 2010: US\$0.1bn net write-downs). Unrealised losses in our available-for-sale reserve continued to reduce due to increases in fair value and the principal amortisation of ABSs as repayments were received at par with the available-for-sale ABS reserve deficit down US\$1.6bn to US\$4.8bn.

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Interim Management Report (continued)*Overall exposure of HSBC*

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|---|---------------------------|--|------------------------------|--|------------------------------|--|
| | Carrying amount US\$bn | Including sub-prime and Alt-A US\$bn | Carrying amount US\$bn | Including sub-prime and Alt-A US\$bn | Carrying amount US\$bn | Including sub-prime and Alt-A US\$bn |
| ABSs | 72.9 | 8.1 | 72.6 | 9.4 | 73.9 | 8.5 |
| fair value through profit or loss | 10.1 | 0.3 | 10.8 | 0.5 | 10.8 | 0.3 |
| available for sale ³ | 54.7 | 6.8 | 53.2 | 7.5 | 54.7 | 7.1 |
| held to maturity ³ | 2.1 | 0.2 | 2.4 | 0.2 | 2.2 | 0.2 |
| loans and receivables | 6.0 | 0.8 | 6.2 | 1.2 | 6.2 | 0.9 |
| Loans at fair value through profit or loss | 1.1 | 0.9 | 1.9 | 1.5 | 1.6 | 1.2 |
| Total ABS and direct lending at fair value through profit or loss | 74.0 | 9.0 | 74.5 | 10.9 | 75.5 | 9.7 |
| Less securities mitigated by credit derivatives with monolines and other financial institutions | (8.4) | (0.3) | (8.6) | (0.6) | (8.3) | (0.4) |
| | 65.6 | 8.7 | 65.9 | 10.3 | 67.2 | 9.3 |
| Leveraged finance loans | 3.7 | | 5.2 | | 4.9 | |
| fair value through profit or loss | 0.1 | | 0.2 | | 0.3 | |
| loans and receivables | 3.6 | | 5.0 | | 4.6 | |
| | 69.3 | 8.7 | 71.1 | 10.3 | 72.1 | 9.3 |
| Exposure including securities mitigated by credit derivatives with monolines and other financial institutions | 77.7 | 9.0 | 79.7 | 10.9 | 80.4 | 9.7 |

For footnote, see page 146.

ABSs classified as available for sale

Our principal holdings of available-for-sale ABSs are in GB&M through special purpose entities (SPE s) which were established from the outset with the benefit of external investor first loss

protection support, together with positions held directly and by Solitaire Funding Limited (Solitaire), where we have first loss risk.

The following table summarises our exposure to ABSs classified as available for sale.

Available-for-sale asset-backed securities exposure

| | At 30 June 2011 | | | At 30 June 2010 | | | At 31 December 2010 | | |
|---|-------------------------|------------------------|------------------------|-------------------------|------------------------|------------------------|-------------------------|------------------------|------------------------|
| | Directly | | | Directly | | | Directly | | |
| | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total | held/ SPEs Total |
| | Solitaire ³⁴ | | | Solitaire ³⁴ | | | Solitaire ³⁴ | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Total carrying amount of net principal exposure | 41,685 | 12,992 | 54,677 | 39,391 | 13,774 | 53,165 | 41,106 | 13,586 | 54,692 |
| Notional principal value of securities impaired | 3,426 | 2,371 | 5,797 | 2,710 | 2,372 | 5,082 | 3,015 | 2,399 | 5,414 |
| Carrying value of capital notes liability | | (333) | (333) | | (320) | (320) | | (254) | (254) |

For footnote, see page 146.

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Interim Management Report (continued)*Movement in the available-for-sale (AFS) reserve*

| | Half-year to 30 June 2011 | | | Half-year to 30 June 2010 | | | Half-year to 31 December 2010 | | |
|--|---|---------------|----------------|---|---------------|----------------|---|---------------|----------------|
| | Directly | | | Directly | | | Directly | | |
| | held/ Solitaire ³⁴ US\$m | SPEs US\$m | Total US\$m | held/ Solitaire ³⁴ US\$m | SPEs US\$m | Total US\$m | held/ Solitaire ³⁴ US\$m | SPEs US\$m | Total US\$m |
| AFS reserve at beginning of period | (4,102) | (2,306) | (6,408) | (7,349) | (4,864) | (12,213) | (4,914) | (3,168) | (8,082) |
| Increase in fair value of securities | 618 | 355 | 973 | 1,678 | 1,051 | 2,729 | 497 | 492 | 989 |
| Impairment charge: | | | | | | | | | |
| borne by HSBC | 238 | | 238 | 277 | | 277 | 167 | | 167 |
| allocated to capital note holders ⁵ | | 137 | 137 | | 488 | 488 | | 43 | 43 |
| Repayment of capital | 142 | 94 | 236 | 301 | 88 | 389 | 239 | 99 | 338 |
| Other movements | 5 | (24) | (19) | 179 | 69 | 248 | (91) | 228 | 137 |
| AFS reserve at end of period | (3,099) | (1,744) | (4,843) | (4,914) | (3,168) | (8,082) | (4,102) | (2,306) | (6,408) |

*For footnotes, see page 146.***Securities investment conduits**

The total carrying amount of ABSs held through SPEs in the above table represents holdings in which significant first loss protection is provided through capital notes issued by SICs, excluding Solitaire.

At each reporting date, we assess whether there is any objective evidence of impairment in the value of the ABSs held by SPEs. Impairment charges incurred on these assets are offset by a credit to the impairment line for the amount of the loss allocated to capital note holders.

The economic first loss protection remaining at 30 June 2011 amounted to US\$2.2bn (30 June 2010: US\$2.2bn; 31 December 2010: US\$2.2bn). On an IFRSs accounting basis, the carrying value of the liability for the capital notes at 30 June 2011 amounted to US\$0.3bn (30 June 2010: US\$0.3bn; 31 December 2010: US\$0.3bn). The impairment charge recognised during the first half of 2011 amounted to US\$137m (first half of 2010: US\$488m; second half of 2010: US\$43m).

At 30 June 2011, the available-for-sale reserve in respect of securities held by the SICs was a deficit of US\$2.0bn (30 June 2010: US\$3.4bn; 31 December 2010: US\$2.7bn). Of this, US\$1.7bn related to ABSs (30 June 2010: US\$3.2bn; 31 December 2010: US\$2.3bn).

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Impairments recognised during the first half of 2011 from assets held directly or within Solitaire, in recognition of the first loss protection of US\$1.2bn we provide through credit enhancement and from drawings against the liquidity facility we

provide, were US\$238m (30 June 2010: US\$277m; 31 December 2010: US\$167m). The reduction in impairment charges compared with the first half of 2010 was due to the falling default rates in the underlying collateral pools. The level of impairment recognised in comparison with the deficit in the available-for-sale reserve was a reflection of the credit quality and seniority of the assets held.

Sub-prime and Alt-A residential mortgage-backed securities

The assets which are most sensitive to possible future impairment are sub-prime and Alt-A residential MBSs. Available-for-sale holdings in these higher risk categories where HSBC does not benefit from significant first loss protection amounted to US\$3.5bn at 30 June 2011 (30 June 2010: US\$4.2bn; 31 December 2010: US\$3.8bn). For these securities the cumulative fair value losses not recognised in the income statement at 30 June 2011 was US\$1.2bn (30 June 2010: losses of US\$3.3bn; 31 December 2010: losses of US\$1.6bn). Other holdings in these higher risk categories classified as available-for-sale are held in vehicles where third party first loss protection exists, as described in the section on SICs, above.

Impairment methodologies

The accounting policy for impairment and indicators of impairment is set out on page 259 and for available-for-sale ABSs on page 131 of the *Annual Report and Accounts 2010*.

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Interim Management Report (continued)

Impairment and cash loss projections

At 31 December 2010, management undertook a stress analysis to estimate further potential impairments and expected cash losses on the available-for-sale ABS portfolio. This exercise comprised a shift of projections of future loss severities, default rates and prepayment rates. The results of the analysis indicated that further impairment charges of some US\$950m and expected cash losses of some US\$250m could arise over the next two to three years.

At 30 June 2011, management re-performed the stress test. Management now estimates that accounting impairments of US\$900m and cash losses of US\$400m may arise over the remaining duration. The result reflects the deterioration in the outlook for the US economy at large and the US housing market in particular compared with previous stress projections. For example, housing prices are now projected to continue to fall further and for a longer period of time, and recover more slowly.

For the purposes of identifying impairment at the reporting date, the future projected cash flows reflect the effect of loss events that have occurred at or prior to the reporting date. For the purposes of

performing stress tests to estimate potential future impairment charges, the projected future cash flows reflect additional assumptions about future loss events after the balance sheet date.

This analysis makes assumptions in respect of the future behaviour of loss severities, default rates and prepayment rates. Movements in the parameters are not independent of each other. For example, increased default rates and increased loss severities, which would imply greater impairments, generally arise under economic conditions that give rise to reduced levels of prepayment, reducing the potential for impairment charges. Conversely, economic conditions which increase the rates of prepayment are generally associated with reduced default rates and decreased loss severities.

At 30 June 2011, the incurred and projected impairment charges, measured in accordance with accounting requirements, significantly exceeded the expected cash losses on the securities. Over the lives of the available-for-sale ABSs the cumulative impairment charges will converge towards the level of cash losses. In respect of the SICs, in particular, the capital notes held by third parties are expected to absorb the cash losses arising in the vehicles.

Carrying amount of HSBC's consolidated holdings of ABSs, and direct lending held at fair value through profit or loss

| | Trading US\$m | Available for sale US\$m | Held to maturity US\$m | Designated at fair value through profit US\$m | Loans and receivables US\$m | Total US\$m | Of which held through consolidated SPEs US\$m |
|-----------------|------------------|--------------------------------|------------------------------|---|--------------------------------------|----------------|---|
| At 30 June 2011 | | | | | | | |

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| | | | | | | | |
|--|-------|--------|-------|-------|-------|--------|--------|
| Mortgage-related assets | | | | | | | |
| Sub-prime residential | 1,022 | 2,556 | | | 598 | 4,176 | 2,696 |
| direct lending | 830 | | | | | 830 | 560 |
| MBSs and MBS CDOs | 192 | 2,556 | | | 598 | 3,346 | 2,136 |
| US Alt-A residential | 163 | 4,231 | 177 | | 255 | 4,826 | 3,417 |
| direct lending | 80 | | | | | 80 | |
| MBSs | 83 | 4,231 | 177 | | 255 | 4,746 | 3,417 |
| US Government agency and sponsored enterprises | | | | | | | |
| MBSs | 217 | 22,570 | 1,933 | | | 24,720 | 17 |
| Other residential | 800 | 3,801 | | | 990 | 5,591 | 2,332 |
| direct lending | 188 | | | | | 188 | |
| MBSs | 612 | 3,801 | | | 990 | 5,403 | 2,332 |
| Commercial property | | | | | | | |
| MBSs and MBS CDOs | 552 | 8,119 | | 111 | 1,935 | 10,717 | 6,439 |
| | 2,754 | 41,277 | 2,110 | 111 | 3,778 | 50,030 | 14,901 |
| Leveraged finance-related assets | | | | | | | |
| ABSs and ABS CDOs | 379 | 5,695 | | | 399 | 6,473 | 4,450 |
| Student loan-related assets | | | | | | | |
| ABSs and ABS CDOs | 137 | 5,110 | | | 151 | 5,398 | 4,411 |
| Other assets | | | | | | | |
| ABSs and ABS CDOs | 1,791 | 2,595 | | 6,053 | 1,637 | 12,076 | 1,783 |
| | 5,061 | 54,677 | 2,110 | 6,164 | 5,965 | 73,977 | 25,545 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Trading US\$m | Available for sale US\$m | Held to maturity US\$m | Designated at fair value through profit US\$m | Loans and receivables US\$m | Total US\$m | Of which held through consolidated SPEs US\$m |
|--|------------------|--------------------------------|------------------------------|--|--------------------------------------|----------------|--|
| At 30 June 2010 | | | | | | | |
| Mortgage-related assets | | | | | | | |
| Sub-prime residential | 1,891 | 2,626 | | | 658 | 5,175 | 3,077 |
| direct lending | 1,438 | | | | | 1,438 | 883 |
| MBSs and MBS CDOs | 453 | 2,626 | | | 658 | 3,737 | 2,194 |
| US Alt-A residential | 115 | 4,907 | 193 | | 536 | 5,751 | 3,720 |
| direct lending | 102 | | | | | 102 | |
| MBSs | 13 | 4,907 | 193 | | 536 | 5,649 | 3,720 |
| US Government agency and sponsored enterprises | | | | | | | |
| MBSs | 472 | 19,341 | 2,254 | | | 22,067 | 347 |
| Other residential | 1,243 | 4,063 | | 59 | 1,303 | 6,668 | 2,771 |
| direct lending | 348 | | | | | 348 | 36 |
| MBSs | 895 | 4,063 | | 59 | 1,303 | 6,320 | 2,735 |
| Commercial property | | | | | | | |
| MBSs and MBS CDOs | 751 | 8,111 | | 75 | 1,905 | 10,842 | 6,470 |
| | 4,472 | 39,048 | 2,447 | 134 | 4,402 | 50,503 | 16,385 |
| Leveraged finance-related assets | | | | | | | |
| ABSs and ABS CDOs | 413 | 6,310 | | | 516 | 7,239 | 4,173 |
| Student loan-related assets | | | | | | | |
| ABSs and ABS CDOs | 141 | 5,241 | | | 144 | 5,526 | 4,192 |
| Other assets | | | | | | | |
| ABSs and ABS CDOs | 1,715 | 2,566 | | 5,852 | 1,116 | 11,249 | 2,439 |
| | 6,741 | 53,165 | 2,447 | 5,986 | 6,178 | 74,517 | 27,189 |
| At 31 December 2010 | | | | | | | |
| Mortgage-related assets | | | | | | | |
| Sub-prime residential | 1,297 | 2,565 | | | 652 | 4,514 | 2,763 |
| direct lending | 1,078 | | | | | 1,078 | 632 |
| MBSs and MBS CDOs | 219 | 2,565 | | | 652 | 3,436 | 2,131 |
| US Alt-A residential | 180 | 4,545 | 191 | | 270 | 5,186 | 3,651 |
| direct lending | 96 | | | | | 96 | |
| MBSs | 84 | 4,545 | 191 | | 270 | 5,090 | 3,651 |
| US Government agency and sponsored enterprises | | | | | | | |
| MBSs | 657 | 21,699 | 2,032 | | | 24,388 | 6 |
| Other residential | 1,075 | 4,024 | | | 1,111 | 6,210 | 2,669 |

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| | | | | | | | |
|----------------------------------|-------|--------|-------|-------|-------|--------|--------|
| direct lending | 417 | | | | 417 | | |
| MBS ⁶ | 658 | 4,024 | | 1,111 | 5,793 | 2,669 | |
| Commercial property | | | | | | | |
| MBSs and MBS CDO ⁶ | 546 | 8,160 | | 111 | 1,942 | 10,759 | 6,441 |
| | 3,755 | 40,993 | 2,223 | 111 | 3,975 | 51,057 | 15,530 |
| Leveraged finance-related assets | | | | | | | |
| ABSs and ABS CDO ⁶ | 392 | 5,418 | | 414 | 6,224 | 3,886 | |
| Student loan-related assets | | | | | | | |
| ABSs and ABS CDO ⁶ | 163 | 5,178 | | 150 | 5,491 | 4,251 | |
| Other assets | | | | | | | |
| ABSs and ABS CDO ⁶ | 1,936 | 3,103 | | 6,017 | 1,710 | 12,766 | 2,526 |
| | 6,246 | 54,692 | 2,223 | 6,128 | 6,249 | 75,538 | 26,193 |

For footnote, see page 146.

The above table excludes leveraged finance transactions, which are shown separately on page 132.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*HSBC's consolidated holdings of ABSs, and direct lending held at fair value through profit or loss*

| | Half-year to 30 June 2011 | | | | At 30 June 2011 | | | |
|--|--------------------------------|----------------------------|---|----------------------------|-------------------------------|--|--------------------------------------|-------------------------------|
| | Income statement ³⁸ | Gross fair value movements | Realised gains/(losses) in the income statement ⁴⁰ | Reclassified ⁴¹ | Gross principal ⁴² | Credit default swap gross protection ⁴³ | Net principal exposure ⁴⁴ | Carrying amount ⁴⁵ |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Mortgage-related assets | | | | | | | | |
| Sub-prime residential | | | | | | | | |
| Direct lending | (12) | | 1 | | 1,854 | | 1,854 | 830 |
| MBSs ³⁶ | (1) | 33 | | 93 | 4,851 | 305 | 4,546 | 3,087 |
| high grade ⁷ | | 37 | | 7 | 1,480 | 180 | 1,300 | 1,125 |
| rated C to A | (1) | (7) | | 86 | 3,236 | 125 | 3,111 | 1,915 |
| not publicly rated | | 3 | | | 135 | | 135 | 47 |
| MBS CDOs ³⁶ | | 3 | | (1) | 78 | | 78 | 21 |
| high grade ⁷ | | | | | 2 | | 2 | 1 |
| rated C to A | | 3 | | (1) | 76 | | 76 | 20 |
| not publicly rated | | | | | | | | |
| | (13) | 36 | 1 | 92 | 6,783 | 305 | 6,478 | 3,938 |
| US Alt-A residential | | | | | | | | |
| Direct lending | 1 | | | | 90 | | 90 | 80 |
| MBSs ³⁶ | | 51 | 2 | 479 | 9,142 | 100 | 9,042 | 4,670 |
| high grade ⁷ | | (4) | | 5 | 531 | 100 | 431 | 376 |
| rated C to A | | 55 | 2 | 472 | 8,549 | | 8,549 | 4,246 |
| not publicly rated | | | | 2 | 62 | | 62 | 48 |
| | 1 | 51 | 2 | 479 | 9,232 | 100 | 9,132 | 4,750 |
| US Government agency and sponsored enterprises | | | | | | | | |
| MBSs ³⁶ | | | | | | | | |
| high grade ⁷ | 1 | 75 | 2 | 68 | 23,815 | | 23,815 | 24,720 |
| Other residential | | | | | | | | |
| Direct lending | 30 | | 21 | | 187 | | 187 | 188 |
| MBSs ³⁶ | 2 | 44 | 1 | (7) | 6,135 | | 6,135 | 5,403 |
| high grade ⁷ | | 43 | 1 | (7) | 5,356 | | 5,356 | 4,786 |
| rated C to A | 2 | 1 | | | 613 | | 613 | 492 |

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| | | | | | | | | |
|----------------------------------|-----|-----|----|------|--------|-------|--------|--------|
| not publicly rated | | | | | 166 | | 166 | 125 |
| | 32 | 44 | 22 | (7) | 6,322 | | 6,322 | 5,591 |
| Commercial property | | | | | | | | |
| MBS and MBS CDOs ³⁶ | (1) | 311 | 2 | (51) | 12,217 | 395 | 11,822 | 10,442 |
| high grade ⁷ | (1) | 84 | | (12) | 4,185 | | 4,185 | 3,911 |
| rated C to A | | 228 | 2 | (41) | 7,903 | 395 | 7,508 | 6,432 |
| not publicly rated | | (1) | | 2 | 129 | | 129 | 99 |
| Leveraged finance-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | | 114 | | (14) | 7,289 | 806 | 6,483 | 5,950 |
| high grade ⁷ | | 122 | | (12) | 6,382 | 384 | 5,998 | 5,507 |
| rated C to A | | (8) | | (2) | 816 | 422 | 394 | 342 |
| not publicly rated | | | | | 91 | | 91 | 101 |
| Student loan-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | 3 | 248 | 1 | 2 | 6,819 | 100 | 6,719 | 5,353 |
| high grade ⁷ | 3 | 59 | 1 | 4 | 3,754 | | 3,754 | 3,339 |
| rated C to A | | 190 | | (2) | 2,606 | 100 | 2,506 | 1,841 |
| not publicly rated | | (1) | | | 459 | | 459 | 173 |
| Other assets | | | | | | | | |
| ABS and ABS CDOs ³⁶ | 19 | 94 | 10 | 23 | 14,799 | 7,924 | 6,875 | 4,806 |
| high grade ⁷ | 6 | 11 | 1 | (5) | 10,056 | 7,255 | 2,801 | 2,146 |
| rated C to A | 14 | 80 | 8 | 28 | 4,226 | 669 | 3,557 | 2,310 |
| not publicly rated | (1) | 3 | 1 | | 517 | | 517 | 350 |
| Total | 42 | 973 | 40 | 592 | 87,276 | 9,630 | 77,646 | 65,550 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Half-year to 30 June 2010 | | | | At 30 June 2010 | | | | |
|--|-------------------------------|----------------------------------|---|---------------------------------|-----------------------------------|-------------------|--------|-----------|---|
| | Gross fair value | | | | | | | | |
| | movements | | Realised | Reclassi- fied ⁴¹ | Gross principal ⁴² | Credit default | Net | | Carrying amount ⁴⁵ US\$m |
| | Income | Other compre- hensive | gains/ (losses) in the income | | | swap | gross | principal | |
| statement ³⁸ US\$m | income ³⁹ US\$m | statement ⁴⁰ US\$m | US\$m | US\$m | protection ⁴³ US\$m | US\$m | US\$m | US\$m | |
| Mortgage-related assets | | | | | | | | | |
| Sub-prime residential | | | | | | | | | |
| Direct lending | (15) | | (14) | | 2,064 | | 2,064 | 1,438 | |
| MBSs ³⁶ | 329 | 186 | 52 | 315 | 5,268 | 456 | 4,812 | 3,142 | |
| high grade ⁷ | 2 | 102 | 2 | 38 | 1,968 | 331 | 1,638 | 1,423 | |
| rated C to A | 327 | 84 | 50 | 277 | 3,194 | 125 | 3,068 | 1,717 | |
| not publicly rated | | | | | 106 | | 106 | 2 | |
| MBS CDOs ³⁶ | 9 | 3 | 52 | | 676 | 14 | 662 | 31 | |
| high grade ⁷ | | 2 | 52 | | 14 | | 14 | 16 | |
| rated C to A | 9 | 1 | | | 524 | 14 | 510 | 13 | |
| not publicly rated | | | | | 138 | | 138 | 2 | |
| | 323 | 189 | 90 | 315 | 8,008 | 470 | 7,538 | 4,611 | |
| US Alt-A residential | | | | | | | | | |
| Direct lending | | | | | 113 | | 113 | 102 | |
| MBSs ³⁶ | | 359 | 9 | 884 | 11,384 | 100 | 11,284 | 5,580 | |
| high grade ⁷ | | 29 | | 30 | 818 | 100 | 718 | 610 | |
| rated C to A | | 323 | 9 | 855 | 10,381 | | 10,381 | 4,811 | |
| not publicly rated | | 7 | | (1) | 185 | | 185 | 159 | |
| | | 359 | 9 | 884 | 11,497 | 100 | 11,397 | 5,682 | |
| US Government agency and sponsored enterprises | | | | | | | | | |
| MBSs ³⁶ | | | | | | | | | |
| high grade ⁷ | (2) | 415 | (3) | (63) | 21,271 | | 21,271 | 22,067 | |
| Other residential | | | | | | | | | |
| Direct lending | 40 | | 16 | | 341 | | 341 | 348 | |
| MBSs ³⁶ | 116 | 108 | 22 | 4 | 7,141 | | 7,141 | 6,320 | |
| high grade ⁷ | 46 | 106 | 22 | 7 | 6,242 | | 6,242 | 5,580 | |
| rated C to A | 70 | | | (3) | 705 | | 705 | 633 | |
| not publicly rated | | 2 | | | 194 | | 194 | 107 | |
| | 156 | 108 | 38 | 4 | 7,482 | | 7,482 | 6,668 | |

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| | | | | | | | | |
|----------------------------------|-------|-------|------|-------|--------|-------|--------|--------|
| Commercial property | | | | | | | | |
| MBS and MBS CDOs ³⁶ | (163) | 946 | (31) | 170 | 12,635 | 412 | 12,223 | 10,580 |
| high grade ⁷ | (174) | 601 | (47) | 119 | 8,682 | 100 | 8,582 | 7,644 |
| rated C to A | 12 | 345 | 15 | 48 | 3,821 | 312 | 3,509 | 2,838 |
| not publicly rated | (1) | | 1 | 3 | 132 | | 132 | 98 |
| Leveraged finance-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | 57 | 462 | 4 | 40 | 8,372 | 514 | 7,858 | 6,725 |
| high grade ⁷ | 57 | 328 | 1 | 23 | 6,943 | 346 | 6,598 | 5,815 |
| rated C to A | | 134 | 3 | 17 | 1,383 | 168 | 1,214 | 864 |
| not publicly rated | | | | | 46 | | 46 | 46 |
| Student loan-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | 3 | 132 | 2 | (3) | 7,317 | | 7,317 | 5,438 |
| high grade ⁷ | 5 | 93 | 2 | (2) | 4,898 | | 4,898 | 4,311 |
| rated C to A | (2) | 46 | | (1) | 1,649 | | 1,649 | 835 |
| not publicly rated | | (7) | | | 770 | | 770 | 292 |
| Other assets | | | | | | | | |
| ABS and ABS CDOs ³⁶ | (204) | 118 | 64 | 55 | 12,775 | 7,076 | 5,699 | 4,160 |
| high grade ⁷ | (312) | (8) | 4 | 3 | 9,176 | 6,613 | 2,563 | 1,794 |
| rated C to A | 107 | 131 | 50 | 52 | 2,784 | 463 | 2,321 | 1,758 |
| not publicly rated | 1 | (5) | 10 | | 815 | | 815 | 608 |
| Total | 170 | 2,729 | 173 | 1,402 | 89,357 | 8,572 | 80,785 | 65,931 |

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HSBC HOLDINGS PLC

Interim Management Report (continued)*HSBC's consolidated holdings of ABSs, and direct lending held at fair value through profit or loss (continued)*

| | Half-year to 31 December 2010 | | | | At 31 December 2010 | | | |
|--|-------------------------------|---------------------------------|-------------------------|---------------------------------|------------------------|-----------|--------|----------|
| | Gross fair value | | Realised | Reclassi- fied ⁴¹ | Credit | | Net | Carrying |
| movements | Other | gains/ (losses) in the | default | | swap | principal | | |
| Income | compre- hensive | income | Gross | gross | exposure ⁴⁴ | | | |
| statement ³⁸ | income ³⁹ | statement ⁴⁰ | principal ⁴² | protection ⁴³ | US\$m | US\$m | US\$m | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | |
| Mortgage-related assets | | | | | | | | |
| Sub-prime residential | | | | | | | | |
| Direct lending | (20) | | (6) | | 2,233 | | 2,233 | 1,078 |
| MBSs ³⁶ | (271) | 127 | (38) | 70 | 5,104 | 336 | 4,768 | 3,135 |
| high grade ⁷ | 4 | 49 | 3 | 14 | 1,996 | 292 | 1,704 | 1,458 |
| rated C to A | (275) | 78 | (43) | 56 | 3,006 | 44 | 2,962 | 1,645 |
| not publicly rated | | | 2 | | 102 | | 102 | 32 |
| MBS CDOs ³⁶ | (9) | 4 | (52) | (3) | 90 | 12 | 78 | 17 |
| high grade ⁷ | | (2) | (52) | | 2 | | 2 | 1 |
| rated C to A | (9) | 5 | | (3) | 86 | 12 | 74 | 14 |
| not publicly rated | | 1 | | | 2 | | 2 | 2 |
| | (300) | 131 | (96) | 67 | 7,427 | 348 | 7,079 | 4,230 |
| US Alt-A residential | | | | | | | | |
| Direct lending | (1) | | | | 108 | | 108 | 96 |
| MBSs ³⁶ | 4 | 216 | (6) | 680 | 9,957 | 100 | 9,857 | 5,013 |
| high grade ⁷ | | 6 | 3 | 15 | 660 | 100 | 560 | 473 |
| rated C to A | 4 | 216 | (9) | 665 | 9,254 | | 9,254 | 4,503 |
| not publicly rated | | (6) | | | 43 | | 43 | 37 |
| | 3 | 216 | (6) | 680 | 10,065 | 100 | 9,965 | 5,109 |
| US Government agency and sponsored enterprises | | | | | | | | |
| MBSs ³⁶ | | | | | | | | |
| high grade ⁷ | 5 | (189) | (8) | 20 | 23,739 | | 23,739 | 24,388 |
| Other residential | | | | | | | | |
| Direct lending | 23 | | 19 | | 424 | | 424 | 417 |

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| | | | | | | | | |
|----------------------------------|-------|------|-------|------|--------|-------|--------|--------|
| MBSs ³⁶ | (110) | 55 | (18) | (11) | 6,571 | | 6,571 | 5,793 |
| high grade ⁷ | (41) | 43 | (18) | (14) | 5,841 | | 5,841 | 5,256 |
| rated C to A | (69) | 14 | | 3 | 648 | | 648 | 450 |
| not publicly rated | | (2) | | | 82 | | 82 | 87 |
| | (87) | 55 | 1 | (11) | 6,995 | | 6,995 | 6,210 |
| Commercial property | | | | | | | | |
| MBS and MBS CDOs ³⁶ | 208 | 420 | 37 | (58) | 12,625 | 421 | 12,204 | 10,493 |
| high grade ⁷ | 179 | (61) | 51 | (48) | 6,341 | 15 | 6,326 | 5,791 |
| rated C to A | 28 | 481 | (13) | (12) | 6,201 | 406 | 5,795 | 4,637 |
| not publicly rated | 1 | | (1) | 2 | 83 | | 83 | 65 |
| Leveraged finance-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | (52) | (9) | (4) | (22) | 7,148 | 788 | 6,360 | 5,721 |
| high grade ⁷ | (54) | (20) | (1) | (31) | 6,078 | 351 | 5,727 | 5,148 |
| rated C to A | 2 | 11 | (3) | 9 | 971 | 437 | 534 | 472 |
| not publicly rated | | | | | 99 | | 99 | 101 |
| Student loan-related assets | | | | | | | | |
| ABSs and ABS CDOs ³⁶ | 4 | 98 | 1 | (3) | 7,161 | 100 | 7,061 | 5,459 |
| high grade ⁷ | 4 | (49) | 1 | (2) | 4,080 | | 4,080 | 3,626 |
| rated C to A | | 111 | | (1) | 2,620 | 100 | 2,520 | 1,663 |
| not publicly rated | | 36 | | | 461 | | 461 | 170 |
| Other assets | | | | | | | | |
| ABS and ABS CDOs ³⁶ | 206 | 267 | (63) | 12 | 15,497 | 7,765 | 7,732 | 5,622 |
| high grade ⁷ | 312 | 196 | (4) | (2) | 10,947 | 7,447 | 3,500 | 2,884 |
| rated C to A | (105) | 57 | (49) | (6) | 4,059 | 318 | 3,741 | 2,379 |
| not publicly rated | (1) | 14 | (10) | 20 | 491 | | 491 | 359 |
| Total | (13) | 989 | (138) | 685 | 90,657 | 9,522 | 81,135 | 67,232 |

For footnotes, see page 146.

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Analysis of exposures and significant movements

Sub-prime residential mortgage-related assets

Sub-prime residential mortgage-related assets included US\$2.8bn (30 June 2010: US\$3.5bn; 31 December 2010: US\$3.1bn) related to US-originated assets and US\$1.1bn (30 June 2010: US\$1.1bn; 31 December 2010: US\$1.1bn) relating to UK non-conforming residential mortgage-related assets. US-originated assets represented US\$1.5bn (30 June 2010: US\$1.5bn; 31 December 2010: US\$1.5bn) of the non-high grade assets held of US\$2.0bn (30 June 2010: US\$1.7bn; 31 December 2010: US\$1.7bn), reflecting the higher quality of the UK-originated assets.

Gains on releases of impairment of US\$2m on assets classified as available for sale were recognised in the first half of 2011 (30 June 2010: losses of US\$100m; 31 December 2010: gains of US\$52m). Of the above gains, first half gains of US\$41m

(30 June 2010: losses of US\$98m; 31 December 2010: gains of US\$44m) occurred in the SICs and were allocated to the capital note holders.

US Alt-A residential mortgage-related assets

During the first half of 2011, further impairments of US\$364m (30 June 2010: US\$598m; 31 December 2010: US\$286m) were recorded in respect of Alt-A mortgage-related assets. Of the impairment above, US\$168m (30 June 2010: US\$369m; 31 December 2010: US\$81m) occurred in the SICs and was allocated to the capital note holders.

The following table shows the vintages of the collateral assets supporting our holdings of US sub-prime and Alt-A MBSs. Market prices for these instruments generally incorporate higher discounts for later vintages. The majority of our holdings of US sub-prime MBSs originated pre-2007; holdings of US Alt-A MBSs are more evenly distributed between pre-2007 vintages and those from 2007.

Vintages of US sub-prime and Alt-A mortgage-backed securities

| Mortgage vintage | Gross principal ⁴² of US sub-prime | | | Gross principal ⁴² of US Alt-A | | |
|------------------|---|--------------------------|------------------------------|---|--------------------------|------------------------------|
| | mortgage-backed securities at | | | mortgage-backed securities at | | |
| | 30 June 2011 US\$m | 30 June 2010 US\$m | 31 December 2010 US\$m | 30 June 2011 US\$m | 30 June 2010 US\$m | 31 December 2010 US\$m |
| Pre-2006 | 888 | 1,358 | 1,061 | 1,024 | 1,389 | 1,159 |
| 2006 | 1,687 | 2,074 | 1,822 | 4,361 | 5,499 | 5,147 |
| 2007 | 933 | 1,060 | 979 | 3,757 | 4,496 | 3,651 |

3,508

4,492

3,862

9,142

11,384

9,957

For footnote, see page 146.

US Government agency and sponsored enterprises mortgage-related assets

During the first half of 2011, we increased our holdings of US Government agency and sponsored enterprises mortgage-related assets by US\$0.3bn.

Other residential mortgage-related assets

The majority of our other residential mortgage-related assets were originated in the UK (30 June 2011: US\$3.6bn; 30 June 2010: US\$4.2bn; 31 December 2010: US\$3.9bn). No impairments were recognised in respect of these UK-originated assets in the first half of 2011, nor throughout 2010, reflecting credit support within the asset portfolio.

Commercial property mortgage-related assets

Of our total of US\$10.4bn (30 June 2010: US\$10.6bn; 31 December 2010: US\$10.5bn) of commercial property mortgage-related assets, US\$4.9bn related to US originated assets (30 June 2010: US\$5.4bn; 31 December 2010: US\$5.2bn). Spreads continued to tighten on both US and non-US commercial property mortgage-related assets during the first half of 2011. Impairments of nil were recognised (30 June 2010: US\$11m; 31 December 2010: write-backs of US\$6m).

Leveraged finance-related assets

The majority of these assets related to US-originated exposures; 93% (30 June 2010: 86%; 31 December 2010: 90%) were high grade with no impairments recorded in the period.

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HSBC HOLDINGS PLC

Interim Management Report (continued)**Student loan-related assets**

Our holdings in student loan-related assets were US\$5.4bn (30 June 2010: US\$5.4bn; 31 December 2010: US\$5.5bn). No impairments were recorded on student loan-related assets in the first half of 2011, nor throughout 2010.

Transactions with monoline insurers

HSBC's exposure to derivative transactions entered into directly with monolines

Our principal exposure to monolines is through a number of OTC derivative transactions, mainly credit default swaps (CDSs). We entered into these CDSs primarily to purchase credit protection against securities held at the time within the trading portfolio.

During the first half of 2011, the notional value of contracts with monolines was largely unchanged, but our overall credit exposure to monolines decreased as credit spreads narrowed. The table below sets out the fair value, essentially the

replacement cost, of the derivative transactions at 30 June 2011, and hence the amount at risk if the CDS protection purchased were to be wholly ineffective because, for example, the monoline insurer was unable to meet its obligations. To further analyse that risk, the value of protection purchased is shown subdivided between those monolines that were rated by S&P at BBB or above at 30 June 2011, and those that were below BBB (BBB is the S&P cut-off for an investment grade classification). The Credit risk adjustment column indicates the valuation adjustment taken against the net exposures, and reflects our best estimate of the likely loss of value on purchased protection arising from the deterioration in creditworthiness of the monolines. These valuation adjustments, which reflect a measure of the irrecoverability of the protection purchased, have been charged to the income statement. During the first half of 2011, the credit risk adjustment on derivative contracts with monolines decreased as the exposures decreased.

HSBC's exposure to derivative transactions entered into directly with monoline insurers

| | Notional amount US\$m | Net exposure before credit risk adjustment ⁴⁶ US\$m | Credit risk adjustment ⁴⁷ US\$m | Net exposure after credit risk adjustment US\$m |
|--|-----------------------------|---|--|--|
| At 30 June 2011 | | | | |
| Derivative transactions with monoline counterparties | | | | |
| Monolines investment grade (BBB or above) | 5,269 | 846 | (85) | 761 |
| Monolines sub-investment grade (below BBB) | 2,224 | 539 | (372) | 167 |
| | 7,493 | 1,385 | (457) | 928 |

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| At 30 June 2010 | | | | |
|--|-------|-------|-------|-------|
| Derivative transactions with monoline counterparties | | | | |
| Monolines investment grade (BBB or above) | 5,103 | 920 | (92) | 828 |
| Monolines sub-investment grade (below BBB) | 2,464 | 751 | (475) | 276 |
| | 7,567 | 1,671 | (567) | 1,104 |
| At 31 December 2010 | | | | |
| Derivative transactions with monoline counterparties | | | | |
| Monolines investment grade (BBB or above) | 5,179 | 876 | (88) | 788 |
| Monolines sub-investment grade (below BBB) | 2,290 | 648 | (431) | 217 |
| | 7,469 | 1,524 | (519) | 1,005 |

For footnotes, see page 146.

The above table can be analysed as follows. At 30 June 2011, HSBC had derivative transactions referenced to underlying securities with a notional value of US\$7.5bn (30 June 2010: US\$7.6bn; 31 December 2010: US\$7.5bn), whose value at that date indicated a potential claim against the protection purchased from the monolines of some US\$1.4bn (30 June 2010: US\$1.7bn; 31 December 2010: US\$1.5bn). On the basis of a credit assessment of the monolines, a provision of US\$457m has been taken (30 June 2010: US\$567m; 31 December 2010:

US\$519m), leaving US\$928m exposed (30 June 2010: US\$1.1bn; 31 December 2010: US\$1.0bn), of which US\$761m is recoverable from monolines rated investment grade at 30 June 2011 (30 June 2010: US\$828m; 31 December 2010: US\$788m). The provisions taken imply in aggregate that 90 cents in the dollar will be recoverable from investment grade monolines and 31 cents in the dollar from non-investment grade monolines (30 June 2010: 90 cents and 37 cents, respectively);

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31 December 2010: 90 cents and 33 cents, respectively).

For the CDSs, market prices are generally not readily available. Therefore the CDSs are valued on the basis of market prices of the referenced securities.

The credit risk adjustment against monolines is determined by one of a number of methodologies, dependent upon the internal credit rating of the monoline. Our assignment of internal credit ratings is based upon detailed credit analysis, and may differ from external ratings.

Credit risk adjustments for monolines

For highly-rated monolines, the standard credit risk adjustment methodology (as described on page 190) applies, with the exception that the future exposure profile is deemed to be constant (equal to the current market value) over the weighted average life of the referenced security, and the credit risk adjustment cannot fall below 10% of the mark-to-market exposure.

In respect of monolines where default has either occurred or there is a strong possibility of default in the near term, the adjustment is determined based on the estimated probabilities of various potential scenarios, and the estimated recovery in each case.

For other monoline exposures, the credit risk adjustment follows the methodology for highly-rated monolines, adjusted to include the probability of a claim arising in respect of the referenced security, and applies implied probabilities of default where the likelihood of a claim is believed to be high.

HSBC's monoline credit risk adjustment calculation utilises a range of approaches depending on the credit quality of the monoline. The net effect of utilising the methodology adopted for highly-rated monolines across all monolines would be to reduce the credit risk adjustment by US\$117m (30 June 2010: US\$14m; 31 December 2010: US\$94m). The net effect of utilising a methodology based on credit default swap spreads would be an increase in credit risk adjustment of US\$49m (30 June 2010: increase of US\$52m; 31 December 2010: increase of US\$8m).

At 30 June 2011, US\$1.2bn (30 June 2010: US\$1.6bn; 31 December 2010: US\$1.4bn) notional value of securities referenced by monoline CDS transactions with a market value of US\$0.9bn (30 June 2010: US\$1.2bn; 31 December 2010: US\$1.0bn) were held in the loans and receivables category, having been included in the reclassification of financial assets described in Note 10 on the Financial Statements. At the date of reclassification, the market value of the assets was US\$1.0bn. The reclassification resulted in an accounting asymmetry between the CDSs, which continue to be held at fair value through profit and loss, and the reclassified securities, which are accounted for on an amortised

cost basis. If the reclassifications had not occurred, the effect on the income statement for the half year to 30 June 2011 would have been an increase in profit of US\$4m (first half of 2010: increase in profit of US\$30m; second half of 2010: decrease in profit of US\$33m). This amount represents the difference between the increase in market value of the securities during the first half of 2011 and the accretion recognised under the amortised cost method in the period.

HSBC's exposure to direct lending and irrevocable commitments to lend to monolines

HSBC had no liquidity facilities to monolines at 30 June 2011 (30 June 2010: nil; 31 December 2010: nil).

HSBC's exposure to debt securities which benefit from guarantees provided by monolines

Within both the trading and available-for-sale portfolios, we hold bonds that are wrapped with a credit enhancement from a monoline. As the bonds are traded explicitly with the benefit of this enhancement, any deterioration in the credit profile of the monoline is reflected in market prices and, therefore, in the carrying amount of these securities at 30 June 2011. For wrapped bonds held in our trading portfolio, the

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mark-to-market movement has been reflected through the income statement. For wrapped bonds held in the available-for-sale portfolio, the mark-to-market movement is reflected in equity unless there is objective evidence of impairment, in which case the impairment loss is reflected in the income statement. No wrapped bonds were included in the reclassification of financial assets described in Note 10 on the Financial Statements.

HSBC's exposure to Credit Derivative Product Companies

CDPCs are independent companies that specialise in selling credit default protection on corporate exposures. At 30 June 2011, HSBC had purchased from CDPCs credit protection with a notional value of US\$4.8bn (30 June 2010: US\$5.0bn; 31 December 2010: US\$4.9bn) which had a fair value of US\$226m (30 June 2010: US\$374m; 31 December 2010: US\$235m), against which a credit risk adjustment (a provision) of US\$49m (30 June 2010: US\$98m; 31 December 2010: US\$63m) was held. At 30 June 2011, none of the exposure was to CDPCs with investment grade ratings (30 June 2010: 23%; 31 December 2010: nil).

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Leveraged finance transactions

Leveraged finance transactions include sub-investment grade acquisition or event-driven financing. The following table shows our exposure to leveraged finance transactions arising from primary transactions. Our additional exposure

to leveraged finance loans through holdings of ABSs from our trading and investment activities is shown in the table on page 124.

HSBC's exposure to leveraged finance transactions

| | Exposures at 30 June 2011 | | | Exposures at 30 June 2010 | | | Exposures at 31 December 2010 | | |
|-----------------------------------|-------------------------------|-------------------------------|----------------|-------------------------------|-------------------------------|----------------|-------------------------------|-------------------------------|----------------|
| | Funded ⁴⁸ US\$m | funded ⁴⁹ US\$m | Total US\$m | Funded ⁴⁸ US\$m | funded ⁴⁹ US\$m | Total US\$m | Funded ⁴⁸ US\$m | funded ⁴⁹ US\$m | Total US\$m |
| Europe | 2,761 | 289 | 3,050 | 3,369 | 393 | 3,762 | 3,337 | 298 | 3,635 |
| Rest of Asia-Pacific | | | | 63 | 24 | 87 | 17 | 22 | 39 |
| North America | 489 | 127 | 616 | 1,204 | 184 | 1,388 | 1,066 | 185 | 1,251 |
| | 3,250 | 416 | 3,666 | 4,636 | 601 | 5,237 | 4,420 | 505 | 4,925 |
| Held within: | | | | | | | | | |
| loans and receivables | 3,249 | 356 | 3,605 | 4,633 | 450 | 5,083 | 4,199 | 393 | 4,592 |
| fair value through profit or loss | 1 | 60 | 61 | 3 | 151 | 154 | 221 | 112 | 333 |

For footnotes, see page 146.

We held leveraged finance commitments of US\$3.8bn at 30 June 2011 (30 June 2010: US\$5.5bn; 31 December 2010: US\$5.1bn), of which US\$3.3bn (30 June 2010: US\$4.9bn; 31 December 2010: US\$4.6bn) was funded.

As described in Note 10 on the Financial Statements, certain leveraged finance loans were reclassified from held for trading to loans and receivables. As a result, these loans are held at amortised cost subject to impairment and are not marked to market, and no net gains (30 June 2010: net losses of US\$0.3bn; 31 December 2010: net gains of US\$0.1bn) were taken to the income statement in the first half of 2011.

At 30 June 2011, our principal exposures were to companies in two sectors: US\$1.5bn to data processing (30 June 2010: US\$3.1bn; 31 December 2010: US\$2.8bn) and US\$1.8bn to communications and infrastructure (30 June 2010: US\$1.7bn; 31 December 2010: US\$1.8bn). During the first half of 2011, 99% of the total fair value movement not recognised was against exposures in these two sectors (30 June 2010:

99%; 31 December 2010: 99%).

Representations and warranties related to mortgage sales and securitisation activities

We have been involved in various activities related to the sale and securitisation of residential mortgages, which are not recognised on our balance sheet. These activities include:

the purchase of US\$24bn by HSBC Bank USA, substantially all of which were originated by non-HSBC entities, with a current outstanding balance of approximately US\$9bn and securitisation of these by HSBC Securities (USA) Inc. (HSI) between 2005 and 2007;

HSI acting as underwriter for third-party issuance of private label MBSs with an original issuance value of US\$37bn and a current outstanding balance of approximately US\$16bn, most of which were sub-prime, as well as underwriting US\$6bn of MBSs issued by HSBC Finance; and

the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities. In sales and securitisations of mortgage loans, various representations and warranties regarding the loans may be made to purchasers of the mortgage loans and MBSs. In respect of the purchase and securitisation of third party originated mortgages and the underwriting of third-party MBSs, the obligation to repurchase loans in the event of a breach of loan level representations and warranties resides predominantly with the organisation that originated the loan. While certain of these originators are or may become financially impaired and, therefore, unable to fulfil their repurchase obligations, we do not believe we have significant exposure for repurchases on these loans.

At 30 June 2011, a liability of US\$237m was recognised in respect of various representations and warranties relating to the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities (30 June 2010:

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US\$205m; 31 December 2010: US\$262m). These relate to, among other things, the ownership of the loans, the validity of the liens, the loan selection and origination process, and the compliance to the origination criteria established by the agencies. In the event of a breach of our representations and warranties, HSBC Bank USA may be obliged to repurchase the loans with identified defects or to indemnify the buyers. The liability is estimated based on the level of outstanding repurchase demands, the level of outstanding requests for loan files and estimated future demands in respect of mortgages sold to date which are either two or more payments delinquent or are expected to become delinquent at an estimated conversion rate. Repurchase demands of US\$103m were outstanding at 30 June 2011 (30 June 2010: US\$160m; 31 December 2010: US\$115m).

Participants in the US mortgage securitisation market that purchased and repackaged whole loans have been the subject of lawsuits and governmental and regulatory investigations and inquiries which have been directed at groups within the US mortgage market such as servicers, originators, underwriters, trustees or sponsors of securitisations. Further information is provided in Note 24 on the Financial Statements.

Risk elements in the loan portfolio

The disclosure of credit risk elements under the following headings reflects US accounting practice and classifications. The purpose of the disclosure is to present within the US disclosure framework those elements of the loan portfolios with a greater risk of loss. The three main classifications of credit risk elements presented are:

impaired loans;

unimpaired loans contractually past due 90 days or more as to interest or principal; and

troubled debt restructurings not included in the above.

Impaired loans

Loans are classified as impaired when there is objective evidence that not all contractual cash flows will be received. In accordance with IFRSs, we recognise interest income on assets after they have been written down as a result of an impairment loss.

Unimpaired loans past due 90 days or more as to principal or interest

Loans that are subject to individual impairment assessment and are over 90 days past due as regards

principal and/or interest are classified as unimpaired loans when we expect to recover contractual cash flows in full.

Troubled debt restructurings

The SEC requires separate disclosure of any loans not included in the previous two categories whose terms have been modified to grant concessions other than are warranted by market conditions because of problems with the borrower. These are classified as troubled debt

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restructurings (TDR s). The definition of TDRs differs from the Renegotiated loans that would otherwise be past due or impaired quantified on page 108 insofar as for TDRs, the delinquency status of the loan following restructuring may continue to be past due not impaired or, where appropriate, impaired. In addition, where a restructure is on market terms, the classification of a loan as a TDR may be discontinued after the first year if the debt performs in accordance with the new terms.

TDRs are broadly unchanged compared with year-end 2010.

In April 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update, Clarifications to Accounting for Troubled Debt Restructurings by Creditors (ASU) which provides additional guidance to assist in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring (TDR). As we report under IFRSs, the guidance will only affect the amounts disclosed by the Group as TDRs in accordance with SEC regulations and not the measurement of impairment allowances under IFRSs. The new guidance will be applied retrospectively to restructurings occurring on or after 1 January 2011. Implementation of this ASU will result in significantly higher volumes of restructured loans, and in particular re-aged and modified accounts in the US, being reported as TDRs as at 31 December 2011. Although we are in the process of evaluating the impact of adopting this ASU, we expect that the impact to our disclosures on TDRs will be material. Additionally, we continue to review our current customer account management policies and practices in the US to determine if any changes will be made in future periods as a result of this guidance.

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Potential problem loans

Credit risk elements also cover potential problem loans. These are loans where information on possible credit problems among borrowers causes management to seriously doubt their ability to comply with the loan repayment terms. There are no potential problem loans other than those identified in the table of risk elements set out below, and as discussed in *Areas of special interest* on page 98. *Areas of special interest* includes further disclosure about certain homogeneous groups of loans which are collectively assessed for impairment and which represent our most significant exposure to potential problem loans. Collectively assessed loans and advances, as set out on page 115, although not classified as impaired until more than 90 days, are assessed collectively for losses that have been incurred but have not yet been individually identified. This policy is further described on page 256 of the *Annual Report and Accounts 2010*.

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Interim Management Report (continued)*Analysis of risk elements in the loan portfolio by geographical region*

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--|--------------------------------|--------------------------------|------------------------------------|
| Impaired loans | | | |
| Europe | 10,309 | 10,398 | 10,663 |
| Hong Kong | 514 | 818 | 665 |
| Rest of Asia-Pacific | 1,210 | 1,147 | 1,324 |
| Middle East and North Africa | 2,215 | 1,998 | 2,453 |
| North America | 9,408 | 11,181 | 10,789 |
| Latin America | 2,523 | 2,573 | 2,390 |
| | 26,179 | 28,115 | 28,284 |
| Unimpaired loans contractually past due 90 days or more as to principal or interest | | | |
| Europe | 22 | 60 | 64 |
| Hong Kong | 3 | 4 | 7 |
| Rest of Asia-Pacific | 17 | 15 | 40 |
| Middle East and North Africa | 185 | 194 | 264 |
| North America | 142 | 94 | 265 |
| Latin America | 3 | 15 | 3 |
| | 372 | 382 | 643 |
| Troubled debt restructurings (not included in the classifications above) | | | |
| Europe | 269 | 342 | 240 |
| Hong Kong | 182 | 235 | 205 |
| Rest of Asia-Pacific | 160 | 173 | 198 |
| Middle East and North Africa | 391 | 94 | 50 |
| North America | 9,350 | 10,290 | 9,670 |
| Latin America | 1,394 | 1,378 | 1,319 |
| | 11,746 | 12,512 | 11,682 |
| Trading loans classified as in default | | | |
| North America | 245 | 512 | 412 |
| Risk elements on loans | | | |
| Europe | 10,600 | 10,800 | 10,967 |

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| | | | |
|---|---------------|----------|----------|
| Hong Kong | 699 | 1,057 | 877 |
| Rest of Asia-Pacific | 1,387 | 1,335 | 1,562 |
| Middle East and North Africa | 2,791 | 2,286 | 2,767 |
| North America | 19,145 | 22,077 | 21,136 |
| Latin America | 3,920 | 3,966 | 3,712 |
| | 38,542 | 41,521 | 41,021 |
| Assets held for resale | | | |
| Europe | 49 | 42 | 47 |
| Hong Kong | 4 | 6 | 2 |
| Rest of Asia-Pacific | 7 | 6 | 5 |
| Middle East and North Africa | | 2 | 2 |
| North America | 797 | 961 | 1,084 |
| Latin America | 119 | 130 | 121 |
| | 976 | 1,147 | 1,261 |
| Total risk elements | | | |
| Europe | 10,649 | 10,842 | 11,014 |
| Hong Kong | 703 | 1,063 | 879 |
| Rest of Asia-Pacific | 1,394 | 1,341 | 1,567 |
| Middle East and North Africa | 2,791 | 2,288 | 2,769 |
| North America | 19,942 | 23,038 | 22,220 |
| Latin America | 4,039 | 4,096 | 3,833 |
| | 39,518 | 42,668 | 42,282 |
| | % | % | % |
| Loan impairment allowances as a percentage of risk elements on loans ¹ | 49.3 | 54.1 | 49.8 |

1 Ratio excludes trading loans classified as in default.

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Interim Management Report (continued)

Liquidity and funding

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| <u>Management of liquidity risk</u> | 134 |
| <u>HSBC Finance</u> | 134 |
| <u>Contingent liability risk</u> | 135 |

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. The risk arises from mismatches in the timing of cash flows.

There have been no material changes to our policies and practices for the management of liquidity and funding risks as described in the *Annual Report and Accounts 2010*.

Our liquidity and funding risk management framework

The objective of our liquidity framework is to allow us to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations.

We expect our operating entities to manage liquidity and funding risk on a standalone basis employing a centrally imposed framework and limit structure which is adapted to variations in business mix and underlying markets. Our operating entities are required to maintain strong liquidity positions and to manage the liquidity profiles of their assets, liabilities and commitments with the objective of ensuring that their cash flows are balanced under various severe stress scenarios and that all their anticipated obligations can be met when due.

A summary of our current policies and practices regarding liquidity and funding is provided in the Appendix to Risk on page 152.

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Interim Management Report (continued)

Liquidity and funding in the first half of 2011

We continued to have good access to debt capital markets during the first half of 2011, with Group entities issuing US\$18bn of term debt securities in the public capital markets. The market's focus on the eurozone sovereign debt problems did not restrict our term issuance during the period.

The liquidity position of the Group remained strong in the first half of 2011. Of particular note was the strong funding position of The Hongkong and Shanghai Banking Corporation, as reflected in the advances to core funding ratio in the table below, which allowed us to take advantage of loan growth opportunities in Asia while still maintaining ratios well below the Group's average. Reduced lending opportunities in the US, combined with further growth in customer deposits in that region, caused the funding position in HSBC Bank USA to strengthen further.

Management of liquidity risk

Advances to core funding ratio

The three principal banking entities listed in the table below represented 61% of HSBC's total core deposits at 30 June 2011 (30 June 2010: 60%; 31 December 2010: 60%). The table shows that loans and advances to customers in HSBC's principal banking entities were overwhelmingly financed by reliable and stable sources of funding. HSBC would meet any unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or collateralised lending markets. The distinction between core and non-core deposits generally means that the Group's measure of advances to core funding is more restrictive than that which can be inferred from the published financial statements.

HSBC's principal banking entities – the management of liquidity risk

| | Advances to core funding ratio | | | Stressed one month coverage ratio | | |
|-----------------------------|--------------------------------|--------------|------------------|-----------------------------------|--------------|------------------|
| | during half-year to: | | | during half-year to: | | |
| | 30 June 2011 | 30 June 2010 | 31 December 2010 | 30 June 2011 | 30 June 2010 | 31 December 2010 |
| | % | % | % | % | % | % |
| HSBC Bank plc ⁵⁰ | 99.7 | 107.3 | 103.0 | 115.9 | 107.4 | 111.1 |

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| | | | | | | |
|--|--------------|-------|-------|--------------|-------|-------|
| Maximum | 103.4 | 110.0 | 107.3 | 115.9 | 111.3 | 111.1 |
| Minimum | 98.4 | 105.0 | 102.6 | 109.4 | 103.2 | 107.4 |
| Average | 101.2 | 107.6 | 104.5 | 112.0 | 106.7 | 109.7 |
| The Hongkong and Shanghai Banking Corporation ⁵⁰ | | | | | | |
| Period-end | 78.9 | 64.8 | 70.3 | 116.9 | 143.0 | 144.6 |
| Maximum | 78.9 | 64.8 | 70.3 | 144.6 | 165.4 | 148.3 |
| Minimum | 70.3 | 55.5 | 64.8 | 116.9 | 143.0 | 132.6 |
| Average | 75.1 | 59.7 | 67.7 | 128.4 | 154.9 | 141.9 |
| HSBC Bank USA | | | | | | |
| Period-end | 81.4 | 95.7 | 98.3 | 117.0 | 110.7 | 108.5 |
| Maximum | 98.3 | 104.0 | 98.3 | 128.3 | 112.9 | 118.5 |
| Minimum | 79.8 | 95.7 | 94.2 | 108.5 | 105.3 | 108.5 |
| Average | 86.3 | 100.4 | 95.4 | 121.7 | 110.1 | 114.3 |
| Total of HSBC's other principal banking entities ⁵¹ | | | | | | |
| Period-end | 89.2 | 85.7 | 89.1 | 117.4 | 123.7 | 119.6 |
| Maximum | 89.8 | 87.2 | 89.1 | 120.8 | 126.5 | 123.7 |
| Minimum | 88.2 | 85.7 | 85.7 | 116.9 | 120.9 | 118.1 |
| Average | 89.2 | 86.6 | 87.2 | 118.8 | 123.7 | 121.0 |

For footnotes, see page 146.

Stressed one month coverage ratio

The stressed one month coverage ratios tabulated above are derived from projected cash flow scenario analyses, described in the Appendix to Risk on page 152 and express the stressed cash inflows as a percentage of stressed cash outflows over a one month time horizon. Group sites are required to target a ratio of 100% or greater.

HSBC Finance

As HSBC Finance is unable to accept standard retail deposits, it takes funding from the professional markets and securitises assets. At 30 June 2011, US\$56bn (30 June 2010: US\$73bn; 31 December 2010: US\$62bn) of HSBC Finance's liabilities were drawn from professional markets, utilising a range of products, maturities and currencies.

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Interim Management Report (continued)*HSBC Finance funding*

| | At | At | At |
|--|--------|--------|--------|
| | 30 Jun | 30 Jun | 31 Dec |
| | 2011 | 2010 | 2010 |
| | US\$bn | US\$bn | US\$bn |
| Maximum amounts of unsecured term funding maturing in any rolling: | | | |
| 3-month period | 5.1 | 5.2 | 5.1 |
| 12-month period | 10.8 | 12.3 | 10.8 |
| Unused committed sources of secured funding ⁵² | 0.5 | 0.5 | 0.5 |
| Committed backstop lines from non-Group entities in support of CP programmes | 4.0 | 4.3 | 4.3 |

For footnote, see page 146.

HSBC Finance uses a range of measures to monitor funding risk, including projected cash flow scenario analysis and caps placed on the amount of unsecured term funding that can mature in any rolling three-month and rolling 12-month periods. HSBC Finance also maintains access to committed sources of secured funding and has in place committed backstop lines for short-term refinancing commercial paper (CP) programmes. A CP

programme is a short-term, unsecured funding tool used to manage day to day cash flow needs. In agreement with the rating agencies, issuance under this programme will not exceed 100% of committed bank backstop lines.

The need for HSBC Finance to refinance maturing term funding is mitigated by the continued run-down of its balance sheet.

Contingent liquidity risk

Contingent liquidity risk is the risk associated with the need to provide additional funds to clients. The client-originated exposure relates to multi-seller conduits, which were established to enable clients to access a flexible market-based source of finance (see page 212). HSBC-managed asset exposures are differentiated in that they relate to consolidated SICs which issue debt secured by ABSs (see page 211). Other conduit exposures relate to third-party sponsored conduits (see page 213). Single issuer liquidity facilities are provided directly to clients rather than via any form of conduit. These facilities are split by the addition of the five largest specific facilities and the single largest market sector.

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The Group's contractual exposures monitored under the contingent liquidity risk limit structure

| | The Hongkong and Shanghai Banking Corporation | | | | | | | | | | | |
|---|---|-------------|-------------|---------------|-------------|-------------|------------------|-------------|-------------|-------------|-------------|-------------|
| | HSBC Bank | | | HSBC Bank USA | | | HSBC Bank Canada | | | Corporation | | |
| | At | At | At | At | At | At | At | At | At | At | At | |
| | 30 Jun 2011 | 30 Jun 2010 | 31 Dec 2010 | 30 Jun 2011 | 30 Jun 2010 | 31 Dec 2010 | 30 Jun 2011 | 30 Jun 2010 | 31 Dec 2010 | 30 Jun 2011 | 30 Jun 2010 | 31 Dec 2010 |
| US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | |
| Conduits | | | | | | | | | | | | |
| Client-originated assets | | | | | | | | | | | | |
| total lines | 9.2 | 7.3 | 7.8 | 1.2 | 5.1 | 4.0 | 0.7 | 0.1 | 0.2 | | 0.2 | |
| largest individual lines | 0.4 | 0.8 | 0.7 | 0.4 | 0.5 | 0.4 | 0.5 | 0.1 | 0.1 | | 0.2 | |
| HSBC-managed assets ⁵³ | 23.6 | 26.9 | 25.6 | | | | | | | | | |
| Other conduits | | | | 1.1 | 1.3 | 1.4 | | | | | | |
| Single-issuer liquidity facilities | | | | | | | | | | | | |
| five largest | 5.4 | 4.1 | 4.2 | 6.6 | 5.7 | 5.3 | 2.2 | 2.0 | 2.0 | 1.9 | 2.8 | 1.4 |
| largest market sector | 9.8 | 6.8 | 8.4 | 5.1 | 4.4 | 4.9 | 4.3 | 3.5 | 3.8 | 2.6 | 2.9 | 2.4 |

For footnote, see page 146.

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| <u>Defined benefit pension schemes</u> | 140 |
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Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

There have been no material changes to our policies and practices for the management of market risk as described in the *Annual Report and Accounts 2010*.

Exposure to market risk

Exposure to market risk is separated into two portfolios:

Trading portfolios include positions arising from market-making and position-taking and others designated as marked to market.

Non-trading portfolios include positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations (see page 142).

Monitoring and limiting market risk exposures

Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with our status as one of the world's largest banking and financial services organisations.

We use a range of tools to monitor and limit market risk exposures, including:

sensitivity measures are used to monitor the market risk positions within each risk type;

value at risk (VAR) is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence; and

in recognition of VAR's limitations we augment VAR with *stress testing* to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables.

The major contributor to the trading and non-trading VAR for the Group is Global Markets.

A summary of our current policies and practices regarding market risk is provided in the Appendix to Risk on page 153.

Market risk in the first half of 2011

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During the first half of 2011 the market continued to be dominated by concerns over sovereign debt and its contagion effects. Middle East turmoil, coupled with the perception that the world economic recovery remained fragile, created volatility in financial markets. In addition, inflationary pressures remained in emerging markets.

The overall impact on VAR was limited, however, as historical data was superseded by less volatile current data in the VAR model.

Further details of trading exposures to eurozone countries under pressure are described on page 98.

Trading and non-trading portfolios

The following table provides an overview of the reporting of risks within this section:

| Risk type | Trading | Portfolio | Non-trading |
|--------------------------------|---------|-----------|-------------------|
| Foreign exchange and commodity | VAR | | VAR ⁵⁴ |
| Interest rate | VAR | | VAR ⁵⁵ |
| Equity | VAR | | Sensitivity |
| Credit spread | VAR | | VAR ⁵⁶ |

For footnotes, see page 146.

Value at risk of the trading and non-trading portfolios

The VAR, both trading and non-trading, for the Group is below. Comparative data have been restated to include credit spread.

Value at risk

| | 30 June 2011 US\$m | Half-year to 30 June 2010 ⁵⁷ US\$m | 31 December 2010 US\$m |
|---------------|--------------------------|--|------------------------------|
| At period-end | 249.7 | 415.8 | 371.6 |
| Average | 289.5 | 294.4 | 418.1 |
| Minimum | 241.1 | 205.3 | 304.1 |
| Maximum | 403.2 | 482.0 | 556.3 |

For footnote, see page 146.

During the first half of 2011, the reduction in VAR mainly came from the non-trading interest rate and credit portfolios. This reduction was the result of volatility rolling out of the historical market data in our VAR model, offset by a reduction in portfolio diversification.

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Interim Management Report (continued)*Daily distribution of Global Markets trading, Balance Sheet Management and other trading revenue⁵⁸*

| | 30 Jun | Half-year to 30 Jun | 31 Dec |
|--|-----------------|------------------------|----------------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Average daily revenue | 50.7 | 60.0 | 38.9 |
| Standard deviation ⁵⁹ | 25.8 | 46.6 | 22.1 |
| Ranges of most frequent daily revenues | 30 to 40 | 60 to 70 | 30 to 40 40 to 50 |
| | days | days | days |
| daily occurrences | 25 | 21 | 24 |
| Days of negative revenue | 2 | 5 | 4 |

*For footnotes, see page 146.***Half-year to 30 June 2011****Number of days**

Half-year to 30 June 2010

Number of days

Half-year to 31 December 2010

Number of days

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The daily VAR, both trading and non-trading, for the Group was as follows:

Daily VAR (trading and non-trading)

(US\$m)

For a description of HSBC's fair value and price verification controls, see page 188.

Trading portfolios

Our control of market risk in the trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by Group Risk, of enforcing new product approval procedures and of restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

The VAR for trading intent activity within Global Markets (as analysed on page 138 by risk type) at 30 June 2011 (US\$91.6m) was higher than at 31 December 2010 (US\$80.8m) due to a reduction in the portfolio diversification benefit across asset classes. However, it was lower than the level at 30 June 2010 (US\$117.7m) as the volatile historical market data rolled off.

Credit spread risk

At 30 June 2011, the Group credit spread VAR was US\$43.5m (30 June 2010: US\$91.7m; 31 December 2010: US\$41.9m). Group credit spread VAR remained consistent with 31 December 2010 though it decreased compared with 30 June 2010 from the effect of volatile credit spread scenarios rolling off from the VAR calculation.

Credit spread risk also arises on credit derivative transactions entered into by Global Banking in order to manage the risk concentrations within our corporate loan portfolio and enhance capital efficiency.

At 30 June 2011, the credit VAR on these transactions was US\$3.7m (30 June 2010: US\$11.6m; 31 December 2010: US\$12.3m). The mark-to-market of these transactions is reflected in the income statement.

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Interim Management Report (continued)**Gap risk**

We did not incur any significant gap loss in the half-year to 30 June 2011.

Non-trading portfolios

The principal objective of market risk management of non-trading portfolios is to optimise net interest income.

VAR by risk type for trading intent activities⁶⁰

| | Foreign exchange and commodity | Interest rate | Equity | Credit spread ⁶¹ | Portfolio diversification ⁶² | Total ⁶³ |
|---------------------------|--------------------------------------|------------------|-------------|--------------------------------|--|---------------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 30 June 2011 | 10.3 | 67.0 | 4.1 | 38.7 | (28.5) | 91.6 |
| At 30 June 2010 | 21.7 | 43.3 | 3.8 | 91.7 | (42.8) | 117.7 |
| At 31 December 2010 | 24.9 | 49.5 | 13.0 | 39.1 | (45.6) | 80.8 |
| Average | | | | | | |
| First half of 2011 | 15.0 | 52.0 | 9.2 | 46.2 | (28.8) | 93.6 |
| First half of 2010 | 31.4 | 56.1 | 11.6 | 63.6 | (39.3) | 123.3 |
| Second half of 2010 | 23.1 | 47.3 | 6.9 | 60.4 | (33.7) | 104.0 |
| Minimum | | | | | | |
| First half of 2011 | 7.6 | 30.1 | 3.6 | 34.7 | | 62.2 |
| First half of 2010 | 13.2 | 43.3 | 2.9 | 40.9 | | 93.6 |
| Second half of 2010 | 8.0 | 34.7 | 3.5 | 33.7 | | 55.0 |
| Maximum | | | | | | |
| First half of 2011 | 26.8 | 80.2 | 17.2 | 56.2 | | 143.9 |
| First half of 2010 | 62.9 | 88.9 | 21.6 | 88.5 | | 169.7 |
| Second half of 2010 | 56.3 | 71.8 | 13.3 | 102.5 | | 212.2 |

For footnotes, see page 146.

Available-for-sale debt securities

At 30 June 2011, the sensitivity of equity capital to the effect of movements in credit spreads on our available-for-sale debt securities, including the gross exposure for the SICs consolidated within our balance sheet, based on credit spread VAR, was US\$220m (30 June 2010: US\$491m; 31 December 2010: US\$299m). This sensitivity is calculated before taking into account losses which would have been absorbed by the capital

note holders.

At 30 June 2011, the capital note holders can absorb the first US\$2.2bn (30 June 2010: US\$2.2bn; 31 December 2010: US\$2.2bn) of any losses incurred by the SICs before we incur any equity losses.

Equity securities classified as available for sale

Fair values of equity securities

| | At | At | At |
|--|---------------|--------|--------|
| | 30 Jun | 30 Jun | 31 Dec |
| | 2011 | 2010 | 2010 |
| | US\$bn | US\$bn | US\$bn |
| Private equity holdings | 2.9 | 4.2 | 2.8 |
| Funds invested for short- term cash management | 0.6 | 0.5 | 0.5 |
| Investment to facilitate ongoing business | 1.1 | 1.0 | 1.0 |
| Other strategic investments | 3.6 | 3.1 | 3.7 |
| | | | |
| Total | 8.2 | 8.8 | 8.0 |

Investments in private equity are primarily made through managed funds that are subject to limits on the amount invested. Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio. Regular reviews are performed to substantiate the valuation of the investments within the portfolio and investments held to facilitate ongoing business, such as holdings in government-sponsored enterprises and local stock exchanges.

The fair value of the constituents of equity securities classified as available for sale can fluctuate considerably. A 10% reduction in the value of the available-for-sale equities at 30 June 2011 would have reduced equity by US\$0.8bn (30 June 2010: US\$0.9bn; 31 December 2010: US\$0.8bn). HSBC's policy for assessing impairment on available-for-sale equity securities is described on page 131 of the *Annual Report and Accounts 2010*.

Structural foreign exchange exposures

Structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than the US dollar. HSBC's policies and procedures for managing these exposures are described on page 149 in the *Annual Report and Accounts 2010*.

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Interim Management Report (continued)**Sensitivity of net interest income**

There have been no material changes since 31 December 2010 to HSBC's measurement and management of the sensitivity of net interest income to movements in interest rates.

The table below sets out the effect on future net interest income of an incremental 25 basis points parallel rise or fall in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 July 2011. Assuming no management actions, a sequence of such rises would increase

planned net interest income for the 12 months to 30 June 2012 by US\$1,020m (to 31 December 2011: US\$882m), while a sequence of such falls would decrease planned net interest income by US\$1,618m (to 31 December 2011: US\$1,525m). These figures incorporate the effect of any option features in the underlying exposures.

Instead of assuming that all interest rates move together, HSBC groups its interest rate exposures into currency blocs whose rates are considered likely to move together. The sensitivity of projected net interest income, on this basis, is as follows:

Sensitivity of projected net interest income

| | Rest of | | | | | | Total |
|--|-------------------|-----------------------------|---------------------|--------------|------------------|--------------|---------|
| | US dollar bloc | Rest of Americas bloc | Hong Kong dollar | Asia bloc | Sterling bloc | Euro bloc | |
| | | | bloc | | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Change in July 2011 to June 2012 projected net interest income arising from a shift in yield curves at the beginning of each quarter of: | | | | | | | |
| + 25 basis points | 237 | 2 | 223 | 242 | 430 | (114) | 1,020 |
| - 25 basis points | (568) | (6) | (309) | (196) | (614) | 75 | (1,618) |
| Change in January 2011 to December 2011 projected net interest income arising from a shift in yield curves at the beginning of each quarter of: | | | | | | | |
| + 25 basis points | 164 | 72 | 191 | 245 | 292 | (82) | 882 |
| - 25 basis points | (550) | (68) | (280) | (143) | (546) | 62 | (1,525) |

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The interest rate sensitivities set out in the table above are illustrative only and are based on simplified scenarios. The limitations of this analysis are discussed in the Appendix to Risk on page 153.

HSBC monitors the sensitivity of reported reserves to interest rate movements on a monthly basis by assessing the expected reduction in

valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100 basis points in all yield curves. The table below describes the sensitivity of HSBC's reported reserves to these movements and the maximum and minimum month-end figures during the period:

Sensitivity of reported reserves to interest rate movements

| | <u>Impact in the preceding 6 months</u> | | |
|---|---|------------------|------------------|
| | US\$m | Maximum US\$m | Minimum US\$m |
| At 30 June 2011 | | | |
| + 100 basis point parallel move in all yield curves | (5,889) | (6,178) | (5,889) |
| As a percentage of total shareholders' equity | (3.7%) | (3.9%) | (3.7%) |
| | | | |
| 100 basis point parallel move in all yield curves | 6,081 | 6,329 | 6,081 |
| As a percentage of total shareholders' equity | 3.8% | 4.0% | 3.8% |
| | | | |
| At 30 June 2010 | | | |
| + 100 basis point parallel move in all yield curves | (4,714) | (4,714) | (3,096) |
| As a percentage of total shareholders' equity | (3.5%) | (3.5%) | (2.3%) |
| | | | |
| 100 basis point parallel move in all yield curves | 4,690 | 4,690 | 3,108 |
| As a percentage of total shareholders' equity | 3.5% | 3.5% | 2.3% |
| | | | |
| At 31 December 2010 | | | |
| + 100 basis point parallel move in all yield curves | (6,162) | (6,162) | (4,549) |
| As a percentage of total shareholders' equity | (4.2%) | (4.2%) | (3.1%) |
| | | | |
| 100 basis point parallel move in all yield curves | 6,174 | 6,174 | 4,604 |
| As a percentage of total shareholders' equity | 4.2% | 4.2% | 3.1% |

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Interim Management Report (continued)

The sensitivities are illustrative only and are based on simplified scenarios. The table above shows the potential sensitivity of reserves to valuation changes in available-for-sale portfolios and from cash flow hedges following the pro forma movements in interest rates. These particular exposures form only a part of the Group's overall interest rate exposures. The accounting treatment under IFRSs of the Group's remaining interest rate exposures, while economically largely offsetting the exposures shown in the above table, does not require revaluation movements to go to reserves.

Defined benefit pension schemes

Market risk arises within HSBC's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows.

HSBC's defined benefit pension schemes

| | At 30 Jun 2011 US\$bn | At 30 Jun 2010 US\$bn | At 31 Dec 2010 US\$bn |
|-----------------------------|--------------------------------|--------------------------------|--------------------------------|
| Liabilities (present value) | 33.7 | 30.0 | 32.6 |
| | % | % | % |
| Assets: | | | |
| Equity investments | 20 | 20 | 20 |
| Debt securities | 69 | 67 | 66 |
| Other (including property) | 11 | 13 | 14 |
| | 100 | 100 | 100 |

Higher corporate bond yields in the UK in 2011 resulted in an increase of 10 basis points in the real discount rate (net of the increase in expected inflation) used to value the accrued benefits payable under the HSBC Bank (UK) Pension Scheme (the Scheme) funded defined benefit plan (the principal plan), the Group's largest plan. The effect of the discount rate change, and other market and actuarial movements in the first half of the year on the principal plan is set out in Note 5 on the Financial Statements.

For details of the latest actuarial valuation of the principal plan, see Note 7 on the Financial Statements in the *Annual Report and Accounts 2010*.

Additional market risk measures applicable only to the parent company

Interest repricing gap table

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The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included within the Group VAR, but is managed on a repricing gap basis. The interest rate repricing gap table below analyses the full-term structure of interest rate mismatches within HSBC Holdings balance sheet. The change in the interest rate gap profile between 30 June 2010 and 30 June 2011 is predominantly due to new variable rate loans to HSBC entities.

Repricing gap analysis of HSBC Holdings

| | Total US\$m | Up to | | | | Non- interest bearing US\$m |
|--|------------------------|-------------------------|----------------------------|-----------------------------|---|--|
| | | 1 year US\$m | 1-5 years US\$m | 5-10 years US\$m | More than 10 years US\$m | |
| At 30 June 2011 | | | | | | |
| Total assets | 123,004 | 27,224 | 1,175 | 1,021 | 624 | 92,960 |
| Total liabilities and equity | (123,004) | (3,886) | (12,468) | (16,243) | (13,373) | (77,034) |
| Off-balance sheet items sensitive to interest rate changes | | (18,990) | 10,033 | 6,315 | 3,535 | (893) |
| Net interest rate risk gap | | 4,348 | (1,260) | (8,907) | (9,214) | 15,033 |
| Cumulative interest rate gap | | 4,348 | 3,088 | (5,819) | (15,033) | |
| At 30 June 2010 | | | | | | |
| Total assets | 117,838 | 18,701 | 1,648 | 300 | 3,733 | 93,456 |
| Total liabilities and equity | (117,838) | (3,290) | (9,844) | (6,376) | (20,455) | (77,873) |
| Off-balance sheet items sensitive to interest rate changes | | (15,302) | 6,724 | 3,899 | 3,794 | 885 |
| Net interest rate risk gap | | 109 | (1,472) | (2,177) | (12,928) | 16,468 |
| Cumulative interest rate gap | | 109 | (1,363) | (3,540) | (16,468) | |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

| | Total | Up to | | 5-10 | More | Non- |
|--|-----------|----------|-----------|----------|----------|----------|
| | US\$m | 1 year | 1-5 years | years | than | interest |
| At 31 December 2010 | US\$m | US\$m | US\$m | US\$m | 10 years | bearing |
| | | | | | US\$m | US\$m |
| Total assets | 119,341 | 21,475 | 1,175 | 2,354 | 1,336 | 93,001 |
| Total liabilities and equity | (119,341) | (3,016) | (10,427) | (14,330) | (13,193) | (78,375) |
| Off-balance sheet items sensitive to interest rate changes | | (15,302) | 7,221 | 4,403 | 3,409 | 269 |

| | | | | | | |
|----------------------------|--|-------|---------|---------|---------|--------|
| Net interest rate risk gap | | 3,157 | (2,031) | (7,573) | (8,448) | 14,895 |
|----------------------------|--|-------|---------|---------|---------|--------|

| | | | | | | |
|------------------------------|--|-------|-------|---------|----------|--|
| Cumulative interest rate gap | | 3,157 | 1,126 | (6,447) | (14,895) | |
|------------------------------|--|-------|-------|---------|----------|--|

Foreign exchange risk

Total foreign exchange VAR arising within HSBC Holdings was as follows:

HSBC Holdings foreign exchange VAR

| | 30 June 2011 US\$m | Half-year to 30 June 2010 US\$m | 31 December 2010 US\$m |
|---------------|-----------------------------|--|------------------------------|
| At period end | 43.4 | 55.3 | 40.4 |
| Average | 40.7 | 62.8 | 50.3 |
| Minimum | 38.2 | 52.7 | 40.2 |
| Maximum | 43.4 | 83.2 | 55.9 |

The foreign exchange risk largely arises from loans to subsidiaries of a capital nature that are not denominated in the functional currency of either the provider or the recipient and which are accounted for as financial assets. Changes in the carrying amount of these loans due to foreign exchange rate differences are taken directly to HSBC Holdings income statement. These loans, and the associated foreign exchange exposures, are eliminated on a Group consolidated basis.

Operational risk

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Operational risk is relevant to every aspect of our business, and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

There have been no material changes to our policies and procedures for the management of operational risk as described in the *Annual Report and Accounts 2010*.

A summary of our current policies and practices regarding operational risk and reputational risk is provided in the Appendix to Risk on pages 156 and 157.

HSBC has continued to enhance its Operational Risk Management Framework including the use of the risk and control assessment process that provides business areas and functions with a forward-looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels.

Operational risk in the first half of 2011

During the first half of 2011, our top and emerging risk analysis included a number of risks which were of an operational nature:

challenges to our operating model in an economic downturn (in developed countries) and rapid growth (in emerging markets);

internet crime and fraud;

level of change creating operational complexity; and

information security.

There were no material issues relating to fraud and security during the period.

Reputational risk

The safeguarding of our reputation is of paramount importance to our continued prosperity and is the responsibility of every member of staff.

There have been no material changes to our objectives, policies and procedures for the management of reputational risk as described in the *Annual Report and Accounts 2010*.

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Interim Management Report (continued)

Risk management of insurance operations

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| <u>Insurance risk in the first half of 2011</u> | 142 |
| <u>Balance sheet of insurance manufacturing subsidiaries by type of contract</u> | 144 |

Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC).

There have been no material changes to our policies and practices for the management of insurance risk, including the risks relating to different life and non-life products, as described in the *Annual Report and Accounts 2010*.

A summary of our policies and practices regarding insurance risk, and the main contracts we manufacture, is provided in the Appendix to Risk on page 157.

HSBC's bancassurance model

We operate a bancassurance model which provides insurance products for customers with whom we have a banking relationship. Insurance products are sold to all customer groups, mainly utilising retail branches, the internet and phone centres. RBWM customers attract the majority of sales and comprise the majority of policyholders.

Many of these insurance products are manufactured by our subsidiaries. This allows us to retain the risks and rewards associated with writing insurance contracts as both the underwriting profit and the commission paid by the manufacturer to the bank distribution channel are kept within the Group.

Where we consider it operationally more effective, third parties are engaged to manufacture insurance products for sale through our banking network. We work with a limited number of market-leading partners to provide the products. These arrangements earn us a commission.

Our bancassurance business operates in all six of our geographical regions with over 30 legal

entities, the majority of which are subsidiaries of banking legal entities, manufacturing insurance products.

The insurance contracts we sell primarily relate to core underlying banking activities, such as savings and investment products, and credit life products.

Our manufacturing business concentrates on personal lines, e.g. contracts written for individuals. This focus on the higher volume, lower individual value personal lines contributes to diversifying risk.

Insurance risk in the first half of 2011

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The principal insurance risk we face is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.

In respect of financial risks, subsidiaries manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising a discretionary bonus feature within the policy.

In January 2009, the Competition Commission (CC) published its report into the PPI market in which it stipulated that short-term income protection (STIP) products will also be subject to their remedies when sold in conjunction with or as a result of a referral following the sale of a loan or similar credit product. We have undertaken an analysis of the required changes to our STIP product and its sales processes resulting from the CC s remedies. On 14 October 2010, the CC confirmed that it intended to proceed with a point of sale ban and this will come into effect on 6 April 2012.

The following tables analyse our insurance risk exposures by geographical region and by type of business. The exposures remain consistent with those observed at 31 December 2010.

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Interim Management Report (continued)*Analysis of life insurance risk liabilities to policyholders⁶⁴*

| | Europe US\$m | Hong Kong US\$m | Rest of Asia- Pacific US\$m | North America US\$m | Latin America US\$m | Total US\$m |
|--|-----------------|-----------------------|--------------------------------------|---------------------------|---------------------------|----------------|
| At 30 June 2011 | | | | | | |
| Life (non-linked) | 1,621 | 19,957 | 997 | 992 | 2,282 | 25,849 |
| Insurance contracts with DPF ⁶⁵ | 364 | 18,875 | 316 | | | 19,555 |
| Credit life | 482 | | 51 | 34 | 2 | 569 |
| Annuities | 473 | | 72 | 749 | 1,699 | 2,993 |
| Term assurance and other long-term contracts | 302 | 1,082 | 558 | 209 | 581 | 2,732 |
| Life (linked) | 2,563 | 3,460 | 525 | | 5,184 | 11,732 |
| Investment contracts with DPF ^{65,66} | 24,652 | | 16 | | | 24,668 |
| Insurance liabilities to policyholders | 28,836 | 23,417 | 1,538 | 992 | 7,466 | 62,249 |
| At 30 June 2010 | | | | | | |
| Life (non-linked) | 1,789 | 16,261 | 617 | 1,017 | 2,002 | 21,686 |
| Insurance contracts with DPF ⁶⁵ | 286 | 15,663 | 240 | | | 16,189 |
| Credit life | 664 | | 41 | 40 | 1 | 746 |
| Annuities | 409 | | 27 | 771 | 1,559 | 2,766 |
| Term assurance and other long-term contracts | 430 | 598 | 309 | 206 | 442 | 1,985 |
| Life (linked) | 1,785 | 2,875 | 422 | | 3,702 | 8,784 |
| Investment contracts with DPF ^{65,66} | 19,636 | | 35 | | | 19,671 |
| Insurance liabilities to policyholders | 23,210 | 19,136 | 1,074 | 1,017 | 5,704 | 50,141 |
| At 31 December 2010 | | | | | | |
| Life (non-linked) | 1,679 | 17,989 | 789 | 1,004 | 2,122 | 23,583 |
| Insurance contracts with DPF ⁶⁵ | 327 | 17,203 | 278 | | | 17,808 |
| Credit life | 565 | | 72 | 36 | 2 | 675 |
| Annuities | 471 | | 31 | 760 | 1,622 | 2,884 |

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| | | | | | | |
|--|--------|--------|-------|-------|-------|--------|
| Term assurance and other long-term contracts | 316 | 786 | 408 | 208 | 498 | 2,216 |
| Life (linked) | 2,274 | 3,235 | 485 | | 4,502 | 10,496 |
| Investment contracts with DPF ^{65,66} | 22,052 | | 22 | | | 22,074 |
| Insurance liabilities to policyholders | 26,005 | 21,224 | 1,296 | 1,004 | 6,624 | 56,153 |

For footnotes, see page 146.

Analysis of non-life insurance risk net written insurance premiums^{64,67}

| | Hong | | | | | Total |
|--|-----------|------------|-----------|-----------|------------|------------|
| | Europe | Kong | Rest of | North | Latin | |
| | US\$m | US\$m | Asia- | America | America | US\$m |
| | US\$m | US\$m | Pacific | US\$m | US\$m | US\$m |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | |
| Accident and health | 19 | 91 | 5 | 1 | 20 | 136 |
| Motor | | 8 | 15 | | 160 | 183 |
| Fire and other damage | 9 | 14 | 5 | 12 | 13 | 53 |
| Liability | | 10 | 3 | | 1 | 14 |
| Credit (non-life) | 7 | | | 27 | 1 | 35 |
| Marine, aviation and transport | | 5 | 2 | | 12 | 19 |
| Other non-life insurance contracts | 6 | 18 | | 4 | 46 | 74 |
| Total net written insurance premiums | 41 | 146 | 30 | 44 | 253 | 514 |
| | | | | | | |
| Net insurance claims incurred and movement in liabilities to policyholders | 25 | (67) | (14) | (7) | (115) | (178) |
| | | | | | | |
| Half-year to 30 June 2010 | | | | | | |
| Accident and health | 45 | 85 | 4 | 1 | 19 | 154 |
| Motor | | 7 | 15 | | 130 | 152 |
| Fire and other damage | 22 | 17 | 4 | 8 | 10 | 61 |
| Liability | | 12 | 2 | | | 14 |
| Credit (non-life) | 11 | | | 28 | 1 | 40 |
| Marine, aviation and transport | 1 | 5 | 3 | | 8 | 17 |
| Other non-life insurance contracts | 13 | 18 | | 5 | 40 | 76 |
| Total net written insurance premiums | 92 | 144 | 28 | 42 | 208 | 514 |
| | | | | | | |
| Net insurance claims incurred and movement in liabilities to policyholders | (85) | (61) | (13) | (3) | (85) | (247) |

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| | Europe US\$m | Rest of | | | | Total US\$m |
|---|-----------------|-----------------------|---------------------------|---------------------------|---------------------------|----------------|
| | | Hong Kong US\$m | Asia- Pacific US\$m | North America US\$m | Latin America US\$m | |
| Half-year to 31 December 2010 | | | | | | |
| Accident and health | 33 | 89 | 4 | 2 | 18 | 146 |
| Motor | | 8 | 13 | | 137 | 158 |
| Fire and other damage | 16 | 12 | 7 | 8 | 12 | 55 |
| Liability | | 8 | 2 | | 2 | 12 |
| Credit (non-life) | 14 | | | 25 | 1 | 40 |
| Marine, aviation and transport | 2 | 5 | 1 | | 10 | 18 |
| Other non-life insurance contracts | 7 | 21 | 1 | 4 | 44 | 77 |
| Total net written insurance premiums | 72 | 143 | 28 | 39 | 224 | 506 |
| Net insurance claims incurred and movement in liabilities to policyholders | (84) | (56) | (12) | (10) | (116) | (278) |

For footnotes, see page 146.

Credit non-life insurance is concentrated in North America and Europe, and is originated in conjunction with the provision of loans. Following a decision taken to close the Consumer Lending network in the US, insurance products written in conjunction with this business are being run off.

Balance sheet of insurance manufacturing subsidiaries by type of contract

A principal tool we use to manage our exposure to insurance risk, in particular for life insurance contracts, is asset and liability matching.

The table below shows the composition of assets and liabilities and demonstrates that there were sufficient assets to cover the liabilities to policyholders at 30 June 2011.

Balance sheet of insurance manufacturing subsidiaries by type of contract

| | Insurance contracts | | | | | Investment contracts | | | | Total US\$m |
|---|----------------------|--------------------------|-------------------------|------------------------------|----------|------------------------------------|--------------------------|----------------|--|----------------|
| | With DPF US\$m | Unit- linked US\$m | Annu- ities US\$m | Term | | With DPF ⁶⁶ US\$m | Unit- linked US\$m | Other US\$m | Other assets ⁶⁹ US\$m | |
| | | | | assur- ance ⁶⁸ | Non-life | | | | | |
| | | | | US\$m | US\$m | | | | | |
| At 30 June 2011 | | | | | | | | | | |
| Financial assets | 19,436 | 10,962 | 2,734 | 3,233 | 2,434 | 24,112 | 8,771 | 4,038 | 7,371 | 83,091 |
| trading assets | | | | | 34 | | | | | 34 |
| financial assets designated at fair value | 1,683 | 10,664 | 474 | 646 | 221 | 6,426 | 8,050 | 1,529 | 1,641 | 31,334 |
| derivatives | 54 | 1 | 1 | 10 | 1 | 279 | 11 | 1 | 2 | 360 |
| financial investments | 14,650 | | 1,929 | 2,061 | 1,169 | 16,178 | | 1,789 | 4,274 | 42,050 |
| other financial assets | 3,049 | 297 | 330 | 516 | 1,009 | 1,229 | 710 | 719 | 1,454 | 9,313 |
| Reinsurance assets PVIF ⁷⁰ | 13 | 802 | 395 | 243 | 424 | | | | 59 | 1,936 |
| Other assets and investment properties | 216 | 10 | 26 | 363 | 208 | 557 | 23 | 51 | 697 | 4,186 |
| Total assets | 19,665 | 11,774 | 3,155 | 3,839 | 3,066 | 24,669 | 8,794 | 4,089 | 12,313 | 2,151 |
| Liabilities under investment contracts: designated at fair value carried at amortised cost | | | | | | | 8,762 | 3,429 | | 12,191 |
| Liabilities under insurance contracts | 19,555 | 11,732 | 2,993 | 3,301 | 2,202 | 24,668 | | 485 | | 485 |
| Deferred tax | 13 | | 22 | 6 | 6 | | | 1 | 970 | 64,451 |
| Other liabilities | | | | | | | | | 2,213 | 1,018 |
| Total liabilities | 19,568 | 11,732 | 3,015 | 3,307 | 2,208 | 24,668 | 8,762 | 3,915 | 3,183 | 2,213 |
| Total equity | | | | | | | | | 11,006 | 11,006 |
| Total equity and liabilities ⁷¹ | 19,568 | 11,732 | 3,015 | 3,307 | 2,208 | 24,668 | 8,762 | 3,915 | 14,189 | 91,364 |

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| | Insurance contracts | | | | | Investment contracts | | | | Total US\$m |
|---|----------------------|--------------------------|-------------------------|---|-------------------|------------------------------------|--------------------------|----------------|--|----------------|
| | With DPF US\$m | Unit- linked US\$m | Annu- ities US\$m | Term assur- ance ⁶⁸ US\$m | Non-life US\$m | With DPF ⁶⁶ US\$m | Unit- linked US\$m | Other US\$m | Other assets ⁶⁹ US\$m | |
| At 30 June 2010 | | | | | | | | | | |
| Financial assets | 16,070 | 7,947 | 2,686 | 2,379 | 2,025 | 19,273 | 6,944 | 3,988 | 6,825 | 68,137 |
| trading assets | | | | | 10 | | | | | 10 |
| financial assets designated at fair value | 876 | 7,643 | 549 | 609 | 56 | 5,018 | 5,838 | 1,450 | 1,207 | 23,246 |
| derivatives | 25 | | | 1 | | 131 | 362 | 1 | 9 | 529 |
| financial investments | 13,371 | | 1,743 | 1,196 | 645 | 13,478 | | 1,757 | 4,293 | 36,483 |
| other financial assets | 1,798 | 304 | 394 | 573 | 1,314 | 646 | 744 | 780 | 1,316 | 7,869 |
| Reinsurance assets | 7 | 872 | 343 | 273 | 422 | | | | 65 | 1,982 |
| PVIF ⁷⁰ | | | | | | | | | 2,966 | 2,966 |
| Other assets and investment properties | 192 | 6 | 18 | 436 | 215 | 398 | 17 | 45 | 648 | 1,975 |
| Total assets | 16,269 | 8,825 | 3,047 | 3,088 | 2,662 | 19,671 | 6,961 | 4,033 | 10,504 | 75,060 |
| Liabilities under investment contracts: designated at fair value carried at amortised cost | | | | | | | 6,934 | 3,450 | | 10,384 |
| | | | | | | | | 413 | | 413 |
| Liabilities under insurance contracts | 16,189 | 8,784 | 2,766 | 2,731 | 2,375 | 19,671 | | | | 52,516 |
| Deferred tax | 7 | | 19 | 3 | 5 | 1 | | 2 | 626 | 663 |
| Other liabilities | | | | | | | | | 1,974 | 1,974 |
| Total liabilities | 16,196 | 8,784 | 2,785 | 2,734 | 2,380 | 19,672 | 6,934 | 3,865 | 2,600 | 65,950 |
| Total equity | | | | | | | | | 9,110 | 9,110 |

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| | | | | | | | | | | |
|--|--------|--------|-------|-------|-------|--------|-------|-------|--------|--------|
| Total equity and liabilities ⁷¹ | 16,196 | 8,784 | 2,785 | 2,734 | 2,380 | 19,672 | 6,934 | 3,865 | 11,710 | 75,060 |
| At 31 December 2010 | | | | | | | | | | |
| Financial assets | 17,665 | 9,763 | 2,615 | 2,671 | 2,231 | 21,511 | 8,338 | 3,927 | 7,157 | 75,878 |
| trading assets | | | | | | 11 | | | | 11 |
| financial assets | | | | | | | | | | |
| designated at fair value | 1,206 | 9,499 | 413 | 523 | 180 | 5,961 | 7,624 | 1,486 | 1,452 | 28,344 |
| derivatives | 53 | | 1 | 6 | | 229 | 7 | 1 | 4 | 301 |
| financial investments | 14,068 | | 1,847 | 1,661 | 692 | 14,465 | | 1,804 | 4,495 | 39,032 |
| other financial assets | 2,338 | 264 | 354 | 481 | 1,348 | 856 | 707 | 636 | 1,206 | 8,190 |
| Reinsurance assets | 10 | 760 | 400 | 263 | 432 | | | | 79 | 1,944 |
| PVIF ⁷⁰ | | | | | | | | | 3,440 | 3,440 |
| Other assets and investment properties | 189 | 6 | 21 | 398 | 213 | 565 | 14 | 56 | 712 | 2,174 |
| Total assets | 17,864 | 10,529 | 3,036 | 3,332 | 2,876 | 22,076 | 8,352 | 3,983 | 11,388 | 83,436 |
| Liabilities under investment contracts: | | | | | | | | | | |
| designated at fair value | | | | | | | 8,321 | 3,379 | | 11,700 |
| carried at amortised cost | | | | | | | | 439 | | 439 |
| Liabilities under insurance contracts | 17,808 | 10,496 | 2,884 | 2,891 | 2,456 | 22,074 | | | | 58,609 |
| Deferred tax | 11 | | 20 | 4 | 6 | | | 1 | 793 | 835 |
| Other liabilities | | | | | | | | | 2,075 | 2,075 |
| Total liabilities | 17,819 | 10,496 | 2,904 | 2,895 | 2,462 | 22,074 | 8,321 | 3,819 | 2,868 | 73,658 |
| Total equity | | | | | | | | | 9,778 | 9,778 |
| Total equity and liabilities ⁷¹ | 17,819 | 10,496 | 2,904 | 2,895 | 2,462 | 22,074 | 8,321 | 3,819 | 12,646 | 83,436 |

For footnotes, see page 146.

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Footnotes to Risk

Credit risk

- 1 *The amount of the loan commitments reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. In addition to those amounts, there is a further maximum possible exposure to credit risk of US\$159.5bn (30 June 2010: US\$158.6bn; 31 December 2010: US\$220.2bn), reflecting the full take-up of such irrevocable loan commitments. The take-up of such offers is generally at modest levels.*
- 2 *Residential mortgages include Hong Kong Government Home Ownership Scheme loans of US\$3.4bn at 30 June 2011 (30 June 2010: US\$3.4bn; 31 December 2010: US\$3.5bn).*
- 3 *Other personal loans and advances include second lien mortgages and other personal property-related lending.*
- 4 *Other commercial loans and advances include advances in respect of agriculture, transport, energy and utilities.*
- 5 *Included within Total gross loans and advances to customers (TGLAC) is credit card lending of US\$59bn (30 June 2010: US\$61bn; 31 December 2010: US\$62bn).*
- 6 *The numbers in North America include a reclassification within the corporate and commercial lending category to reflect a more accurate presentation of lending in the region.*
- 7 *The impairment allowances on loans and advances to banks relate to the geographical regions, Europe, Middle East and North Africa, and North America.*
- 8 *We have not reclassified any assets from the available-for-sale category as permitted by the 2008 amendment to IAS 39, Financial instruments: Recognition and measurement . The majority of our available-for-sale holdings in sovereign and agency debt of Italy of US\$1.5bn is held to support insurance contracts which provide discretionary profit participation to policyholders. For such contracts, unrealised movements in liabilities are recognised in other comprehensive income, following the treatment of the unrealised movements on related available-for-sale assets. To the extent that the movements offset, no movement in the available-for-sale reserve is recognised.*
- 9 *Trading assets net of short positions.*
- 10 *Derivative assets net of collateral and derivative liabilities for which a legally enforceable right of offset exists.*
- 11 *Includes residential mortgages of HSBC Bank USA and HSBC Finance.*
- 12 *Comprising Hong Kong, Rest of Asia-Pacific, Middle East and North Africa, and Latin America.*
- 13 *Negative equity arises when the value of the property used to secure a loan is below the balance outstanding on the loan, generally based on values at the balance sheet date.*
- 14 *Loan-to-value ratios are generally based on values at the balance sheet date.*
- 15 *HSBC Finance lending is shown on a management basis and includes loans transferred to HSBC USA Inc. which are managed by HSBC Finance.*
- 16 *Interest-only (affordability mortgages) are loans which are classified as interest only for an initial period before reverting to repayment. As a consequence, in the table Mortgage lending products on page 105 these balances are included in the category Affordability mortgages, including ARMs .*
- 17 *Stated income lending forms a subset of total Mortgage Services lending across all categories.*
- 18 *By states which individually account for 5% or more of HSBC Finance s US customer loan portfolio.*
- 19 *The average loss on sale of foreclosed properties is calculated as cash proceeds after deducting selling costs, commissions and other ancillary costs, minus the book value of the property when it was moved to assets held for sale divided by the book value of the property when it was moved to assets held for sale.*
- 20 *The average total loss on foreclosed properties sold during each quarter includes both the loss on sale and the cumulative write-downs recognised on the loans up to and upon classification as assets held for sale. This average total loss on foreclosed properties is expressed as a percentage of the book value of the property prior to its transfer to assets held for sale.*
- 21 *Percentages are expressed as a function of the relevant gross loans and receivables balance.*
- 22 *At 30 June 2011, 31 December 2010 and 30 June 2010, real estate secured delinquency included US\$4.2bn, US\$4.2bn and US\$3.8bn, respectively, of loans that we carried at the lower of cost or net realisable value.*
- 23 *We observe the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see page 114, Past due but not impaired gross financial instruments).*
- 24 *The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost of recoveries.*
- 25 *Impairment allowances are not reported for financial instruments whereby the carrying amount is reduced directly for impairment and not through the use of an allowance account.*
- 26 *Impairment is not measured for assets held in trading portfolios or designated at fair value as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, all such balances are reported under Neither past due nor*

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impaired .

- 27 *Loans and advances to customers include asset-backed securities that have been externally rated as strong (30 June 2011: US\$4.1bn; 30 June 2010: US\$4.2bn; 31 December 2010: US\$4.1bn), good (30 June 2011: US\$748m; 30 June 2010: US\$1,039m; 31 December 2010: US\$627m), satisfactory (30 June 2011: US\$227m; 30 June 2010: US\$223m; 31 December 2010: US\$452m), sub-standard (30 June 2011: US\$480m; 30 June 2010: US\$511m; 31 December 2010: US\$669m) and impaired (30 June 2011: US\$49m; 30 June 2010: US\$243m; 31 December 2010: US\$29m).*
- 28 *Impaired loans and advances are those classified as CRR 9, CRR 10, EL 9 or EL 10 and all retail loans 90 days or more past due, unless individually they have been assessed as not impaired.*
- 29 *Collectively assessed loans and advances comprise homogeneous groups of loans that are not considered individually significant, and loans subject to individual assessment where no impairment has been identified on an individual basis, but on which a collective impairment allowance has been calculated to reflect losses which have been incurred but not yet identified.*
- 30 *Collectively assessed loans and advances not impaired are those classified as CRR1 to CRR8 and EL1 to EL8 but excluding retail loans 90 days past due.*
- 31 *Net of repo transactions, settlement accounts and stock borrowings.*
- 32 *As a percentage of loans and advances to banks and loans and advances to customers, as applicable.*
- 33 *Total includes holdings of ABSs issued by Freddie Mac and Fannie Mae.*
- 34 *Directly held includes assets held by Solitaire where we provide first loss protection and assets held directly by the Group.*

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- 35 Impairment charges allocated to capital note holders represent impairments where losses would be borne by external third-party investors in the structures.
- 36 Mortgage-backed securities (MBS s), asset-backed securities (ABS s) and collateralised debt obligations (CDO s).
- 37 High grade assets rated AA or AAA.
- 38 Gains or losses on the net principal exposure (footnote 44) recognised in the income statement as a result of changes in the fair value of the asset.
- 39 Fair value gains and losses on the net principal exposure (footnote 44) recognised in other comprehensive income as a result of the changes in the fair value of available-for-sale assets.
- 40 Realised fair value gains and losses on the net principal exposure (footnote 44) recognised in the income statement as a result of the disposal of assets or the receipt of cash flows from assets.
- 41 Reclassified from equity on impairment, disposal or payment. This includes impairment losses recognised in the income statement in respect of the net principal exposure (footnote 44) of available-for-sale assets. Payments are the contractual cash flows received on the assets.
- 42 The gross principal is the redemption amount on maturity or, in the case of an amortising instrument, the sum of the future redemption amounts through the residual life of the security.
- 43 A credit default swap (CDS) gross protection is the gross principal of the underlying instrument that is protected by CDSs.
- 44 Net principal exposure is the gross principal amount of assets that are not protected by CDSs. It includes assets that benefit from monoline protection, except where this protection is purchased with a CDS.
- 45 Carrying amount of the net principal exposure.
- 46 Net exposure after legal netting and any other relevant credit mitigation prior to deduction of the credit risk adjustment.
- 47 Cumulative fair value adjustment recorded against exposures to OTC derivative counterparties to reflect their creditworthiness.
- 48 Funded exposures represent the loan amount advanced to the customer, less any fair value write-downs, net of fees held on deposit.
- 49 Unfunded exposures represent the contractually committed loan facility amount not yet drawn down by the customer, less any fair value write-downs, net of fees held on deposit.

Liquidity and funding

- 50 Figures provided for HSBC Bank plc and The Hongkong and Shanghai Banking Corporation incorporate all overseas branches. Subsidiaries of these entities are not included unless there is unrestricted transferability of liquidity between the subsidiaries and the parent. The comparatives for the stressed one month coverage ratio during the half-year to 30 June 2010 have been revised upwards to better reflect intra-Group netting.
- 51 This comprises our main banking subsidiaries and, as such, includes businesses spread across a range of locations, in many of which we may require a higher ratio of advances to core funding to reflect local market conditions.
- 52 Unused committed sources of secured funding for which eligible assets were held.
- 53 HSBC-managed asset exposures relate to consolidated securities investment conduits, primarily Solitaire and Mazarin (see page 209). These vehicles issue debt secured by ABSs which are managed by HSBC. Of the total contingent liquidity risk under this category, US\$8.9bn was already funded on-balance sheet at 30 June 2011 (30 June 2010: US\$ 8.5bn; 31 December 2010: US\$7.6bn) leaving a net contingent exposure of US\$14.3bn (30 June 2010: US\$18.4bn; 31 December 2010: US\$18.0bn).

Market risk

- 54 The structural foreign exchange risk is monitored using sensitivity analysis (see page 138). The reporting of commodity risk is consolidated with foreign exchange risk and is not applicable to non-trading portfolios.
- 55 The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included in the Group VAR. The management of this risk is described on page 140.
- 56 Credit spread sensitivity is reported separately for insurance operations (see page 142).
- 57 We completed the introduction of credit spread within our VaR models globally during the first half of 2010. For the six months ended 30 June 2010, the average maximum and minimum included credit spread risk for the majority of our regions.
- 58 The effect of any month-end adjustments not attributable to a specific daily market move is spread evenly over the days in the month in question.
- 59 The standard deviation measures the variation of daily revenues about the mean value of those revenues.
- 60 Trading intent portfolios include positions arising from market-making and position taking.

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61 Trading credit spread VAR was previously reported in the Group trading credit VAR. See page 137.

62 A negative number represents the benefit of portfolio diversification. As the maximum and minimum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures.

63 The total VAR is non-additive across risk types due to diversification effects. It incorporates credit spread VAR.

Risk management of insurance operations

64 HSBC has no insurance manufacturing subsidiaries in the Middle East.

65 Insurance contracts and investment contracts with discretionary participation features (DPF) can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount and timing are determined by HSBC. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.

66 Although investment contracts with DPF are financial instruments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.

67 Net written insurance premiums represent gross written premiums less gross written premiums ceded to reinsurers.

68 Term assurance includes credit life insurance.

69 Other assets comprise shareholder assets.

70 Present value of in-force long-term insurance contracts and investment contracts with DPF.

71 Does not include associated insurance companies, Ping An, SABB Takaful Company or Bao Viet, or joint venture insurance companies, Hana Life and Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.

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Appendix Risk policies and practices

This appendix describes the significant policies and practices employed by HSBC in managing our credit risk, liquidity and funding, market risk, operational risk, reputational risk and insurance risk.

Managing risk

HSBC's approach to risk is encapsulated within our risk appetite framework. It is approved by the Group Risk Committee and the Board. For further details of activities of the Group Risk Committee see pages 197 to 201 of the *Annual Report and Accounts 2010*.

The framework is maintained at Group, regional, global business and customer group levels, operating through governance bodies, processes and metrics designed to assist in risk management. Risk appetite statements define, at various levels of the business, the qualitative and quantitative expressions of the risks which HSBC is prepared to embrace in alignment with its strategy and business plans. Quantitative metrics are assigned to five key categories: earnings, capital and liquidity, impairments and expected losses, risk category and diversification and scenario stress testing. Measurement against the metrics serves to:

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

determine risk-adjusted remuneration;

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

promptly identify business decisions needed to mitigate risk.

Risk governance

Our strong risk governance reflects the importance placed by the Board on shaping the Group's risk strategy and managing risks effectively. It is supported by a clear policy framework of risk ownership, by the cascading from the Group Management Board (GMB) of balanced scorecards that align business and risk objectives, and by the accountability of all staff for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, experience and mandatory learning, helps to foster a disciplined and constructive culture of risk management and control throughout HSBC.

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During the period we developed a new operating model for the global risk function. The new model integrates Compliance within Global Risk, establishes risk roles for RBWM and CMB in alignment with other global businesses and broadens the responsibility of Fraud and Security Risk. The new model is designed to enable the end-to-end management of risk in a consistent manner.

Scenario stress testing

We conduct a range of Group stress testing scenarios including, but not limited to, severe global economic downturn, country, sector and counterparty failures and a variety of projected major operational risk events. The outcomes of the stress scenarios are used to assess the potential impact on demand for regulatory capital against its supply. We also participate, where appropriate, in scenario analyses requested by regulatory bodies.

In addition to the suite of risk scenarios considered for the Group, each major HSBC subsidiary conducts regular macro-economic and event-driven scenario analyses specific to its region.

Stress testing is also used by the market risk discipline to evaluate the potential impact on portfolio values of events or movements in a set of financial variables.

Credit risk

Credit risk management

The Credit Risk department fulfils the role of an independent credit control unit as part of the Global Risk function in GMO. Its risk management and internal control procedures are designed for all stages of the economic and financial cycles, including the current environment, and there were no significant changes during the first half of 2011. Full details of the roles and responsibilities of the Credit Risk management function and the policies and procedures for managing credit risk are set out on page 197 of the *Annual Report and Accounts 2010*.

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Principal objectives of our credit risk management

to maintain across HSBC a strong culture of responsible lending and a robust risk policy and control framework;

to both partner and challenge our businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and

to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.
Collateral and other credit enhancements

Collateral held against financial instruments is described in more detail below.

Loans and advances

Although collateral can be an important mitigant of credit risk, it is our policy to lend on the basis of the customer's capacity to repay rather than to rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured.

We employ the following principal collateral types:

in the personal sector, mortgages over residential properties;

in the commercial and industrial sector, charges over business assets such as premises, stock and debtors;

in the commercial real estate sector, charges over the properties being financed; and

in the financial sector, charges over financial instruments such as cash, debt securities and equities in support of trading facilities.
In addition, credit derivatives and securitisation structures are used to hedge or transfer credit risk within our loan portfolio.

Derivatives

The International Swaps and Derivatives Association (ISDA) Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex (CSA) in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in

outstanding positions. The majority of our CSAs are with financial institutional clients.

Treasury, other eligible bills and debt securities

Debt securities, treasury and other eligible bills are generally unsecured except for ABSs and similar instruments, which are secured by pools of financial assets.

Items in the course of collection from other banks

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of our transactions with each one on any single day. We substantially mitigate settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems or on a delivery-versus-payment basis.

Concentration of exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. We use a number of controls and measures to minimise undue concentration of exposure in our portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk is an aggravated form of concentration risk and arises when there is a strong correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. We use a range of

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procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

Forbearance strategies and renegotiated loans

A range of forbearance strategies are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Our policies and practices are based on criteria which, in the judgement of local management, indicate that repayment is likely to continue.

Forbearance arrangements include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, other modifications, and loan restructures. These management policies and practices typically provide the customer with terms and conditions that are more favourable than those provided initially. Such arrangements could include cases where an account is reset as up-to-date without full repayment of all the arrears. In the US, this is referred to as a re-age. Loans that have been reset as up-to-date are not disclosed as past due unless the account subsequently experiences further payment defaults.

Loan restructures are our most common forbearance arrangements, the majority of which are loan modifications and re-ages applied to real estate loans within consumer finance portfolios in the US. Modification occurs when the terms of a loan are changed either temporarily or permanently. Modification may also lead to a re-ageing of the account, although an account may be re-aged without any modification to the original terms and conditions of the loan. It is our practice in the US to defer past due interest on re-aged real estate and personal non-credit card accounts to the end of the loan period. We do not accrue interest on these past due interest payments.

Our credit risk management policy sets out restrictions on the number and frequency of restructures, the minimum period an account must have been opened before any restructure can be considered, and the number of qualifying payments that must be received before an account may be considered restructured and up-to-date. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Typically the receipt of two or more qualifying payments is required within a certain period, generally 60 days (in the case of HSBC Finance, in certain circumstances, for example where debt has been restructured in bankruptcy proceedings, fewer or no payments may be required). Loans that have been restructured and would otherwise have been past due or impaired are classified as renegotiated.

Renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment, to reflect the higher rates of losses often encountered in this segment of the portfolio. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, such as for re-aged loans in the US, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances.

The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Where a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated. Interest is recorded on renegotiated loans on the basis of new contractual terms following renegotiation.

Credit quality of financial instruments

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The five credit quality classifications defined on page 114 of the *Annual Report and Accounts 2010* describe the credit quality of our lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities.

There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

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Interim Management Report (continued)*Credit quality classification*

| Quality classification | Debt securities | Wholesale lending | | | | Retail lending | |
|------------------------|-----------------------|-------------------|----------------|-----------------------------|--------|----------------------------|--|
| | and other bills | and derivatives | | Internal | | Expected | |
| | External | Internal | Probability of | Internal | loss % | | |
| | credit rating | credit rating | default % | credit rating ²³ | | | |
| Strong | A and above | CRR1 to CRR2 | 0 0.169 | EL1 to EL2 | 0 | 0.999 | |
| Good | BBB+ to BBB | CRR3 | 0.170 0.740 | EL3 | 1.000 | 4.999 | |
| Satisfactory | BB+ to B+ and unrated | CRR4 to CRR5 | 0.741 4.914 | EL4 to EL5 | 5.000 | 19.999 | |
| Sub-standard | B and below | CRR6 to CRR8 | 4.915 99.999 | EL6 to EL8 | 20.000 | 99.999 | |
| Impaired | Impaired | CRR9 to CRR10 | 100 | EL9 to EL10 | 100+ | or defaulted ²⁴ | |

*For footnotes, see page 146.***Nature of HSBC's securitisation and other structured exposures**

MBSs are securities that represent interests in groups of mortgages and provide investors with the right to receive cash from future mortgage payments (interest and/or principal). An MBS, which references mortgages with different risk profiles, is classified according to the highest risk class.

CDOs are securities backed by a pool of bonds, loans or other assets such as ABSs. CDOs may include exposure to sub-prime or Alt-A mortgage assets where these are part of the underlying assets or reference assets. As there is often uncertainty surrounding the precise nature of the underlying collateral supporting CDOs, all CDOs supported by residential mortgage-related assets are classified as sub-prime. Our holdings of ABSs and CDOs and direct lending positions, and the categories of mortgage collateral and lending activity, are described below.

Categories of

| ABSs and CDOs | Definition | Classification |
|---|---|--|
| Sub-prime | Loans to customers who have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions. | For US mortgages, standard US credit scores are primarily used to determine whether a loan is sub-prime; for non-US mortgages, management judgement is used. |
| US Home Equity Lines of Credit (HELOCs) | A form of revolving credit facility provided to customers, which is supported by a first or second lien charge over residential property. | Holdings of HELOCs are classified as sub-prime. |

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| | | |
|--|---|--|
| US Alt-A | Lower risk loans than sub-prime, but they share higher risk characteristics than lending under fully conforming standard criteria. | US credit scores and the completeness of documentation held (such as proof of income), are considered when determining whether an Alt-A classification is appropriate. Non sub-prime mortgages in the US are classified as Alt-A if they are not eligible for sale to the major US Government mortgage agencies or sponsored entities. |
| US Government agency and sponsored enterprises mortgage-related assets | Securities that are guaranteed by US Government agencies such as the Government National Mortgage Association (Ginnie Mae), or by US Government sponsored entities including the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). | Holdings of US Government agency and US Government sponsored enterprises mortgage-related assets are classified as prime exposures. |
| UK non-conforming mortgages | UK mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as income with self-certification), or where poor credit history increases risk and results in pricing at a higher than normal lending rate. | UK non-conforming mortgages are treated as sub-prime exposures. |
| Other mortgages | Residential mortgages, including prime mortgages, that do not meet any of the classifications described above. | Prime residential mortgage-related assets are included in this category. |

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HSBC HOLDINGS PLC

Interim Management Report (continued)

Our exposure to non-residential mortgage-related ABSs and direct lending includes securities with collateral relating to:

commercial property mortgages;

leveraged finance loans;

student loans; and

other assets, such as securities with other receivable-related collateral.

Liquidity and funding

The management of liquidity and funding is primarily undertaken locally in our operating entities in compliance with practices and limits set by the Risk Management Meeting. These limits vary according to the depth and the liquidity of the markets in which the entities operate. Our general policy is that each banking entity should be self-sufficient in funding its own operations.

Primary sources of funding

Current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access professional markets in order to obtain funding for non-banking subsidiaries that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local money markets. In aggregate, our banking entities are liquidity providers to the interbank market, placing significantly more funds with other banks than they borrow.

The main operating subsidiary that does not accept deposits is HSBC Finance, which is funded principally by taking term funding in the professional markets.

The management of liquidity risk

We use a number of principal measures to manage liquidity risk, as described below.

Advances to core funding ratio

We emphasise the importance of core customer deposits as a source of funds to finance lending to customers, and discourage reliance on short-term professional funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding; this measure is referred to as the advances to

core funding ratio.

Advances to core funding ratio limits are set by the Risk Management Meeting and monitored by Group Finance. The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where we receive securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

Stressed one month coverage ratio

The stressed one month coverage ratios are derived from projected cash flow scenario analyses, and express the stressed cash inflows as a percentage of stressed cash outflows over a one month time horizon. Group sites are required to target a ratio of 100% or greater.

Projected cash flow scenario analysis

We use a number of standard projected cash flow scenarios designed to model both Group-specific and market-wide liquidity crises in which the rate and timing of deposit withdrawals and drawdowns on committed lending facilities are varied, and the ability to access interbank funding and term debt markets and to generate funds from asset portfolios are restricted. The scenarios are modelled by all Group banking entities and by HSBC Finance. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to our standard projected cash flow scenarios, individual entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

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Interim Management Report (continued)

Limits for cumulative net cash flows under stress scenarios are set for each banking entity and for HSBC Finance. Both ratio and cash flow limits reflect the local market place, the diversity of funding sources available and the concentration risk from large depositors. Compliance with entity level limits is monitored centrally by Group Finance and reported regularly to the Risk Management Meeting.

Contingent liquidity risk

In the normal course of business, we provide customers with committed facilities, including committed backstop lines to conduit vehicles we sponsor and standby facilities to corporate customers. These facilities increase our funding requirements when customers choose to raise drawdown levels above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. The Risk Management Meeting also sets limits for non-cancellable contingent funding commitments by entity after due consideration of each entity's ability to fund them. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

Market risk

Monitoring and limiting market risk exposures

The management of market risk is principally undertaken in Global Markets using risk limits approved by the GMB. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set. Group Risk, an independent unit within GMO, is responsible for our market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Global Markets unit for management, or to separate books managed under the supervision of the local Asset and Liability Management Committee (ALCO). Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, we use simulation modelling to identify the impact of varying scenarios on valuations and net interest income.

We employ a range of tools to monitor and limit market risk exposures. These include sensitivity analysis, value at risk and stress testing.

Sensitivity analysis

We use sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

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The VAR models we use are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking account of inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

Our historical simulation models assess potential market movements with reference to data from the past two years and calculate VAR to a 99% confidence level and for a one-day holding period.

We routinely validate the accuracy of our VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, we would expect to see losses in excess of VAR only 1% of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

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Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

the use of a one-day holding period assumes that all positions can be liquidated or the risks offset in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;

the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;

VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and

VAR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

Stress testing

In recognition of the limitations of VAR, we augment it with stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables.

The process is governed by the Stress Testing Review Group forum which, in conjunction with regional risk managers, determines the scenarios to be applied at portfolio and consolidated levels, as follows:

sensitivity scenarios, consider the impact of any single risk factor or set of factors that are unlikely to be captured within the VAR models, such as the break of a currency peg;

technical scenarios, consider the largest move in each risk factor, without consideration of any underlying market correlation;

hypothetical scenarios, consider potential macro economic events, for example, a global flu pandemic; and

historical scenarios, which incorporate historical observations of market movements during previous periods of stress which would not be captured within VAR.

Stress testing results provide senior management with an assessment of the financial effect such events would have on our profit.

Trading portfolios

Credit spread risk

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR.

Credit spread risk also arises on credit derivative transactions entered into by Global Banking in order to manage the risk concentrations within the corporate loan portfolio and so enhance capital efficiency. The mark-to-market of these transactions is reflected in the income statement.

Gap risk

Even for transactions that are structured to render the risk to HSBC negligible under a wide range of market conditions or events, there exists a remote possibility that a significant gap event could lead to loss. A gap event could arise from a significant change in market price with no accompanying trading opportunity, with the result that the threshold is breached beyond which the risk profile changes from no risk to full exposure to the underlying structure. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, the market for a specific investment becomes illiquid, making hedging impossible.

Given their characteristics, these transactions make little or no contribution to VAR or to traditional market risk sensitivity measures. We capture their risks within our stress testing scenarios and monitor gap risk on an ongoing basis. We regularly consider the probability of gap loss, and fair value adjustments are booked against this risk.

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ABS/MBS exposures

The ABS/MBS exposures within the trading portfolios are managed within sensitivity and VAR limits as described on page 145 in the *Annual Report and Accounts 2010*, and are included within the stress testing scenarios described above.

Non-trading portfolios

The principal objective of market risk management of non-trading portfolios is to optimise net interest income.

Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts.

Our control of market risk in the non-trading portfolios is based on transferring the risks to the books managed by Global Markets or the local ALCO. The net exposure is typically managed through the use of interest rate swaps within agreed limits. The VAR for these portfolios is included within the Group VAR.

Sensitivity of net interest income

A principal part of our management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

For simulation modelling, entities use a combination of scenarios relevant to their local businesses and markets and standard scenarios which are required throughout HSBC. The latter are consolidated to illustrate the combined pro forma effect on our consolidated portfolio valuations and net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group's current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by Global Markets or in the business units to mitigate the effect of interest rate risk. In reality, Global Markets seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The projections also assume that interest rates of all maturities move by the same amount (although rates are not assumed to become negative in the falling rates scenario) and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. In addition, the projections take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates linked to other bases (such as Central Bank rates or product rates over which the entity has discretion in terms of the timing and extent of rate changes). The projections make other simplifying assumptions, including that all positions run to maturity.

Projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures. Our exposure to the effect of movements in interest rates on our net interest income arises in two main areas: core deposit franchises and Global Markets. This is described more fully in the *Annual Report and Accounts 2010*.

Defined benefit pension schemes

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Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. Pension scheme assets include equities and debt securities, the cash flows of which change as equity prices and interest rates vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess these risks using reports prepared by independent external actuaries, take action and, where appropriate, adjust investment strategies and contribution levels accordingly.

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Operational risk

The objective of our operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with our risk appetite, as defined by the GMB.

A formal governance structure provides oversight over the management of operational risk. A Global Operational Risk and Control Committee, which reports to the Risk Management Meeting, meets at least quarterly to discuss key risk issues and review the effective implementation of our operational risk management framework.

In each of our subsidiaries, business managers are responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The operational risk management framework helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk self-assessments are input and maintained by business units. To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed US\$10,000.

Further details of our approach to operational risk management can be found in the *Annual Report and Accounts 2010*, supplemented by the *Capital and Risk Management Pillar 3 Disclosures as at 31 December 2010*.

Legal risk

Each operating company is required to have processes and procedures in place to manage legal risk that conform to our standards.

Legal risk falls within the definition of operational risk and includes:

contractual risk, which is the risk that the rights and/or obligations of an HSBC company within a contractual relationship are defective;

dispute risk, which is made up of the risks that an HSBC company is subject to when it is involved in or managing a potential or actual dispute;

legislative risk, which is the risk that an HSBC company fails to adhere to the laws of the jurisdictions in which it operates; and

non-contractual rights risk, which is the risk that an HSBC company's assets are not properly owned or are infringed by others, or an HSBC company infringes another party's rights.

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We have a global legal function to assist management in controlling legal risk. The function provides legal advice and support. The GMO Legal department oversees the global legal function and is headed by a Group General Counsel. There are legal departments in 58 of the countries in which we operate. There are also regional legal functions in each of Europe, North America, Latin America, the Middle East and North Africa and Asia-Pacific headed by Regional General Counsels.

Compliance risk

All Group companies are required to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice. These rules, regulations, other standards and Group policies include those relating to anti-money laundering, counter terrorist financing and sanctions compliance.

The Group Compliance function supports line management in ensuring that there are adequate policies and procedures, and is responsible for maintaining adequate resources to mitigate compliance risk. The GMO Compliance department oversees the global compliance function and is headed by the Head of Group Compliance who in turn reports to the Group Chief Risk Officer. There are compliance teams in all of the countries where we operate. These compliance teams are principally overseen by Regional Compliance Officers located in Europe, North America, Latin America, the Middle East and North Africa and Asia-Pacific.

Group Compliance policies and procedures require the prompt identification and escalation to GMO Compliance of all actual or suspected breaches of any law, rule, regulation, Group policy or other relevant requirement. These escalation procedures are supplemented by a requirement for the submission of compliance certificates at the half-year and year-end by all Group companies detailing any known breaches as above. The contents of these escalation

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and certification processes are used for reporting to the Risk Management Meeting, the Group Risk Committee and the Board and disclosure in the *Annual Report and Accounts* and *Interim Report*, if appropriate.

Global security and fraud risk

Security and fraud risk issues are managed at Group level by Global Security and Fraud Risk. This unit, which has responsibility for physical risk, fraud, information and contingency risk, and security and business intelligence is fully integrated within the central GMO Risk function. This enables management to identify and mitigate the permutations of these and other non-financial risks to its business lines across the jurisdictions in which we operate.

Reputational risk

Reputational risks can arise from a wide variety of causes, including environmental, social and governance risks and operational risk events. As a banking group, our good reputation depends upon the way in which we conduct our business, but it can also be affected by the way in which our clients conduct themselves in such areas.

A Group Reputational Risk Committee (GRRC) has been established to bring focus to activities that could attract reputational risk. The primary role of the GRRC is to consider areas and activities presenting significant reputational risk and, where appropriate, to make recommendations to the Risk Management Meeting and the GMB for policy or procedural changes to mitigate such risk. Reputational Risk Committees have also been established in each of our geographical regions. These committees ensure that reputational risks are considered at a regional as well as Group level. Minutes from the regional committees are tabled at GRRC. A wider description of HSBC s management of reputational risk is provided on page 172 in the *Annual Report and Accounts 2010*.

Insurance risk

Overview of insurance products

The main contracts we manufacture are listed below:

Life insurance business

life insurance contracts with DPF;

credit life insurance business;

annuities;

term assurance and critical illness policies;

linked life insurance;

investment contracts with DPF;

unit-linked investment contracts; and

other investment contracts (including pension contracts written in Hong Kong).

Non-life insurance business

Non-life insurance contracts include motor, fire and other damage to property, accident and health, repayment protection and commercial insurance.

The management of insurance risk

Life and non-life business insurance risks are controlled by high-level policies and procedures set centrally, taking into account where appropriate local market conditions and regulatory requirements. Formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations are applied, supplemented with stress testing.

As well as exercising underwriting controls, we use reinsurance as a means of mitigating exposure to insurance risk, in particular to aggregations of catastrophe risk. When we manage our exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to them. Although reinsurance provides a means of managing insurance risk, such contracts expose us to credit risk, the risk of default by the reinsurer.

HSBC's management of insurance risk, including the risks relating to different life and non-life products, is described on page 156 in the *Annual Report and Accounts 2010*.

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Capital

Capital management

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate.

It is our objective to maintain a strong capital base to support the development of our business and to meet regulatory capital requirements at all times. To achieve this, our policy is to hold capital in a range of different forms and from diverse sources. All capital raising is agreed with major subsidiaries as part of their individual and the Group's overall capital management processes.

Our policy is underpinned by a capital management framework, which enables us to manage our capital in a consistent and aligned manner. The framework, which is approved by the GMB annually, incorporates a number of different capital measures including market capitalisation, invested capital, economic capital and regulatory capital.

Capital measures

market capitalisation is the stock market value of the company;

invested capital is the equity capital invested in HSBC by our shareholders;

economic capital is the internally calculated capital requirement which we deem necessary to support the risks to which we are exposed at a confidence level consistent with a target credit rating of AA; and

regulatory capital is the capital which we are required to hold in accordance with the rules established by the FSA for the consolidated Group and by our local regulators for individual Group companies.

The following risks managed through the capital management framework have been identified as material: credit, market, operational, interest rate risk in the banking book, pension fund, insurance and residual risks.

We incorporate stress testing in the capital management framework, and it is important in understanding the sensitivities of the core assumptions in our capital plans to the adverse effect of extreme, but plausible, events. Stress testing allows us to formulate our response, including risk mitigation actions, in advance of conditions starting to exhibit the stress scenarios identified. The actual market stresses which occurred throughout the financial system during recent years have been used to inform our capital planning process and further develop the stress scenarios we employ.

In addition to our internal stress tests, others are carried out, both at the request of regulators and by

the regulators themselves using their prescribed assumptions. We take into account the results of all such regulatory stress testing when undertaking our internal capital management assessment.

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The responsibility for global capital allocation principles and decisions rests with the GMB. Through our structured internal governance processes, we maintain discipline over our investment and capital allocation decisions and seek to ensure that returns on investment are adequate after taking account of capital costs. Our strategy is to allocate capital to businesses on the basis of their economic profit generation, regulatory and economic capital requirements and cost of capital.

Our capital management process is articulated in the annual Group capital plan which is approved by the Board. The plan is drawn up with the objective of maintaining both an appropriate amount of capital and an optimal mix between the different components of capital. HSBC Holdings and its major subsidiaries raise non-equity tier 1 capital and subordinated debt in accordance with our guidelines on market and investor concentration, cost, market conditions, timing, capital composition and maturity profile. Application of the eligibility requirements for non-equity tier 1 and tier 2 instruments under Basel III has not been clearly defined in the UK. We have therefore not issued any non-equity capital securities in the first half of 2011. Each of our subsidiaries manages its own capital to support its planned business growth and meet its local regulatory requirements within the context of the approved annual Group capital plan. In accordance with our capital management framework, capital generated by subsidiaries in excess of planned requirements is returned to HSBC Holdings, normally by way of dividends.

HSBC Holdings is the primary provider of equity capital to its subsidiaries and also provides tier 2 capital to subsidiaries where necessary. These investments are substantially funded by HSBC Holdings' own capital issuance and profit retention. As part of its capital management process, HSBC Holdings seeks to maintain a prudent balance between the composition of its capital and that of its investment in subsidiaries.

Capital measurement and allocation

The FSA supervises HSBC on a consolidated basis and therefore receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking

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supervisors, who set and monitor their capital adequacy requirements.

Regulatory and accounting consolidations

The basis of consolidation for financial accounting purposes is described on page 251 of the *Annual Report and Accounts 2010* and differs from that used for regulatory purposes. Investments in banking associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory consolidation and are deducted from regulatory capital. The regulatory consolidation does not include SPEs where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

We calculate capital at a Group level using the Basel II framework of the Basel Committee on Banking Supervision. However, local regulators are at different stages of implementation and local reporting may still be on a Basel I basis, notably in the US. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

Basel II is structured around three pillars : minimum capital requirements, supervisory review process and market discipline. The Capital Requirements Directive (CRD) implemented Basel II in the EU and the FSA then gave effect to the CRD by including the latter s requirements in its own rulebooks.

Regulatory capital

Our capital is divided into two tiers:

tier 1 capital is divided into core tier 1 and other tier 1 capital. Core tier 1 capital comprises shareholders equity and related non-controlling interests. The book values of goodwill and intangible assets are deducted from core tier 1 capital and other regulatory adjustments are made for items reflected in shareholders equity which are treated differently for the purposes of capital adequacy. Qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities are included in other tier 1 capital; and

tier 2 capital comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available for sale. Tier 2 capital also includes reserves arising from the revaluation of properties.

To ensure the overall quality of the capital base, the FSA s rules set limits on the amount of hybrid

capital instruments that can be included in tier 1 capital relative to core tier 1 capital, and also limits overall tier 2 capital to no more than tier 1 capital.

Pillar 1 capital requirements

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Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes counterparty credit risk and securitisation requirements. These requirements are expressed in terms of risk-weighted assets (RWA s).

Credit risk capital requirements

Basel II applies three approaches of increasing sophistication to the calculation of pillar 1 credit risk capital requirements. The most basic level, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties and group other counterparties into broad categories and apply standardised risk weightings to these categories. The next level, the internal ratings-based (IRB) foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of the probability that a counterparty will default (PD), but subjects their quantified estimates of exposure at default (EAD) and loss given default (LGD) to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules, which incorporates PD, LGD, EAD and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed total accounting impairment allowances.

For credit risk, with the FSA s approval, we have adopted the IRB advanced approach for the majority of our business, with the remainder on either IRB foundation or standardised approaches.

For consolidated Group reporting, the FSA s rules permit the use of other regulators standardised approaches where they are considered equivalent. The use of other regulators IRB approaches is subject to the agreement of the FSA. Under our Basel II rollout plans, a number of our Group companies and portfolios are in transition to advanced IRB approaches. At June 2011, portfolios in much of Europe, Hong Kong, Rest of Asia-Pacific

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and North America were on advanced IRB approaches. Others remain on the standardised or foundation approaches under Basel II, pending definition of local regulations or model approval, or under exemptions from IRB treatment.

Counterparty credit risk

Counterparty credit risk arises for OTC derivatives and securities financing transactions. It is calculated in both the trading and non-trading books and is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating counterparty credit risk and determining exposure values are defined by Basel II: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

We use the mark-to-market and internal model method approaches for counterparty credit risk. Our longer-term aim is to migrate more positions from the mark-to-market to the internal model method approach.

Securitisation

Securitisation positions in the trading book are treated in the same way as other market risk positions.

For non-trading book securitisation positions, Basel II specifies two methods for calculating credit risk requirements, these being the standardised and IRB approaches. Both approaches rely on the mapping of rating agency credit ratings to risk weights, which range between 7% and 1,250%. Positions that would otherwise be weighted at 1,250% are deducted from capital.

Within the IRB approach, we use the Ratings Based Method for the majority of our non-trading book securitisation positions, and the Internal Assessment Approach for unrated liquidity facilities and programme-wide enhancements for asset-backed securitisations.

Market risk capital requirement

The market risk capital requirement is measured, with the FSA's permission, using VAR models, or the standard rules prescribed by the FSA.

We use both VAR and standard rules approaches for market risk. Our aim is to migrate more positions from standard rules to VAR.

Operational risk capital requirement

Basel II includes a capital requirement for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements.

We have adopted the standardised approach in determining our operational risk capital requirements.

Pillar 2 capital requirements

The second pillar of Basel II (Supervisory Review and Evaluation Process) involves both firms and regulators taking a view on whether a firm should hold additional capital against risks not covered in pillar 1. Part of the pillar 2 process is the Internal Capital Adequacy Assessment

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Process which is the firm's self assessment of the levels of capital that it needs to hold. The pillar 2 process culminates in the FSA providing firms with Individual Capital Guidance (ICG). The ICG is set as a capital resources requirement higher than that required under pillar 1. In 2011, this is expected to be supplemented by an additional Capital Planning Buffer, set by the FSA, to cover capital demand should economic conditions worsen considerably against the current outlook.

Pillar 3 disclosure requirements

Pillar 3 of Basel II is related to market discipline and aims to make firms more transparent by requiring them to publish specific, prescribed details of their risks, capital and risk management under the Basel II framework. Our pillar 3 disclosures for the year ended 31 December 2010 were published as a separate document on the Group Investor Relations website.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Capital structure*

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---|--------------------------------|--------------------------------|------------------------------------|
| Composition of regulatory capital | | | |
| Tier 1 capital | | | |
| Shareholders' equity | 154,652 | 136,719 | 142,746 |
| Shareholders' equity per balance sheet | 160,250 | 135,943 | 147,667 |
| Preference share premium | (1,405) | (1,405) | (1,405) |
| Other equity instruments | (5,851) | (5,851) | (5,851) |
| Deconsolidation of special purpose entities ² | 1,658 | 8,032 | 2,335 |
| Non-controlling interests | 3,871 | 3,949 | 3,917 |
| Non-controlling interests per balance sheet | 7,287 | 7,380 | 7,248 |
| Preference share non-controlling interests | (2,445) | (2,391) | (2,426) |
| Non-controlling interest transferred to tier 2 capital | (507) | (676) | (501) |
| Non-controlling interest in deconsolidated subsidiaries | (464) | (364) | (404) |
| Regulatory adjustments to the accounting basis | 888 | (3,079) | 1,794 |
| Unrealised (gains)/losses on available-for-sale debt securities ³ | 3,290 | (797) | 3,843 |
| Own credit spread | (773) | (1,779) | (889) |
| Defined benefit pension fund adjustment ⁴ | 1,211 | 1,940 | 1,676 |
| Reserves arising from revaluation of property and unrealised gains on available-for-sale equities | (3,085) | (2,500) | (3,121) |
| Cash flow hedging reserve | 245 | 57 | 285 |
| Deductions | (33,649) | (30,753) | (32,341) |
| Goodwill capitalised and intangible assets | (29,375) | (26,398) | (28,001) |
| 50% of securitisation positions | (1,274) | (1,754) | (1,467) |
| 50% of tax credit adjustment for expected losses | 126 | 269 | 241 |
| 50% of excess of expected losses over impairment allowances | (3,126) | (2,870) | (3,114) |
| Core tier 1 capital | 125,762 | 106,836 | 116,116 |
| Other tier 1 capital before deductions | 18,339 | 17,577 | 17,926 |
| Preference share premium | 1,405 | 1,405 | 1,405 |
| Preference share non-controlling interests | 2,445 | 2,391 | 2,426 |
| Hybrid capital securities | 14,489 | 13,781 | 14,095 |
| Deductions | (988) | (345) | (863) |
| Unconsolidated investments ⁵ | (1,114) | (614) | (1,104) |
| 50% of tax credit adjustment for expected losses | 126 | 269 | 241 |
| Tier 1 capital | 143,113 | 124,068 | 133,179 |
| Tier 2 capital | | | |

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| | | | |
|---|----------------|-----------|-----------|
| Total qualifying tier 2 capital before deductions | 50,544 | 48,170 | 52,713 |
| Reserves arising from revaluation of property and unrealised gains on available-for-sale equities | 3,085 | 2,500 | 3,121 |
| Collective impairment allowances ⁶ | 2,772 | 3,526 | 3,109 |
| Perpetual subordinated debt | 2,782 | 2,982 | 2,781 |
| Term subordinated debt | 41,605 | 38,862 | 43,402 |
| Non-controlling interest in tier 2 capital | 300 | 300 | 300 |
| Total deductions other than from tier 1 capital | (19,873) | (17,352) | (18,337) |
| Unconsolidated investments ⁵ | (15,471) | (12,727) | (13,744) |
| 50% of securitisation positions | (1,274) | (1,754) | (1,467) |
| 50% of excess of expected losses over impairment allowances | (3,126) | (2,870) | (3,114) |
| Other deductions | (2) | (1) | (12) |
| Total regulatory capital | 173,784 | 154,886 | 167,555 |
| Risk-weighted assets | | | |
| Credit risk | 947,525 | 839,079 | 890,696 |
| Counterparty credit risk | 52,985 | 57,323 | 50,175 |
| Market risk | 44,456 | 52,964 | 38,679 |
| Operational risk | 123,563 | 125,898 | 123,563 |
| Total | 1,168,529 | 1,075,264 | 1,103,113 |

For footnotes, see page 164.

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HSBC HOLDINGS PLC

Interim Management Report (continued)*Capital structure (continued)*

| | At 30 June 2011 | At 30 June 2010 | At 31 December 2010 |
|-----------------------|--------------------|--------------------|------------------------|
| | % | % | % |
| Capital ratios | | | |
| Core tier 1 ratio | 10.8 | 9.9 | 10.5 |
| Tier 1 ratio | 12.2 | 11.5 | 12.1 |
| Total capital ratio | 14.9 | 14.4 | 15.2 |

Source and application of tier 1 capital

| | 30 June 2011 | Half-year to 30 June 2010 | 31 December 2010 |
|---|-----------------|---------------------------------|---------------------|
| | US\$m | US\$m | US\$m |
| Movement in tier 1 capital | | | |
| Opening tier 1 capital | 133,179 | 122,157 | 124,068 |
| Contribution to tier 1 capital from profit for the period | 9,315 | 6,030 | 7,188 |
| Consolidated profits attributable to shareholders of the parent company | 9,215 | 6,763 | 6,396 |
| Removal of own credit spread net of tax | 100 | (733) | 792 |
| Net dividends | (2,672) | (1,678) | (2,149) |
| Dividends | (4,006) | (3,261) | (3,089) |
| Add back: shares issued in lieu of dividends | 1,334 | 1,583 | 940 |
| Decrease/(increase) in goodwill and intangible assets deducted | (1,374) | 2,282 | (1,603) |
| Ordinary shares issued | 13 | 61 | 119 |
| Hybrid capital securities issued net of redemptions | | 2,368 | |
| Foreign currency translation differences | 4,471 | (6,002) | 5,476 |
| Other | 181 | (1,150) | 80 |
| Closing tier 1 capital | 143,113 | 124,068 | 133,179 |
| Movement in risk-weighted assets | | | |
| At beginning of period | 1,103,113 | 1,133,168 | 1,075,264 |
| Movements | 65,416 | (57,904) | 27,849 |
| At end of period | 1,168,529 | 1,075,264 | 1,103,113 |

Movement in tier 1 capital

We complied with the FSA's capital adequacy requirements through 2010 and the first half of 2011. Internal capital generation contributed US\$6.6bn to tier 1 capital, being profits attributable to shareholders of the parent company after taking account of own credit spread and net dividends. Tier 1 capital was further strengthened by foreign currency translation differences of US\$4.5bn, partly offset by an increase in goodwill of US\$1.4bn also due to exchange movements.

Movement in risk-weighted assets

RWAs increased by US\$65.4bn or 6% in the first half of 2011. Foreign currency translation effects are estimated to have increased RWAs by US\$16.2bn, mainly as a result of the weakening of the US dollar, particularly against sterling and the euro. Of the underlying rise of US\$49.2bn, US\$40.6bn was due to credit risk, predominantly reflecting the growth in lending in Hong Kong, Rest of Asia-Pacific and Latin America. Market risk RWAs rose by US\$5.8bn and counterparty credit risk RWAs by

US\$2.8bn, largely as a result of increased trading volumes.

Future developments

The regulation and supervision of financial institutions continues to undergo significant change in response to the global financial crisis. In December 2010, the Basel Committee issued final rules in two documents: *A global regulatory framework for more resilient banks and banking systems* and *International framework for liquidity risk measurement, standards and monitoring*, which together are commonly referred to as Basel III .

The minimum common equity tier 1 requirement of 4.5% and additional capital conservation buffer requirement of 2.5%, will be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019. Any additional countercyclical capital buffer requirements will also be phased in, starting in 2016, in parallel with the capital conservation buffer to a maximum level of 2.5% effective on 1 January 2019, although individual jurisdictions may choose to

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Interim Management Report (continued)

implement larger countercyclical capital buffers. The leverage ratio will be subject to a supervisory monitoring period, which commenced on 1 January 2011, and a parallel run period which will run from 1 January 2013 until 1 January 2017. Further calibration of the leverage ratio will be carried out in the first half of 2017, with a view to migrating to a pillar 1 requirement from 1 January 2018.

On 1 June 2011, the Basel Committee issued a revised version of *A global regulatory framework for more resilient banks and banking systems* that set out the finalised capital treatment for counterparty credit risk in bilateral trades.

On 20 July 2011, the European Commission published proposals for a new Regulation and Directive, which collectively are known as CRD IV, to give effect to the Basel III framework in the EU. The measures are subject to agreement by the European Parliament, the Council and EU member states. We will continue to assess the impact of these new proposals on HSBC's capital position.

The Basel Committee has increased the capital requirements for the trading book and complex securitisation exposures, under what is commonly known as Basel 2.5, which are due to take effect from 31 December 2011.

On 13 January 2011, the Basel Committee issued further minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of securities issued prior to this date will be phased out over a 10-year period commencing on 1 January 2013.

The Basel Committee issued a consultative document on 19 July 2011, *Global systemically important banks: Assessment methodology and the additional loss absorbency requirement*. It sets out the assessment methodology for global systemically important banks (G-SIBs) which is based on an indicator-based approach and comprises five broad categories: size, interconnectedness, lack of substitutability, global (cross-jurisdictional) activity and complexity. Those banks designated as G-SIBs will be required to hold a minimum amount of loss absorbency capital depending on their relative systemic importance. This requirement ranges from 1% to 2.5% and will be met with common equity tier 1 capital. An additional 1% surcharge will be applied to banks, if any, exceeding a certain level of systemic importance relative to their peers, as a disincentive to materially grow their

operations further. These requirements will be phased-in in parallel with the capital conservation and countercyclical capital buffers between 1 January 2016 and 31 December 2018, becoming fully effective on 1 January 2019.

Impact of Basel 2.5 and Basel III

In order to provide some insight into the possible effects of the new Basel 2.5 and Basel III rules on HSBC, we have estimated the pro forma common equity tier 1 ratio of the Group on the basis of our interpretation of those rules, as they would apply at 1 January 2019, but based on the position at 30 June 2011.

Our estimate includes mitigating actions planned by management, but does not take account of any future retained earnings. On this basis, the resulting common equity tier 1 ratio would be lower than the Basel II core tier 1 ratio by some 170 basis points, comprising 270bps gross impact less 100bps from mitigating action planned by management. The estimated impact is subject to change as further clarification emerges around the practical application and interpretation of the requirements.

The Basel 2.5 changes, which are due to take effect from 31 December 2011, primarily relate to market risk amendments. These changes are estimated to reduce the common equity tier 1 capital ratio by 50bps. We expect to be able to reduce this impact by 20bps by running off non-core and legacy positions and actively managing the correlation trading portfolio and the market risk capital requirement.

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The Basel III changes, which will be progressively phased in, relate to increased capital deductions, new regulatory adjustments and increases in RWAs. We estimate that the initial introduction of these rules on 1 January 2013, on a pro forma basis, will result in a reduction in the common equity tier 1 capital ratio of 90bps. We plan to mitigate this impact by 40bps, over the period between 1 January 2012 and 31 December 2013, by continuing the actions mentioned above, and by active management of the counterparty credit risk capital requirement. The remainder of the Basel III changes, mainly relating to regulatory adjustments, will be phased in over the period from 1 January 2014 up to 31 December 2018 with a further reduction in the common equity tier 1 capital ratio of 130bps, partly off-set by an estimated 40bps through the continued run-off of non-core portfolios and legacy positions. This phase includes the majority of the unconsolidated investments that we previously deducted from capital, together with

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Interim Management Report (continued)

changes to the treatment of deferred tax assets and the 50% of excess of expected loss over impairment allowances previously deducted from total capital.

Further uncertainty remains regarding any capital requirements which may be imposed on the Group over the period to 1 January 2019 in respect of the countercyclical capital buffer and any additional regulatory requirements for G-SIBs.

Under the Basel III rules as they will apply from 1 January 2019, we believe that ultimately the level for the common equity tier 1 ratio of the Group may lie in the range 9.5% to 10.5%. This exceeds the minimum requirement for common equity tier 1 capital plus the capital conservation buffer. HSBC has a strong track record of capital generation and actively manages its RWAs.

Footnotes to Capital

- 1 *Includes externally verified profits for the half-year to 30 June 2011.*
- 2 *Mainly comprises unrealised losses on available-for-sale debt securities within SPEs which are excluded from the regulatory consolidation.*
- 3 *Under FSA rules, unrealised gains/losses on debt securities net of tax must be excluded from capital resources.*
- 4 *Under FSA rules, the defined benefit liability may be substituted with the additional funding that will be paid into the relevant schemes over the following five year period.*
- 5 *Mainly comprise investments in insurance entities.*
- 6 *Under FSA rules, collective impairment allowances on loan portfolios on the standardised approach are included in tier 2 capital.*

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HSBC HOLDINGS PLC

Board of Directors and Senior Management

Directors

D J Flint, CBE, Group Chairman

Age 56. Group Chairman and chairman of the Nomination Committee since December 2010. Joined HSBC as Group Finance Director in 1995 and served as Chief Financial Officer, Executive Director, Risk and Regulation from February 2010 to December 2010. A director of The Hong Kong Association since 6 February 2011. Former appointments include: a non-executive director of BP p.l.c. from 2005 to 14 April 2011; co-chairman of the Counterparty Risk Management Policy Group III in 2008; chairman of the Financial Reporting Council's review of the Turnbull Guidance on Internal Control in 2004; member of the Accounting Standards Board; member of the Standards Advisory Council of the International Accounting Standards Board from 2001 to 2004; served on the Large Business Forum on Tax and Competitiveness and the Consultative Committee of the Large Business Advisory Board of HM Revenue and Customs; and a former partner in KPMG.

Mr Flint has extensive governance experience gained through membership of the Boards of HSBC and BP as well as considerable knowledge of finance and risk management in banking, multinational financial reporting, treasury and securities trading operations. In 2006 he was honoured with a CBE in recognition of his services to the finance industry. He is a member of the Institute of Chartered Accountants of Scotland and the Association of Corporate Treasurers and he is a Fellow of The Chartered Institute of Management Accountants.

S T Gulliver, Group Chief Executive

Age 52. Group Chief Executive and chairman of the Group Management Board since 1 January 2011. An executive Director since 2008. Joined HSBC in 1980. Appointed a Group General Manager in 2000 and a Group Managing Director in 2004. Chairman of The Hongkong and Shanghai Banking Corporation Limited since 1 January 2011. Chairman of HSBC France and of HSBC Private Banking Holdings (Suisse) SA. Former appointments include: Deputy chairman of HSBC Trinkaus & Burkhardt AG and a member of its Supervisory Board from 2006 until 7 June 2011; Chairman, Europe, Middle East and Global Businesses from April 2010 to December 2010; Chairman of HSBC Bank plc from April 2010 to December 2010; HSBC Bank Middle East Limited from February 2010 to December 2010; Head of Global Banking and Markets from 2006 to 2010 and co-head from 2003 to 2006; Head of Global Markets from 2002 to 2003; and Head of Treasury and Capital Markets in Asia-Pacific from 1996 to 2002.

Mr Gulliver is a career banker with over 30 years' international experience with HSBC. He has held a number of key roles in the Group's operations worldwide, including in London, Hong Kong, Tokyo, Kuala Lumpur and the United Arab Emirates. He played a leading role in developing and expanding Global Banking and Markets, the wholesale banking division of the Group with operations in over 65 countries and territories.

S A Catz

Age 49. President and Chief Financial Officer of Oracle Corporation. A non-executive Director since 2008. Managing Director of Donaldson, Lufkin & Jenrette from 1997 to 1999. Joined Oracle in 1999 and appointed to the Board of Directors in 2001.

Ms Catz brings to the Board a background in international business leadership, having helped transform Oracle into the largest producer of business management software and the world's leading supplier of software for information management.

L M L Cha, GBS

Age 61. Non-executive Deputy Chairman of The Hongkong and Shanghai Banking Corporation Limited. A non-executive Director since 1 March 2011 and a member of the Corporate Sustainability Committee since 3 May 2011. A non-official member of the Executive Council of

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Hong Kong SAR. Director of Hong Kong Exchanges and Clearing Limited, Tata Consultancy Services Limited and China Telecom Corporation Limited. Chairman of the ICAC Advisory Committee on Corruption and of the University Grants Committee in Hong Kong. Vice-chairman of the International Advisory Council of the China Securities Regulatory Commission and a Hong Kong delegate to the 11th National People's Congress of China. A member of the Advisory Board of the Yale School of Management, and Millstein Center of Corporate Governance and Performance at Yale University and a Senior International Advisor for Foundation Asset Management Sweden AB. Former appointments include: a non-executive director of Bank of Communications Co., Ltd., Baoshan Iron and Steel Co. Limited and Johnson Electric Holdings Limited. A member of the State Bar of California. She was awarded a Silver Bauhinia Star in 2001 and a Gold Bauhinia Star in 2009 by the Hong Kong Government for her public service.

Mrs Cha brings to the Board extensive regulatory and policy making experience in the finance and securities sector in Hong Kong and mainland China. Mrs Cha was Vice Chairman of the China Securities Regulatory Commission (CSRC) from 2001 to 2004. She was appointed to the post by the State Council and became the first person outside mainland China to join the Central Government of the People's Republic of China at the vice-ministerial rank. Prior to her post at the CSRC, Mrs Cha worked in the Securities and Futures Commission in Hong Kong from 1991 to 2000, becoming its Deputy Chairman in 1998. During her career she has worked in the US and Asia.

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HSBC HOLDINGS PLC

Board of Directors and Senior Management (continued)

M K T Cheung, GBS, OBE

Age 63. Non-executive chairman of the Airport Authority Hong Kong. A non-executive Director since 2009 and a member of the Group Audit Committee since March 2010. A non-executive director of Hang Seng Bank Limited and HKR International Limited. A non-official member of the Executive Council of the Hong Kong SAR. Non-executive chairman of the Council of the Hong Kong University of Science and Technology. A director of The Association of Former Council Members of The Stock Exchange of Hong Kong Limited and The Hong Kong International Film Festival Society Limited. Former appointments include: a non-executive director of Sun Hung Kai Properties Limited and Hong Kong Exchanges and Clearing Limited; Chairman and Chief Executive Officer of KPMG Hong Kong; and a Council Member of the Open University of Hong Kong. Awarded the Gold Bauhinia Star by the Hong Kong Government in 2008.

Dr Cheung brings to the Board a background in international business and financial accounting, particularly in greater China and the wider Asian economy. He retired from KPMG Hong Kong in 2003 after more than 30 years distinguished service with the firm. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

J D Coombe

Age 66. Non-executive chairman of Hogg Robinson Group plc. A non-executive Director since 2005 and chairman of the Group Audit Committee since July 2010. A member of the Remuneration Committee and, since February 2010, the Group Risk Committee. A non-executive director of Home Retail Group plc, council member of The Royal Academy of Arts and a Trustee of the Royal Academy Trust. Former appointments include: executive director and Chief Financial Officer of GlaxoSmithKline plc; non-executive director of GUS plc; a member of the Supervisory Board of Siemens AG; chairman of The Hundred Group of Finance Directors; and a member of the Accounting Standards Board.

Mr Coombe brings to the Board a background in international business, financial accounting and the pharmaceutical industry. As Chief Financial Officer of GlaxoSmithKline he had responsibility for the Group's financial operations globally. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

R A Fairhead

Age 49. Chairman, Chief Executive Officer and a director of Financial Times Group Limited. A non-executive Director since 2004. Chairman of the Group Risk Committee since February 2010. A member of the Group Audit Committee, having

ceased to be chairman in July 2010. A member of the Nomination Committee. A director of Pearson plc and a non-executive director of The Economist Newspaper Limited. A non-executive member of the board of the UK Government's Cabinet Office. Former appointments include: Executive Vice President, Strategy and Group Control of Imperial Chemical Industries plc; Finance Director of Pearson plc; and chairman and a director of Interactive Data Corporation.

Mrs Fairhead brings to the Board a background in international industry, publishing, finance and general management. As the former Finance Director of Pearson plc she oversaw the day to day running of the finance function and was directly responsible for global financial reporting and control, tax and treasury. She has a Master's in Business Administration from the Harvard Business School.

A A Flockhart, CBE

Age 59. Chairman, Europe, Middle East, Africa, Latin America, Commercial Banking and Chairman of HSBC Bank plc since 1 January 2011. An executive Director since 2008. Joined HSBC in 1974. Appointed a Group General Manager in 2002 and a Group Managing Director in 2006. Chairman of HSBC Latin America Holdings (UK) Limited and a director of HSBC Bank Australia Limited and HSBC Bank Middle East

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Limited since 7 July 2011. Former appointments include: Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited from 2007 to February 2010; a director of Hang Seng Bank Limited; President and Group Managing Director Latin America and the Caribbean; Chief Executive Officer, Mexico; Senior Executive Vice-President, Commercial Banking, HSBC Bank USA, N.A.; Managing Director of The Saudi British Bank; Chairman, Personal and Commercial Banking and Insurance; and a member of the Visa Asia Pacific Senior Advisory Council, Visa Inc.

Mr Flockhart is a career banker, being an emerging markets specialist with over 35 years experience with HSBC across Latin America, the Middle East, US and Asia. In 2007 he was honoured with a CBE in recognition of his services to British business and charitable services and institutions in Mexico.

J W J Hughes-Hallett, SBS

Age 61. Chairman of John Swire & Sons Limited. A non-executive Director since 2005. A member of the Nomination Committee and, since February 2010, of the Group Risk Committee. A non-executive director and former chairman of Cathay Pacific Airways Limited and Swire Pacific Limited. A trustee of the Dulwich Picture Gallery and the Esmée Fairbairn Foundation. A member of The Hong Kong Association and the Governing Board of the

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HSBC HOLDINGS PLC

Board of Directors and Senior Management (continued)

Courtauld Institute of Art. A former member of the Group Audit Committee and a non-executive director of The Hongkong and Shanghai Banking Corporation Limited from 1999 to 2004. Awarded the Silver Bauhinia Star by the Hong Kong Government in 2004.

Mr Hughes-Hallett brings to the Board a background in financial accounting and the management of a broad range of businesses in a number of international industries, including aviation, insurance, property, shipping, manufacturing and trading in the Far East, UK, US and Australia. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

W S H Laidlaw

Age 55. Chief Executive Officer of Centrica plc. A non-executive Director since 2008. A member of the Remuneration Committee. A member of the UK Prime Minister's Business Advisory Group and the Lead Non-executive Board Member of the Department for Transport. Former appointments include Executive Vice President of Chevron Corporation; a non-executive director of Hanson PLC; Chief Executive Officer of Enterprise Oil plc; and President and Chief Operating Officer of Amerada Hess Corporation.

Mr Laidlaw brings to the Board significant international experience, particularly in the energy sector, having had responsibility for businesses in four continents. He has a Master's in Business Administration from INSEAD.

J R Lomax

Age 66. Former Deputy Governor, Monetary Stability, at the Bank of England and a member of the Monetary Policy Committee. A non-executive Director since 2008. A member of the Group Audit Committee since 2009 and of the Group Risk Committee since February 2010. A non-executive director of The Scottish American Investment Company PLC, Reinsurance Group of America Inc., Arcus European Infrastructure Fund GP LLP and BAA Limited. A director of the Council of Imperial College, London and a member of the Board of the Royal National Theatre. President of the Institute of Fiscal Studies. Former appointments include: Deputy Governor of the Bank of England; Permanent Secretary at the UK Government Departments for Transport and Work and Pensions and the Welsh Office; and Vice President and Chief of Staff to the President of the World Bank.

Ms Lomax brings to the Board business experience in both the public and private sectors and a deep knowledge of the operation of the UK government and the financial system.

I J Mackay, Group Finance Director

Age 49. An executive Director since December 2010. Joined HSBC in 2007. A Director of Hang Seng Bank Limited until December 2010. Chief Financial Officer, Asia Pacific from 2009 to December 2010 and Chief Financial Officer, North America from 2007 to 2009. Former appointments include: Vice President and Chief Financial Officer of GE Consumer Finance and Vice President and Chief Financial Officer of GE Healthcare - Global Diagnostic Imaging.

Mr Mackay has extensive financial and international experience. He has worked in London, Paris, US and Asia. He is a member of the Institute of Chartered Accountants of Scotland.

G Morgan, CM

Age 65. Non-executive Chairman of SNC-Lavalin Group Inc. A non-executive Director since 2006. A member of the Remuneration Committee. A member of the Board of Trustees of The Fraser Institute and the Manning Centre for Building Democracy. A non-executive director of HSBC Bank Canada from 1996 to 2006. Former appointments include Founding President, Chief Executive Officer and Vice Chairman of EnCana Corporation; director of Alcan Inc.; and director of Lafarge North America, Inc.

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Mr Morgan brings to the Board a background in technical, operational, financial and management positions and has led large international companies in the energy and engineering sectors. He has been recognised as Canada's most respected Chief Executive Officer in a national poll of Chief Executives. He is currently a business columnist for Canada's largest national newspaper. He was appointed a Member of the Order of Canada in December 2010 for his contributions as a business and community leader and as a philanthropist.

N R N Murthy, CBE

Age 64. Chairman and Chief Mentor and former Chief Executive Officer of Infosys Limited. A non-executive Director since 2008. Chairman of the Corporate Sustainability Committee since May 2010. A director of the United Nations Foundation. Former appointments include: a director of Unilever plc and a non-executive director of DBS Group Holdings Limited, DBS Bank Limited and New Delhi Television Limited.

Mr Murthy brings to the Board experience in information technology, corporate governance and education, particularly in India. He founded Infosys Limited in India in 1981 and was its Chief Executive Officer for 21 years. Under his leadership, Infosys established a global footprint and was listed on NASDAQ in 1999. During his career he has worked in France and India.

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HSBC HOLDINGS PLC

Board of Directors and Senior Management (continued)

Sir Simon Robertson, Deputy Chairman, senior independent non-executive Director

Age 70. Non-executive chairman of Rolls-Royce Group plc and the founder member of Simon Robertson Associates LLP. A non-executive Director since 2006. Senior independent non-executive Director since 2007 and Deputy Chairman since December 2010. A member of the Nomination Committee. A non-executive director of Berry Bros. & Rudd Limited, The Economist Newspaper Limited and Royal Opera House Covent Garden Limited. A trustee of the Eden Project Trust and of the Royal Opera House Endowment Fund. Former appointments include: Managing Director of Goldman Sachs International and chairman of Dresdner Kleinwort Benson.

Sir Simon brings to the Board a background in international corporate advisory with a wealth of experience in mergers and acquisitions, merchant banking, investment banking and financial markets. During his career he has worked in France, Germany, the UK and the US. In June 2010, he was honoured with a knighthood in recognition of his services to business.

J L Thornton

Age 57. A non-executive Director since 2008. Chairman of the Remuneration Committee since May 2010. Non-executive chairman and a director of HSBC North America Holdings Inc. since 2008. Professor and director of the Global Leadership Program at the Tsinghua University School of Economics and Management. Chairman of the Brookings Institution Board of Trustees. A non-executive director of Ford Motor Company, News Corporation, Inc. and China Unicom (Hong Kong) Limited. A director of National Committee on

United States-China Relations and a Trustee of Asia Society, China Institute, The China Foreign Affairs University, the Palm Beach Civic Association and the United World College of East Africa Trust. A member of the Council on Foreign Relations, the China Securities Regulatory Commission International Advisory Committee and China Reform Forum International Advisory Committee. Former appointments include: a non-executive director of Industrial and Commercial Bank of China Limited; Intel Corporation, Inc.; and President of the Goldman Sachs Group, Inc.

Mr Thornton brings to the Board experience that bridges developed and developing economies and the public and private sectors. He has a deep knowledge of financial services and education systems, particularly in Asia. During his 23 year career with Goldman Sachs, he played a key role in the firm's global development and was Chairman of Goldman Sachs Asia.

Sir Brian Williamson, CBE

Age 66. A non-executive Director since 2002. A member of the Nomination Committee, having ceased to be its chairman in February 2010. A director of NYSE Euronext. Former appointments include: chairman of Electra Private Equity plc, London International Financial Futures and Options Exchange and Gerrard Group plc; a director of Climate Exchange plc; and a non-executive director of Resolution plc, the Financial Services Authority and the Court of The Bank of Ireland.

Sir Brian brings to the Board extensive experience in money and bond markets, insurance, private equity, futures, options and commodities trading internationally. He established the London International Financial Futures and Options Exchange in the 1980s and led the Exchange's development of its electronic trading platform in the mid-1990s. He was the first chairman of Resolution plc, established to consolidate life assurance business in the UK. He is a member of the Guild for International Bankers.

Independent non-executive Director

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HSBC HOLDINGS PLC

Board of Directors and Senior Management (continued)

Secretary

R G Barber

Age 60. Group Company Secretary since 1986. Appointed a Group General Manager in 2006. Joined HSBC in 1980. Company Secretary of HSBC Holdings plc since 1990. Chairman of the Disclosure Committee. A member of the Listing Authority Advisory Committee of the Financial Services Authority and of the Primary Markets Group of the London Stock Exchange. Former appointments include: Corporation Secretary of The Hongkong and Shanghai Banking Corporation Limited and Company Secretary of HSBC Bank plc.

Adviser to the Board

D J Shaw

Age 65. An Adviser to the Board since 1998. Solicitor. A former partner in Norton Rose. A director of HSBC Bank Bermuda Limited, HSBC Private Banking Holdings (Suisse) SA and HSBC Private Bank (Suisse) SA. An independent non-executive director of Kowloon Development Company Limited and Shui On Land Limited.

Group Managing Directors

A Almeida

Age 55. Group Head of Human Resources and Corporate Sustainability. A Group Managing Director since 2008. Joined HSBC in 1992. Appointed a Group General Manager in 2007. Former appointments include: Global Head of Human Resources for Global Banking and Markets, Global Private Banking, Global Transaction Banking and HSBC Amanah.

E Alonso

Age 56. Group Managing Director and Head of HSBC Latin America and the Caribbean. A Group Managing Director since 2008. Joined HSBC in 1997. Appointed a Group General Manager in 2006. Chairman of Grupo Financiero HSBC, S.A. de C.V., HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC and HSBC Bank (Panamá) S.A. Chief Executive Officer and a director of HSBC Latin America Holdings (UK) Limited and director of HSBC Argentina Holdings S.A. Former appointments include: director of HSBC Bank Brasil S.A. Banco Múltiplo; Managing Director of HSBC Serviços e Participações Ltda; and HSBC (Brasil) Administradora de Consorcio Ltda.

S Assaf

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Age 51. Chief Executive, Global Banking and Markets. A Group Managing Director since 1 January 2011. Joined HSBC France in 1994. Appointed a Group General Manager in 2008. A director of HSBC Bank Egypt S.A.E. Ceased to be a director of HSBC Global Asset Management Limited on 24 June 2011. Former appointments include: Head of Global Markets and Head of Global Markets for Europe, Middle East and Africa.

R E T Bennett

Age 59. Group General Counsel. A Group Managing Director since 3 May 2011. Joined HSBC in 1979. Appointed a Group General Manager in 1998. A director of HSBC Finance (Netherlands) and HSBC IM Pension Trust Limited. Former appointments include: Head of Group Legal & Compliance and Head of Legal & Compliance, Asia Pacific.

N S K Booker

Age 52. Chief Executive Officer, HSBC North America Holdings Inc. A Group Managing Director since August 2010. Joined HSBC in 1981. Appointed a Group General Manager in 2004. Chairman of HSBC Bank USA, National

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HSBC HOLDINGS PLC

Board of Directors and Senior Management (continued)

Association, HSBC Financial Corporation and HSBC USA Inc. A director of HSBC North America Holdings Inc. and HSBC Bank Canada. Former appointments include: Chief Executive Officer of HSBC Finance Corporation; Deputy Chairman and Chief Executive Officer of HSBC Bank Middle East Limited; and Chief Executive Officer, India.

A M Keir

Age 52. Global Head of Commercial Banking. A Group Managing Director since 1 January 2011. Joined HSBC in 1981. Appointed a Group General Manager in 2006. Ceased to be a director of HSBC Bank A.S. on 1 April 2011. Former appointments include: Group General Manager, Commercial Banking, Europe; Global Co-Head, Global Commercial Banking; and Global Co-Head of the Group's commercial banking activities.

M M Moses

Age 53. Group Chief Risk Officer. A Group Managing Director since December 2010. Joined HSBC in 2005. Appointed a Group General Manager in May 2010. A director of HSBC Insurance (Bermuda) Limited. Former appointments include: Chief Financial and Risk Officer, Global Banking and Markets.

S P O Sullivan

Age 55. Chief Operating Officer. Appointed a Group Managing Director with effect from 30 July 2011. Joined HSBC in 1980. Appointed Group General Manager and Chief Technology and Services Officer, UK in January 2010 and Group Chief Technology and Services Officer from 11 January 2011. Former appointments include: Chief Operating Officer (UK), Chairman of HSBC Securities (Canada) Inc. and HSBC Trust Company (UK) Limited; Chief Operating Officer (Canada); and a director of HSBC Bank plc, HFC Bank Limited and Marks and Spencer Financial Services plc.

B Robertson

Age 57. Chief Executive, HSBC Bank plc. A Group Managing Director since 2008. Joined HSBC in 1975. Appointed a Group General Manager in 2003. Chairman of HSBC Life (UK) Limited and a director of HSBC Bank plc. Former appointments include: Group Chief Risk Officer; Group General Manager, Group Credit and Risk; and Head of Global Banking and Markets for North America.

P A Thurston

Age 57. Chief Executive, Retail Banking and Wealth Management. A Group Managing Director since 2008. Joined HSBC in 1975. Appointed a Group General Manager in 2003. A director of HSBC Bank plc. A director of HSBC Private Banking Holdings (Suisse) SA since 21 March 2011 and of The Hongkong and Shanghai Banking Corporation Limited since 20 April 2011. Former appointments include: Chief Executive of HSBC Bank plc and Chairman of HSBC Life (UK) Limited.

P T S Wong

Age 59. Chief Executive, The Hongkong and Shanghai Banking Corporation Limited. A Group Managing Director since February 2010. Joined HSBC and appointed a Group General Manager in 2005. Chairman of HSBC Bank (China) Company Limited since 17 June 2011 and of HSBC Bank Malaysia Berhad. Vice Chairman of HSBC Bank (Vietnam) Ltd. A non-executive director of Hang Seng Bank Limited, Bank of Communications Co., Ltd and Ping An Insurance (Group) Company of China, Ltd. An independent non-executive director of Cathay Pacific Airways Limited. Former appointments include: a director of HSBC Bank Australia Limited.

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HSBC HOLDINGS PLC

Financial Statements (unaudited)**Consolidated income statement for the half-year to 30 June 2011**

| | 30 June | Half-year to 30 June | 31 December |
|---|-----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| | <i>Notes</i> | | |
| Interest income | 31,046 | 28,686 | 29,659 |
| Interest expense | (10,811) | (8,929) | (9,975) |
| Net interest income | 20,235 | 19,757 | 19,684 |
| Fee income | 10,944 | 10,405 | 10,712 |
| Fee expense | (2,137) | (1,887) | (1,875) |
| Net fee income | 8,807 | 8,518 | 8,837 |
| Trading income excluding net interest income | 3,231 | 2,309 | 2,371 |
| Net interest income on trading activities | 1,581 | 1,243 | 1,287 |
| Net trading income | 4,812 | 3,552 | 3,658 |
| Changes in fair value of long-term debt issued and related derivatives | (494) | 1,125 | (1,383) |
| Net income/(expense) from other financial instruments designated at fair value | 394 | (40) | 1,518 |
| Net income/(expense) from financial instruments designated at fair value | (100) | 1,085 | 135 |
| Gains less losses from financial investments | 485 | 557 | 411 |
| Dividend income | 87 | 59 | 53 |
| Net earned insurance premiums | 6,700 | 5,666 | 5,480 |
| Other operating income | 1,285 | 1,478 | 1,084 |
| Total operating income | 42,311 | 40,672 | 39,342 |
| Net insurance claims incurred and movement in liabilities to policyholders | (6,617) | (5,121) | (6,646) |
| Net operating income before loan impairment charges and other credit risk provisions | 35,694 | 35,551 | 32,696 |
| Loan impairment charges and other credit risk provisions | (5,266) | (7,523) | (6,516) |

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| | | | | |
|--|---|-----------------|----------|----------|
| Net operating income | | 30,428 | 28,028 | 26,180 |
| Employee compensation and benefits | | (10,521) | (9,806) | (10,030) |
| General and administrative expenses | | (8,419) | (7,014) | (8,142) |
| Depreciation and impairment of property, plant and equipment | | (805) | (834) | (879) |
| Amortisation and impairment of intangible assets | | (765) | (457) | (526) |
| Total operating expenses | | (20,510) | (18,111) | (19,577) |
| Operating profit | | 9,918 | 9,917 | 6,603 |
| Share of profit in associates and joint ventures | | 1,556 | 1,187 | 1,330 |
| Profit before tax | | 11,474 | 11,104 | 7,933 |
| Tax expense | 6 | (1,712) | (3,856) | (990) |
| Profit for the period | | 9,762 | 7,248 | 6,943 |
| Profit attributable to shareholders of the parent company | | 9,215 | 6,763 | 6,396 |
| Profit attributable to non-controlling interests | | 547 | 485 | 547 |
| | | US\$ | US\$ | US\$ |
| Basic earnings per ordinary share | 4 | 0.51 | 0.38 | 0.35 |
| Diluted earnings per ordinary share | 4 | 0.50 | 0.38 | 0.34 |

The accompanying notes on pages 179 to 218 form an integral part of these financial statements¹.

For footnote, see page 178.

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2011**

| | 30 June 2011 US\$m | Half-year to 30 June 2010 US\$m | 31 December 2010 US\$m |
|---|-----------------------------------|--|------------------------------|
| Profit for the period | 9,762 | 7,248 | 6,943 |
| Other comprehensive income/(expense) | | | |
| Available-for-sale investments | 1,136 | 4,206 | 1,629 |
| fair value gains/(losses) | 1,378 | 4,698 | 1,670 |
| fair value (gains)/losses transferred to income statement on disposal | (529) | (574) | (600) |
| amounts transferred to the income statement in respect of impairment losses | 287 | 678 | 440 |
| income taxes | | (596) | 119 |
| Cash flow hedges | 40 | (45) | (226) |
| fair value gains/(losses) | 231 | (1,687) | 1,509 |
| fair value (gains)/losses transferred to income statement | (196) | 1,644 | (1,808) |
| income taxes | 5 | (2) | 73 |
| Actuarial gains/(losses) on defined benefit plans | (19) | (60) | (1) |
| before income taxes | (18) | (82) | 22 |
| income taxes | (1) | 22 | (23) |
| Share of other comprehensive income of associates and joint ventures | (146) | 73 | 34 |
| Exchange differences | 4,404 | (6,128) | 5,561 |
| Income tax attributable to exchange differences | 165 | | |
| Other comprehensive income/(expense) for the period, net of tax | 5,580 | (1,954) | 6,997 |
| Total comprehensive income for the period | 15,342 | 5,294 | 13,940 |
| Total comprehensive income for the period attributable to: | | | |
| shareholders of the parent company | 14,728 | 4,901 | 13,186 |
| non-controlling interests | 614 | 393 | 754 |
| | 15,342 | 5,294 | 13,940 |

The accompanying notes on pages 179 to 218 form an integral part of these financial statements¹.

For footnote, see page 178.

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)**Consolidated balance sheet at 30 June 2011**

| | Notes | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--|-------|--------------------------------|--------------------------------|------------------------------------|
| <i>Assets</i> | | | | |
| Cash and balances at central banks | | 68,218 | 71,576 | 57,383 |
| Items in the course of collection from other banks | | 15,058 | 11,195 | 6,072 |
| Hong Kong Government certificates of indebtedness | | 19,745 | 18,364 | 19,057 |
| Trading assets | 7 | 474,950 | 403,800 | 385,052 |
| Financial assets designated at fair value | 11 | 39,565 | 32,243 | 37,011 |
| Derivatives | 12 | 260,672 | 288,279 | 260,757 |
| Loans and advances to banks | | 226,043 | 196,296 | 208,271 |
| Loans and advances to customers | | 1,037,888 | 893,337 | 958,366 |
| Financial investments | 13 | 416,857 | 385,471 | 400,755 |
| Other assets | | 47,503 | 42,140 | 43,251 |
| Current tax assets | | 1,487 | 1,070 | 1,096 |
| Prepayments and accrued income | | 12,556 | 11,586 | 11,966 |
| Interests in associates and joint ventures | | 18,882 | 15,701 | 17,198 |
| Goodwill and intangible assets | | 32,028 | 27,859 | 29,922 |
| Property, plant and equipment | | 11,594 | 13,291 | 11,521 |
| Deferred tax assets | | 7,941 | 6,246 | 7,011 |
| Total assets | | 2,690,987 | 2,418,454 | 2,454,689 |
| <i>Liabilities and equity</i> | | | | |
| Liabilities | | | | |
| Hong Kong currency notes in circulation | | 19,745 | 18,364 | 19,057 |
| Deposits by banks | | 125,479 | 127,316 | 110,584 |
| Customer accounts | | 1,318,987 | 1,147,321 | 1,227,725 |
| Items in the course of transmission to other banks | | 16,317 | 11,976 | 6,663 |
| Trading liabilities | 15 | 385,824 | 274,836 | 300,703 |
| Financial liabilities designated at fair value | 16 | 98,280 | 80,436 | 88,133 |
| Derivatives | 12 | 257,025 | 287,014 | 258,665 |
| Debt securities in issue | | 149,803 | 153,600 | 145,401 |
| Other liabilities | | 31,583 | 71,732 | 28,050 |
| Current tax liabilities | | 2,629 | 2,558 | 1,804 |
| Liabilities under insurance contracts | | 64,451 | 52,516 | 58,609 |
| Accruals and deferred income | | 13,432 | 12,174 | 13,906 |
| Provisions | 17 | 3,027 | 1,828 | 2,138 |
| Deferred tax liabilities | | 1,157 | 1,264 | 1,093 |

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| | | | |
|-------------------------------------|------------------|-----------|-----------|
| Retirement benefit liabilities | 2,958 | 3,949 | 3,856 |
| Subordinated liabilities | 32,753 | 28,247 | 33,387 |
| Total liabilities | 2,523,450 | 2,275,131 | 2,299,774 |
| Equity | | | |
| Called up share capital | 8,909 | 8,755 | 8,843 |
| Share premium account | 8,401 | 8,423 | 8,454 |
| Other equity instruments | 5,851 | 5,851 | 5,851 |
| Other reserves | 31,085 | 18,721 | 25,414 |
| Retained earnings | 106,004 | 94,193 | 99,105 |
| Total shareholders' equity | 160,250 | 135,943 | 147,667 |
| Non-controlling interests | 7,287 | 7,380 | 7,248 |
| Total equity | 167,537 | 143,323 | 154,915 |
| Total equity and liabilities | 2,690,987 | 2,418,454 | 2,454,689 |

The accompanying notes on pages 179 to 218 form an integral part of these financial statements¹.

For footnote, see page 178.

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)**Consolidated statement of cash flows for the half-year to 30 June 2011**

| | 30 June 2011 | Half-year to 30 June 2010 | 31 December 2010 |
|--|---------------------------|--|-----------------------------|
| | US\$m | US\$m | US\$m |
| <i>Notes</i> | | | |
| Cash flows from operating activities | | | |
| Profit before tax | 11,474 | 11,104 | 7,933 |
| Adjustments for: | | | |
| net gain from investing activities | (544) | (1,111) | (587) |
| share of profit in associates and joint ventures | (1,556) | (1,187) | (1,330) |
| other non-cash items included in profit before tax | <i>19</i> 8,825 | 9,553 | 9,334 |
| change in operating assets | <i>19</i> (92,560) | 14,130 | (27,397) |
| change in operating liabilities | <i>19</i> 130,301 | (1,389) | 43,661 |
| elimination of exchange differences | (16,046) | 17,993 | (19,792) |
| dividends received from associates | 246 | 198 | 243 |
| contributions paid to defined benefit plans | (588) | (2,899) | (422) |
| tax paid | (1,709) | (247) | (2,046) |
| Net cash generated from operating activities | 37,843 | 46,145 | 9,597 |
| Cash flows from investing activities | | | |
| Purchase of financial investments | (156,596) | (199,567) | (141,635) |
| Proceeds from the sale and maturity of financial investments | 153,407 | 178,272 | 143,574 |
| Purchase of property, plant and equipment | (665) | (739) | (1,794) |
| Proceeds from the sale of property, plant and equipment | 194 | 3,338 | 1,035 |
| Proceeds from the sale of loan portfolios | | 929 | 3,314 |
| Net purchase of intangible assets | (893) | (521) | (658) |
| Net cash outflow from acquisition of subsidiaries | | (34) | (52) |
| Net cash inflow from disposal of subsidiaries | 5 | 191 | 275 |
| Net cash outflow from acquisition of or increase in stake of associates | (39) | (563) | (1,026) |
| Net cash outflow from the deconsolidation of funds | | | (19,566) |
| Proceeds from disposal of associates and joint ventures | 11 | 171 | 83 |
| Net cash used in investing activities | (4,576) | (18,523) | (16,450) |
| Cash flows from financing activities | | | |
| Issue of ordinary share capital | 13 | | 180 |
| Issue of other equity instruments | | 3,718 | |
| Net sales of own shares for market-making and investment purposes | 27 | 61 | 102 |
| (Purchases)/sales of own shares to meet share awards and share option awards | (27) | 19 | (8) |
| On exercise of share options | | 61 | (59) |
| Subordinated loan capital issued | | 1,329 | 3,152 |
| Subordinated loan capital repaid | (2,574) | (2,408) | (67) |
| Net cash outflow from change in stake in subsidiaries | | | (229) |
| Dividends paid to ordinary shareholders of the parent company | (2,192) | (2,126) | (1,315) |

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| | | | | |
|--|----|----------------|----------|---------|
| Dividends paid to non-controlling interests | | (321) | (329) | (266) |
| Dividends paid to holders of other equity instruments | | (286) | (134) | (279) |
| Net cash generated from/(used in) financing activities | | (5,360) | 191 | 1,211 |
| Net increase/(decrease) in cash and cash equivalents | | 27,907 | 27,813 | (5,642) |
| Cash and cash equivalents at the beginning of the period | | 274,076 | 250,766 | 265,910 |
| Exchange differences in respect of cash and cash equivalents | | 10,368 | (12,669) | 13,808 |
| Cash and cash equivalents at the end of the period | 19 | 312,351 | 265,910 | 274,076 |

The accompanying notes on pages 179 to 218 form an integral part of these financial statements¹.

For footnotes, see page 178.

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)**Consolidated statement of changes in equity for the half-year to 30 June 2011**

| | Half-year to 30 June 2011 | | | | | | | | | | | |
|---|---------------------------|----------------------------|--------------------------|------------------------------------|----------------------------|--|--------------------------|-------------------------------|-----------------------------|----------------------------|---------------------------|--------------|
| | Called up share capital | Share premium ⁴ | Other equity instruments | Retained earnings ^{3,5,6} | Available-for-sale reserve | Cash flow hedging reserve ⁷ | Foreign exchange reserve | Merger reserve ^{5,8} | Other reserves ³ | Total share-holders equity | Non-controlling interests | Total equity |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 1 January 2011 | 8,843 | 8,454 | 5,851 | 99,105 | (4,077) | (285) | 2,468 | 27,308 | | 147,667 | 7,248 | 154,915 |
| Profit for the period | | | | 9,215 | | | | | | 9,215 | 547 | 9,762 |
| Other comprehensive income (net of tax) | | | | (144) | 1,146 | 40 | 4,471 | | | 5,513 | 67 | 5,580 |
| Available-for-sale investments | | | | | 1,146 | | | | | 1,146 | (10) | 1,136 |
| Cash flow hedges | | | | | | 40 | | | | 40 | | 40 |
| Actuarial gains/(losses) on defined benefit plans | | | | 2 | | | | | | 2 | (21) | (19) |
| Share of other comprehensive income of associates and joint ventures | | | | (146) | | | | | | (146) | | (146) |
| Exchange differences | | | | | | | 4,471 | | | 4,471 | 98 | 4,569 |
| Total comprehensive income for the period | | | | 9,071 | 1,146 | 40 | 4,471 | | | 14,728 | 614 | 15,342 |
| Shares issued under employee share plans | 1 | 12 | | | | | | | | 13 | | 13 |
| Shares issued in lieu of dividends and amounts arising thereon ⁴ | 65 | (65) | | 1,334 | | | | | | 1,334 | | 1,334 |
| Dividends to shareholders | | | | (4,006) | | | | | | (4,006) | (413) | (4,419) |
| Tax credits on dividends | | | | 64 | | | | | | 64 | | 64 |
| Own shares adjustment | | | | (225) | | | | | | (225) | | (225) |
| Cost of share-based payment arrangements | | | | 588 | | | | | | 588 | | 588 |
| | | | | 36 | | | | | | 36 | | 36 |

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| | | | | | | | | | | | |
|---|-------|-------|-------|---------|---------|-------|-------|--------|---------|-------|---------|
| Income taxes on share-based payments | | | | | | | | | | | |
| Other movements | | | | 37 | 14 | | | | 51 | 1 | 52 |
| Acquisition and disposal of subsidiaries | | | | | | | | | | (261) | (261) |
| Changes in ownership interests in subsidiaries that did not result in loss of control | | | | | | | | | | 98 | 98 |
| At 30 June 2011 | 8,909 | 8,401 | 5,851 | 106,004 | (2,917) | (245) | 6,939 | 27,308 | 160,250 | 7,287 | 167,537 |

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)**Consolidated statement of changes in equity for the half-year to 30 June 2011 (continued)**

| | Called up share capital | | Other equity instruments | Retained earnings ^{3,5,6} | Half-year to 30 June 2010 Other reserves ³ | | | Merger reserve ^{5,8} | Total share-holders equity | Non-controlling interests | Total equity |
|---|-------------------------|-------------------------------|--------------------------|------------------------------------|--|---|---|-------------------------------|----------------------------|---------------------------|--------------|
| | US\$m | premium ⁴ US\$m | | | US\$m | Available-for-sale reserve fair value US\$m | Cash flow hedging reserve ⁷ US\$m | | | | |
| At 1 January 2010 | 8,705 | 8,413 | 2,133 | 88,737 | (9,965) | (26) | 2,994 | 27,308 | 128,299 | 7,362 | 135,661 |
| Profit for the period | | | | 6,763 | | | | | 6,763 | 485 | 7,248 |
| Other comprehensive income (net of tax) | | | | 28 | 4,151 | (39) | (6,002) | | (1,862) | (92) | (1,954) |
| Available-for-sale investments | | | | | 4,151 | | | | 4,151 | 55 | 4,206 |
| Cash flow hedges | | | | | | (39) | | | (39) | (6) | (45) |
| Actuarial losses on defined benefit plans | | | | (45) | | | | | (45) | (15) | (60) |
| Share of other comprehensive income of associates and joint ventures | | | | 73 | | | | | 73 | | 73 |
| Exchange differences | | | | | | | (6,002) | | (6,002) | (126) | (6,128) |
| Total comprehensive income for the period | | | | 6,791 | 4,151 | (39) | (6,002) | | 4,901 | 393 | 5,294 |
| Shares issued under employee share plans | 3 | 58 | | | | | | | 61 | | 61 |
| Shares issued in lieu of dividends and amounts arising thereon ⁴ | 47 | (48) | | 1,584 | | | | | 1,583 | | 1,583 |
| Capital securities issued during the period ⁹ | | | 3,718 | | | | | | 3,718 | | 3,718 |
| Dividends to shareholders | | | | (3,261) | | | | | (3,261) | (409) | (3,670) |
| Tax credits on dividends | | | | 54 | | | | | 54 | | 54 |
| Own shares adjustment | | | | 80 | | | | | 80 | | 80 |

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| | | | | | | | | | | | |
|---|-------|-------|-------|--------|---------|------|---------|--------|---------|-------|---------|
| Exercise and lapse of share options and vesting of share awards | | | | (119) | | | | | (119) | | (119) |
| Cost of share-based payment arrangements | | | | 371 | | | | | 371 | | 371 |
| Income taxes on share-based payments | | | | (14) | | | | | (14) | | (14) |
| Other movements | | | | (30) | 294 | 8 | (2) | | 270 | (1) | 269 |
| Changes in ownership interests in subsidiaries that did not result in loss of control | | | | | | | | | | 35 | 35 |
| At 30 June 2010 | 8,755 | 8,423 | 5,851 | 94,193 | (5,520) | (57) | (3,010) | 27,308 | 135,943 | 7,380 | 143,323 |

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)

| | Half-year to 31 December 2010 | | | | | | | | | | |
|---|-------------------------------|-------|--------------------------|-------------------|-----------------------------|---------------------------------------|--|--------------------------|-------------------------------|--------------|---------------------|
| | Called up share capital | | Other equity instruments | Retained earnings | Other reserves ³ | | | Total | | Total equity | |
| US\$m | US\$m | US\$m | | | 3,5,6 | Available-for-sale fair value reserve | Cash flow hedging reserve ⁷ | Foreign exchange reserve | Merger reserve ^{5,8} | | shareholders equity |
| At 1 July 2010 | 8,755 | 8,423 | 5,851 | 94,193 | (5,520) | (57) | (3,010) | 27,308 | 135,943 | 7,380 | 143,323 |
| Profit for the period | | | | 6,396 | | | | | 6,396 | 547 | 6,943 |
| Other comprehensive income (net of tax) | | | | 21 | 1,520 | (227) | 5,476 | | 6,790 | 207 | 6,997 |
| Available-for-sale investments | | | | | 1,520 | | | | 1,520 | 109 | 1,629 |
| Cash flow hedges | | | | | | (227) | | | (227) | 1 | (226) |
| Actuarial losses on defined benefit plans | | | | (13) | | | | | (13) | 12 | (1) |
| Share of other comprehensive income of associates and joint ventures | | | | 34 | | | | | 34 | | 34 |
| Exchange differences | | | | | | | 5,476 | | 5,476 | 85 | 5,561 |
| Total comprehensive income for period | | | | 6,417 | 1,520 | (227) | 5,476 | | 13,186 | 754 | 13,940 |
| Shares issued under employee share plans | 9 | 110 | | | | | | | 119 | | 119 |
| Shares issued in lieu of dividends and amounts arising thereon ⁴ | 79 | (79) | | 940 | | | | | 940 | | 940 |
| Dividends to shareholders | | | | (3,089) | | | | | (3,089) | (316) | (3,405) |
| Tax credits on dividends | | | | 68 | | | | | 68 | | 68 |
| Own shares adjustment | | | | 94 | | | | | 94 | | 94 |
| Exercise and lapse of share options and vesting of share awards | | | | 119 | | | | | 119 | | 119 |
| Cost of share-based payment arrangements | | | | 441 | | | | | 441 | | 441 |
| Other movements | | | | (28) | (77) | (1) | 2 | | (104) | 4 | (100) |
| Acquisition and disposal of subsidiaries | | | | | | | | | | (436) | (436) |

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Changes in ownership interests in subsidiaries that did not result in loss of control

(50) (50) (138) (188)

At 31 December 2010

| | | | | | | | | | | | |
|--|-------|-------|-------|--------|---------|-------|-------|--------|---------|-------|---------|
| | 8,843 | 8,454 | 5,851 | 99,105 | (4,077) | (285) | 2,468 | 27,308 | 147,667 | 7,248 | 154,915 |
|--|-------|-------|-------|--------|---------|-------|-------|--------|---------|-------|---------|

Dividends per ordinary share at 30 June 2011 were US\$0.21 (30 June 2010: US\$0.18; 31 December 2010: US\$0.16).

The accompanying notes on pages 179 to 218 form an integral part of these financial statements¹.

For footnotes, see page 178.

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HSBC HOLDINGS PLC

Financial Statements (unaudited) (continued)

Footnotes to Financial Statements

- 1 *The following tables also form an integral part of these financial statements: Maximum exposure to credit risk (page 92), Gross loans and advances by industry sector (page 93), Gross loans and advances to customers by industry sector and by geographical region (page 93), Movement in impairment allowances on loans and advances to customers and banks (page 117), and Composition of regulatory capital within Capital structure (page 161).*
- 2 *Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.*
- 3 *The movement in reserves relating to equity-settled share-based payment arrangements is recognised in Retained earnings in the Consolidated statement of change in equity, with effect from 1 January 2011. Previously, it was disclosed separately in a Share-based payment reserve within Other reserves. Comparative data have been restated accordingly. The adjustment reduced Other reserves and increased Retained earnings by US\$1,765m at 30 June 2011 (30 June 2010: US\$1,268m; 31 December 2010: US\$1,755m). There was no effect on basic or diluted earnings per share following this change.*
- 4 *No deduction (30 June 2010: US\$1m; 31 December 2010: nil) in respect of issue costs incurred during the period is included in share premium.*
- 5 *Cumulative goodwill amounting to US\$5,138m has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US\$3,469m charged against the merger reserve arising on the acquisition of HSBC Bank. The balance of US\$1,669m was charged against retained earnings.*
- 6 *Retained earnings include 77,926,453 (US\$968m) of own shares held within HSBC's insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets (30 June 2010: 127,950,817 (US\$1,578m); 31 December 2010: 123,331,979 (US\$1,799m)).*
- 7 *Amounts transferred to the income statement in respect of cash flow hedges include US\$345m gain (30 June 2010: US\$129m loss; 31 December 2010: US\$734m gain) taken to Net interest income and US\$149m loss (30 June 2010: US\$1,515m loss; 31 December 2010: US\$1,074m gain) taken to Net trading income.*
- 8 *Statutory share premium relief under Section 131 of the Companies Act 1985 (the Act) was taken in respect of the acquisition of HSBC Bank in 1992, HSBC France in 2000 and HSBC Finance in 2003 and the shares issued were recorded at their nominal value only. In HSBC's consolidated financial statements the fair value differences of US\$8,290m in respect of HSBC France and US\$12,768m in respect of HSBC Finance were recognised in the merger reserve. The merger reserve created on the acquisition of HSBC Finance subsequently became attached to HSBC Overseas Holdings (UK) Limited (HOHU), following a number of intra-Group reorganisations. At 30 June 2011, nil (30 June 2010: nil; 31 December 2010: nil) was transferred from this reserve to retained earnings as a result of impairment in HSBC Holdings' investment in HOHU. During 2009, pursuant to Section 131 of the Companies Act 1985, statutory share premium relief was taken in respect of the rights issue and US\$15,796m was recognised in the merger reserve. The merger reserve includes the deduction of US\$614m in respect of costs relating to the rights issue, of which US\$149m was subsequently transferred to the income statement. Of this US\$149m, US\$121m was a loss arising from accounting for the agreement with the underwriters as a contingent forward contract. The merger reserve excludes the loss of US\$344m on a forward foreign exchange contract associated with hedging the proceeds of the rights issue.*
- 9 *During June 2010, HSBC Holdings issued US\$3,800m of Perpetual Subordinated Capital Securities, Series 2 (capital securities), on which there were US\$82m of external issuance costs and US\$23m of intra-Group issuance costs which are classified as equity under IFRSs. The capital securities are exchangeable at HSBC Holdings' option into non-cumulative US dollar preference shares on any coupon payment date. Interest on the capital securities is paid quarterly and may be deferred at the discretion of HSBC Holdings. The capital securities may only be redeemed at the option of HSBC Holdings.*

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Notes on the Financial Statements (unaudited)

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1 Basis of preparation**(a) Compliance with International Financial Reporting Standards**

The interim consolidated financial statements of HSBC have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Services Authority and IAS 34 Interim Financial Reporting (IAS 34) as issued by the International Accounting Standards Board (IASB) and as endorsed by the EU.

The consolidated financial statements of HSBC at 31 December 2010 were prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards

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effective for the year ended 31 December 2010 affecting the consolidated financial statements at that date, 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 2010 were prepared in accordance with IFRSs as issued by the IASB.

At 30 June 2011, there were no unendorsed standards effective for the period ended 30 June 2011 affecting these interim consolidated 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.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee (IFRIC) and its predecessor body.

During the period ended 30 June 2011, HSBC adopted a number of interpretations and amendments to standards which had an insignificant effect on these interim consolidated financial statements.

(b) Presentation of information

In accordance with HSBC's policy to provide meaningful disclosures that help investors and other stakeholders understand the Group's performance, financial position and changes thereto, the information provided in the Notes on the Financial Statements and the Interim Management Report goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules. In particular, HSBC has adopted the British Bankers' Association Code for Financial Reporting Disclosure (the BBA Code). The BBA Code aims to increase the quality and comparability of banks' disclosures and sets out five disclosure principles together with supporting guidance. In line with the principles of the BBA Code, HSBC assesses the applicability and relevance of good practice recommendations issued from time to time by relevant regulators and standard setters, enhancing disclosures where appropriate.

HSBC's consolidated financial statements are presented in US dollars which is also HSBC Holdings' functional currency. HSBC Holdings' functional currency is the US dollar because the US dollar and currencies linked to it are the most significant currencies relevant to the underlying transactions, events and conditions of its subsidiaries, as well as representing a significant proportion of its funds generated from financing activities.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

HSBC uses the US dollar as its presentation currency in its consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts and funds its business.

(c) Comparative information

These interim consolidated financial statements include comparative information as required by IAS 34, the UK Disclosure Rules and Transparency Rules and the Hong Kong Listing Rules.

(d) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from those reported. Management believes that HSBC's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, the impairment of available-for-sale financial assets and deferred tax assets. These critical accounting policies are described on pages 33 to 36 of the *Annual Report and Accounts 2010*.

(e) Consolidation

The interim consolidated financial statements of HSBC comprise the financial statements of HSBC Holdings and its subsidiaries. The method adopted by HSBC to consolidate its subsidiaries is described on pages 251 to 252 of the *Annual Report and Accounts 2010*.

(f) Future accounting developments

At 30 June 2011, a number of standards and interpretations, and amendments thereto, had been issued by the IASB which are not yet effective for these consolidated financial statements, the most significant of which are described below. The IASB is continuing to work on projects on insurance, revenue recognition and lease accounting, which together with IFRS 9 and the standards described below, represent widespread and significant changes to accounting requirements from 2013.

IFRS 9 Financial Instruments is described on pages 252 and 253 of the *Annual Report and Accounts 2010*, including the second and third phases in the IASB's project to replace IAS 39, which address the impairment of financial assets measured at amortised cost and hedge accounting. The IASB did not finalise the replacement of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders. As a consequence, the IASB is consulting on its proposal to change the effective date of IFRS 9 to 1 January 2015 to facilitate the adoption of the entire replacement of IAS 39. The EU is not expected to endorse IFRS 9 until the completed standard is available. Therefore, HSBC remains unable to provide a date by which it plans to apply IFRS 9 and it remains impracticable to quantify the impact of IFRS 9 as at the date of publication of these consolidated financial statements.

Standards issued by the IASB but not endorsed by the EU

In May 2011, the IASB issued IFRS 10 Consolidated Financial Statements (IFRS 10), IFRS 11 Joint Arrangements (IFRS 11) and IFRS 12 Disclosure of Interests in Other Entities (IFRS 12). The standards are effective for annual periods beginning on or after 1 January 2013 with

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early adoption permitted. IFRSs 10 and 11 are to be applied retrospectively.

Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on rights and obligations than on legal form, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

HSBC is currently assessing the impact of these new IFRSs, but it is impracticable to quantify their effect as at the date of publication of these consolidated financial statements.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

In May 2011, the IASB also issued IFRS 13 Fair Value Measurement (IFRS 13). This standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

HSBC is currently assessing the impact of this new IFRS but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

In June 2011, the IASB issued amendments to IAS 19 Employee Benefits (IAS 19 revised). The revised standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IAS 19 revised must be applied retrospectively.

The most significant amendment for HSBC is the replacement of interest cost and expected return on plan assets by a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement will be presented in other comprehensive income. The effect of this change is to increase the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

Based on an initial estimate of the impact of this particular amendment on the 2010 consolidated financial statements, the change would decrease pre-tax profit, with no effect on the pension liability. The effect on total operating expenses and pre-tax profit is not expected to be material. The effect at the date of adoption will depend on market interest rates, rates of return and the actual mix of scheme assets at that time.

(g) Changes in composition of the Group

There were no material changes in the composition of the Group.

2 Accounting policies

The accounting policies adopted by HSBC for these interim consolidated financial statements are consistent with those described on pages 253 to 270 of the *Annual Report and Accounts 2010*, with the exception of the presentation of the consolidated statement of changes in equity which no longer includes a separate Share-based payment reserve which has now been incorporated into retained earnings. The methods of computation applied by HSBC for these interim consolidated financial statements are consistent with those applied for the *Annual Report and Accounts 2010*.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)**3 Dividends**

The Directors declared after the end of the period a second interim dividend in respect of the financial year ending 31 December 2011 of US\$0.09 per ordinary share, a distribution of approximately US\$1,604m which will be payable on 6 October 2011. No liability is recorded in the financial statements in respect of this dividend.

Dividends to shareholders of the parent company

| | 30 June 2011 | | | Half-year to 30 June 2010 | | | 31 December 2010 | | |
|---|----------------------|----------------|------------------------------|------------------------------|----------------|------------------------------|----------------------|----------------|------------------------------|
| | Per share US\$ | Total US\$m | Settled in scrip US\$m | Per share US\$ | Total US\$m | Settled in scrip US\$m | Per share US\$ | Total US\$m | Settled in scrip US\$m |
| Dividends declared on ordinary shares | | | | | | | | | |
| In respect of previous year: | | | | | | | | | |
| fourth interim dividend | 0.12 | 2,119 | 1,130 | 0.10 | 1,733 | 838 | | | |
| In respect of current year: | | | | | | | | | |
| first interim dividend | 0.09 | 1,601 | 204 | 0.08 | 1,394 | 746 | | | |
| second interim dividend | | | | | | | 0.08 | 1,402 | 735 |
| third interim dividend | | | | | | | 0.08 | 1,408 | 205 |
| | 0.21 | 3,720 | 1,334 | 0.18 | 3,127 | 1,584 | 0.16 | 2,810 | 940 |
| Quarterly dividends on preference shares classified as equity | | | | | | | | | |
| March dividend | 15.50 | 22 | | 15.50 | 22 | | | | |
| June dividend | 15.50 | 23 | | 15.50 | 23 | | | | |
| September dividend | | | | | | | 15.50 | 22 | |
| December dividend | | | | | | | 15.50 | 23 | |
| | 31.00 | 45 | | 31.00 | 45 | | 31.00 | 45 | |
| Quarterly coupons on capital securities classified as equity¹ | | | | | | | | | |
| January coupon | 0.508 | 44 | | 0.508 | 44 | | | | |
| March coupon | 0.500 | 76 | | | | | | | |
| April coupon | 0.508 | 45 | | 0.508 | 45 | | | | |
| June coupon | 0.500 | 76 | | | | | | | |
| July coupon | | | | | | | 0.508 | 45 | |
| September coupon | | | | | | | 0.450 | 68 | |

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| | | | | | | |
|-----------------|--------------|------------|-------|----|-------|-----|
| October coupon | | | | | 0.508 | 45 |
| December coupon | | | | | 0.500 | 76 |
| | 2.016 | 241 | 1.016 | 89 | 1.966 | 234 |

1 HSBC Holdings issued Perpetual Subordinated Capital Securities of US\$3,800m in June 2010.

On 15 July 2011, HSBC paid a further coupon on the capital securities of US\$0.508 per security, a distribution of US\$45m. No liability is recorded in the financial statements in respect of this coupon payment.

4 Earnings per share

Basic earnings per ordinary share was calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding, excluding own shares held. Diluted earnings per ordinary share was calculated by dividing the basic earnings, which require no adjustment for the effects of dilutive potential ordinary shares, by the weighted average number of ordinary shares outstanding, excluding own shares held, plus the weighted average number of ordinary shares that would be issued on conversion of dilutive potential ordinary shares.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

Profit attributable to ordinary shareholders of the parent company

| | 30 June | Half-year to 30 June | 31 December |
|--|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Profit attributable to shareholders of the parent company | 9,215 | 6,763 | 6,396 |
| Dividend payable on preference shares classified as equity | (45) | (45) | (45) |
| Coupon payable on capital securities classified as equity | (241) | (89) | (234) |
| Profit attributable to ordinary shareholders of the parent company | 8,929 | 6,629 | 6,117 |

Basic and diluted earnings per share

| | Half-year to 30 June 2011 | | | Half-year to 30 June 2010 | | | Half-year to 31 December 2010 | | |
|---|---------------------------|---------------------|---------------------|---------------------------|---------------------|---------------------|-------------------------------|---------------------|---------------------|
| | Profit | Number of shares | Amount per share | Profit | Number of shares | Amount per share | Profit | Number of shares | Amount per share |
| | US\$m | (millions) | US\$ | US\$m | (millions) | US\$ | US\$m | (millions) | US\$ |
| Basic ¹ | 8,929 | 17,631 | 0.51 | 6,629 | 17,310 | 0.38 | 6,117 | 17,496 | 0.35 |
| Effect of dilutive potential ordinary shares | | 266 | | | 202 | | | 256 | |
| Diluted ² | 8,929 | 17,897 | 0.50 | 6,629 | 17,512 | 0.38 | 6,117 | 17,752 | 0.34 |

1 Weighted average number of ordinary shares outstanding.

2 Weighted average number of ordinary shares outstanding assuming dilution.

5 Post-employment benefits

Included within Employee compensation and benefits are components of net periodic benefit cost related to HSBC's defined benefit pension plans and other post-employment benefits, as follows:

| | 30 June | Half-year to 30 June | 31 December |
|--------------------------------|----------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Current service cost | 287 | 291 | 273 |
| Interest cost | 892 | 811 | 835 |
| Expected return on plan assets | (919) | (717) | (825) |
| Past service cost | (581) | 8 | 3 |
| Gains on curtailments | | (148) | (3) |
| (Gains)/losses on settlements | | 1 | (3) |
| Total (income)/expense | (321) | 246 | 280 |

HSBC revalues its defined benefit post-employment plans each year at 31 December, in consultation with the plans' local actuaries. The assumptions underlying the calculations are used to determine the expected income statement charge for the year going forward. At 30 June each year, HSBC revalues all plan assets to current market prices. HSBC also reviews the assumptions used to calculate the defined benefit obligations (the liabilities of the plans) and updates the carrying amount of the obligations if there have been significant changes as a consequence of changes in assumptions.

Retirement benefit liabilities for the Group have reduced from US\$3.9bn at 31 December 2010 to US\$3.0bn at 30 June 2011, US\$0.7bn of this reduction being in respect of the HSBC Bank (UK) Pension Scheme funded defined benefit plan (the principal plan). A small net retirement benefit asset was recognised for the principal plan as at 30 June 2011 as a result of this reduction, which was mainly due to the change in indexation of deferred pensions, discussed below, and changes in actuarial assumptions.

Changes in actuarial assumptions increased the defined benefit obligation for the principal plan by US\$36m, recognised directly in other comprehensive income as an actuarial loss. The net increase resulted from an increase in inflation assumptions and the effect of changes to assumed commutation factors, less the effect of an increase in the nominal discount rate. However, the actual return on the plan assets of the principal plan was higher than the expected return by US\$179m, recognised as an actuarial gain directly in other comprehensive income.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

A change in indexation for deferred pensions was one of the most significant reasons for the reduction in the defined benefit of the principal plan. The expected cash flows of the principal plan were historically projected by reference to the Retail Prices Index (RPI) swap curve in calculating the liability recognised. The Occupational Pensions (Revaluation) Order 2010 confirmed the UK government's intention to move to using the Consumer Prices Index (CPI) rather than RPI as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. Historical annual CPI increases have generally been lower than annual RPI increases. The rules of the principal plan prescribe that annual increases for pensions in payment are in line with RPI, but for deferred pensions, i.e. pensions for members of the scheme who have left HSBC employment but whose pensions are yet to commence, are linked to the statutory index prior to retirement. However, consistent with communications to Scheme members, HSBC has historically used RPI in calculating the pension liability for deferred pensions.

In May 2011, the trustee of the principal plan communicated to scheme members the impact on scheme benefits of the UK government's announcement. At 30 June 2011, HSBC used CPI in calculating the pension liability recognised, which resulted in a reduction of the principal plan's liabilities in respect of deferred pensioners of US\$587m. A corresponding gain was recognised as a credit to past service cost and is included within Employee compensation and benefits in the income statement.

The discount rates used to calculate HSBC's obligations under its defined benefit pension and post-employment healthcare plans were as follows:

Discount rates

| | At 30 June 2011 % | At 30 June 2010 % | At 31 December 2010 % |
|-------------|----------------------------|----------------------------|--------------------------------|
| UK | 5.60 | 5.40 | 5.40 |
| Hong Kong | 2.28 | 2.29 | 2.85 |
| US | 5.35 | 5.45 | 5.41 |
| Jersey | 5.40 | 5.70 | 5.40 |
| Mexico | 7.50 | 7.50 | 7.50 |
| Brazil | 11.00 | 11.25 | 10.51 |
| France | 5.00 | 4.50 | 4.75 |
| Canada | 5.75 | 5.75 | 5.45 |
| Switzerland | 2.60 | 2.60 | 2.60 |
| Germany | 5.00 | 4.50 | 5.00 |

The inflation rate used to calculate the principal plan obligation at 30 June 2011 was 3.8%. (30 June 2010: 3.5%; 31 December 2010: 3.7%). Other than described above, there were no material changes to other assumptions.

Actuarial gains and losses

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| | 30 June | Half-year to 30 June | 31 December |
|--|--------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Experience losses on plan liabilities | (36) | (17) | (410) |
| Experience gains on plan assets | 162 | 956 | 1,216 |
| Losses from changes in actuarial assumptions | (128) | (1,038) | (773) |
| Other movements ¹ | (16) | 17 | (11) |
| | | | |
| Total net actuarial gains/(losses) | (18) | (82) | 22 |

¹ *Other movements include changes in the effect of the limit on plan surpluses.*

Actuarial gains and losses comprise experience adjustments on plan assets and liabilities as well as adjustments arising from changes in actuarial assumptions. The experience gains and losses on plan assets arise as a result of the difference between the expected returns on the plan assets and the actual movement in the value of the plan assets during the period. The changes in actuarial assumptions arise as a result of changes in the plan assumptions, primarily discount rates and inflation rates, as previously described.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

Total cumulative net actuarial losses, including the cumulative effect of the limit on plan surpluses recognised in equity at 30 June 2011, were US\$4,738m (30 June 2010: US\$4,742m cumulative losses; 31 December 2010: US\$4,720m cumulative losses). Of this the cumulative effect of the limit on plan surpluses was US\$65m (30 June 2010: US\$29m; 31 December 2010: US\$47m).

On 17 June 2010, HSBC Bank plc agreed with the Trustee to accelerate the reduction of the deficit of the plan with a special contribution of £1,760m (US\$2,638m) in June 2010 followed by a revised payment schedule in the following years, as shown below:

| | Revised plan US\$m ¹ | Revised plan £m |
|------|---------------------------------------|-----------------------|
| 2016 | 792 | 495 |
| 2017 | 1,008 | 630 |
| 2018 | 1,008 | 630 |

1 The payment schedule was agreed with the Trustee in pounds sterling and the equivalent US dollar amounts are shown at the exchange rate effective as at 30 June 2011.

The next actuarial valuation of the principal plan is due to be made as at 31 December 2011.

As disclosed in Related party transactions on page 368 in the *Annual Report and Accounts 2010*, the principal plan entered into collateralised swap transactions with HSBC to manage the inflation and interest rate sensitivity of the Scheme's pension obligations. At 30 June 2011, the swaps had a positive fair value of US\$2,457m to the Scheme (30 June 2010: US\$1,891m positive to the Scheme; 31 December 2010: US\$2,173m positive to the Scheme). All swaps were executed at prevailing market rates and within standard market bid-offer spreads.

6 Tax expense

| 30 June 2011 US\$m | Half-year to 30 June 2010 US\$m | 31 December 2010 US\$m |
|--------------------------|--|------------------------------|
| | | |

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| | | | |
|---|-------|-------|-------|
| Current tax | | | |
| UK corporation tax charge | 230 | 609 | (226) |
| Overseas tax ¹ | 1,694 | 2,439 | 889 |
| | 1,924 | 3,048 | 663 |
| Deferred tax | | | |
| Origination and reversal of temporary differences | (212) | 808 | 327 |
| | 1,712 | 3,856 | 990 |
| Tax expense | | | |
| | 1,712 | 3,856 | 990 |
| Effective tax rate | 14.9% | 34.7% | 12.5% |

1 Overseas tax included Hong Kong profits tax of US\$453m (first half of 2010: US\$426m; second half of 2010: US\$536m). Subsidiaries in Hong Kong provided for Hong Kong profits tax at the rate of 16.5% (2010: 16.5%) on the profits for the period assessable in Hong Kong. Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

The following table reconciles the overall tax expense which would apply if all profits had been taxed at the UK corporation tax rate of 26.5% (2010: 28%):

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

| | 30 June 2011 | | Half-year to 30 June 2010 | | 31 December 2010 | |
|--|--------------|-------------|------------------------------|-------------|------------------|-------------|
| | US\$m | % | US\$m | % | US\$m | % |
| Analysis of tax expense | | | | | | |
| Taxation at UK corporation tax rate of 26.5% (2010: 28%) | 3,041 | 26.5 | 3,109 | 28.0 | 2,221 | 28.0 |
| Effect of taxing overseas profits in principal locations at different rates | (275) | (2.4) | (326) | (2.9) | (418) | (5.3) |
| Adjustments in respect of prior period liabilities | 522 | 4.5 | (20) | (0.2) | 20 | 0.2 |
| Deferred tax temporary differences not provided/ (previously not recognised) | (1,008) | (8.8) | 8 | 0.1 | (14) | (0.2) |
| Low income housing tax credits | (42) | (0.4) | (44) | (0.4) | (42) | (0.5) |
| Effect of profit in associates and joint ventures | (412) | (3.6) | (332) | (3.0) | (373) | (4.7) |
| Tax effect of intra-Group transfer of subsidiary | | | 1,590 | 14.3 | (374) | (4.7) |
| Effect of gains arising from dilution of interests in associates | (48) | (0.4) | | | (53) | (0.6) |
| Non taxable income | (179) | (1.5) | (164) | (1.5) | (210) | (2.6) |
| Gains not subject to tax | (5) | | (180) | (1.6) | (95) | (1.2) |
| Permanent disallowables | 95 | 0.8 | 99 | 0.9 | 177 | 2.2 |
| Effect of bank payroll tax | | | 91 | 0.8 | (12) | (0.2) |
| Change in tax rates | 2 | | | | 31 | 0.4 |
| Local taxes and overseas withholding tax | 117 | 1.0 | 38 | 0.3 | 23 | 0.3 |
| Other items | (96) | (0.8) | (13) | (0.1) | 109 | 1.4 |
| Overall tax expense | 1,712 | 14.9 | 3,856 | 34.7 | 990 | 12.5 |

The effective tax rate for the first half of 2011 was 14.9% compared with 34.7% for the first half of 2010. The lower tax charge in the first half of 2011 included the benefit of deferred tax recognised in respect of foreign tax credits, partly offset by a current tax charge in respect of prior periods in a number of jurisdictions. The tax charge in the first half of 2010 included US\$1.6bn attributable to a taxable gain arising from an internal reorganisation within our North American operations.

The UK government has announced that the main rate of corporation tax for the year beginning 1 April 2011 will reduce by 2 percentage points from 28% to 26% to be followed over a period of three years by further 1 percentage point reductions to 23% for the year beginning 1 April 2014. This results in a weighted average rate of 26.5% for 2011 (2010: 28%). It is not expected that the proposed future rate reductions will have a significant effect on the UK net deferred tax asset recognised at 30 June 2011 of US\$237m.

For the period ended 30 June 2011, HSBC's share of associates' tax on profit was US\$418m (30 June 2010: US\$356m; 31 December 2010: US\$418m), which is included within share of profit in associates and joint ventures in the income statement.

Of the total net deferred tax assets of US\$6.8bn at 30 June 2011 (30 June 2010: US\$5.0bn; 31 December 2010: US\$5.9bn), US\$5.2bn (30 June 2010: US\$3.5bn; 31 December 2010: US\$4.0bn) arose in respect of HSBC's US operations where there has been a recent history of losses. Management's updated analysis is consistent with the assumption that it is probable that there will be sufficient taxable income to support the deferred tax assets that have been recognised in respect of the US operations as at 30 June 2011.

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Notes on the Financial Statements (unaudited) (continued)**7 Trading assets**

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--|--------------------------------|--------------------------------|------------------------------------|
| Trading assets: | | | |
| not subject to repledge or resale by counterparties | 338,455 | 315,137 | 284,940 |
| which may be repledged or resold by counterparties | 136,495 | 88,663 | 100,112 |
| | 474,950 | 403,800 | 385,052 |
| Treasury and other eligible bills | 23,899 | 22,236 | 25,620 |
| Debt securities | 208,805 | 194,390 | 168,268 |
| Equity securities | 36,718 | 27,360 | 41,086 |
| Trading securities valued at fair value | 269,422 | 243,986 | 234,974 |
| Loans and advances to banks | 100,134 | 77,434 | 70,456 |
| Loans and advances to customers | 105,394 | 82,380 | 79,622 |
| | 474,950 | 403,800 | 385,052 |
| <i>Trading securities valued at fair value¹</i> | | | |

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| | 30 June 2011 US\$m | 30 June 2010 US\$m | 31 December 2010 US\$m |
|---|--------------------------|--------------------------|------------------------------|
| US Treasury and US Government agencies ² | 23,849 | 22,774 | 20,239 |
| UK Government | 30,535 | 11,874 | 17,036 |
| Hong Kong Government | 7,228 | 14,325 | 11,053 |
| Other government | 110,691 | 79,177 | 92,826 |
| Asset-backed securities ³ | 3,742 | 4,381 | 3,998 |
| Corporate debt and other securities | 56,659 | 84,095 | 48,736 |
| Equity securities | 36,718 | 27,360 | 41,086 |
| | 269,422 | 243,986 | 234,974 |

1 Included within these figures are debt securities issued by banks and other financial institutions of US\$40,033m (30 June 2010: US\$35,424m; 31 December 2010: US\$37,170m), of which US\$8,311m (30 June 2010: US\$8,399m; 31 December 2010: US\$8,330m) are guaranteed by various governments.

2 Includes securities that are supported by an explicit guarantee issued by the US Government.

3 Excludes asset-backed securities included under US Treasury and US Government agencies.

Trading securities listed on a recognised exchange and unlisted

| | Treasury and other eligible bills US\$m | Debt securities US\$m | Equity securities US\$m | Total US\$m |
|--|--|-----------------------------|-------------------------------|----------------|
| Fair value at 30 June 2011 | | | | |
| Listed on a recognised exchange ¹ | 205 | 149,912 | 35,944 | 186,061 |
| Unlisted ² | 23,694 | 58,893 | 774 | 83,361 |
| | 23,899 | 208,805 | 36,718 | 269,422 |
| Fair value at 30 June 2010 | | | | |
| Listed on a recognised exchange ¹ | 2,097 | 146,713 | 26,900 | 175,710 |
| Unlisted ² | 20,139 | 47,677 | 460 | 68,276 |
| | 22,236 | 194,390 | 27,360 | 243,986 |
| Fair value at 31 December 2010 | | | | |
| Listed on a recognised exchange ¹ | 698 | 113,878 | 40,098 | 154,674 |
| Unlisted ² | 24,922 | 54,390 | 988 | 80,300 |
| | | 168,268 | 41,086 | 234,974 |

- 1 *Included within listed securities are US\$3,080m (30 June 2010: US\$3,384m; 31 December 2010: US\$3,254m) of investments listed in Hong Kong.*
- 2 *Unlisted treasury and other eligible bills primarily comprise treasury bills not listed on a recognised exchange but for which there is a liquid market.*

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Notes on the Financial Statements (unaudited) (continued)*Loans and advances to banks held for trading*

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---------------------|--------------------------------|--------------------------------|------------------------------------|
| Reverse repos | 60,833 | 43,820 | 45,771 |
| Settlement accounts | 19,465 | 12,843 | 5,226 |
| Stock borrowing | 7,374 | 5,793 | 6,346 |
| Other | 12,462 | 14,978 | 13,113 |
| | 100,134 | 77,434 | 70,456 |

Loans and advances to customers held for trading

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---------------------|--------------------------------|--------------------------------|------------------------------------|
| Reverse repos | 50,540 | 36,330 | 46,366 |
| Settlement accounts | 28,274 | 22,039 | 7,516 |
| Stock borrowing | 12,452 | 12,487 | 11,161 |
| Other | 14,128 | 11,524 | 14,579 |
| | 105,394 | 82,380 | 79,622 |

8 Fair values of financial instruments carried at fair value

The accounting policies which determine the classification of financial instruments and the use of assumptions and estimation in valuing them are described on pages 253 to 270 and 34 to 36, respectively, of the *Annual Report and Accounts 2010*.

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Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The following table sets out the financial instruments carried at fair value.

Financial instruments carried at fair value and bases of valuation

| | Valuation techniques | | | Total |
|--|---|---|---|---------|
| | Quoted market price Level 1 US\$m | Using observable inputs Level 2 US\$m | significant unobservable inputs Level 3 US\$m | |
| At 30 June 2011 | | | | |
| Assets | | | | |
| Trading assets | 303,025 | 165,224 | 6,701 | 474,950 |
| Financial assets designated at fair value | 24,805 | 14,118 | 642 | 39,565 |
| Derivatives | 1,337 | 255,511 | 3,824 | 260,672 |
| Financial investments: available for sale | 225,469 | 162,711 | 8,592 | 396,772 |
| Liabilities | | | | |
| Trading liabilities | 165,552 | 207,126 | 13,146 | 385,824 |
| Financial liabilities designated at fair value | 27,570 | 70,110 | 600 | 98,280 |
| Derivatives | 1,521 | 252,154 | 3,350 | 257,025 |

At 30 June 2010

| | | | | |
|--|---------|---------|-------|---------|
| Assets | | | | |
| Trading assets | 258,303 | 139,855 | 5,642 | 403,800 |
| Financial assets designated at fair value | 19,043 | 12,151 | 1,049 | 32,243 |
| Derivatives | 1,844 | 281,705 | 4,730 | 288,279 |
| Financial investments: available for sale | 181,160 | 177,447 | 7,951 | 366,558 |
| Liabilities | | | | |
| Trading liabilities | 126,435 | 139,961 | 8,440 | 274,836 |
| Financial liabilities designated at fair value | 28,271 | 51,689 | 476 | 80,436 |
| Derivatives | 1,612 | 281,126 | 4,276 | 287,014 |

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Notes on the Financial Statements (unaudited) (continued)

| | Valuation techniques | | | Total US\$m |
|--|---------------------------|-------------------------------|---|----------------|
| | Quoted market price | Using observable inputs | With significant unobservable inputs | |
| | Level 1 US\$m | Level 2 US\$m | Level 3 US\$m | |
| At 31 December 2010 | | | | |
| Assets | | | | |
| Trading assets | 224,613 | 154,750 | 5,689 | 385,052 |
| Financial assets designated at fair value | 23,641 | 12,783 | 587 | 37,011 |
| Derivatives | 2,078 | 254,718 | 3,961 | 260,757 |
| Financial investments: available for sale | 214,276 | 158,743 | 8,237 | 381,256 |
| Liabilities | | | | |
| Trading liabilities | 124,874 | 164,436 | 11,393 | 300,703 |
| Financial liabilities designated at fair value | 22,193 | 65,370 | 570 | 88,133 |
| Derivatives | 1,808 | 253,051 | 3,806 | 258,665 |

The increase in Level 1 assets and liabilities reflects a significant increase in settlement account balances, which vary considerably in proportion with the level of trading activity. The increase in Level 1 assets also reflects increased holdings of debt securities, driven by higher issuances of and customer demand for government and government agency debt securities. A rise in short bond positions, which was in line with the growth in the Rates portfolio, contributed to the increase in Level 1 and Level 2 trading liabilities. The increase in Level 2 assets reflects higher reverse repo balances used to cover short positions, notably in Europe, North America and Latin America, and an increase in repo balances contributed to the growth in Level 2 liabilities.

There were no material transfers between Level 1 and Level 2 in the period.

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with Finance, which reports functionally to the Group Finance Director. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring compliance with all relevant accounting standards.

Further details of the control framework are included on pages 308 to 309 of the *Annual Report and Accounts 2010*.

Determination of fair value

Fair values are determined according to the following hierarchy:

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Level 1 quoted market price: financial instruments with quoted prices for identical instruments in active markets.

Level 2 valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

Level 3 valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. Further details on fair values determined using valuation techniques are included on pages 309 to 310 of the Annual Report and Accounts 2010.

HSBC has, for swaps with collateralised counterparties and in significant currencies, adopted a discounting curve that reflects the overnight interest rate (OIS discounting). Prior to 2010, in line with market practice, discount curves did not reflect this overnight interest rate component but were based on a term LIBOR rate. During the period, HSBC applied an OIS discounting curve to an expanded range of significant currencies in line with evolving market practice. The financial effect of this change was not significant.

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Notes on the Financial Statements (unaudited) (continued)

Fair value adjustments

Fair value adjustments are adopted when HSBC considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. The magnitude of fair value adjustments depends upon many entity-specific factors, and therefore fair value adjustments may not be comparable across the banking industry.

HSBC classifies fair value adjustments as either risk-related or model-related. The majority of these adjustments relate to Global Banking and Markets.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

Global Banking and Markets fair value adjustments

| Type of adjustment | At | At | At |
|---|-----------------|-----------------|---------------------|
| | 30 June 2011 | 30 June 2010 | 31 December 2010 |
| | US\$m | US\$m | US\$m |
| Risk-related | 1,934 | 2,243 | 2,171 |
| Bid-offer | 623 | 560 | 620 |
| Uncertainty | 110 | 162 | 136 |
| Credit risk adjustment | 1,192 | 1,493 | 1,355 |
| Other | 9 | 28 | 60 |
| Model-related | 351 | 447 | 389 |
| Model limitation | 344 | 367 | 383 |
| Other | 7 | 80 | 6 |
| Inception profit (Day 1 P&L reserves) (Note 12) | 279 | 256 | 250 |
| | 2,564 | 2,946 | 2,810 |

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Fair value adjustments declined by US\$246m during the period. The most significant movement was a reduction of US\$163m in credit risk adjustment driven by a variety of factors including reduction in exposure to monoline insurers and credit derivative product companies and inclusion of mandatory break clauses within the calculation methodology.

Detailed descriptions of risk-related and model-related adjustments are provided on page 311 of the *Annual Report and Accounts 2010*.

Credit risk adjustment methodology

HSBC calculates a separate credit risk adjustment for each HSBC legal entity, and within each entity for each counterparty to which the entity has exposure. The calculation of the monoline credit risk adjustment and sensitivity to different methodologies that could be applied is described on page 131. Of the total credit risk adjustment at 30 June 2011 of US\$1,192m (30 June 2010: US\$1,493m; 31 December 2010: US\$1,355m), US\$735m (30 June 2010: US\$926m; 31 December 2010: US\$836m) relates to the credit risk adjustment taken against non-monoline counterparties. The methodology for calculating the credit risk adjustment for non-monoline counterparties is described below.

HSBC calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. The calculation is performed over the life of the potential exposure.

The probability of default is based on HSBC's internal credit rating for the counterparty, taking into account how credit ratings may deteriorate over the duration of the exposure through the use of historical rating transition matrices. For most products, to calculate the expected positive exposure to a counterparty, HSBC uses a simulation methodology to incorporate the range of potential exposures across the portfolio of transactions with the counterparty over the life of an instrument. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty. A standard loss given default assumption of 60% is

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Notes on the Financial Statements (unaudited) (continued)

generally adopted. HSBC does not adjust derivative liabilities for HSBC's own credit risk, such an adjustment is often referred to as a debit valuation adjustment.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, HSBC adopts alternative methodologies. These may involve mapping to the results for similar products from the simulation tool or where such a mapping approach is not appropriate, a simplified methodology is used, generally following the same principles as the simulation methodology. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the simulation methodology described previously.

The methodologies do not, in general, account for wrong-way risk. Wrong-way risk arises where the underlying value of the derivative prior to any credit risk adjustment is positively correlated to the probability of default of the counterparty. Where there is significant wrong-way risk, a trade specific approach is applied to reflect the wrong-way risk within the valuation.

HSBC includes all third party counterparties in the credit risk adjustment calculation and does not net credit risk adjustments across HSBC Group entities. During the period, there were no material changes made by HSBC to the methodologies used to calculate the credit risk adjustment.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

| | Assets | | | | Liabilities Designated | | |
|--|-----------------------------|---------------------------|---------------------------------|----------------------|---------------------------|---------------------------------|----------------------|
| | Designated at fair value | | | | at fair value | | |
| | Available for sale US\$m | Held for trading US\$m | through profit or loss US\$m | Derivatives US\$m | Held for trading US\$m | through profit or loss US\$m | Derivatives US\$m |
| At 30 June 2011 | | | | | | | |
| Private equity including strategic investments | 3,915 | 88 | 178 | | | | |
| Asset-backed securities | 1,711 | 1,093 | | | | | |
| Leveraged finance | | | | | | | 10 |
| Loans held for securitisation | | 806 | | | | | |
| Structured notes | | 74 | | | 12,453 | | |
| Derivatives with monolines | | | | 930 | | | |
| Other derivatives | | | | 2,894 | | | 3,340 |
| Other portfolios | 2,966 | 4,640 | 464 | | 693 | 600 | |
| | 8,592 | 6,701 | 642 | 3,824 | 13,146 | 600 | 3,350 |

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| At 30 June 2010 | | | | | | | |
|--|-------|-------|-------|-------|--------|-----|-------|
| Private equity including strategic investments | 3,672 | 195 | 396 | | | | |
| Asset-backed securities | 1,903 | 659 | | | | | |
| Leveraged finance | | 42 | | | | | 18 |
| Loans held for securitisation | | 1,127 | | | | | |
| Structured notes | | | | | 7,786 | | |
| Derivatives with monolines | | | | 1,104 | | | |
| Other derivatives | | | | 3,626 | | | 4,258 |
| Other portfolios | 2,376 | 3,619 | 653 | | 654 | 476 | |
| | 7,951 | 5,642 | 1,049 | 4,730 | 8,440 | 476 | 4,276 |
| At 31 December 2010 | | | | | | | |
| Private equity including strategic investments | 4,057 | 278 | 120 | | | | |
| Asset-backed securities | 1,949 | 566 | | | | | |
| Leveraged finance | | | | | | | 11 |
| Loans held for securitisation | | 1,043 | | | | | |
| Structured notes | | | | | 10,667 | | |
| Derivatives with monolines | | | | 1,005 | | | |
| Other derivatives | | | | 2,956 | | | 3,787 |
| Other portfolios | 2,231 | 3,802 | 467 | | 726 | 570 | 8 |
| | 8,237 | 5,689 | 587 | 3,961 | 11,393 | 570 | 3,806 |

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Notes on the Financial Statements (unaudited) (continued)

Private equity including strategic investments

HSBC's private equity strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Asset-backed securities

While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For ABSs including residential MBSs, the valuation uses an industry standard model and the assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

Loans, including leveraged finance and loans held for securitisation

Loans held at fair value are valued from broker quotes and/or market data consensus providers when available. In the absence of an observable market, the fair value is determined using valuation techniques. These techniques include discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan, derived from other market instruments issued by the same or comparable entities.

Structured notes

The fair value of structured notes valued using a valuation technique is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes, which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon no-arbitrage principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices. The valuation of derivatives with monolines is discussed on page 130.

Derivative products valued using valuation techniques with significant unobservable inputs included certain types of correlation products, such as foreign exchange basket options, equity basket options, foreign exchange interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options and certain credit derivatives. Credit derivatives include

certain tranching CDS transactions.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

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Notes on the Financial Statements (unaudited) (continued)*Movement in Level 3 financial instruments*

| | Assets | | | | Liabilities Designated | | |
|---|--------------------|------------------|---|--------------|------------------------|---|--------------|
| | Available for sale | Held for trading | Designated at fair value through profit or loss | Derivatives | Held for trading | Designated at fair value through profit or loss | Derivatives |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| At 1 January 2011 | 8,237 | 5,689 | 587 | 3,961 | 11,393 | 570 | 3,806 |
| Total gains/(losses) recognised in profit or loss | 187 | (112) | 12 | (43) | 71 | 12 | 298 |
| Total gains/(losses) recognised in other comprehensive income ¹ | 182 | 68 | (4) | 47 | 199 | 18 | 92 |
| Purchases | 1,277 | 908 | 132 | | (89) | | |
| New issuances | | | | | 3,401 | | |
| Sales | (417) | (323) | (16) | | | | |
| Settlements | (815) | (104) | (4) | (145) | (1,561) | | (736) |
| Transfers out | (885) | (273) | (75) | (139) | (565) | | (362) |
| Transfers in | 826 | 848 | 10 | 143 | 297 | | 252 |
| At 30 June 2011 | 8,592 | 6,701 | 642 | 3,824 | 13,146 | 600 | 3,350 |
| Total gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2011 | 54 | (146) | 12 | 131 | 103 | 12 | 382 |
| At 1 January 2010 | 10,214 | 6,420 | 1,224 | 4,453 | 8,774 | 507 | 5,192 |
| Total gains/(losses) recognised in profit or loss | 112 | 131 | 41 | 199 | (245) | (8) | (431) |
| Total gains/(losses) recognised in other comprehensive income ¹ | 198 | (181) | (36) | (133) | (325) | (23) | (24) |
| Purchases | 1,428 | 419 | 36 | | | | |
| New issuances | | | | | 1,730 | | |
| Sales | (960) | (1,044) | (28) | | | | |
| Settlements | (173) | 18 | (6) | (92) | (823) | | (407) |
| Transfers out | (4,731) | (339) | (304) | (442) | (1,165) | | (423) |

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| | | | | | | | |
|---|-------|-------|-------|-------|-------|-----|-------|
| Transfers in | 1,863 | 218 | 122 | 745 | 494 | | 369 |
| At 30 June 2010 | 7,951 | 5,642 | 1,049 | 4,730 | 8,440 | 476 | 4,276 |
| Total gains/(losses) recognised in profit or loss relating to assets and liabilities held at 30 June 2010 | 70 | 74 | 42 | 720 | (246) | (8) | 105 |

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Notes on the Financial Statements (unaudited) (continued)*Movement in Level 3 financial instruments (continued)*

| | Assets Designated | | | | Liabilities Designated | | | Derivatives US\$m |
|---|----------------------|----------|----------------|-------------|---------------------------|----------------|-------|----------------------|
| | at fair value | | | | at fair value | | | |
| | Available | Held for | through profit | | Held for | through | | |
| | for sale | trading | or loss | Derivatives | trading | profit or loss | | |
| US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | | |
| At 1 July 2010 | 7,951 | 5,642 | 1,049 | 4,730 | 8,440 | 476 | 4,276 | |
| Total gains/(losses) recognised in profit or loss | 233 | 27 | 22 | (874) | 411 | (3) | 191 | |
| Total gains recognised in other comprehensive income ¹ | 420 | 80 | | 23 | 168 | 97 | 117 | |
| Purchases | 2,280 | 439 | 45 | | (356) | | | |
| New issuances | | | | | 2,295 | | | |
| Sales | (1,501) | (499) | 20 | | | | | |
| Settlements | (859) | (17) | (16) | 156 | (125) | | (413) | |
| Transfers out | (2,334) | (290) | (590) | (227) | (585) | | (580) | |
| Transfers in | 2,047 | 307 | 57 | 153 | 1,145 | | 215 | |
| | | | | | | | | |
| At 31 December 2010 | 8,237 | 5,689 | 587 | 3,961 | 11,393 | 570 | 3,806 | |
| | | | | | | | | |
| Total gains/(losses) recognised in profit or loss relating to assets and liabilities held at 31 December 2010 | 113 | 116 | 17 | 268 | 180 | (14) | 361 | |

1 Included in Available-for-sale investments: Fair value gains/(losses) and Exchange differences in the consolidated statement of comprehensive income. There were few significant movements in Level 3 assets or liabilities during the period. Purchases of available-for-sale securities reflects the acquisition of corporate bonds across a range of geographies. New issuances of trading liabilities were driven primarily by equity structured note issuances and settlements of trading liabilities reflect structured note maturities during the period.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on

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observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonably possible alternative assumptions

| | Reflected in profit or loss | | Reflected in other comprehensive income | |
|--|-----------------------------|------------------|---|------------------|
| | Favourable | Unfavourable | Favourable | Unfavourable |
| | changes US\$m | changes US\$m | changes US\$m | changes US\$m |
| At 30 June 2011 | | | | |
| Derivatives, trading assets and trading liabilities ¹ | 414 | (310) | | |
| Financial assets and liabilities designated at fair value | 72 | (64) | | |
| Financial investments: available for sale | | | 673 | (711) |
| | 486 | (374) | 673 | (711) |
| At 30 June 2010 | | | | |
| Derivatives, trading assets and trading liabilities ¹ | 661 | (637) | | |
| Financial assets and liabilities designated at fair value | 116 | (103) | | |
| Financial investments: available for sale | | | 595 | (573) |
| | 777 | (740) | 595 | (573) |
| At 31 December 2010 | | | | |
| Derivatives, trading assets and trading liabilities ¹ | 554 | (444) | | |
| Financial assets and liabilities designated at fair value | 77 | (75) | | |
| Financial investments: available for sale | | | 763 | (744) |
| | 631 | (519) | 763 | (744) |

¹ Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.

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Notes on the Financial Statements (unaudited) (continued)

The decrease in the effect of changes in significant unobservable inputs in relation to derivatives, trading assets and trading liabilities during the period primarily reflected greater certainty in pricing of structured credit transactions as a number of trades were unwound and the residual maturity of the portfolio reduced, as well as greater certainty in a number of structured rates transactions. The decrease in the effect of changes in significant unobservable inputs for available-for-sale assets arose from increased pricing certainty in respect of ABSs.

Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type

| | Reflected in other comprehensive income | | | |
|--|---|----------------------------|---------------|---------------|
| | Reflected in profit or loss | | Favourable | Unfavourable |
| | Favourable changes US\$m | Unfavourable changes US\$m | changes US\$m | changes US\$m |
| At 30 June 2011 | | | | |
| Private equity including strategic investments | 103 | (57) | 368 | (368) |
| Asset-backed securities | 3 | (3) | 130 | (124) |
| Leveraged finance | | | | |
| Loans held for securitisation | 5 | (5) | | |
| Structured notes | 16 | (16) | | |
| Derivatives with monolines | 117 | | | |
| Other derivatives | 126 | (169) | | |
| Other portfolios | 116 | (124) | 175 | (219) |
| | 486 | (374) | 673 | (711) |
| At 30 June 2010 | | | | |
| Private equity including strategic investments | 69 | (59) | 356 | (340) |
| Asset-backed securities | 18 | (11) | 131 | (134) |
| Leveraged finance | 1 | (1) | | |
| Loans held for securitisation | 10 | (10) | | |
| Structured notes | 24 | (33) | | |
| Derivatives with monolines | 116 | (85) | | |
| Other derivatives | 328 | (370) | | |
| Other portfolios | 211 | (171) | 108 | (99) |
| | 777 | (740) | 595 | (573) |

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| | | | | |
|--|-----|-------|-----|-------|
| At 31 December 2010 | | | | |
| Private equity including strategic investments | 112 | (71) | 383 | (383) |
| Asset-backed securities | 8 | (8) | 179 | (181) |
| Leveraged finance | | | | |
| Loans held for securitisation | 8 | (8) | | |
| Structured notes | 18 | (16) | | |
| Derivatives with monolines | 94 | (8) | | |
| Other derivatives | 256 | (258) | | |
| Other portfolios | 135 | (150) | 201 | (180) |
| | 631 | (519) | 763 | (744) |

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgemental.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

In respect of private equity investments, in many of the methodologies the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For ABSs, the principal assumptions in the models are based on benchmark information about prepayment speeds, default rates, loss severities and the historical performance of the underlying assets.

For leveraged finance, loans held for securitisation and derivatives with monolines the principal assumption concerns the appropriate value to be attributed to the counterparty credit risk. This requires estimation of exposure at default, probability of default and recovery in the event of default. For loan transactions, assessment of exposure at default is straightforward. For derivative transactions, a future exposure profile is generated on the basis of current market data.

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Notes on the Financial Statements (unaudited) (continued)

Probabilities of default and recovery levels are estimated using available evidence, which may include financial information, historical experience, CDS spreads and consensus recovery levels.

For structured notes and other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values. These principal assumptions include credit volatilities and correlations used in the valuation of structured credit derivatives (including leveraged credit derivatives). For such unobservable assumptions, estimates are based on available market data, which may include the use of a proxy method to derive a volatility or a correlation from comparable assets for which market data is more readily available, and/or an examination of historical levels.

9 Fair values of financial instruments not carried at fair value

The accounting policies which determine the classification of financial instruments and the use of assumptions and estimation in valuing them are described on pages 253 to 270 and 34 to 36, respectively, of the *Annual Report and Accounts 2010*.

Fair values of financial instruments which are not carried at fair value on the balance sheet

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|-----------------------------------|-----------------|-----------|-----------------|-----------|---------------------|-----------|
| | Carrying | Fair | Carrying | Fair | Carrying | Fair |
| | amount | value | amount | value | amount | value |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Assets | | | | | | |
| Loans and advances to banks | 226,043 | 226,150 | 196,296 | 196,122 | 208,271 | 208,311 |
| Loans and advances to customers | 1,037,888 | 1,011,319 | 893,337 | 864,274 | 958,366 | 934,444 |
| Financial investments: | | | | | | |
| debt securities | 19,883 | 21,320 | 18,788 | 20,075 | 19,386 | 20,374 |
| treasury and other eligible bills | 202 | 202 | 125 | 125 | 113 | 113 |
| Liabilities | | | | | | |
| Deposits by banks | 125,479 | 125,492 | 127,316 | 127,286 | 110,584 | 110,563 |
| Customer accounts | 1,318,987 | 1,318,873 | 1,147,321 | 1,148,229 | 1,227,725 | 1,227,428 |
| Debt securities in issue | 149,803 | 149,947 | 153,600 | 152,820 | 145,401 | 145,417 |
| Subordinated liabilities | 32,753 | 32,931 | 28,247 | 27,978 | 33,387 | 33,161 |

Fair values of financial instruments held for sale which are not carried at fair value on the balance sheet

At 30 June 2011

At 30 June 2010

At 31 December 2010

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| | Carrying amount US\$m | Fair value US\$m | Carrying amount US\$m | Fair value US\$m | Carrying amount US\$m | Fair value US\$m |
|---|--------------------------|---------------------|--------------------------|---------------------|--------------------------|---------------------|
| Assets classified as held for sale | | | | | | |
| Loans and advances to banks and customers | 62 | 62 | 40 | 40 | 116 | 116 |
| Financial investments: debt securities | | | 70 | 70 | | |

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and balances at central banks

Items in the course of collection from other banks

Hong Kong Government certificates of indebtedness

Endorsements and acceptances

Short-term receivables within Other assets

Accrued income

Liabilities

Hong Kong currency notes in circulation

Items in the course of transmission to other banks

Investment contracts with discretionary participation features within Liabilities under insurance contracts

Endorsements and acceptances

Short-term payables within Other liabilities

Accruals

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Notes on the Financial Statements (unaudited) (continued)*Analysis of loans and advances to customers by geographical segment*

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|--|------------------|------------------|-----------------|----------------|---------------------|----------------|
| | Carrying | Fair | Carrying | Fair | Carrying | Fair |
| | amount US\$m | value US\$m | amount US\$m | value US\$m | amount US\$m | value US\$m |
| Loans and advances to customers | | | | | | |
| Europe | 486,331 | 478,660 | 407,226 | 400,580 | 435,799 | 430,333 |
| Hong Kong | 159,370 | 157,859 | 114,075 | 114,265 | 140,691 | 140,699 |
| Rest of Asia-Pacific | 121,429 | 121,069 | 91,672 | 91,616 | 108,731 | 108,582 |
| Middle East and North Africa | 25,694 | 25,781 | 23,394 | 23,389 | 24,626 | 24,539 |
| North America | 179,262 | 162,704 | 208,141 | 185,643 | 190,532 | 172,522 |
| Latin America | 65,802 | 65,246 | 48,829 | 48,781 | 57,987 | 57,769 |
| | 1,037,888 | 1,011,319 | 893,337 | 864,274 | 958,366 | 934,444 |

Valuation

The calculation of fair value incorporates HSBC's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that HSBC expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available, so comparisons of fair values between entities may not be meaningful and users are advised to exercise caution when using this data.

Following the recent market disruption, there remains a significant reduction in the secondary market demand for US consumer lending assets. Uncertainty over the extent and timing of future credit losses, together with a near absence of liquidity for non-prime ABSs and loans, continued to be reflected in a lack of bid prices at 30 June 2011. It is not possible from the indicative market prices that are available to distinguish between the relative discount to nominal value within the fair value measurement that reflects cash flow impairment due to expected losses to maturity, and the discount that the market is demanding for holding an illiquid asset. Under impairment accounting for loans and advances, there is no requirement to adjust carrying value to reflect illiquidity as HSBC's intention is to fund assets until the earlier of prepayment, charge-off or repayment on maturity. The fair value, by contrast, reflects both incurred loss and loss expected through the life of the asset, a discount for illiquidity and a credit spread which reflects the market's current risk preferences. This usually differs from the credit spread applicable in the market at the time the loan was underwritten and funded.

The estimated fair values at 30 June 2011, 30 June 2010 and 31 December 2010 of loans and advances to customers in North America reflect the combined effect of these conditions. As a result, the fair values are substantially lower than the carrying amount of customer loans held on-balance sheet. Accordingly, the fair values reported do not reflect HSBC's estimate of the underlying long-term value of the assets.

Fair values of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

Loans and advances to banks and customers

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The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models.

Performing loans are grouped, as far as possible, into homogeneous pools segregated by maturity and interest rates and the contractual cash flows are generally discounted using HSBC's estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, re-pricing and credit risk characteristics.

The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

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Notes on the Financial Statements (unaudited) (continued)**Deposits by banks and customer accounts**

For the purpose of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to HSBC as a going concern.

10 Reclassification of financial assets

During the second half of 2008, HSBC reclassified US\$15.3bn and US\$2.6bn of financial assets from the held-for-trading category to the loans and receivables and available-for-sale classifications, respectively, as permitted by the relevant amendment to IAS 39. The accounting policy for reclassifications is set out on page 255 of the *Annual Report and Accounts 2010*. No further reclassifications were undertaken by HSBC.

Reclassified financial assets

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|--|-----------------|--------------|-----------------|------------|---------------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value |
| | US\$m | US\$m | US\$m | US\$m | US\$ | US\$m |
| Reclassified to loans and receivables | | | | | | |
| Asset-backed securities | 5,664 | 4,928 | 6,172 | 4,947 | 5,892 | 4,977 |
| Trading loans – commercial mortgage loans | 559 | 529 | 484 | 440 | 522 | 493 |
| Leveraged finance and syndicated loans | 2,337 | 2,087 | 5,015 | 4,338 | 4,533 | 4,166 |
| | 8,560 | 7,544 | 11,671 | 9,725 | 10,947 | 9,636 |
| Reclassified to available for sale | | | | | | |
| Corporate debt and other securities | 64 | 62 | 103 | 103 | 91 | 91 |
| | | 7,606 | 11,774 | 9,828 | 11,038 | 9,727 |

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8,624

The following table shows the fair value gains and losses, income and expense recognised in the income statement in respect of reclassified assets and the gains and losses that would have been recognised if no reclassification had taken place.

Effect of reclassifying and not reclassifying financial assets

| | Financial assets reclassified to: | | | | | Total US\$m |
|---|-----------------------------------|-------------|------------------|-----------|----------------|----------------|
| | loans and receivables | | | available | | |
| | Trading loans | Leveraged | for sale | | | |
| | commercial | finance and | Corporate | | | |
| Asset-backed securities | mortgage | syndicated | debt and | | Total US\$m | |
| | loans | loans | other securities | | | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2011 | | | | | | |
| Recorded in the income statement ¹ | 118 | 14 | 93 | 225 | 8 | 233 |
| Assuming no reclassification ² | 375 | 15 | 158 | 548 | (10) | 538 |
| | | | | | | |
| Net effect of reclassification | (257) | (1) | (65) | (323) | 18 | (305) |
| | | | | | | |
| Attributable to: | | | | | | |
| Europe | (245) | (1) | (39) | (285) | 18 | (267) |
| North America | (12) | | (20) | (32) | | (32) |
| Middle East and North Africa | | | (6) | (6) | | (6) |

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Notes on the Financial Statements (unaudited) (continued)

| | Financial assets reclassified to: | | | | | Total |
|---|-----------------------------------|-------|-------|-------|------------------|-------|
| | Asset-backed securities | loans | loans | Total | other securities | |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Half-year to 30 June 2010 | | | | | | |
| Recorded in the income statement ¹ | 214 | 12 | 177 | 403 | 55 | 458 |
| Assuming no reclassification ² | 538 | 10 | (170) | 378 | 69 | 447 |
| Net effect of reclassification | (324) | 2 | 347 | 25 | (14) | 11 |
| Attributable to: | | | | | | |
| Europe | (247) | 2 | 176 | (69) | (13) | (82) |
| North America | (77) | | 110 | 33 | (1) | 32 |
| Middle East and North Africa | | | 61 | 61 | | 61 |
| Half-year to 31 December 2010 | | | | | | |
| Recorded in the income statement ¹ | 21 | 17 | 169 | 207 | 1 | 208 |
| Assuming no reclassification ² | 370 | 35 | 477 | 882 | (10) | 872 |
| Net effect of reclassification | (349) | (18) | (308) | (675) | 11 | (664) |
| Attributable to: | | | | | | |
| Europe | (280) | (18) | (199) | (497) | 11 | (486) |
| North America | (69) | | (61) | (130) | | (130) |
| Middle East and North Africa | | | (48) | (48) | | (48) |

¹ *Income and expense recorded in the income statement represents the accrual of the effective interest rate and, for the first half of 2011, includes US\$15m in respect of impairment (first half of 2010: write-back of US\$25m; second half of 2010: US\$31m).*

² *Effect on the income statement during the period had the reclassification not occurred.*

11 Financial assets designated at fair value

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| | At | At | At |
|---|---------------|---------|-------------|
| | 30 June | 30 June | 31 December |
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Financial assets designated at fair value: | | | |
| not subject to repledge or resale by counterparties | 39,526 | 32,239 | 36,990 |
| which may be repledged or resold by counterparties | 39 | 4 | 21 |
| | 39,565 | 32,243 | 37,011 |
| Treasury and other eligible bills | 207 | 249 | 159 |
| Debt securities | 18,496 | 16,153 | 18,248 |
| Equity securities | 19,588 | 13,893 | 17,418 |
| Securities designated at fair value | 38,291 | 30,295 | 35,825 |
| Loans and advances to banks | 355 | 1,149 | 315 |
| Loans and advances to customers | 919 | 799 | 871 |
| | 39,565 | 32,243 | 37,011 |

Securities designated at fair value¹

| | At | At | At |
|---|---------------|---------|-------------|
| | 30 June | 30 June | 31 December |
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| US Treasury and US Government agencies ² | 87 | 49 | 78 |
| UK Government | 739 | 1,119 | 1,304 |
| Hong Kong Government | 152 | 155 | 151 |
| Other government | 4,762 | 3,206 | 4,130 |
| Asset-backed securities ³ | 6,164 | 5,986 | 6,128 |
| Corporate debt and other securities | 6,799 | 5,887 | 6,616 |
| Equity securities | 19,588 | 13,893 | 17,418 |
| | 38,291 | 30,295 | 35,825 |

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Notes on the Financial Statements (unaudited) (continued)

- 1 Included within these figures are debt securities issued by banks and other financial institutions of US\$9,746m (30 June 2010: US\$9,643m; 31 December 2010: US\$10,185m), of which US\$46m (30 June 2010: US\$46m; 31 December 2010: US\$48m) are guaranteed by various governments.
- 2 Includes securities that are supported by an explicit guarantee issued by the US Government.
- 3 Excludes asset-backed securities included under US Treasury and US Government agencies. Securities listed on a recognised exchange and unlisted

Fair value at 30 June 2011Listed on a recognised exchange¹
Unlisted

Fair value at 30 June 2010

Listed on a recognised exchange¹
Unlisted

Fair value at 31 December 2010

Listed on a recognised exchange¹
Unlisted

| | Treasury and other | | | Total US\$m |
|--|----------------------------|-----------------------------|-------------------------------|----------------|
| | eligible bills US\$m | Debt securities US\$m | Equity securities US\$m | |
| Listed on a recognised exchange ¹ | 6 | 3,605 | 13,521 | 17,132 |
| Unlisted | 201 | 14,891 | 6,067 | 21,159 |
| | 207 | 18,496 | 19,588 | 38,291 |
| Listed on a recognised exchange ¹ | 105 | 3,252 | 9,358 | 12,715 |
| Unlisted | 144 | 12,901 | 4,535 | 17,580 |
| | 249 | 16,153 | 13,893 | 30,295 |
| Listed on a recognised exchange ¹ | 21 | 4,168 | 12,548 | 16,737 |
| Unlisted | 138 | 14,080 | 4,870 | 19,088 |
| | 159 | 18,248 | 17,418 | 35,825 |

- 1 Included within listed securities are US\$668m (30 June 2010: US\$544m; 31 December 2010: US\$756m) of investments listed in Hong Kong.

12 Derivatives

Fair values of derivatives by product contract type

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| | Trading US\$m | Assets Hedging US\$m | Total US\$m | Trading US\$m | Liabilities Hedging US\$m | Total US\$m |
|--------------------------------|------------------|----------------------------|------------------|------------------|---------------------------------|------------------|
| At 30 June 2011 | | | | | | |
| Foreign exchange | 71,280 | 1,550 | 72,830 | 71,621 | 175 | 71,796 |
| Interest rate | 283,315 | 2,236 | 285,551 | 277,545 | 3,577 | 281,122 |
| Equities | 15,348 | | 15,348 | 17,416 | | 17,416 |
| Credit | 19,284 | | 19,284 | 18,613 | | 18,613 |
| Commodity and other | 1,084 | | 1,084 | 1,503 | | 1,503 |
| Gross total fair values | 390,311 | 3,786 | 394,097 | 386,698 | 3,752 | 390,450 |
| Netting | | | (133,425) | | | (133,425) |
| Total | | | 260,672 | | | 257,025 |
| At 30 June 2010 | | | | | | |
| Foreign exchange | 60,502 | 775 | 61,277 | 61,269 | 879 | 62,148 |
| Interest rate | 311,491 | 3,461 | 314,952 | 306,571 | 4,250 | 310,821 |
| Equities | 15,381 | | 15,381 | 17,805 | | 17,805 |
| Credit | 26,223 | | 26,223 | 25,227 | | 25,227 |
| Commodity and other | 927 | | 927 | 1,494 | | 1,494 |
| Gross total fair values | 414,524 | 4,236 | 418,760 | 412,366 | 5,129 | 417,495 |
| Netting | | | (130,481) | | | (130,481) |
| Total | | | 288,279 | | | 287,014 |

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Notes on the Financial Statements (unaudited) (continued)

| | Assets | | | Liabilities | | |
|-------------------------|------------------|------------------|----------------|------------------|------------------|----------------|
| | Trading US\$m | Hedging US\$m | Total US\$m | Trading US\$m | Hedging US\$m | Total US\$m |
| At 31 December 2010 | | | | | | |
| Foreign exchange | 65,905 | 1,304 | 67,209 | 67,564 | 340 | 67,904 |
| Interest rate | 278,364 | 2,764 | 281,128 | 273,222 | 3,909 | 277,131 |
| Equities | 13,983 | | 13,983 | 14,716 | | 14,716 |
| Credit | 20,907 | | 20,907 | 20,027 | | 20,027 |
| Commodity and other | 1,261 | | 1,261 | 2,618 | | 2,618 |
| Gross total fair values | 380,420 | 4,068 | 384,488 | 378,147 | 4,249 | 382,396 |
| Netting | | | (123,731) | | | (123,731) |
| Total | | | 260,757 | | | 258,665 |

Derivative assets were largely unchanged during the first half of 2011, as higher client activity drove an increase in fair value of foreign exchange contracts, offset by greater netting from increased trades through clearing houses where the settlement arrangements satisfied the IFRSs netting criteria.

A description of HSBC's determination of the fair values of financial instruments, including derivatives, is provided on page 312 of the *Annual Report and Accounts 2010*.

Trading derivatives

The notional contract amount of derivatives held for trading purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk. The 18% increase in the notional amounts of HSBC's derivative assets during the first half of 2011 was primarily driven by an increase in the market of open interest rate and foreign exchange contracts, reflecting increased trading volumes in the period.

Notional contract amounts of derivatives held for trading purposes by product type

| At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|--------------------------------|--------------------------------|------------------------------------|
|--------------------------------|--------------------------------|------------------------------------|

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| | | | |
|---------------------|-------------------|------------|------------|
| Foreign exchange | 4,440,515 | 3,373,419 | 3,692,798 |
| Interest rate | 21,305,123 | 16,377,107 | 18,104,141 |
| Equities | 400,877 | 240,954 | 294,587 |
| Credit | 1,091,052 | 1,147,016 | 1,065,218 |
| Commodity and other | 97,825 | 77,683 | 82,856 |
| | 27,335,392 | 21,216,179 | 23,239,600 |

Credit derivatives

The notional contract amount of credit derivatives of US\$1,091bn (30 June 2010: US\$1,147bn; 31 December 2010: US\$1,065bn) consisted of protection bought of US\$539bn (30 June 2010: US\$571bn; 31 December 2010: US\$530bn) and protection sold of US\$552bn (30 June 2010: US\$576bn; 31 December 2010: US\$535bn).

HSBC manages the credit risk arising on buying and selling credit derivative protection by including the related credit exposures within its overall credit limit structure for the relevant counterparty. Trading of credit derivatives is restricted to a small number of offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products. The credit derivative business operates within the market risk management framework described on page 136.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows.

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Notes on the Financial Statements (unaudited) (continued)

Unamortised balance of derivatives valued using models with unobservable inputs

| | 30 June | Half-year to | |
|---|----------------|--------------|-------------|
| | 2011 | 30 June | 31 December |
| | US\$m | US\$m | US\$m |
| Unamortised balance at beginning of period | 250 | 260 | 256 |
| Deferral on new transactions | 161 | 223 | 108 |
| Recognised in the income statement during the period: | | | |
| amortisation | (74) | (48) | (58) |
| subsequent to unobservable inputs becoming observable | (38) | (14) | (3) |
| maturity or termination, or offsetting derivative | (25) | (134) | (29) |
| Exchange differences | 9 | (21) | 6 |
| Risk hedged | (4) | (10) | (30) |
| | | | |
| Unamortised balance at end of period ¹ | 279 | 256 | 250 |

¹ This amount is yet to be recognised in the consolidated income statement.

Hedging instruments

The notional contract amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for hedging purposes by product type

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|------------------|-----------------|---------------|-----------------|------------|---------------------|------------|
| | Cash flow | Fair value | Cash flow | Fair value | Cash flow | Fair value |
| | hedge | hedge | hedge | hedge | hedge | hedge |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Foreign exchange | 11,476 | 1,403 | 11,143 | 1,748 | 10,599 | 1,392 |
| Interest rate | 340,773 | 74,434 | 241,552 | 51,734 | 282,412 | 62,757 |
| | 352,249 | 75,837 | 252,695 | 53,482 | 293,011 | 64,149 |

Fair value hedges

Fair value of derivatives designated as fair value hedges

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|------------------|-----------------|--------------|-----------------|-------|---------------------|-------|
| | Liabilities | | Liabilities | | Liabilities | |
| | Assets US\$m | US\$m | Assets US\$m | US\$m | Assets US\$m | US\$m |
| Foreign exchange | 236 | | 120 | | 153 | |
| Interest rate | 427 | 2,351 | 136 | 2,285 | 443 | 2,226 |
| | 663 | 2,351 | 256 | 2,285 | 596 | 2,226 |

Gains/(losses) arising from fair value hedges

| | 30 June 2011 US\$m | Half-year to | |
|---|--------------------------|--------------|-------------|
| | | 30 June | 31 December |
| | | 2010 | 2010 |
| Gains/(losses): | | US\$m | US\$m |
| on hedging instruments | (794) | (1,249) | 419 |
| on the hedged items attributable to the hedged risk | 722 | 1,266 | (398) |
| | (72) | 17 | 21 |

The gains and losses on ineffective portions of fair value hedges are recognised immediately in Net trading income .

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Notes on the Financial Statements (unaudited) (continued)**Cash flow hedges***Fair value of derivatives designated as cash flow hedges*

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|------------------|-----------------|----------------------|-----------------|----------------------|---------------------|----------------------|
| | Assets US\$m | Liabilities US\$m | Assets US\$m | Liabilities US\$m | Assets US\$m | Liabilities US\$m |
| Foreign exchange | 1,314 | 175 | 655 | 879 | 1,151 | 340 |
| Interest rate | 1,809 | 1,226 | 3,325 | 1,965 | 2,321 | 1,683 |
| | 3,123 | 1,401 | 3,980 | 2,844 | 3,472 | 2,023 |

The gains and losses on ineffective portions of such derivatives are recognised immediately in *Net trading income*. During the period to 30 June 2011, a gain of US\$2m was recognised due to hedge ineffectiveness (first half of 2010: loss of US\$24m; second half of 2010: gain of US\$15m).

Hedges of net investments in foreign operations

The Group applies hedge accounting in respect of certain consolidated net investments. Hedging is undertaken using forward foreign exchange contracts or by financing with currency borrowings.

At 30 June 2011, the fair values of outstanding financial instruments designated as hedges of net investments in foreign operations were liabilities of US\$30m (30 June 2010: assets of US\$3m and liabilities of US\$38m; 31 December 2010: liabilities of US\$34m), and notional contract values of US\$1,251m (30 June 2010: US\$617m; 31 December 2010: US\$644m).

No ineffectiveness was recognised in *Net trading income* for the period ended 30 June 2011 (both halves of 2010: nil).

13 Financial investments

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---|--------------------------------|--------------------------------|------------------------------------|
| Financial investments: not subject to repledge or resale by counterparties | 385,126 | 361,931 | 369,597 |
| which may be repledged or resold by counterparties | 31,731 | 23,540 | 31,158 |

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416,857

385,471

400,755

Carrying amount and fair values of financial investments

| | At 30 June 2011 | | At 30 June 2010 | | At 31 December 2010 | |
|--|--------------------------|---------------------|--------------------------|---------------------|--------------------------|---------------------|
| | Carrying amount US\$m | Fair value US\$m | Carrying amount US\$m | Fair value US\$m | Carrying amount US\$m | Fair value US\$m |
| Treasury and other eligible bills available for sale | 61,664 | 61,664 | 61,275 | 61,275 | 57,129 | 57,129 |
| held to maturity | 61,462 | 61,462 | 61,150 | 61,150 | 57,016 | 57,016 |
| | 202 | 202 | 125 | 125 | 113 | 113 |
| Debt securities available for sale | 346,986 | 348,423 | 315,367 | 316,654 | 335,643 | 336,632 |
| held to maturity | 327,103 | 327,103 | 296,579 | 296,579 | 316,257 | 316,257 |
| | 19,883 | 21,320 | 18,788 | 20,075 | 19,386 | 20,375 |
| Equity securities available for sale | 8,207 | 8,207 | 8,829 | 8,829 | 7,983 | 7,983 |
| | 416,857 | 418,294 | 385,471 | 386,758 | 400,755 | 401,744 |

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Notes on the Financial Statements (unaudited) (continued)*Financial investments at amortised cost and fair value¹*

| | Amortised cost US\$m | Fair value US\$m |
|---|----------------------------|------------------------|
| At 30 June 2011 | | |
| US Treasury | 37,584 | 37,697 |
| US Government agencies ² | 21,910 | 22,500 |
| US Government sponsored entities ² | 4,669 | 4,958 |
| UK Government | 30,034 | 30,787 |
| Hong Kong Government | 31,700 | 31,734 |
| Other government | 125,452 | 126,088 |
| Asset-backed securities ³ | 37,835 | 32,292 |
| Corporate debt and other securities | 122,521 | 124,031 |
| Equities | 5,849 | 8,207 |
| | 417,554 | 418,294 |
| At 30 June 2010 | | |
| US Treasury | 24,162 | 24,756 |
| US Government agencies ² | 18,418 | 19,051 |
| US Government sponsored entities ² | 5,016 | 5,278 |
| UK Government | 27,339 | 28,191 |
| Hong Kong Government | 35,447 | 35,443 |
| Other government | 94,320 | 95,478 |
| Asset-backed securities ³ | 42,534 | 34,010 |
| Corporate debt and other securities | 134,393 | 135,722 |
| Equities | 6,568 | 8,829 |
| | 388,197 | 386,758 |
| At 31 December 2010 | | |
| US Treasury | 37,380 | 37,255 |
| US Government agencies ² | 20,895 | 21,339 |
| US Government sponsored entities ² | 5,029 | 5,267 |
| UK Government | 31,069 | 31,815 |
| Hong Kong Government | 29,770 | 29,793 |
| Other government | 108,947 | 109,806 |
| Asset-backed securities ³ | 39,845 | 33,175 |
| Corporate debt and other securities | 124,704 | 125,311 |
| Equities | 5,605 | 7,983 |
| | 403,244 | 401,744 |

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- 1 Included within these figures are debt securities issued by banks and other financial institutions with a carrying amount of US\$98,472m (30 June 2010: US\$115,836m; 31 December 2010: US\$99,733m), of which US\$37,929m (30 June 2010: US\$45,171m; 31 December 2010: US\$38,862m) are guaranteed by various governments. The fair value of the debt securities issued by banks and other financial institutions at 30 June 2011 was US\$98,939m (30 June 2010: US\$116,316m; 31 December 2010: US\$100,070m).
- 2 Includes securities that are supported by an explicit guarantee issued by the US Government.
- 3 Excludes asset-backed securities included under US Government agencies and sponsored entities.
- Financial investments listed on a recognised exchange and unlisted

| | Treasury | | | | | Total US\$m | | |
|--|---|---|--|--|--|----------------|-----|---------|
| | Treasury and other eligible bills available for sale US\$m | and other eligible bills held to maturity US\$m | Debt securities available for sale US\$m | Debt securities held to maturity US\$m | Equity securities available for sale US\$m | | | |
| | Carrying amount at 30 June 2011 | | | | | | | |
| | Listed on a recognised exchange ¹ | 2,049 | | 152,844 | 4,237 | | 690 | 159,820 |
| Unlisted ² | 59,413 | 202 | 174,259 | 15,646 | 7,517 | 257,037 | | |
| | 61,462 | 202 | 327,103 | 19,883 | 8,207 | 416,857 | | |
| | | | | | | | | |
| Carrying amount at 30 June 2010 | | | | | | | | |
| Listed on a recognised exchange ¹ | 3,394 | 125 | 139,398 | 3,142 | 524 | 146,583 | | |
| Unlisted ² | 57,756 | | 157,181 | 15,646 | 8,305 | 238,888 | | |
| | 61,150 | 125 | 296,579 | 18,788 | 8,829 | 385,471 | | |

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Notes on the Financial Statements (unaudited) (continued)

| | Treasury and other eligible bills available for sale | Treasury and other eligible bills held to maturity | Debt securities available for sale | Debt securities held to maturity | Equity securities available for sale | Total |
|--|--|--|---|---|---|---------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Carrying amount at 31 December 2010 | | | | | | |
| Listed on a recognised exchange ¹ | 1,400 | | 138,374 | 4,182 | 851 | 144,807 |
| Unlisted ² | 55,616 | 113 | 177,883 | 15,204 | 7,132 | 255,948 |
| | 57,016 | 113 | 316,257 | 19,386 | 7,983 | 400,755 |

1 The fair value of listed held-to-maturity debt securities at 30 June 2011 was US\$4,483m (30 June 2010: US\$3,302m; 31 December 2010: US\$4,332m). Included within listed investments were US\$3,125m (30 June 2010: US\$1,668m; 31 December 2010: US\$1,902m) of investments listed in Hong Kong.

2 Unlisted treasury and other eligible bills available for sale primarily comprise treasury bills not listed on a recognised exchange but for which there is a liquid market.

Maturities of investments in debt securities at their carrying amount

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---|--------------------------------|--------------------------------|------------------------------------|
| Remaining contractual maturities of total debt securities: | | | |
| 1 year or less | 110,240 | 74,101 | 92,961 |
| 5 years or less but over 1 year | 116,145 | 138,240 | 124,596 |
| 10 years or less but over 5 years | 56,531 | 42,770 | 56,926 |
| over 10 years | 64,070 | 60,256 | 61,160 |
| | 346,986 | 315,367 | 335,643 |
| Remaining contractual maturities of debt securities available for sale: | | | |
| 1 year or less | 108,930 | 73,411 | 91,939 |
| 5 years or less but over 1 year | 109,498 | 131,587 | 117,931 |

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| | | | |
|---|----------------|---------|---------|
| 10 years or less but over 5 years | 49,501 | 36,301 | 50,113 |
| over 10 years | 59,174 | 55,280 | 56,274 |
| | 327,103 | 296,579 | 316,257 |
| Remaining contractual maturities of debt securities held to maturity: | | | |
| 1 year or less | 1,310 | 690 | 1,022 |
| 5 years or less but over 1 year | 6,647 | 6,653 | 6,665 |
| 10 years or less but over 5 years | 7,030 | 6,469 | 6,813 |
| over 10 years | 4,896 | 4,976 | 4,886 |
| | 19,883 | 18,788 | 19,386 |

14 Assets held for sale

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|----------------------------------|--------------------------------|--------------------------------|------------------------------------|
| Disposal groups | 445 | | 530 |
| Non-current assets held for sale | 1,154 | 1,426 | 1,461 |
| interest in associates | | 85 | |
| property, plant and equipment | 1,055 | 1,224 | 1,342 |
| financial assets | 96 | 110 | 116 |
| other | 3 | 7 | 3 |
| Total assets held for sale | 1,599 | 1,426 | 1,991 |

Disposal groups

At 30 June 2011, disposal groups included:

US\$124m related to the sale of the Mexican pension funds management business. Associated liabilities of US\$11m were included in Other liabilities. Neither a gain nor a loss was recognised on reclassifying the assets as held for sale. The transaction is expected to complete in the third quarter of 2011.

US\$303m related to the sale of a majority interest in the Middle East private equity fund management business

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Notes on the Financial Statements (unaudited) (continued)

to the unit's senior management team. Associated liabilities of US\$30m were included in Other liabilities. A loss of US\$7m was recognised on reclassifying the assets as held for sale. The transaction is expected to complete in the second half of 2011.

Property, plant and equipment

Property, plant and equipment classified as held for sale principally results from the repossession of property that had been pledged as collateral by customers. These assets are expected to be disposed of within 12 months of acquisition. The majority arose within the geographical segment, North America.

Neither a gain nor a loss was recognised on reclassifying these assets as held for sale during the period.

15 Trading liabilities

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---|--------------------------------|--------------------------------|------------------------------------|
| Deposits by banks | 54,651 | 52,639 | 38,678 |
| Customer accounts | 166,974 | 102,919 | 125,684 |
| Other debt securities in issue | 37,746 | 28,782 | 33,726 |
| Other liabilities – net short positions in securities | 126,453 | 90,496 | 102,615 |
| | 385,824 | 274,836 | 300,703 |

At 30 June 2011, the cumulative amount of change in fair value attributable to changes in credit risk was a gain of US\$202m (30 June 2010: gain of US\$374m; 31 December 2010: gain of US\$142m).

16 Financial liabilities designated at fair value

| At 30 June | At 30 June | At 31 December |
|---------------|---------------|-------------------|
|---------------|---------------|-------------------|

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| | 2011 | 2010 | 2010 |
|---|---------------|--------|--------|
| | US\$m | US\$m | US\$m |
| Deposits by banks and customer accounts | 6,515 | 6,360 | 6,527 |
| Liabilities to customers under investment contracts | 12,191 | 10,384 | 11,700 |
| Debt securities in issue | 55,885 | 41,042 | 46,091 |
| Subordinated liabilities | 18,920 | 18,763 | 19,395 |
| Preferred securities | 4,769 | 3,887 | 4,420 |
| | 98,280 | 80,436 | 88,133 |

The carrying amount at 30 June 2011 of financial liabilities designated at fair value was US\$2,144m more than the contractual amount at maturity (30 June 2010: US\$1,987m more; 31 December 2010: US\$1,631m more). At 30 June 2011, the cumulative amount of the change in fair value attributable to changes in credit risk was a gain of US\$1,114m (30 June 2010: gain of US\$2,571m; 31 December 2010: gain of US\$1,279m).

17 Provisions

| | 30 June | Half-year to 30 June | 31 December |
|--|--------------|-------------------------|-------------|
| | 2011 | 2010 | 2010 |
| | US\$m | US\$m | US\$m |
| Balance at beginning of period | 2,138 | 1,965 | 1,828 |
| Additional provisions/increase in provisions | 1,090 | 245 | 567 |
| Provisions utilised | (207) | (210) | (354) |
| Amounts reversed | (153) | (87) | (45) |
| Exchange differences and other movements | 159 | (85) | 142 |
| Balance at end of period | 3,027 | 1,828 | 2,138 |

Provisions include US\$1,998m (30 June 2010: US\$990m; 31 December 2010: US\$1,257m) relating to legal proceedings, investigations and regulatory matters, US\$426m (30 June 2010: US\$313m; 31 December 2010:

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Notes on the Financial Statements (unaudited) (continued)

US\$405m) relating to costs arising from contingent liabilities and contractual commitments; and US\$98m (30 June 2010: US\$117m; 31 December 2010: US\$118m) relating to provisions for onerous property contracts.

18 Maturity analysis of assets and liabilities

The following is an analysis, by remaining contractual maturities at the reporting date, of asset and liability line items that combine amounts within one year, and after one year. Trading assets and liabilities are excluded because they are not held for collection or settlement over the period of contractual maturity.

| | Due within one year US\$m | Due after more than one year US\$m | Total US\$m |
|--|---------------------------------|---|------------------|
| At 30 June 2011 | | | |
| Assets | | | |
| Financial assets designated at fair value | 3,064 | 36,501 | 39,565 |
| Loans and advances to banks | 216,034 | 10,009 | 226,043 |
| Loans and advances to customers | 482,370 | 555,518 | 1,037,888 |
| Financial investments | 172,407 | 244,450 | 416,857 |
| Other financial assets | 24,822 | 5,692 | 30,514 |
| | 898,697 | 852,170 | 1,750,867 |
| Liabilities | | | |
| Deposits by banks | 118,505 | 6,974 | 125,479 |
| Customer accounts | 1,272,152 | 46,835 | 1,318,987 |
| Financial liabilities designated at fair value | 9,670 | 88,610 | 98,280 |
| Debt securities in issue | 82,747 | 67,056 | 149,803 |
| Other financial liabilities | 27,494 | 4,606 | 32,100 |
| Subordinated liabilities | 575 | 32,178 | 32,753 |
| | 1,511,143 | 246,259 | 1,757,402 |
| At 30 June 2010 | | | |
| Assets | | | |
| Financial assets designated at fair value | 3,887 | 28,356 | 32,243 |
| Loans and advances to banks | 188,946 | 7,350 | 196,296 |
| Loans and advances to customers | 405,218 | 488,119 | 893,337 |
| Financial investments | 135,608 | 249,863 | 385,471 |
| Other financial assets | 21,205 | 5,766 | 26,971 |
| | 754,864 | 779,454 | 1,534,318 |

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| | | | |
|--|-----------|---------|-----------|
| Liabilities | | | |
| Deposits by banks | 122,026 | 5,290 | 127,316 |
| Customer accounts | 1,103,851 | 43,470 | 1,147,321 |
| Financial liabilities designated at fair value | 7,773 | 72,663 | 80,436 |
| Debt securities in issue | 89,012 | 64,588 | 153,600 |
| Other financial liabilities | 69,905 | 5,705 | 75,610 |
| Subordinated liabilities | 381 | 27,866 | 28,247 |
| | 1,392,948 | 219,582 | 1,612,530 |
| At 31 December 2010 | | | |
| Assets | | | |
| Financial assets designated at fair value | 3,030 | 33,981 | 37,011 |
| Loans and advances to banks | 200,098 | 8,173 | 208,271 |
| Loans and advances to customers | 424,713 | 533,653 | 958,366 |
| Financial investments | 149,954 | 250,801 | 400,755 |
| Other financial assets | 19,417 | 5,519 | 24,936 |
| | 797,212 | 832,127 | 1,629,339 |
| Liabilities | | | |
| Deposits by banks | 105,462 | 5,122 | 110,584 |
| Customer accounts | 1,181,095 | 46,630 | 1,227,725 |
| Financial liabilities designated at fair value | 10,141 | 77,992 | 88,133 |
| Debt securities in issue | 86,096 | 59,305 | 145,401 |
| Other financial liabilities | 24,865 | 4,792 | 29,657 |
| Subordinated liabilities | 791 | 32,596 | 33,387 |
| | 1,408,450 | 226,437 | 1,634,887 |

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Notes on the Financial Statements (unaudited) (continued)**19 Notes on the statement of cash flows**

| | 30 June 2011 | Half-year to 30 June 2010 | 31 December 2010 |
|---|-------------------------|---------------------------------|---------------------|
| | US\$m | US\$m | US\$m |
| <i>Other non-cash items included in profit before tax</i> | | | |
| Depreciation, amortisation and impairment | 1,631 | 1,442 | 1,359 |
| Gains arising from dilution of interests in associates | (181) | (188) | |
| Revaluations on investment property | (38) | 8 | (101) |
| Share-based payment expense | 588 | 371 | 441 |
| Loan impairment losses gross of recoveries and other credit risk provisions | 6,011 | 7,976 | 7,083 |
| Provisions | 937 | 158 | 522 |
| Impairment of financial investments | 339 | 40 | 65 |
| Charge/(credit) for defined benefit plans | (321) | 246 | 280 |
| Accretion of discounts and amortisation of premiums | (141) | (500) | (315) |
| | 8,825 | 9,553 | 9,334 |
| <i>Change in operating assets</i> | | | |
| Change in prepayments and accrued income | (590) | 839 | (382) |
| Change in net trading securities and net derivatives | 7,079 | 20,176 | 40,161 |
| Change in loans and advances to banks | (6,738) | (8,515) | 13,728 |
| Change in loans and advances to customers | (85,132) | (3,812) | (75,471) |
| Change in financial assets designated at fair value | (2,480) | 5,460 | (5,306) |
| Change in other assets | (4,699) | (18) | (127) |
| | (92,560) | 14,130 | (27,397) |
| <i>Change in operating liabilities</i> | | | |
| Change in accruals and deferred income | (474) | (1,016) | 1,732 |
| Change in deposits by banks | 14,895 | 2,444 | (16,732) |
| Change in customer accounts | 91,262 | (11,714) | 80,405 |
| Change in debt securities in issue | 4,402 | 6,583 | (8,078) |
| Change in financial liabilities designated at fair value | 11,285 | 342 | 5,317 |
| Change in other liabilities | 8,931 | 1,972 | (18,983) |
| | 130,301 | (1,389) | 43,661 |

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| | At 30 June 2011 | At 30 June 2010 | At 31 December 2010 |
|--|-----------------------|-----------------------|---------------------------|
| | US\$m | US\$m | US\$m |
| <i>Interest and dividends</i> | | | |
| Interest paid | (12,644) | (9,932) | (11,473) |
| Interest received | 33,578 | 31,397 | 32,299 |
| Dividends received | 376 | 380 | 183 |
| <i>Cash and cash equivalents</i> | | | |
| Cash and balances at central banks | 68,218 | 71,576 | 57,383 |
| Items in the course of collection from other banks | 15,058 | 11,195 | 6,072 |
| Loans and advances to banks of one month or less | 215,381 | 171,022 | 189,197 |
| Treasury bills, other bills and certificates of deposit less than three months | 30,011 | 24,093 | 28,087 |
| Less: items in the course of transmission to other banks | (16,317) | (11,976) | (6,663) |
| | 312,351 | 265,910 | 274,076 |

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Notes on the Financial Statements (unaudited) (continued)**20 Contingent liabilities, contractual commitments and guarantees**

| | At 30 June 2011 US\$m | At 30 June 2010 US\$m | At 31 December 2010 US\$m |
|---|--------------------------------|--------------------------------|------------------------------------|
| Contingent liabilities and guarantees | | | |
| Guarantees and irrevocable letters of credit pledged as collateral security | 75,281 | 66,140 | 71,157 |
| Other contingent liabilities | 356 | 173 | 166 |
| | 75,637 | 66,313 | 71,323 |
| Commitments | | | |
| Documentary credits and short-term trade-related transactions | 13,616 | 10,618 | 12,051 |
| Forward asset purchases and forward deposits placed | 66 | 29 | 30 |
| Undrawn formal standby facilities, credit lines and other commitments to lend | 646,493 | 538,063 | 590,432 |
| | 660,175 | 548,710 | 602,513 |

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees; mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit. Contingent liabilities arising from legal proceedings, investigations and regulatory matters against the Group are disclosed in Note 24. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. The amount of the loan commitments shown above reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury. HSBC Bank could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury which at 1 March 2011 stood at approximately £20bn (US\$30bn). Currently, the levy paid by the bank represents its share of the interest on these borrowings. The accrual at 30 June 2011 was US\$157m in respect of the 2010/11 and 2011/12 levy years (30 June 2010: US\$207m in respect of the 2009/10 and 2010/11 levy years; 31 December 2010: US\$144m in respect of the 2010/11 and 2011/12 levy years).

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The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the interest rate, the level of protected deposits and the population of FSCS members at the time.

21 Special purpose entities

HSBC enters into certain transactions with customers in the ordinary course of business which involve the establishment of special purpose entities (SPE s) to facilitate or secure customer transactions. HSBC structures that utilise SPEs are authorised centrally when they are established to ensure appropriate purpose and governance. The activities of SPEs administered by HSBC are closely monitored by senior management.

SPEs are assessed for consolidation in accordance with the accounting policy set out on page 251 of the *Annual Report and Accounts 2010*.

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Notes on the Financial Statements (unaudited) (continued)*Total consolidated assets held by SPEs by balance sheet classification*

| | Non-money | | | | Total |
|---|-------------|----------------------|-------------|------------|--------------|
| | Conduits | Securit- isations | Money | market | |
| US\$bn | | | US\$bn | market | investment |
| | | | funds | funds | |
| | | | US\$bn | US\$bn | US\$bn |
| At 30 June 2011 | | | | | |
| Cash | 0.7 | 0.5 | | 0.3 | 1.5 |
| Trading assets | 0.1 | 0.6 | 0.3 | 0.5 | 1.5 |
| Financial assets designated at fair value | 0.1 | | | 7.9 | 8.0 |
| Derivatives | | 0.3 | | | 0.3 |
| Loans and advances to banks | | 0.9 | | | 0.9 |
| Loans and advances to customers | 9.7 | 20.2 | | | 29.9 |
| Financial investments | 29.6 | | | | 29.6 |
| Other assets | 1.9 | 0.2 | | | 2.1 |
| | 42.1 | 22.7 | 0.3 | 8.7 | 73.8 |
| At 30 June 2010 | | | | | |
| Cash | | | | 0.4 | 0.4 |
| Trading assets | | 0.9 | 44.4 | 0.7 | 46.0 |
| Financial assets designated at fair value | 0.1 | | | 5.3 | 5.4 |
| Derivatives | | 0.9 | | | 0.9 |
| Loans and advances to banks | 0.2 | | | | 0.2 |
| Loans and advances to customers | 9.6 | 29.7 | | | 39.3 |
| Financial investments | 30.9 | | | | 30.9 |
| Other assets | 2.1 | | | | 2.1 |
| | 42.9 | 31.5 | 44.4 | 6.4 | 125.2 |
| At 31 December 2010 | | | | | |
| Cash | 1.0 | 0.7 | | 0.3 | 2.0 |
| Trading assets | 0.1 | 0.6 | 0.4 | 0.5 | 1.6 |
| Financial assets designated at fair value | 0.1 | | | 6.4 | 6.5 |
| Derivatives | | 0.3 | | | 0.3 |
| Loans and advances to banks | | 1.4 | | | 1.4 |
| Loans and advances to customers | 8.4 | 22.2 | | | 30.6 |
| Financial investments | 30.5 | 0.1 | | | 30.6 |
| Other assets | 1.6 | 0.4 | | 0.4 | 2.4 |

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41.7 25.7 0.4 7.6 75.4

HSBC's maximum exposure to SPEs

The following table shows the total assets of the various types of SPEs and the amount of funding provided by HSBC to these SPEs. The table also shows HSBC's maximum exposure to the SPEs and, within that exposure, the liquidity and credit enhancements provided by HSBC. The maximum exposures to SPEs represent HSBC's maximum possible risk exposure that could occur as a result of the Group's arrangements and commitments to SPEs. The maximum amounts are contingent in nature, and may arise as a result of drawdowns under liquidity facilities, where these have been provided, and any other funding commitments, or as a result of any loss protection provided by HSBC to the SPEs. The conditions under which such exposure might arise differ depending on the nature of each SPE and HSBC's involvement with it.

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Notes on the Financial Statements (unaudited) (continued)*Total assets of consolidated and unconsolidated SPEs and HSBC's funding and maximum exposure*

| | Consolidated SPEs Liquidity | | | | Unconsolidated SPEs | | |
|-----------------------------------|--------------------------------|-------------|-------------|-------------|---------------------|-------------|--|
| | Funding | and credit | HSBC's | Funding | HSBC's | | |
| | Total | enhance- | maximum | Total | maximum | | |
| assets | ments | exposure | assets | exposure | | | |
| | by HSBC | | | by HSBC | | | |
| | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | US\$bn | |
| At 30 June 2011 | | | | | | | |
| Conduits | 42.1 | 28.4 | 38.1 | 49.9 | | | |
| Securities investment conduits | 31.6 | 28.0 | 23.2 | 35.0 | | | |
| Multi-seller conduits | 10.5 | 0.4 | 14.9 | 14.9 | | | |
| Securitisations | 22.7 | 1.9 | 0.1 | 4.3 | 9.0 | 0.4 | |
| Money market funds | 0.3 | 0.3 | | 0.3 | 93.7 | 0.9 | |
| Constant net asset value funds | | | | | 69.2 | 0.7 | |
| Other | 0.3 | 0.3 | 0.3 | 0.3 | 24.5 | 0.2 | |
| Non-money market investment funds | 8.7 | 8.4 | 8.4 | 8.4 | 288.7 | 1.6 | |
| Other | | | | | 19.2 | 9.4 | |
| | 73.8 | 39.0 | 38.2 | 62.9 | 410.6 | 11.9 | |
| | | | | | | 7.2 | |
| At 30 June 2010 | | | | | | | |
| Conduits | 42.9 | 31.1 | 39.6 | 52.4 | | | |
| Securities investment conduits | 32.9 | 30.5 | 26.9 | 39.7 | | | |
| Multi-seller conduits | 10.0 | 0.6 | 12.7 | 12.7 | | | |
| Securitisations | 31.5 | 2.5 | 0.1 | 5.9 | 10.0 | | |
| Money market funds | 44.4 | 1.2 | | 1.2 | 55.2 | 0.3 | |
| Constant net asset value funds | 43.9 | 0.7 | | 0.7 | 30.3 | 0.1 | |
| Other | 0.5 | 0.5 | 0.5 | 0.5 | 24.9 | 0.2 | |
| Non-money market investment funds | 6.4 | 6.1 | 6.1 | 6.1 | 237.4 | 1.4 | |
| Other | | | | | 19.3 | 8.8 | |
| | | | | | | 3.4 | |

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| | | | | | | | |
|-----------------------------------|-------|------|------|------|-------|------|-----|
| | 125.2 | 40.9 | 39.7 | 65.6 | 321.9 | 10.5 | 5.1 |
| At 31 December 2010 | | | | | | | |
| Conduits | 41.7 | 28.6 | 38.3 | 50.5 | | | |
| Securities investment conduits | 32.2 | 28.6 | 25.6 | 37.8 | | | |
| Multi-seller conduits | 9.5 | | 12.7 | 12.7 | | | |
| Securitisations | 25.7 | 1.9 | 0.1 | 4.7 | 9.9 | | |
| Money market funds | 0.4 | 0.4 | | 0.4 | 95.8 | 0.7 | 0.7 |
| Constant net asset value funds | | | | | 74.9 | 0.5 | 0.5 |
| Other | 0.4 | 0.4 | | 0.4 | 20.9 | 0.2 | 0.2 |
| Non-money market investment funds | 7.6 | 6.9 | | 6.9 | 274.7 | 1.7 | 1.7 |
| Other | | | | | 19.0 | 9.4 | 3.7 |
| | 75.4 | 37.8 | 38.4 | 62.5 | 399.4 | 11.8 | 6.1 |

Conduits

HSBC sponsors and manages two types of conduits: securities investment conduits (SIC s) and multi-seller conduits.

Securities investment conduits

Solitaire, HSBC s principal SIC, purchases highly rated ABSs to facilitate tailored investment opportunities. At 30 June 2011, Solitaire held US\$11.8bn of ABSs (30 June 2010: US\$12.0bn; 31 December 2010: US\$11.7bn). These are included within the disclosures of ABS held through consolidated SPEs on page 124. HSBC s other SICs, Mazarin Funding Limited (Mazarin), Barion Funding Limited (Barion) and Malachite Funding Limited (Malachite), evolved from the restructuring of HSBC s sponsored structured investment vehicles (SIV s) in 2008.

Solitaire

Commercial Paper (CP) issued by Solitaire benefits from a 100% liquidity facility provided by HSBC. At 30 June 2011, US\$8.9bn of Solitaire s assets were funded by the draw-down of the liquidity facility (30 June 2010: US\$8.5bn; 31 December 2010: US\$7.6bn). HSBC is exposed to credit losses on the drawn amounts.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (unaudited) (continued)

HSBC's maximum exposure represents the risk that HSBC may be required to fund the vehicle in the event the CP is redeemed without reinvestment from third parties. At 30 June 2011 this amounted to US\$15.9bn (30 June 2010: US\$18.0bn; 31 December 2010: US\$16.8bn).

Mazarin

HSBC is exposed to the par value of Mazarin's assets through the provision of a liquidity facility equal to the lesser of the amortised cost of issued senior debt and the amortised cost of non-defaulted assets. At 30 June 2011, this amounted to US\$10.2bn (30 June 2010: US\$12.1bn; 31 December 2010: US\$11.6bn). First loss protection is provided through the capital notes issued by Mazarin, which are substantially all held by third parties.

At 30 June 2011, HSBC held 1.3% of Mazarin's capital notes (30 June 2010: 1.3%; 31 December 2010: 1.3%) which have a par value of US\$17m (30 June 2010: US\$17m; 31 December 2010: US\$17m) and a carrying amount of US\$0.6m (30 June 2010: US\$0.6m; 31 December 2010: US\$0.6m).

Barion and Malachite

HSBC's primary exposure to these SICs is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 30 June 2011, this amounted to US\$8.9bn (30 June 2010: US\$9.6bn; 31 December 2010: US\$9.4bn). First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

At 30 June 2011, HSBC held 3.8% of the capital notes issued by these vehicles (30 June 2010: 3.8%; 31 December 2010: 3.7%) which have a par value of US\$36.3m (30 June 2010: US\$34m; 31 December 2010: US\$35m) and a carrying amount of US\$2m (30 June 2010: US\$1.9m; 31 December 2010: US\$2m).

Multi-seller conduits

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for HSBC's clients.

HSBC's maximum exposure is equal to the transaction-specific liquidity facilities offered to the multi-seller conduits. First loss protection is provided by the originator of the assets, and not by HSBC, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by HSBC in the form of programme-wide enhancement facilities.

The following table sets out the weighted average life of the asset portfolios for the above mentioned conduits:

Weighted average life of portfolios

| Weighted average life (years) | Total multi- | | | |
|-------------------------------|--------------|------------|------------|-----------------|
| | Solitaire | Other SICs | Total SICs | seller conduits |
| At 30 June 2011 | 5.9 | 4.2 | 4.9 | 2.1 |
| At 30 June 2010 | 5.8 | 3.9 | 4.6 | 2.1 |
| At 31 December 2010 | 5.1 | 4.0 | 4.4 | 1.8 |
| Securitisations | | | | |

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HSBC uses SPEs to securitise customer loans and advances that it has originated in order to diversify its sources of funding for asset origination and for capital efficiency purposes. The loans and advances are transferred by HSBC to the SPEs for cash, and the SPEs issue debt securities to investors to fund the cash purchases.

HSBC's maximum exposure is the aggregate of any holdings of notes issued by these vehicles and the reserve account positions intended to provide credit support under certain pre-defined circumstances to senior note holders.

In addition, HSBC uses SPEs to mitigate the capital absorbed by some of the customer loans and advances it has originated. Credit derivatives are used to transfer the credit risk associated with these customer loans and advances to an SPE, using securitisations commonly known as synthetic securitisations by which the SPE writes credit default swap protection to HSBC. The SPE is funded by the issuance of notes with the cash held as collateral against the credit default protection. From a UK regulatory perspective, the credit protection issued by the SPE in respect of the customer loans allows the risk weight of the loans to be replaced by the risk weight of the collateral in the SPE and as a result mitigates the capital absorbed by the customer loans. Any notes issued by the SPE and held by HSBC attract

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the appropriate risk weight under the relevant regulatory regime. These SPEs are consolidated when HSBC is exposed to the majority of risks and rewards of ownership.

Money market funds

HSBC has established and manages a number of money market funds which provide customers with tailored investment opportunities within narrow and well-defined objectives.

The majority of these money market funds are Constant Net Asset Value funds (CNAV), which invest in shorter-dated and highly-rated money market securities with the objective of providing investors with a highly liquid and secure investment.

In December 2010, management determined that it was no longer appropriate to consolidate certain CNAV funds which HSBC had previously consolidated in September 2008. Further details are included on pages 363 and 364 of the *Annual Report and Accounts 2010*.

HSBC's maximum exposure to money market funds is represented by HSBC's investment in the units of each fund, which at 30 June 2011 amounted to US\$1.2bn (30 June 2010: US\$1.5bn; 31 December 2010: US\$1.1bn).

Non-money market investment funds

HSBC has established a large number of non-money market investment funds to enable customers to invest in a range of assets, typically equities and debt securities.

HSBC's maximum exposure to non-money market investment funds is represented by its investment in the units of each fund which at 30 June 2011 amounted to US\$10.0bn (30 June 2010: US\$7.5bn; 31 December 2010: US\$8.6bn).

Other

HSBC also establishes SPEs in the normal course of business for a number of purposes, for example, structured credit transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions.

In certain transactions, HSBC is exposed to risk often referred to as gap risk. Gap risk typically arises in transactions where the aggregate potential claims against the SPE by HSBC pursuant to one or more derivatives could be greater than the value of the collateral held by the SPE and securing such derivatives. HSBC often mitigates such gap risk by incorporating in the SPE transaction features which allow for deleveraging, a managed liquidation of the portfolio, or other mechanisms including trade restructuring or unwinding the trade. Following the inclusion of such risk reduction mechanisms, HSBC has, in certain circumstances, retained all or a portion of the underlying exposure in the transaction. In these circumstances, HSBC assesses whether the exposure retained causes a requirement under IFRSs to consolidate the SPE. When this retained exposure represents ABSs, it has been included in Securitisation exposures and other structured products on page 121.

Third-party sponsored SPEs

Through standby liquidity facility commitments, HSBC has exposure to third-party sponsored SIVs, conduits and securitisations under normal banking arrangements on standard market terms. These exposures are not considered significant to HSBC's operations.

Additional off-balance sheet arrangements and commitments

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Additional off-balance sheet commitments such as financial guarantees, letters of credit and commitments to lend are disclosed in Note 20.

Leveraged finance transactions

Loan commitments in respect of leveraged finance transactions are accounted for as derivatives where it is HSBC's intention to sell the loan after origination. Further information is provided on page 132.

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Notes on the Financial Statements (unaudited) (continued)**22 Segmental analysis**

The basis of identifying segments and measuring segmental results is set out on page 296 of the *Annual Report and Accounts 2010*. There have been no material changes to the segments identified since 31 December 2010.

| | Rest of | | | | | Intra- | | |
|---------------------------------|------------------|----------------|----------------|---------------|----------------|----------------|------------------|------------------|
| | Hong | Asia- | | North | Latin | HSBC | | |
| | Kong | Pacific | MENA | America | America | items | | Total |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| <i>Net operating income</i> | | | | | | | | |
| Half-year to: | | | | | | | | |
| 30 June 2011 | 10,167 | 5,389 | 5,248 | 1,137 | 5,191 | 4,863 | (1,567) | 30,428 |
| 30 June 2010 | 11,220 | 4,833 | 4,351 | 750 | 4,446 | 3,895 | (1,467) | 28,028 |
| 31 December 2010 | 8,510 | 5,255 | 4,442 | 1,033 | 4,306 | 4,292 | (1,658) | 26,180 |
| <i>Profit/(loss) before tax</i> | | | | | | | | |
| Half-year to: | | | | | | | | |
| 30 June 2011 | 2,147 | 3,081 | 3,742 | 747 | 606 | 1,151 | | 11,474 |
| 30 June 2010 | 3,521 | 2,877 | 2,985 | 346 | 492 | 883 | | 11,104 |
| 31 December 2010 | 781 | 2,815 | 2,917 | 546 | (38) | 912 | | 7,933 |
| <i>Total assets</i> | | | | | | | | |
| At 30 June 2011 | 1,379,308 | 474,044 | 298,590 | 58,038 | 529,386 | 163,611 | (211,990) | 2,690,987 |
| At 30 June 2010 | 1,280,698 | 410,991 | 244,624 | 49,637 | 495,408 | 121,885 | (184,789) | 2,418,454 |
| At 31 December 2010 | 1,249,527 | 429,565 | 278,062 | 52,757 | 492,487 | 139,938 | (187,647) | 2,454,689 |

23 Goodwill impairment

It is HSBC's policy to test goodwill allocated to each cash-generating unit (CGU) for impairment as at 1 July each year. Goodwill is also tested for impairment whenever there is an indication that goodwill may be impaired.

The allocation of goodwill to CGUs is described on page 333 of the *Annual Report and Accounts 2010*.

There was no indication of impairment in the period to 30 June 2011 and therefore goodwill has not been retested.

24 Legal proceedings, investigations and regulatory matters

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions including the UK, EU and the US arising out of its normal business operations. Apart from the matters described below, HSBC considers that none of these matters is material, either individually or in the aggregate. HSBC recognises 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. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory matters as at 30 June 2011 (see Note 17, Provisions).

Securities litigation

As a result of an August 2002 restatement of previously reported consolidated financial statements and other corporate events, including the 2002 settlement with 46 State Attorneys General relating to real estate lending practices, Household International (now HSBC Finance) and certain former officers were named as defendants in a class action law suit, *Jaffe v Household International Inc, et al* No 2. C 5893 (N.D.Ill, filed 19 August 2002). The complaint asserted claims under the US Securities Exchange Act of 1934, on behalf of all persons who acquired and disposed of Household International common stock between 30 July 1999 and 11 October 2002. The claims alleged that the defendants knowingly or recklessly made false and misleading statements of material fact relating to Household's Consumer Lending operations, including collections, sales and lending practices, some of which ultimately led to the 2002 State settlement agreement, and facts relating to accounting practices evidenced by the restatement. Following a jury trial concluded in April 2009, which was decided partly in favour of the plaintiffs, the Court issued a ruling on 22 November 2010 within the second phase of the case to determine actual damages, that claim forms should be mailed to class members, and also set out a method for calculating damages for class members

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who filed claims. As previously reported, lead plaintiffs, in court filings in March 2010, estimated that damages could range somewhere between US\$2.4bn to US\$3.2bn to class members, before pre-judgement interest.

Class members had until 24 May 2011 to file claims. In filings with the Court, plaintiffs indicated that the Court-appointed claims administrator has made a preliminary determination that 45,332 of the claimants have an allowed loss, and that the preliminary, estimated damages for these potential class members, subject to revision as duplicate claims are identified and supplemental information is received, exceeds US\$2bn. All submitted claims are subject to a validation process that, as indicated in the plaintiffs' filings, will not be completed until December 2011. Once the claims administration process is complete, plaintiffs are expected to ask the Court to assess pre-judgement interest to be included as part of the Court's final judgement.

Despite the jury verdict and the 22 November 2010 ruling, HSBC continues to believe that it has meritorious grounds for appeal of one or more of the rulings in the case, and intends to seek an appeal of the Court's final judgement, which could involve a substantial amount. Upon appeal, HSBC Finance will be required to provide security for the judgement in order to suspend its execution while the appeal is ongoing by depositing cash in an interest-bearing escrow account or posting an appeal bond in the amount of the judgement (including any pre-judgement interest awarded).

Given the complexity and uncertainties associated with the actual determination of damages, including the outcome of any appeals, there is a wide range of possible damages. HSBC believes it has meritorious grounds for appeal on matters of both liability and damages and will argue on appeal that damages should be nil or a relatively insignificant amount. If the Appeals Court partially accepts or rejects HSBC's arguments, the cost of damages, including pre-judgement interest, could be higher, and may lie in a range from a relatively insignificant amount to somewhere in the region of US\$3bn.

Bernard L. Madoff Investment Securities LLC

In December 2008, Bernard L. Madoff (Madoff) was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L. Madoff Investment Securities LLC (Madoff Securities), an SEC-registered broker-dealer and investment adviser. Since his appointment, the trustee has been recovering assets and processing claims of Madoff Securities customers. Madoff subsequently pleaded guilty to various charges and is serving a 150 year prison sentence. He has acknowledged, in essence, that while purporting to invest his customers' money in securities and, upon request, return their profits and principal, he in fact never invested in securities and used other customers' money to fulfil requests for the return of profits and principal. The relevant US authorities are continuing their investigations into his fraud, and have brought charges against others.

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities.

Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US\$8.4bn, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, we estimate that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US\$4.3bn.

Plaintiffs (including funds, fund investors, and the Madoff Securities trustee) have commenced Madoff-related proceedings against numerous defendants in a multitude of jurisdictions. Various HSBC companies have been named as defendants in suits in the US, Ireland, Luxembourg, and other jurisdictions. The suits (which include US class actions) allege that the HSBC defendants knew or should have known of Madoff's fraud and breached various duties to the funds and fund investors.

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One of the funds HSBC companies provided custodial and administration services for was Thema International Fund plc, a limited liability company incorporated and authorised in Ireland as a UCITS fund under the European Communities (Undertaking for Collective Investments in Transferable Securities) Regulations 1985. HSBC estimates that the purported net asset value of Thema International Fund plc as at 30 November 2008 was US\$1.1bn and that Thema International Fund plc's actual transfers to Madoff Securities minus its actual withdrawals were approximately US\$312m. On 7 June 2011, HSBC Securities Services (Ireland) Limited, HSBC Institutional Trust Services (Ireland) Limited, HSBC Holdings plc and, subject to the granting of leave to effect a proposed pleading amendment, HSBC Bank USA, N.A. entered into an agreement, without any admission of wrongdoing or liability, to settle the action pending in the US District Court for the Southern District of New York, relating to Thema

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International Fund plc. The settlement is subject to various conditions to its effectiveness and the HSBC defendants may terminate the settlement in certain circumstances. The payment to be made by the HSBC defendants is US\$62.5m.

In December 2010, the Madoff Securities trustee commenced suits against various HSBC companies in the US bankruptcy court and in the English High Court. The US action (which also names certain funds, investment managers, and other entities and individuals) seeks US\$9bn in damages and additional recoveries from HSBC and the various co-defendants. It seeks damages against HSBC for allegedly aiding and abetting Madoff's fraud and breach of fiduciary duty. In July 2011, after withdrawing the case from the Bankruptcy Court in order to decide certain threshold issues, the US District Court Judge dismissed the trustee's various common law claims on the grounds that the trustee lacks standing to assert them. The trustee may appeal this ruling. The District Court returned the case to the US Bankruptcy Court for further proceedings on the remaining claims. Those claims seek, pursuant to US bankruptcy law, recovery of unspecified amounts received by HSBC from funds invested with Madoff, including amounts that HSBC received when it redeemed units HSBC held in the various funds. HSBC acquired those fund units in connection with financing transactions HSBC had entered into with various clients. The trustee's US bankruptcy law claims also seek recovery of fees earned by HSBC for providing custodial, administration and similar services to the funds. The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the ground that the HSBC defendants actually or constructively knew of Madoff's fraud.

In July 2011, one of the clients with whom HSBC entered into a Madoff-related financing transaction commenced suit in the US seeking to rescind the transaction and recover approximately US\$16m it paid to HSBC in connection with the transaction.

Between October 2009 and March 2011, Fairfield Sentry Limited and Fairfield Sigma Limited (Fairfield), funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the British Virgin Islands (BVI) and the US against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield actions seek restitution of amounts paid to the defendants in connection with share redemptions, on the ground that such payments were made by mistake, based on inflated values resulting from Madoff's fraud, and some actions also seek recovery of the share redemptions under BVI insolvency law.

There are many factors which may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings, including but not limited to the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. Many of the cases where HSBC companies are named as a defendant are at an early stage. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities, or ranges of liabilities, that might arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

Payment Protection Insurance

On 10 August 2010 the FSA published Policy Statement 10/12 (PS 10/12) on the assessment and redress of Payment Protection Insurance (PPI) complaints. On 8 October 2010, an application for Judicial Review was issued by the British Bankers' Association (BBA) acting on behalf of a group of UK banks, which included HSBC Bank, seeking an order to quash PS 10/12 and also Guidance issued by the Financial Ombudsman Service (FOS) on handling PPI complaints. The Judicial Review application was heard by the Court in January 2011.

On 20 April 2011, the High Court issued an adverse judgement on the Judicial Review application. Subsequently the BBA, acting on behalf of its members, confirmed that it would not appeal the judgement. HSBC Bank accepts the High Court's decision and is working with the FSA and the FOS in order to ensure all PPI complaints are handled and, where appropriate, redressed in accordance with PS 10/12.

There are many factors affecting the resulting financial impact of the judgement, including the effect of the decision on the nature and volume of customer complaints; and the extent to which HSBC Bank might be required to take action, and the nature of any such action, in relation to non-complainants. The extent of any redress that may be required as a result of the decision to uphold PS 10/12 and the FOS Guidance will also

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depend on the facts and circumstances of each individual customer's case. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress for this matter. There is a provision of US\$509m as at 30 June 2011 in respect of the estimated liability for redress in respect of the possible mis-selling of PPI policies in previous years.

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US mortgage-related investigations

In April 2011, HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and HSBC Finance and HSBC North America entered into a similar consent order with the Federal Reserve Board following completion of a broad horizontal review of industry residential mortgage foreclosure practices. These consent orders require prescribed actions to address the deficiencies noted in the joint examination and described in the consent orders. These consent orders require a review of foreclosures from January 2009 to December 2010 to determine if any customer was financially injured as a result of an error in the foreclosure process. An independent consultant has been retained to conduct that review, and remediation, including restitution, may be required if a customer is found to have been financially injured. HSBC Bank USA, HSBC Finance and HSBC North America continue to work with the Office of the Comptroller of the Currency and the Federal Reserve Board to define and address the requirements of the consent orders.

These consent orders do not preclude additional enforcement actions against HSBC Bank USA, HSBC Finance or HSBC North America by bank regulatory, governmental or law enforcement agencies, such as the US Department of Justice (DoJ) or State Attorneys General, which could include the imposition of fines and actions to recover civil money penalties and other financial penalties relating to the activities that were the subject of the consent orders. The Federal Reserve Board has indicated in a press release relating to the financial services industry in general that it believes monetary sanctions are appropriate for the enforcement actions and that it plans to announce monetary penalties. An increase in private litigation concerning these practices is also possible. While it is possible that civil money penalties will be imposed on HSBC Bank USA, HSBC Finance or HSBC North America, HSBC is unable at this time to estimate reliably the amounts, or range of possible amounts, of any such penalties, or claims arising from any private litigation.

Media reports suggest that the five largest US mortgage servicers are engaged in discussions with bank regulators, the DoJ and State Attorneys General regarding a broader settlement with respect to foreclosure and other mortgage servicing practices, and that the settlement will involve a substantial payment. Following the conclusion of these discussions and the announcement of any such settlement with the five largest servicers, it is expected that the next nine largest mortgage servicers, including HSBC Bank USA and HSBC Finance, will be approached regarding a settlement although the timing and proposed terms of such settlement discussions are not presently known.

Participants in the US mortgage securitisation market that purchased and repackaged whole loans have been the subject of lawsuits and governmental and regulatory investigations and inquiries, which have been directed at groups within the US mortgage market, such as servicers, originators, underwriters, trustees or sponsors of securitisations, and at particular participants within these groups. HSBC Bank USA has received subpoenas from the Securities and Exchange Commission (SEC) and DoJ seeking production of documents and confirmation relating to its involvement and the involvement of its affiliates in specified private-label residential mortgage-backed securities (MBS) transactions as an issuer, sponsor, underwriter, depositor, trustee, custodian or servicer. As the industry's residential mortgage foreclosure issues continue, HSBC Bank USA has taken title to an increasing number of foreclosed homes as trustee on behalf of various securitisation trusts. As record owner of these properties, HSBC Bank USA has been sued by municipalities and tenants alleging various violations of law, including laws regarding property upkeep and tenants rights. While HSBC believes and continues to maintain that the obligations at issue and the related liability are properly those of the servicer of each trust, HSBC continues to receive significant and adverse publicity in connection with these and similar matters. In addition, HSBC Securities Inc. has been named as defendant in a small number of actions in its role as underwriter in specified private-label residential MBS offerings, which generally allege that the offering documents for securities issued by securitisation trusts contained material misstatements and omissions, including statements regarding the underwriting standards governing the underlying mortgage loans. HSBC expects this level of focus will continue and, potentially, intensify, so long as the US real estate markets continue to be distressed. As a result, HSBC Group companies may be subject to additional litigation and governmental and regulatory scrutiny related to its participation in the US mortgage securitisation market, either individually or as a member of a group. HSBC is unable to estimate reliably the financial effect of any action or litigation relating to these matters. As situations develop it is possible that any related claims could be significant.

Other US regulatory and law enforcement investigations

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In October 2010, HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and the indirect parent of that company, HSBC North America, entered into a consent cease and desist order with the Federal Reserve Board. These actions require improvements for an effective compliance risk management programme across the Group's US businesses, including US Bank Secrecy Act (BSA) and Anti

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Notes on the Financial Statements (unaudited) (continued)

Money Laundering (AML) compliance. Steps continue to be taken to address the requirements of these Orders and to ensure that compliance and effective policies and procedures are maintained. Various HSBC Group companies are the subject of ongoing investigations, including Grand Jury subpoenas and other requests for information, by US Government agencies, including the US Attorney's Office, the DoJ and the New York County District Attorney's Office. These investigations pertain to, among other matters, HSBC Bank USA's bank note and dollar clearing services and their compliance with BSA and AML controls, as well as various HSBC Group companies' compliance with Office of Foreign Asset Control (OFAC) requirements, and whether various HSBC Group companies acted appropriately in relation to certain customers who had US tax reporting requirements and various HSBC Group companies' adherence to the US broker dealer rules when dealing with US securities. In April 2011, HSBC Bank USA received a summons from the US Internal Revenue Service directing HSBC Bank USA to produce records identifying US taxpayers with bank accounts at the offices of an HSBC Group company and continues to work with the US Internal Revenue Service to meet their requirements.

The consent cease and desist orders do not preclude additional enforcement actions against HSBC Bank USA, HSBC Finance, or HSBC North America by bank regulatory or law enforcement agencies, including actions to recover civil money penalties, fines and other financial penalties relating to activities which were the subject of the cease and desist orders. In addition, it is likely that there could be some form of formal enforcement action in respect of some or all of the ongoing investigations. Actual or threatened enforcement actions against other financial institutions for breaches of BSA, AML and OFAC requirements have resulted in settlements involving fines and penalties, some of which have been significant depending on the individual circumstances of each action. The ongoing investigations are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to determine the terms on which the ongoing investigations will be resolved or the timing of such resolution or for HSBC to estimate reliably the amounts, or range of possible amounts, of any fines and/or penalties. As matters progress, it is possible that any fines and/or penalties could be significant.

Investigations into the setting of London interbank offered rates

Various regulators and enforcement authorities around the world including in the UK, the US and the EU, are conducting investigations related to certain past submissions made by panel banks to the BBA in connection with the setting of London interbank offered rates (LIBOR). As HSBC Bank is a panel bank, HSBC and/or its subsidiaries have received requests from these various regulators for information and are cooperating with their enquiries. In addition, HSBC and other panel banks have been named recently in several putative class action lawsuits filed by private parties in the US with respect to the setting of LIBOR. These ongoing matters are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these regulatory investigations or putative class action lawsuits, including the timing and potential impact, if any, on HSBC.

25 Events after the balance sheet date

On 31 July 2011, we announced that we had reached an agreement with First Niagara Bank, N.A. to sell 195 retail branches, including certain loans, deposits and related branch premises, primarily located in upstate New York, for consideration of a premium equal to 6.67% of the deposits to be transferred at closing. Based on 31 May 2011 balances, the consideration would represent approximately US\$1.0bn. This will result in a gain upon closing of the transaction. Branch premises will be sold for fair value and loans and other transferred assets will be sold at their book values. The all-cash transaction is expected to close in early 2012, subject to regulatory approvals, including approval by the acquirer's regulator. The branches held approximately US\$15.0bn in deposits and US\$2.8bn in loans as of 31 May 2011.

A second interim dividend for the financial year ending 31 December 2011 was declared by the Directors after 30 June 2011, as described in Note 3.

26 *Interim Report 2011* and statutory accounts

The information in this *Interim Report 2011* is unaudited and does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. The *Interim Report 2011* was approved by the Board of Directors on 1 August 2011. The statutory accounts for the year ended 31 December 2010 have been delivered to the Registrar of Companies in England and Wales in accordance with section 447 of the Companies Act 2006. The auditor has reported on those accounts. Its report was unqualified; did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

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1 Directors' interests

According to the register of Directors' interests maintained by HSBC Holdings pursuant to section 352 of the Securities and Futures Ordinance of Hong Kong, the Directors of HSBC Holdings at 30 June 2011 had the following interests, all beneficial unless otherwise stated, in the shares and loan capital of HSBC and its associated corporations:

Directors' interests

HSBC Holdings ordinary shares of US\$0.50

| | At 30 June 2011 | | | | | Total |
|----------------------|-------------------|------------------|--------------------------|---------------------|---------------------|-----------|
| | At 1 January 2011 | Beneficial owner | Child under 18 or spouse | with another person | Trustee | |
| J D Coombe | 20,341 | 20,736 | | | | 20,736 |
| R A Fairhead | 21,300 | | | 21,300 | | 21,300 |
| D J Flint | 178,681 | 237,460 | | | 34,422 ² | 271,882 |
| A A Flockhart | 230,112 | 62,605 | | | 337,461 | 400,066 |
| S T Gulliver | 2,731,077 | 2,553,592 | 177,496 | | | 2,731,088 |
| J W J Hughes-Hallett | 39,577 | | | | 46,952 ² | 46,952 |

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| | | | | | |
|----------------------|---------|---------|---------------------|----------------------|---------|
| W S H Laidlaw | 30,948 | 29,877 | | 1,416 ² | 31,293 |
| I J Mackay | 34,217 | 104,007 | | | 104,007 |
| G Morgan | 81,166 | 82,742 | | | 82,742 |
| Sir Simon Robertson | 176,373 | 8,789 | | 167,750 ² | 176,539 |
| J L Thornton | 10,250 | | 10,250 ³ | | 10,250 |
| Sir Brian Williamson | 37,607 | 38,338 | | | 38,338 |

1 *Details of executive Directors' other interests in ordinary shares arising from the HSBC Holdings savings-related share option plans, the HSBC Share Plan and HSBC Share Plan 2011 are set out on the following pages. At 30 June 2011, the aggregate interests under the Securities and Futures Ordinance of Hong Kong in HSBC Holdings ordinary shares of US\$0.50, including interests arising through employee share plans, were: D J Flint 621,280; A A Flockhart 1,399,379; S T Gulliver 4,854,243; and I J Mackay 440,635. Each Director's total interests represent less than 0.03% of the shares in issue.*

2 *Non-beneficial.*

3 *Interest of spouse in 2,050 listed American Depositary Shares (ADS), which are categorised as equity derivatives under Part XV of the Securities and Futures Ordinance of Hong Kong. Each ADS represents five HSBC Holdings ordinary shares of US\$0.50.*

L M L Cha has an interest as beneficial owner in US\$300,000 6.5% Subordinated Notes 2036 issued by HSBC Holdings plc, which she has held throughout the period since her appointment on 1 March 2011.

As a director of HSBC France, S T Gulliver has an interest as beneficial owner in one share of 5 in that company (representing less than 0.01% of the shares in issue), which he held throughout the period. He has waived his right to receive dividends on this share and has undertaken to transfer it to HSBC on ceasing to be a director of HSBC France.

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HSBC HOLDINGS PLC

Additional Information (continued)

Savings-related share option plans, the HSBC Share Plan and the HSBC Share Plan 2011

HSBC Holdings savings-related share option plans

HSBC Holdings ordinary shares of US\$0.50

| | Date of award | Exercise price | Exercisable | | Held at | Held at |
|---------------|---------------|----------------|-------------------|-------------|------------|-------------|
| | | | from ¹ | until | 1 Jan 2011 | 30 Jun 2011 |
| D J Flint | 25 Apr 2007 | £6.1760 | 1 Aug 2012 | 31 Jan 2013 | 2,650 | 2,650 |
| A A Flockhart | 29 Apr 2009 | £3.3116 | 1 Aug 2014 | 31 Jan 2015 | 4,529 | 4,529 |
| I J Mackay | 30 Apr 2008 | US\$ 11.8824 | 1 Aug 2011 | 31 Jan 2012 | 1,531 | 1,531 |

The HSBC Holdings savings-related share option plans are all-employee share plans under which eligible HSBC employees may be granted options to acquire shares. Employees may make contributions of up to £250 (or equivalent) each month over a period of one, three or five years which may be used on the first, third or fifth anniversary of the commencement of the relevant savings contract, at the employee's election, to exercise the options. The plans help align the interests of employees with the creation of shareholder value and, as such, exercise of the options is not subject to any performance conditions. The options were awarded for nil consideration and are exercisable at a 20% discount to the average market value of the ordinary shares on the five business days immediately preceding the invitation date. No options lapsed during the period. There are no performance criteria conditional upon which the outstanding options are exercisable and there have been no variations to the terms and conditions since the awards were made. The market value per ordinary share at 30 June 2011 was £6.18. The highest and lowest market values per share during the period were £7.31 and £6.01. Market value is the middle market closing price derived from the London Stock Exchange Daily Official List on the relevant date. Under the Securities and Futures Ordinance of Hong Kong, the options are categorised as unlisted physically settled equity derivatives.

¹ May be advanced to an earlier date in certain circumstances, e.g. retirement.

Awards of Performance Shares*HSBC Share Plan*

HSBC Holdings ordinary shares of US\$0.50

| Date of award | Year in which awards vested | Awards | Awards vested during | Awards |
|---------------|-----------------------------|--------------------|-----------------------------------|---------------------|
| | | held at 1 Jan 2011 | period ^{1,2} Monetary | held at 30 Jun 2011 |
| | | 2011 | Number ³ value | 2011 |
| | | | £000 | |

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| | | | | | |
|---------------|------------|------|----------------|----------------|------------|
| D J Flint | 3 Jun 2008 | 2011 | 470,596 | 102,184 | 662 |
| A A Flockhart | 3 Jun 2008 | 2011 | 160,474 | 34,844 | 226 |
| S T Gulliver | 3 Jun 2008 | 2011 | 69,917 | 15,181 | 98 |

Vesting of these awards of Performance Shares was subject to the achievement of the corporate performance conditions set out on pages 226 to 228 of the Annual Report and Accounts 2010. Interests in awards of Performance Shares are categorised under the Securities and Futures Ordinance of Hong Kong as the interests of a beneficiary of a trust.

- 1 *The performance conditions of the total shareholder return element of the award were partially met and the following part of the awards vested on 4 April 2011, when the market value per share was £6.48: D J Flint, 101,003 shares; A A Flockhart, 34,442 shares; and S T Gulliver, 15,006 shares. The following awards representing the fourth interim dividend for 2010 vested on 5 May 2011 when the market value per share was £6.46: D J Flint, 1,181 shares; A A Flockhart, 402 shares; and S T Gulliver, 175 shares. The market value per share on the date of the award, 3 June 2008, was £8.56. Market value is the middle market closing price derived from the London Stock Exchange Daily Official List on the relevant date.*
- 2 *The performance conditions for the earnings per share, the economic profit element and the remaining part of the total shareholder return element of the award were not met and, under the terms of the Plan, the following awards were forfeited on 4 April 2011: D J Flint, 373,193 shares; A A Flockhart, 127,259 shares; and S T Gulliver, 55,445 shares. As a consequence, there was no entitlement to the fourth interim dividend for 2010 on the forfeited shares.*
- 3 *Includes additional shares arising from scrip dividends.*

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HSBC HOLDINGS PLC

Additional Information (continued)**Awards of Restricted Shares***HSBC Share Plan*

HSBC Holdings ordinary shares of US\$0.50

| | Date of award | Year in which awards may vest | Awards held at 1 Jan 2011 | Awards made during period | | Awards vested during period | | Awards held at 30 Jun 2011 ¹ |
|---------------|---------------|-------------------------------|---------------------------|---------------------------|--------|-----------------------------|--------|---|
| | | | Number | Monetary value £000 | Number | Monetary value £000 | Number | Monetary value £000 |
| D J Flint | 1 Mar 2010 | 2011-2013 ² | 316,252 | | | 105,162 ³ | 713 | 216,007 |
| | 15 Mar 2011 | 2011-2014 | | 215,383 ⁴ | 1,391 | 86,153 ⁵ | 557 | 130,741 |
| A A Flockhart | 3 Mar 2008 | 2011 | 15,572 | | | 15,875 ⁶ | 102 | |
| | 2 Mar 2009 | 2012 | 514,960 | | | | | 524,970 |
| | 1 Mar 2010 | 2011-2013 ² | 305,806 | | | 101,688 ³ | 689 | 208,872 |
| | 15 Mar 2011 | 2011-2014 | | 139,079 ⁴ | 898 | 55,632 ⁵ | 359 | 84,423 |
| S T Gulliver | 3 Mar 2008 | 2009-2011 | 192,796 | | | 194,270 ⁷ | 1,317 | |
| | 1 Mar 2010 | 2011-2013 ² | 1,355,371 | | | 450,694 ³ | 3,056 | 925,751 |
| | 15 Mar 2011 | 2012-2014 | | 800,000 ⁸ | 5,168 | | | 809,360 |
| I J Mackay | 31 Jul 2007 | 2009-2011 ⁹ | 47,679 | | | | | 48,606 |
| | 31 Mar 2008 | 2011 | 46,252 | | | 47,152 ¹⁰ | 302 | |
| | 2 Mar 2009 | 2012 | 100,309 | | | | | 102,258 |
| | 1 Mar 2010 | 2011-2013 ² | 59,262 | | | 19,706 ³ | 134 | 40,477 |
| | 15 Mar 2011 | 2011-2014 | | 58,103 ⁴ | 375 | 23,241 ⁵ | 150 | 35,269 |

Vesting of Restricted Share awards is normally subject to the Director remaining an employee on the vesting date. The vesting date may be advanced to an earlier date in certain circumstances, e.g. death or retirement. Under the Securities and Futures Ordinance of Hong Kong, interests in Restricted Share awards granted in 2007 and 2008 are categorised as the interests of a beneficiary of a trust and interests in Restricted Share awards granted in 2009, 2010 and 2011 are categorised as the interests of a beneficial owner.

¹ Includes additional shares arising from scrip dividends.

² 33% of the award vests on each of the first and second anniversaries of the date of the award, with the balance vesting on the third anniversary of the date of the award.

³ At the date of vesting, 28 February 2011, the market value per share was £6.78. The market value per share on the date of the award, 1 March 2010, was £6.82. Market value is the middle market closing price derived from the London Stock Exchange Daily Official List on the relevant date.

⁴ At the date of the award, 15 March 2011, the market value per share was £6.46. The number of shares comprises a deferred award and non-deferred award of Restricted Shares. In respect of the deferred award, 33% vests on each of the first and second anniversaries of the date of the award, with the balance vesting on the third anniversary of the date of the award.

⁵ The non-deferred award vested immediately on 15 March 2011 and is subject to a 6 month retention period. At the date of vesting, the market value per share was £6.46.

⁶ 15,691 shares vested on 31 March 2011 when the market value per share was £6.41. The market value per share on the date of the award, 3 March 2008, was £7.90. An award of 184 shares representing the fourth interim dividend for 2011 vested on 5 May 2011 when the market value per share was £6.46.

⁷

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At the date of vesting, 28 February 2011, the market value per share was £6.78. The market value per share on the date of the award, 3 March 2008, was £7.90.

8 At the date of the award, 15 March 2011, the market value per share was £6.46. The number of shares comprises a deferred award of Restricted Shares. 33% of the award vests on each of the first and second anniversaries of the date of the award, with the balance vesting on the third anniversary of the date of the award.

9 33% of the award vests on each of the second and third anniversaries of the date of the award, with the balance vesting on the fourth anniversary of the date of the award.

10 46,606 shares vested on 31 March 2011 when the market value per share was £6.41. The market value per share on the date of the award, 31 March 2008, was £8.30. An award of 546 shares representing the fourth interim dividend for 2011 vested on 5 May 2011 when the market value per share was £6.46.

HSBC Share Plan 2011

HSBC Holdings ordinary shares of US\$0.50

| | Date of award | Year in which awards may vest | Awards | | | |
|---------------|---------------|-------------------------------|---------------------------|--|---------|----------------------------|
| | | | Awards held at 1 Jan 2011 | Awards made during period ¹ | | Awards held at 30 Jun 2011 |
| | | | | Monetary | | |
| | | | Number | value | £000 | Number |
| A A Flockhart | 23 Jun 2011 | 2016 | 176,519 | 1,061 | 176,519 | |
| S T Gulliver | 23 Jun 2011 | 2016 | 388,044 | 2,332 | 388,044 | |
| I J Mackay | 23 Jun 2011 | 2016 | 108,487 | 652 | 108,487 | |

The Group Performance Share Plan (GPSP) is the long-term incentive plan under the HSBC Share Plan 2011. Vesting of GPSP awards is normally subject to the Director remaining an employee on the vesting date. Any shares (net of tax) which the Director becomes entitled to on the vesting date are subject to a retention requirement until cessation of employment. Under the Securities and Futures Ordinance of Hong Kong, interests in awards are categorised as the interests of a beneficial owner.

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HSBC HOLDINGS PLC

Additional Information (continued)

1 *Conditional awards of shares made under the GPSP. At the date of award, 23 June 2011, the market value per share was £6.01.*

No Directors held any short position as defined in the Securities and Futures Ordinance of Hong Kong in the shares and loan capital of HSBC Holdings and its associated corporations. Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings or any associated corporation at the beginning or at the end of the period, and none of the Directors or members of their immediate families were awarded or exercised any right to subscribe for any shares or debentures in any HSBC corporation during the period. Since the end of the period, the interests of each of the following Directors have increased by the number of HSBC Holdings ordinary shares shown against their name:

Increase in Directors' interests since 30 June 2011

HSBC Holdings ordinary shares of US\$0.50

| | Beneficial owner | Child under 18 or spouse ¹ | Trustee ¹ |
|----------------------|---------------------|---|----------------------|
| J D Coombe | 183 ¹ | | |
| D J Flint | 3,151 ² | | 303 ³ |
| A A Flockhart | 7,766 ⁴ | | 2,974 |
| S T Gulliver | 15,298 ⁵ | 6 | |
| W S H Laidlaw | 263 ¹ | | |
| I J Mackay | 1,999 ⁵ | | |
| G Morgan | 729 ¹ | | |
| Sir Simon Robertson | 77 ¹ | | |
| Sir Brian Williamson | 338 ¹ | | |

1 *Scrip dividend.*

2 *Comprises the automatic reinvestment of dividend income by an Individual Savings Account manager (50 shares), the acquisition of shares in the HSBC Holdings UK Share Incentive Plan through regular monthly contributions (21 shares), the automatic reinvestment of dividend income on shares held in the plan (22 shares) and scrip dividends on Performance Share awards and Restricted Share awards granted under the HSBC Share Plan (3,058 shares).*

3 *Non-beneficial.*

4 *Comprises scrip dividend on ordinary shares (551 shares) and on Performance Share awards and Restricted Share awards granted under the HSBC Share Plan (7,215 shares).*

5 *Scrip dividend on Performance Share awards and Restricted Share awards granted under the HSBC Share Plan.*

2 Directors fees

At the Annual General Meeting in 2011, shareholders approved an increased fee of £95,000 per annum payable to each non-executive Director with effect from 1 January 2011. In addition, the Board approved an increased fee of £45,000 per annum for the senior independent

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non-executive Director and the following increased fees for service on Board Committees with effect from 1 January 2011:

Board Committee fees

| | Chairman £000 | Member £000 |
|------------------------------------|--------------------------|------------------------|
| Group Audit Committee | 50 | 30 |
| Group Risk Committee | 50 | 30 |
| Remuneration Committee | 50 | 30 |
| Nomination Committee | 40 | 25 |
| Corporate Sustainability Committee | 40 | 25 |

3 Employee share option plans

To help align the interests of employees with those of shareholders, options are granted under all-employee share option plans. The following are particulars of outstanding options, including those held by employees working under employment contracts that are regarded as continuous contracts for the purposes of the Hong Kong Employment Ordinance. The options were granted for nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services, or in excess of the individual limit for each share plan. No options were cancelled by HSBC during the period. Share options may also be granted under the HSBC Share Plan 2011, which replaced the HSBC Share Plan on 27 May 2011, following shareholder approval at the Annual General Meeting. No share options have been granted under this plan.

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HSBC HOLDINGS PLC

Additional Information (continued)

A summary for each plan of the total number of the options which were awarded, exercised or lapsed during the period is shown in the tables below. Further details required to be disclosed pursuant to Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited are available on our website at www.hsbc.com by selecting Investor Relations, then Governance then Share Plans, and on the website of The Stock Exchange of Hong Kong Limited at www.hkex.com.hk or can be obtained upon request from the Group Company Secretary, 8 Canada Square, London E14 5HQ. Particulars of options held by Directors of HSBC Holdings are set out on page 222.

All-employee share option plans

All employees employed within the Group on the first working day of the year may be granted options to acquire HSBC Holdings ordinary shares under shareholder-approved all-employee share option plans. Options under the plans are usually exercisable after one, three or five years.

The exercise of the options may be advanced to an earlier date in certain circumstances, for example, on retirement, and may be extended in certain circumstances, for example, on the death of a participant, the executors may exercise the options up to six months beyond the normal exercise period. The middle market closing price per HSBC Holdings ordinary share quoted on the London Stock Exchange, as derived from the Daily Official List on 19 April 2011, the day before options were awarded in 2011, was £6.41.

HSBC Holdings Savings-Related Share Option Plan

HSBC Holdings ordinary shares of US\$0.50

| Dates of award from | to | Exercise price (£) | | Exercisable | | At | Awarded | Exercised | Lapsed | At |
|------------------------|----------------|-----------------------|--------|---------------|----------------|---------------|------------------|-------------------------------|------------------|----------------|
| | | from | to | from | to | 1 Jan 2011 | during period | during period ¹ | during period | 30 Jun 2011 |
| 24 May 2005 | 20 Apr 2011 | 3.3116 | 6.6870 | 1 Aug 2010 | 31 Jan 2017 | 67,737,865 | 7,742,930 | 500,322 | 2,715,360 | 72,265,113 |

¹ The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.73. The fair value of options granted in the period under the Plan was US\$17m.

HSBC Holdings Savings-Related Share Option Plan: International

HSBC Holdings ordinary shares of US\$0.50

| Dates of award from | to | Exercise price | | Exercisable | | At | Awarded | Exercised | Lapsed | At |
|------------------------|----|----------------|----|-------------|----|---------------|------------------|-------------------------------|------------------|----------------|
| | | from | to | from | to | 1 Jan 2011 | during period | during period ¹ | during period | 30 Jun 2011 |

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| | | | | | | | | | | |
|----------------|---------|---------|---------------|----------------|-------------------|------------------|----------------|------------------|-------------------|--|
| 24 May 2005 | (£) | (£) | | | | | | | | |
| 20 Apr 2011 | 3.3116 | 6.6870 | 1 Aug 2010 | 31 Jan 2017 | 28,660,942 | 7,557,671 | 203,621 | 1,927,545 | 34,087,447 | |
| 26 Apr 2006 | (US\$) | (US\$) | | | | | | | | |
| 20 Apr 2011 | 4.8876 | 12.0958 | 1 Aug 2010 | 31 Jan 2017 | 10,899,415 | 2,189,050 | 53,538 | 1,091,500 | 11,943,427 | |
| 26 Apr 2006 | () | () | | | | | | | | |
| 20 Apr 2011 | 3.6361 | 9.5912 | 1 Aug 2010 | 31 Jan 2017 | 3,128,508 | 581,297 | 702 | 138,029 | 3,571,074 | |
| 26 Apr 2006 | (HK\$) | (HK\$) | | | | | | | | |
| 20 Apr 2011 | 37.8797 | 94.5057 | 1 Aug 2010 | 31 Jan 2017 | 47,428,892 | 5,127,912 | 94,411 | 1,395,499 | 51,066,894 | |

1 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.75.

The fair value of options granted in the period under the Plan was US\$33m.

Fair values of options granted under all-employee share option plans in 2011, estimated at the date of grant of the share option, are calculated using a Black-Scholes model.

The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The significant weighted average assumptions used to estimate the fair value of the options granted in 2011 were as follows:

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HSBC HOLDINGS PLC

Additional Information (continued)

| | 1-year savings-related share option plan | 3-year savings-related share option plans | 5-year savings-related share option plans |
|--|---|--|--|
| Risk-free interest rate (%) ¹ | 0.8 | 1.7 | 2.5 |
| Expected life (years) ² | 1 | 3 | 5 |
| Expected volatility (%) ³ | 25 | 25 | 25 |

1 The risk-free interest rate was determined from the UK gilts zero-coupon yield curve for the HSBC Holdings Savings-Related Share Option Plan. A similar yield curve was used for the HSBC Holdings Savings-Related Share Option Plan: International.

2 Expected life is not a single input parameter but a function of various behavioural assumptions.

3 Expected volatility is estimated by considering historic average HSBC share price volatility and implied volatility for traded options over HSBC shares of similar maturity to those of the employee options.

Expected dividend yield was determined to be 4.5% per annum, in line with consensus analyst forecasts.

Discretionary Share Plans

There have been no awards of discretionary share options under employee share plans since 30 September 2005.

HSBC Holdings Group Share Option Plan¹

HSBC Holdings ordinary shares of US\$0.50

| Dates of award from | to | Exercise price (£) | | Exercisable | | At | Exercised | Lapsed | At |
|------------------------|----------------|-----------------------|--------|----------------|----------------|---------------|-------------------------------|------------------|----------------|
| | | from | to | from | to | 1 Jan 2011 | during period ² | during period | 30 Jun 2011 |
| 23 Apr 2001 | 20 Apr 2005 | 6.0216 | 7.9806 | 23 Apr 2004 | 20 Apr 2015 | 153,189,587 | 641,241 | 30,165,926 | 122,382,420 |

1 The HSBC Holdings Group Share Option Plan expired on 26 May 2005. No options have been granted under the Plan since that date.

2 The weighted average closing price of the ordinary shares immediately before the dates on which options were exercised was £6.91.
HSBC Share Plan

HSBC Holdings ordinary shares of US\$0.50

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| Date of award | Exercise price (£) | Exercisable | | At | Exercised | Lapsed | At |
|---------------|--------------------|-------------|-------------|---------------|---------------|---------------|---------------|
| | | from | to | 1 Jan 2011 | during period | during period | 30 Jun 2011 |
| 30 Sep 2005 | 7.9911 | 30 Sep 2008 | 30 Sep 2015 | 86,046 | | | 86,046 |

Subsidiary company share plans

HSBC Private Bank France

When it was acquired in 2000, HSBC Private Bank France operated employee share option plans under which options could be granted over its shares. No options under the plan have been granted since the acquisition and no further options will be granted under the plan. The following are details of options to acquire shares in HSBC Private Bank France.

HSBC Private Bank France

Shares of 2

| Dates of award from | to | Exercise price () | | Exercisable from | to | At | Exercised | Lapsed | At |
|---------------------|------------|--------------------|-------|------------------|------------|----------------|----------------------------|----------------|-----------------------------|
| | | from | to | | | 1 Jan 2011 | during period ¹ | during period | At 30 Jun 2011 ¹ |
| 15 May 2001 | 1 Oct 2002 | 20.80 | 22.22 | 15 May 2002 | 1 Oct 2012 | 287,100 | | 141,525 | 145,575 |

¹ Following exercise of the options, the HSBC Private Bank France shares are exchangeable for HSBC Holdings ordinary shares in the ratio of 2.099984 HSBC Holdings ordinary shares for each HSBC Private Bank France share. At 30 June 2011, The CCF Employee Benefit Trust 2001 held 989,502 HSBC Holdings ordinary shares which may be exchanged for HSBC Private Bank France shares arising from the exercise of these options.

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HSBC HOLDINGS PLC

Additional Information (continued)**HSBC Finance**

Following the acquisition of HSBC Finance in 2003, all outstanding options and equity-based awards over HSBC Finance common shares were converted into rights to receive HSBC Holdings ordinary shares in the same ratio as the share exchange offer for the acquisition of HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share) and the exercise prices per share were adjusted accordingly. No further options will be granted under the plans.

The following are details of options and equity-based awards to acquire shares in HSBC Holdings. At 30 June 2011, the HSBC (Household) Employee Benefit Trust 2003 held 2,335,315 HSBC Holdings ordinary shares and 1,445 American Depositary Shares, each of which represents five HSBC Holdings ordinary shares, which may be used to satisfy the exercise of employee share options.

HSBC Finance: 1996 Long-Term Executive Incentive Compensation Plan

HSBC Holdings ordinary shares of US\$0.50

| Dates of award from | to | Exercise price (US\$) | | Exercisable | | At | Exercised during period | Lapsed during period | At |
|------------------------|----------------|--------------------------|-------|----------------|----------------|---------------|-------------------------------|----------------------------|----------------|
| | | from | to | from | to | 1 Jan 2011 | | | 30 Jun 2011 |
| 12 Nov 2001 | 20 Nov 2002 | 9.29 | 18.62 | 12 Nov 2002 | 20 Nov 2012 | 11,117,826 | | | 11,117,826 |

HSBC Bank Bermuda

Following the acquisition of HSBC Bank Bermuda in 2004, all outstanding options over HSBC Bank Bermuda shares were converted into rights to receive HSBC Holdings ordinary shares based on the consideration of US\$40 for each HSBC Bank Bermuda share and the average closing price of HSBC Holdings ordinary shares, derived from the London Stock Exchange Daily Official List, for the five business days preceding the closing date of the acquisition. No further options will be granted under any of these plans.

All outstanding options over HSBC Bank Bermuda shares vested on completion of the acquisition. The following are details of options to acquire HSBC Holdings ordinary shares. At 30 June 2011, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 2,108,830 HSBC Holdings ordinary shares which may be used to satisfy the exercise of employee share options.

HSBC Bank Bermuda: Executive Share Option Plan 1997

HSBC Holdings ordinary shares of US\$0.50

| Date of award | Exercise price | Exercisable | | At | Exercised during period | Lapsed during period | At |
|---------------|-------------------|-------------|-------|---------------|-------------------------------|----------------------------|----------------|
| | | from | until | 1 Jan 2011 | | | 30 Jun 2011 |

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| | | (US\$) | | | | | | | |
|---|-------------|-----------------------|-------|-------------|-------------|------------------|-------------------------|----------------------|------------------|
| | | | | 11 Jan 2002 | 11 Jan 2011 | | | | |
| 11 Jan 2001 | | 12.44 | | | | 61,901 | | 61,901 | |
| <i>HSBC Bank Bermuda: Share Option Plan 2000</i> | | | | | | | | | |
| HSBC Holdings ordinary shares of US\$0.50 | | | | | | | | | |
| Dates of award | | Exercise price (US\$) | | Exercisable | | At | | | At |
| from | to | from | to | from | to | 1 Jan 2011 | Exercised during period | Lapsed during period | 30 Jun 2011 |
| 11 Jan 2001 | 21 Apr 2003 | 9.32 | 15.99 | 11 Jan 2002 | 21 Apr 2013 | 2,250,966 | | 802,468 | 1,448,498 |
| <i>HSBC Bank Bermuda: Directors Share Option Plan</i> | | | | | | | | | |
| HSBC Holdings ordinary shares of US\$0.50 | | | | | | | | | |
| Dates of award | | Exercise price (US\$) | | Exercisable | | At | | | At |
| from | to | from | to | from | to | 1 Jan 2011 | Exercised during period | Lapsed during period | 30 Jun 2011 |
| 28 Mar 2001 | 3 Apr 2003 | 13.73 | 13.95 | 28 Mar 2002 | 3 Apr 2012 | 26,166 | | 9,285 | 16,881 |
| 227 | | | | | | | | | |

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HSBC HOLDINGS PLC

Additional Information (continued)

4 Notifiable interests in share capital

As at 30 June 2011, the following disclosures of major holdings of voting rights had been received by HSBC Holdings (and have not been subsequently amended or withdrawn) pursuant to the requirements of rule 5 of the FSA Disclosure Rules and Transparency Rules:

Legal & General Group Plc gave notice on 9 March 2010 that it had a direct interest on 8 March 2010 in 696,851,431 HSBC Holdings ordinary shares, representing 3.99% of the total voting rights at that date; and

BlackRock, Inc. gave notice on 9 December 2009 that on 7 December 2009 it had the following: an indirect interest in HSBC Holdings ordinary shares of 1,142,439,457; qualifying financial instruments with 705,100 voting rights that may be acquired if the instruments are exercised or converted; and financial instruments with similar economic effect to qualifying financial instruments which refer to 234,880 voting rights, each representing 6.56%, 0.0041% and 0.0013% respectively of the total voting rights at that date.

As at 30 June 2011, according to the register maintained by HSBC Holdings pursuant to section 336 of the Securities and Futures Ordinance of Hong Kong:

JPMorgan Chase & Co. gave notice on 27 May 2011 that on 24 May 2011 it had the following interests in HSBC Holdings ordinary shares: a long position of 1,226,942,153 shares; a short position of 131,511,811 shares; and a lending pool of 890,915,822 shares, each representing 6.89%, 0.74% and 5.00% respectively of the ordinary shares in issue at that date; and

BlackRock, Inc. gave notice on 13 May 2011 that on 11 May 2011 it had the following interests in HSBC Holdings ordinary shares: a long position of 1,060,826,866 shares and a short position of 25,971,269 shares, each representing 5.95% and 0.15% respectively of the ordinary shares in issue at that date.

5 Dealings in HSBC Holdings shares

Except for dealings as intermediaries by HSBC Bank plc and The Hongkong and Shanghai Banking Corporation Limited, which are members of a European Economic Area exchange, neither HSBC Holdings nor any subsidiary undertaking has bought, sold or redeemed any securities of HSBC Holdings during the six months to 30 June 2011.

6 First interim dividend for 2011

The first interim dividend for 2011 of US\$0.09 per ordinary share was paid on 6 July 2011.

7 Second interim dividend for 2011

The Directors have declared a second interim dividend for 2011 of US\$0.09 per ordinary share. The second interim dividend will be payable on 6 October 2011 to holders of record on 18 August 2011 on the Hong Kong Overseas Branch Register and 19 August 2011 on the Principal Register in the United Kingdom or the Bermuda Overseas Branch Register. The dividend will be payable in cash, US dollars, sterling or Hong Kong dollars, or a combination of these currencies, at the forward exchange rates quoted by HSBC Bank plc in London at or about 11.00 am on 26 September 2011, and with a scrip dividend alternative. Particulars of these arrangements will be sent to shareholders on or about 31 August 2011 and elections must be received by 21 September 2011.

The dividend will be payable on ordinary shares held through Euroclear France, the settlement and central depository system for Euronext Paris, on 6 October 2011 to the holders of record on 19 August 2011. The dividend will be payable by Euroclear France in cash in euros at the forward exchange rate quoted by HSBC France on 26 September 2011, or as a scrip dividend alternative. Particulars of these arrangements will be announced through Euronext Paris on 16 August and 24 August 2011.

The dividend will be payable on ADSs each of which represents five ordinary shares, on 6 October 2011 to holders of record on 19 August 2011. The dividend of US\$0.45 per ADS will be payable by the depository in cash, in US dollars and with a scrip dividend alternative of new ADSs. Particulars of these arrangements will be mailed to ADS holders on or about 31 August 2011. Elections must be received by the depository on or before 21 September 2011. Alternatively, the cash dividend may be invested in additional ADSs for participants in the dividend reinvestment plan operated by the depository.

Ordinary shares will be quoted ex-dividend in London, Hong Kong, Paris and Bermuda on 17 August 2011. The ADSs will be quoted ex-dividend in New York on 17 August 2011.

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HSBC HOLDINGS PLC

Additional Information (continued)

Any person who has acquired ordinary shares registered on the Hong Kong Overseas Branch Register but who has not lodged the share transfer with the Hong Kong Branch Registrar should do so before 4.00pm on 18 August 2011 in order to receive the dividend.

Any person who has acquired ordinary shares registered on the Principal Register in the United Kingdom or on the Bermuda Overseas Branch Register of shareholders but who has not lodged the share transfer with the Principal Registrar or the Bermuda Overseas Branch Registrar respectively, should do so before 4.00pm on 19 August 2011 in order to receive the dividend.

Removals of ordinary shares may not be made to or from the Hong Kong Overseas Branch Register on 19 August 2011. Accordingly any person who wishes to remove ordinary shares to the Hong Kong Overseas Branch Register must lodge the removal request with the Principal Registrar in the United Kingdom or the Bermuda Branch Registrar by 4.00pm on 17 August 2011; any person who wishes to remove ordinary shares from the Hong Kong Overseas Branch Register must lodge the removal request with the Hong Kong Branch Registrar by 4.00pm on 18 August 2011.

Transfers of ADSs must be lodged with the depository by 12 noon on 19 August 2011 in order to receive the dividend.

8 Proposed interim dividends for 2011

The Board has adopted a policy of paying quarterly dividends on the ordinary shares. Under this policy it is intended to have an annual pattern of three equal interim dividends with a variable fourth interim dividend. The proposed timetables for dividends payable on the ordinary shares in respect of 2011 that have not yet been declared are:

| | Third interim dividend for 2011 | Fourth interim dividend for 2011 |
|---|--|---|
| Announcement | 7 November 2011 | 27 February 2012 |
| Shares quoted ex-dividend in London, Hong Kong, Paris and Bermuda | 23 November 2011 | 14 March 2012 |
| ADSs quoted ex-dividend in New York | 23 November 2011 | 14 March 2012 |
| Record date in Hong Kong | 24 November 2011 | 15 March 2012 |
| Record date in London, New York, Paris and Bermuda ¹ | 25 November 2011 | 16 March 2012 |
| Payment date | 18 January 2012 | 2 May 2012 |

¹ Removals to and from the Overseas Branch Register of shareholders in Hong Kong will not be permitted on these dates.

9 Interim Management Statement

An *Interim Management Statement* is expected to be issued on 9 November 2011.

10 Final results

The results for the year to 31 December 2011 are expected to be announced on Monday 27 February 2012.

11 Corporate governance

HSBC is committed to high standards of corporate governance.

HSBC Holdings has complied throughout the six months to 30 June 2011 with the applicable code provisions of the UK Corporate Governance Code issued by the Financial Reporting Council and the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, save that the Group Risk Committee (all the members of which are independent non-executive Directors), which was established in accordance with the recommendations of the Report on Governance in UK banks and other financial industry entities, is responsible for the oversight of internal control (other than internal financial control) and risk management systems (Hong Kong code provisions C.3.3 paragraphs (f), (g) and (h)). If there were no risk committee, these matters would be the responsibility of an audit committee.

The Board of HSBC Holdings has adopted a code of conduct for transactions in HSBC Group securities by Directors. The code of conduct complies with The Model Code in the Listing Rules of the Financial Services Authority and with The Model Code for Securities Transactions by Directors of Listed Issuers (Hong Kong Model Code) set out in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, save that The Stock Exchange of Hong Kong Limited has granted certain waivers from strict compliance with the Hong Kong Model Code. The waivers granted by The Stock Exchange of Hong Kong Limited primarily take into account accepted practices in

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HSBC HOLDINGS PLC

Additional Information (continued)

the UK, particularly in respect of employee share plans. Following specific enquiry, each Director has confirmed that he or she has complied with the code of conduct for transactions in HSBC Group securities throughout the period.

There have been no material changes to the information disclosed in the *Annual Report and Accounts 2010* in respect of the number and remuneration of employees, remuneration policies, bonus and share option plans and training schemes save that shareholders approved the HSBC Share Plan 2011 at the 2011 Annual General Meeting.

The biographies of Directors on pages 165 to 170 and part 2 of this Additional Information Section on page 221 include changes during 2011 and the updated information required pursuant to rule 13.51B (1) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

12 Going concern basis

The financial statements are prepared on the going concern basis, as the Directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including projections of future profitability, cash flows and capital resources. Further information relevant to the assessment is provided elsewhere in this *Interim Report 2011*.

In particular, HSBC's principal activities and strategic direction are described in the Overview section and challenges and uncertainties, as well as HSBC's exposure to credit, liquidity and market risks, are described in the Risk section. Details of capital management and allocation are described in the Capital section.

13 Telephone and online share dealing service

For shareholders on the Principal Register who are resident in the UK, Channel Islands or Isle of Man with a UK, Channel Islands or Isle of Man postal address, and who hold an HSBC Bank personal current account, the HSBC InvestDirect share dealing service is available for buying and selling HSBC Holdings ordinary shares. Details are available from: HSBC InvestDirect, PO Box 1683, Frobisher House, Nelson Gate, Southampton, SO15 9DG, UK telephone : 08456 080 848, overseas telephone: + 44 (0) 1226 261090, textphone: 18001 08456 088 877, web: www.hsbc.co.uk/shares.

14 Stock symbols

HSBC Holdings plc ordinary shares of US\$0.50 trade under the following stock symbols:

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| | |
|-------------------------------|------|
| London Stock Exchange | HSBA |
| Hong Kong Stock Exchange | 5 |
| New York Stock Exchange (ADS) | HBC |
| Euronext Paris | HSB |
| Bermuda Stock Exchange | HSBC |

15 Copies of the *Interim Report 2011* and shareholder enquiries and communications

Further copies of the *Interim Report 2011* may be obtained from Group Communications, HSBC Holdings plc, 8 Canada Square, London E14 5HQ, United Kingdom; from Group Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong; from Internal Communications, HSBC North America, 26525 North Riverwoods Boulevard, Mettawa, Illinois 60045, USA; or from the HSBC website, www.hsbc.com.

Shareholders may at any time choose to receive corporate communications in printed form or to receive a notification of their availability on HSBC's website. To receive future notifications of the availability of a corporate communication on HSBC's website by email, or revoke or amend an instruction to receive such notifications by email, go to www.hsbc.com/ecomms. If you provide an email address to receive electronic communications from HSBC, we will also send notifications of your dividend entitlements by email. If you received a notification of the availability of this document on HSBC's website and would like to receive a printed copy, or if you would like to receive future corporate communications in printed form, please write or send an email to the appropriate Registrars at the address given below. Printed copies will be provided without charge.

Any enquiries relating to your shareholdings on the share register, for example transfers of shares, change of name or address, lost share certificates or dividend cheques, should be sent to the Registrars at the address given below. The

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HSBC HOLDINGS PLC

Additional Information (continued)

Registrars offer an online facility, Investor Centre, which enables shareholders to manage their shareholding electronically.

| <i>Principal Register</i> | <i>Hong Kong Overseas Branch Register</i> | <i>Bermuda Overseas Branch Register</i> |
|---|--|---|
| Computershare Investor Services PLC | Computershare Hong Kong Investor | Investor Relations Team |
| The Pavilions | Services Limited | HSBC Bank Bermuda Limited |
| Bridgwater Road | Rooms 1712-1716, 17th Floor | 6 Front Street |
| Bristol BS99 6ZZ | Hopewell Centre | Hamilton HM 11 |
| United Kingdom | 183 Queen s Road East | Bermuda |
| | Hong Kong | |
| Telephone: +44 (0) 870 702 0137 | Telephone: +852 2862 8555 | Telephone: +1 441 299 6737 |
| Email via website: | Email: hsbc.ecom@computershare.com.hk | Email: hbbm.shareholder.services@hsbc.bm |
| www.investorcentre.co.uk/contactus | | |
| Investor Centre: | Investor Centre: | Investor Centre: |
| www.computershare.com/investor/uk | www.computershare.com/hk/investors | www.computershare.com/investor/bm |
| Any enquiries relating to ADSs should be sent to the depository, The Bank of New York Mellon, at: | | |
| BNY Mellon Shareowner Services | | |
| PO Box 358516 | | |
| Pittsburgh | | |
| PA 15252-8516 | | |
| USA | | |
| Telephone (US): +1 877 283 5786 | | |
| Telephone (international): 201 680 6825 | | |
| Email: shrrelations@bnymellon.com | | |

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Website: www.bnymellon.com/shareowner

Any enquiries relating to shares held through Euroclear France, the settlement and central depository system for Euronext Paris, should be sent to the paying agent:

HSBC France

103 avenue des Champs Elysées

75419 Paris Cedex 08

France

Telephone: +33 1 40 70 22 56

Email: ost-agence-des-titres-hsbc-reims.hbfr-do@hsbc.fr

Website: www.hsbc.fr

A Chinese translation of this and future documents may be obtained on request from the Registrars. Please also contact the Registrars if you have received a Chinese translation of this document and do not wish to receive such translations in the future.

Persons whose shares are held on their behalf by another person may have been nominated to receive communications from HSBC pursuant to section 146 of the UK Companies Act 2006 (nominated person). The main point of contact for a nominated person remains the registered shareholder (for example your stockbroker, investment manager, custodian or other person who manages the investment on your behalf). Any changes or queries relating to a nominated person's personal details and holding (including any administration thereof) must continue to be directed to the registered shareholder and not HSBC's Registrars. The only exception is where HSBC, in exercising one of its powers under the UK Companies Act 2006, writes to a nominated person directly for a response.

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HSBC HOLDINGS PLC

Glossary

| Abbreviation | Brief description |
|------------------------|---|
| A | |
| ABS ¹ | Asset-backed security |
| ADS | American Depositary Share |
| Advance | HSBC Advance, a global banking proposition for the mass-affluent segment of customers |
| AIEA | Average interest-earning assets |
| ALCO | Asset and Liability Management Committee |
| AML | Anti-money laundering |
| ARM ¹ | Adjustable-rate mortgage |
| ASF | Asset and Structured Finance |
| B | |
| Bank of Communications | Bank of Communications Co., Limited, one of China's largest banks |
| Bao Viet | BaoViet Holdings, an insurance and financial services company in Vietnam |
| Barion | Barion Funding Limited, a term funding vehicle |
| Basel Committee | Basel Committee on Banking Supervision |
| Basel I | 1988 Basel Capital Accord |
| Basel II ¹ | 2006 Basel Capital Accord |
| Basel III ¹ | Basel Committee's reforms to strengthen global capital and liquidity rules |
| BBA | British Bankers' Association |
| bps | Basis points. One basis point is equal to one-hundredth of a percentage point |
| C | |
| CARD Act | Credit Card Accountability, Responsibility and Disclosure Act, US |
| CD | Certificate of deposit |
| CDS ¹ | Credit default swap |
| CDO ¹ | Collateralised debt obligation |
| CDPC ¹ | Credit derivative product companies |
| CGU | Cash-generating unit |
| CMB | Commercial Banking, a customer group |
| CNAV ¹ | Constant Net Asset Value |
| CP ¹ | Commercial paper |
| CPI | Consumer price index |
| CRR ¹ | Customer risk rating |
| D | |
| DPF | Discretionary participation feature of insurance and investment contracts |
| E | |
| EAD ¹ | Exposure at default |
| EL ¹ | Expected loss |
| EPS | Earnings per share |
| EU | European Union |
| F | |
| Fannie Mae | Federal National Mortgage Association, US |
| Freddie Mac | Federal Home Loan Mortgage Corporation, US |
| FSA | Financial Services Authority (UK) |
| FTSE | Financial Times Stock Exchange index |

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| | |
|----------------|--|
| G | |
| G20 | Leaders, finance ministers and central bank governors of the Group of Twenty countries |
| GB&M | Global Banking and Markets, a global business |
| GDP | Gross domestic product |
| Ginnie Mae | Government National Mortgage Association, US |
| Global Markets | HSBC's treasury and capital markets services in Global Banking and Markets |
| GMB | Group Management Board |
| GMO | Group Management Office |
| GPB | Global Private Banking, a global business |
| Group | HSBC Holdings together with its subsidiary undertakings |
| G-SIB | Global systemically important bank |
| G-SIFI | Global systemically important financial institution |

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HSBC HOLDINGS PLC

Glossary (continued)

| Abbreviation | Brief description |
|----------------------------|---|
| H | |
| Hang Seng Bank | Hang Seng Bank Limited, one of Hong Kong's largest banks |
| HELoC ¹ | Home equity lines of credit |
| HFC | HFC Bank Limited, the UK-based consumer finance business acquired through the acquisition of HSBC Finance by HSBC |
| HIBOR | Hong Kong Interbank Offer Rate |
| HKMA | Hong Kong Monetary Authority |
| Hong Kong | Hong Kong Special Administrative Region of the People's Republic of China |
| HSBC | HSBC Holdings together with its subsidiary undertakings |
| HSBC Assurances | HSBC Assurances, comprising Erisa S.A., the French life insurer, and Erisa I.A.R.D., the property and casualty insurer (together, formerly Erisa) |
| HSBC Bank | HSBC Bank plc, formerly Midland Bank plc |
| HSBC Bank Argentina | HSBC Bank Argentina S.A. |
| HSBC Bank Bermuda | HSBC Bank Bermuda Limited, formerly The Bank of Bermuda Limited |
| HSBC Bank Malaysia | HSBC Bank Malaysia Berhad |
| HSBC Bank Middle East | HSBC Bank Middle East Limited, formerly The British Bank of the Middle East |
| HSBC Bank USA | HSBC's retail bank in the US, HSBC Bank USA, N.A. (formerly HSBC Bank USA, Inc.) |
| HSBC Finance | HSBC Finance Corporation, the US consumer finance company (formerly Household International, Inc.) |
| HSBC France | HSBC's French banking subsidiary, formerly CCF S.A. |
| HSBC Holdings | HSBC Holdings plc, the parent company of HSBC |
| HSBC Private Bank (Suisse) | HSBC Private Bank (Suisse) S.A., HSBC's private bank in Switzerland |
| I | |
| IAS | International Accounting Standards |
| IASB | International Accounting Standards Board |
| IFRIC | International Financial Reporting Interpretations Committee |
| IFRSs | International Financial Reporting Standards |
| Industrial Bank | Industrial Bank Co. Limited, a national joint-stock bank in mainland China held by Hang Seng Bank |
| IRB ¹ | Internal ratings-based |
| K | |
| KPMG | KPMG Audit Plc and its affiliates |
| L | |
| LGD ¹ | Loss given default |
| LIBOR | London Interbank Offered Rate |
| Losango | Losango Promoções e Vendas Ltda, the Brazilian consumer finance company |
| M | |
| M&S Money | Marks and Spencer Retail Financial Services Holdings Limited |
| Madoff Securities | Bernard L Madoff Investment Securities LLC |
| Mainland China | People's Republic of China excluding Hong Kong |
| Malachite | Malachite Funding Limited, a term funding vehicle |
| Mazarin | Mazarin Funding Limited, an asset-backed CP conduit |
| MBS ¹ | US mortgage-backed security |
| MENA | Middle East and North Africa |
| Monoline ¹ | Monoline insurance company |
| MSCI | Morgan Stanley Capital International index |
| MTN ¹ | Medium-term notes |

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N
NYSE

New York Stock Exchange

O
OFAC
OIS¹
OTC¹

Office of Foreign Assets Control
Overnight Index Swap
Over-the-counter

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HSBC HOLDINGS PLC

Glossary (continued)

| Abbreviation | Brief description |
|---|---|
| P | |
| PD ¹ | Probability of default |
| Performance Shares ¹ | Awards of HSBC Holdings ordinary shares under employee share plans that are subject to corporate performance conditions |
| Ping An | Ping An Insurance (Group) Company of China, Limited, the second-largest life insurer in the People's Republic of China |
| PPI | Payment protection insurance product |
| Premier | HSBC Premier, HSBC's premium global banking service |
| PVIF | Present value of in-force long-term insurance business |
| R | |
| RBWM | Retail Banking and Wealth Management, a customer group |
| Repo ¹ | Sale and repurchase transaction |
| Restricted Shares ¹ | Awards of Restricted Shares define the number of HSBC Holdings ordinary shares to which the employee will become entitled, generally between one and three years from the date of the award, and normally subject to the individual remaining in employment |
| Reverse repo | Security purchased under commitments to sell |
| RPI | Retail price index (UK) |
| RoRWA | Return on average risk weighted assets |
| RWA ¹ | Risk-weighted assets |
| S | |
| S&P | Standard and Poor's rating agency |
| SEC | Securities and Exchange Commission (US) |
| SIC | Securities investment conduit |
| SIV ¹ | Structured investment vehicle |
| SME | Small and medium-sized enterprise |
| Solitaire | Solitaire Funding Limited, a special purpose entity managed by HSBC |
| SPE ¹ | Special purpose entity |
| STIP | Short-term income protection insurance product |
| T | |
| The Hongkong and Shanghai Banking Corporation | The Hongkong and Shanghai Banking Corporation Limited, the founding member of the HSBC Group |
| U | |
| UAE | United Arab Emirates |
| UK | United Kingdom |
| US | United States of America |
| V | |
| VAR ¹ | Value at risk |

¹ For full definitions, see page 236.

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|--|---|
| A | |
| Adjustable-rate mortgages (ARM s) | Mortgage loans in the US on which the interest rate is periodically changed based on a reference price. These are included within affordability mortgages . |
| Affordability mortgages | Mortgage loans where the customer s monthly payments are set out at a low initial rate, either variable or fixed, before resetting to a higher rate once the introductory period is over. |
| Agency exposures | Exposures to near or quasi-government agencies including public sector entities fully owned by governments carrying out non-commercial activities, provincial and local government authorities, development banks and funds set up by government. |
| Alt-A | A US description for loans regarded as lower risk than sub-prime, but with higher risk characteristics than lending under normal criteria. |
| Arrears | Customers are said to be in arrears (or in a state of delinquency) when they are behind in fulfilling their obligations, with the result that an outstanding loan is unpaid or overdue. When a customer is in arrears, the total outstanding loans on which payments are overdue are described as delinquent. |
| Asset-backed securities (ABS s) | Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages. |
| B | |
| Back-testing | A statistical technique used to monitor and assess the accuracy of a model, and how that model would have performed had it been applied in the past. |
| Bail-in/Bail-inable debt | Bail-in refers to the imposition of losses at the point of non-viability (but before insolvency) on bank liabilities (bail-inable debt) that are not exposed to losses while the institution remains a viable, going concern. Whether by way of write-down or conversion into equity, this has the effect of recapitalising the bank (although it does not provide any new funding). |
| Basel II | The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the International Convergence of Capital Measurement and Capital Standards . |
| Basel III | In December 2010, the Basel Committee issued final rules Basel III: A global regulatory framework for more resilient banks and banking systems and Basel III: International framework for liquidity risk measurement, standards and monitoring . Together these documents present the Basel Committee s reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019. |
| C | |
| Capital conservation buffer | A capital buffer, prescribed by regulators under Basel III, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank s capital levels fall within the capital conservation buffer range, dividends and share buybacks, discretionary payments on non-equity capital instruments and discretionary bonus payments to staff will be constrained by the regulators. |
| Capital planning buffer | A capital buffer, prescribed by the FSA under Basel II, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank s capital levels fall within the capital planning buffer range, a period of heightened regulatory interaction would be triggered. |
| Collateralised debt obligation (CDO) | A security issued by a third-party which references ABSs and/or certain other related assets purchased by the issuer. CDOs may feature exposure to sub-prime mortgage assets through the underlying assets. |
| Collectively assessed impairment | Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment. |
| Commercial paper (CP) | An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. The debt is usually issued at a discount, reflecting prevailing market interest rates. |

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| | |
|--|---|
| Commercial real estate | Any real estate investment, comprising buildings or land, intended to generate a profit, either from capital gain or rental income. |
| Common equity tier 1 capital | The highest quality form of regulatory capital under Basel III that comprises common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments. |
| Conduits | HSBC sponsors and manages multi-seller conduits and securities investment conduits (SIC s). The multi-seller conduits hold interests in diversified pools of third-party assets such as vehicle loans, trade receivables and credit card receivables funded through the issuance of short-dated commercial paper and supported by a liquidity facility. The SICs hold predominantly asset-backed securities referencing such items as commercial and residential mortgages, vehicle loans and credit card receivables funded through the issuance of both long-term and short-term debt. |
| Constant net asset value fund (CNAV) | A fund that prices its assets on an amortised cost basis, subject to the amortised book value of the portfolio remaining within 50 basis points of its market value. |
| Contractual maturities | The date on which the final payment (principal or interest) of any financial instrument is due to be paid, at which point all the remaining outstanding principal and interest have been repaid. |
| Core tier 1 capital | The highest quality form of regulatory capital that comprises total shareholders equity and related non-controlling interests, less goodwill and intangible assets and certain other regulatory adjustments. |

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|--|---|
| Countercyclical capital buffer | A capital buffer, prescribed by regulators under Basel III, which aims to ensure that capital requirements take account of the macro-financial environment in which banks operate. This will provide the banking sector with additional capital to protect it against potential future losses, when excess credit growth in the financial system as a whole is associated with an increase in system-wide risk. |
| Credit default swap (CDS) | A derivative contract whereby a buyer pays a fee to a seller in return for receiving a payment in the event of a defined credit event (e.g. bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency) on an underlying obligation (which may or may not be held by the buyer). |
| Credit derivative product company (CDPC) | Independent company that specialises in selling credit default protection on corporate exposures in the form of credit derivatives. |
| Credit enhancements | Facilities used to enhance the creditworthiness of financial obligations and cover losses due to asset default. |
| Credit risk | Risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises mainly from direct lending, trade finance and leasing business, but also from products such as guarantees, derivatives and debt securities. |
| Credit risk adjustment | An adjustment to the valuation of OTC derivative contracts to reflect the creditworthiness of OTC derivative counterparties. |
| Credit risk mitigation | A technique to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantee and credit protection. |
| Credit risk spread | The premium over the benchmark or risk-free rate required by the market to accept a lower credit quality. The yield spread between securities with the same coupon rate and maturity structure but with different associated credit risks. The yield spread rises as the credit rating worsens. |
| Customer deposits | Money deposited by account holders. Such funds are recorded as liabilities. |
| Customer risk rating (CRR) | A scale of 23 grades measuring internal obligor probability of default. |
| D | |
| Debt restructuring | A restructuring by which the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction. |
| Debt securities | Financial assets on the Group's balance sheet representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by central banks. |
| Debt securities in issue | Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are financial liabilities of the Group and include certificates of deposits. |
| Delinquency | See Arrears . |
| E | |
| Economic capital | The internally calculated capital requirement which is deemed necessary by HSBC to support the risks to which it is exposed at a confidence level consistent with a target credit rating of AA. |
| Economic profit | The difference between the return on financial capital invested by shareholders and the cost of that capital. Economic profit may be expressed as a whole number or as a percentage. |
| Equity risk | The risk arising from positions, either long or short, in equities or equity-based instruments, which create exposure to a change in the market price of the equities or equity instruments. |
| Expected loss (EL) | A regulatory calculation of the amount expected to be lost on an exposure using a 12-month time horizon and downturn loss estimates. EL is calculated by multiplying the Probability of Default (a percentage) by the Exposure at Default (an amount) and Loss Given Default (a percentage). |
| Exposure | A claim, contingent claim or position which carries a risk of financial loss. |
| Exposure at default (EAD) | The amount expected to be outstanding after any credit risk mitigation, if and when the counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures. |

F

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| | |
|------------------------|---|
| Fair value adjustment | An adjustment to the fair value of a financial instrument which is determined using a valuation technique (level 2 and level 3) to include additional factors that would be considered by a market participant that are not incorporated within the valuation model. |
| First lien | A security interest granted over an item of property to secure the repayment of a debt that places its holder first in line to collect repayment from the sale of the underlying collateral in the event of a default on the debt. |
| Forbearance strategies | Strategies that are employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Such arrangements include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures, and loan restructures (which includes loan modifications and re-ages). |
| Funded exposures | A funded exposure is one where the notional amount of a contract is or has been exchanged. |
| Funding risk | A form of liquidity risk arising when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required. |

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|--|--|
| G | |
| Government-sponsored enterprises (GSE s) | A group of financial services enterprises created by the US Congress. Their function is to reduce the cost of capital for certain borrowing sectors of the economy, and to make them more efficient and transparent. Examples in the residential mortgage borrowing segment are Freddie Mac and Fannie Mae. GSEs carry the implicit backing, but are not direct obligations, of the US Government. |
| GPSP awards | Awards that define the number HSBC Holdings ordinary shares to which the employee will become entitled, generally five years from the date of the award, and normally subject to the individual remaining in employment. The shares to which the employee becomes entitled are subject to a retention requirement until cessation of employment. |
| H | |
| Historical rating transition matrices (HRTM) | HRTMs show the probability of a counterparty with a particular rating moving to a different rating over a defined time horizon. |
| Home Equity Lines of Credit (HELoC s) | A form of revolving credit facility provided to US customers, which is supported by a first or second lien charge over residential property. |
| I | |
| Impaired loans | Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due. |
| Impairment allowances | Management s best estimate of losses incurred in the loan portfolios at the balance sheet date. |
| Individually assessed impairment | Exposure to loss is assessed on all individually significant accounts and all other accounts that do not qualify for collective assessment. |
| Insurance risk | A risk, other than a financial risk, transferred from the holder of a contract to the insurance provider. The principal insurance risk is that, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income. |
| Internal Capital Adequacy Assessment Process | The Group s own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints. |
| Internal Model Method (IMM) | One of three approaches defined by Basel II to determine exposure values for counterparty credit risk. |
| Internal ratings-based approach (IRB) | A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters. |
| Invested capital | Equity capital invested in HSBC by its shareholders. |
| IRB advanced approach | A method of calculating credit risk capital requirements using internal PD, LGD and EAD models. |
| IRB foundation approach | A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD. |
| ISDA | International Swaps and Derivatives Association. |
| ISDA Master agreement | Standardised contract developed by ISDA used as an umbrella contract under which bilateral derivatives contracts are entered into. |
| K | |
| Key management personnel | Directors and Group Managing Directors of HSBC Holdings. |
| L | |
| Level 1 quoted market price | Financial instruments with quoted prices for identical instruments in active markets. |
| Level 2 valuation technique using observable inputs | Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable. |
| Level 3 valuation technique with significant unobservable inputs | Financial instruments valued using valuation techniques where one or more significant inputs are unobservable. |

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| | |
|-----------------------------|--|
| Leveraged finance | Funding provided for entities with higher than average indebtedness, which typically arises from sub-investment grade acquisitions or event-driven financing. |
| Leverage ratio | A measure, prescribed by regulators under Basel III, which is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and should generally follow the accounting measure of exposure. This supplementary measure to the risk-based capital requirements is intended to constrain the build-up of excess leverage in the banking sector. |
| Liquidity risk | The risk that HSBC does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. |
| Loan modification | An account management action that results in a change to the original terms and conditions of a loan either temporarily or permanently without resetting its delinquency status, except in case of a modification re-age where delinquency status is also reset to up-to-date. Account modifications may include revisions to one or more terms of the loan including, but not limited to, a change in interest rate, extension of the amortisation period, reduction in payment amount and partial forgiveness or deferment of principal. |
| Loan-to-value ratio (LTV) | A mathematical calculation that expresses the amount of the loan as a percentage of the value of security. A high LTV indicates that there is less cushion to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding loan balance. |

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|--|---|
| Loss given default (LGD) | The estimated ratio (percentage) of the loss on an exposure to the amount outstanding at default (EAD) upon default of a counterparty. |
| Loss severity | The realised amount of losses incurred (including ancillary amounts owed) when a loan is foreclosed or disposed of through the arrangement with the borrower. The loss severity is represented as a percentage of the outstanding loan balance. |
| M | |
| Market risk | The risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce income or portfolio values. |
| Medium term notes (MTN s) | Notes issued by corporates across a range of maturities. MTNs are frequently issued by corporates under MTN Programmes whereby notes are offered on a regular and continuous basis to investors. |
| Monoline insurers (monolines) | Entities which specialise in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as CDSs referencing the underlying exposures held. |
| Mortgage-backed securities (MBS s) | Securities that represent interests in groups of mortgages, which may be on residential or commercial properties. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal). When the MBS references mortgages with different risk profiles, the MBS is classified according to the highest risk class. |
| Mortgage-related assets | Assets which are referenced to underlying mortgages. |
| Mortgage vintage | The year a mortgage was originated. |
| N | |
| Negative equity mortgages | Equity is the value of the asset less the outstanding balance on the loan. Negative equity arises when the value of the property purchased is below the balance outstanding on the loan. |
| Net asset value per share | Total shareholders' equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue. |
| Net interest income | The amount of interest received or receivable on assets net of interest paid or payable on liabilities. |
| Net principal exposure | The gross principal amount of a financial asset after taking account of credit protection purchased but excluding the effect of any counterparty credit valuation adjustment to that protection. It includes assets that benefit from monoline protection, except where this protection is purchased with a CDS. |
| Non-conforming mortgages | US mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as with income self-certification), or where poor credit history increases the risk and results in pricing at a higher than normal lending rate. |
| O | |
| Overnight Index Swap (OIS) discounting | A method of valuing collateralised interest rate derivatives which uses a discount curve that reflects the overnight interest rate typically earned or paid in respect of collateral received. |
| Operational risk | The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. |
| Over-the-counter (OTC) | A bilateral transaction (e.g. derivatives) that is not exchange traded and that is valued using valuation models. |
| P | |
| Past due loans and advances | Loans on which repayments are overdue. |
| Performance Shares | Awards that define the number of HSBC Holdings ordinary shares to which the employee will become entitled subject to satisfaction of corporate performance conditions. |
| Prime | A US description for mortgages granted to the most creditworthy category of borrowers. |
| Private equity investments | Equity securities in operating companies not quoted on a public exchange, often involving the investment of capital in private companies or the acquisition of a public company that results in its delisting. |

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| | |
|-------------------------------|---|
| Probability of default (PD) | The probability that an obligor will default within a one-year time horizon. |
| R | |
| Re-age | A US account management action that results in the resetting of the contractual delinquency status of an account to up-to-date, without full repayment of all the arrears, upon fulfilment of certain requirements which indicate that payments are expected to be made in accordance with the contractual terms. It is our practice in the US to defer past due interest on re-aged real estate and personal non-credit card accounts to the end of the loan period. |
| Refi rate | The refi (or refinancing) rate is set by the European Central Bank (ECB) and is the price banks pay to borrow from the ECB. |
| Regulatory capital | The capital which HSBC holds, determined in accordance with rules established by the FSA for the consolidated Group and by local regulators for individual Group companies. |
| Renegotiated loans | Loans whose terms have been renegotiated and are treated as up-to-date loans for measurement purposes once the specified number and/or amount of qualifying payments required under the new arrangements have been received. |

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|---|--|
| Restricted Shares | Awards that define the number of HSBC Holdings ordinary shares to which the employee will become entitled, generally between one and three years from the date of the award, and normally subject to the individual remaining in employment. The shares to which the employee becomes entitled may be subject to a retention requirement. |
| Retail loans | Money lent to individuals rather than institutions. This includes both secured and unsecured loans such as residential mortgages, overdrafts and credit card balances. |
| Return on equity | Profit attributable to ordinary shareholders divided by average invested capital. |
| Risk appetite | An assessment of the types and quantum of risks to which HSBC wishes to be exposed. |
| Risk-weighted assets (RWA s) | Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure in accordance with the applicable Standardised or IRB approach rules. |
| S | |
| Sale and repurchase agreement (repo) | A repo is a short-term funding agreement that allows a borrower to create a collateralised loan by selling a financial asset to a lender. As part of the agreement the borrower commits to repurchase the security at a date in the future repaying the proceeds of the loan. For the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or a reverse repo. |
| Seasoning | The emergence of credit loss patterns in portfolios over time. |
| Second lien | A security interest granted over an item of property to secure the repayment of a debt that is issued against the same collateral as a first lien but that is subordinate to it. In the case of default, repayment for this debt will only be received after the first lien has been repaid. |
| Securitisation | A transaction or scheme whereby the credit risk associated with an exposure, or pool of exposures, is tranching and where payments to investors in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures. A traditional securitisation involves the transfer of the exposures being securitised to an SPE which issues securities. In a synthetic securitisation, the tranching is achieved by the use of credit derivatives and the exposures are not removed from the balance sheet of the originator. |
| Single-issuer liquidity facility | A liquidity or stand-by line provided to a corporate customer which is different from a similar line provided to a conduit funding vehicle. |
| Sovereign exposures | Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks. |
| Special purpose entities (SPE s) | A corporation, trust or other non-bank entity, established for a narrowly defined purpose, including for carrying on securitisation activities. The structure of the SPE and its activities are intended to isolate its obligations from those of the originator and the holders of the beneficial interests in the securitisation. |
| Standardised approach | In relation to credit risk, a method for calculating credit risk capital requirements using External Credit Assessment Institutions (ECAI) ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of a supervisory defined percentage charge to the gross income of eight specified business lines. |
| Structured finance / notes | An instrument whose return is linked to the level of a specified index or the level of a specified asset. The return on a structured note can be linked to equities, interest rates, foreign exchange, commodities or credit. Structured notes may or may not offer full or partial capital protection in the event of a decline in the underlying index or asset. |
| Structured Investment Vehicles (SIV s) | Special purpose entities which invest in diversified portfolios of interest-earning assets, generally funded through issues of commercial paper, medium-term notes and other senior debt to take advantage of the spread differentials between the assets in the SIV and the funding cost. |
| Student loan related assets | Securities with collateral relating to student loans. |
| Subordinated liabilities | Liabilities which rank after the claims of other creditors of the issuer in the event of insolvency or liquidation. |
| Sub-prime | A US description for customers with high credit risk, for example those who have limited credit histories, modest incomes, high debt-to-income ratios, high loan-to-value ratios (for real estate secured products) or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related problems. |

| | |
|-----------------------------|--|
| T | |
| Tier 1 capital | A component of regulatory capital, comprising core tier 1 and other tier 1 capital. Other tier 1 capital includes qualifying capital instruments such as non-cumulative perpetual preference shares and hybrid capital securities. |
| Tier 2 capital | A component of regulatory capital, comprising qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. Tier 2 capital also includes reserves arising from the revaluation of properties. |
| Troubled debt restructuring | A US description for restructuring a debt whereby the creditor for economic or legal reasons related to a debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. |

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HSBC HOLDINGS PLC

Glossary (continued)

| Term | Definition |
|--|---|
| U | |
| Unfunded exposures | An exposure where the notional amount of a contract has not been exchanged. |
| US government agency and US government sponsored enterprises mortgage-related assets | Securities that are guaranteed by US government agencies such as Ginnie Mae, or by US government sponsored entities including Fannie Mae and Freddie Mac. |
| V | |
| Value-at-risk (VAR) | A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence. |
| W | |
| Wholesale lending | Money lent to sovereign borrowers, banks, non-bank financial institutions and corporate entities. |
| Write-down | Reduction in the carrying value of an asset due to impairment or fair value movements. |
| Wrong-way risk | An adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction. |

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SIGNATURE

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

HSBC Holdings plc

By: /s/ I J Mackay

Name: I J Mackay

Title: Chief Finance Director

5 August 2011