COMPANY NUMBER 14259

HSBC BANK PLC

ANNUAL REPORT AND ACCOUNTS
FOR THE YEAR ENDED
31 DECEMBER 2004

Annual Report and Accounts 2004

Contents

Presentation of Information

This document comprises the *Annual Report and Accounts 2004* for HSBC Bank plc (the 'bank') and its subsidiary undertakings (together the 'group'). It contains the Directors' Report and Accounts, together with the Auditors' report, as required by the UK Companies Act 1985.

Business Highlights 2004

- Operating income up £563 million, 7 per cent
- Profit before tax up £348 million, 16 per cent

UK Personal Banking – profit up £102 million or 15 per cent
- Strong growth in mortgages and personal lending, particularly in the UK *
  - 20 per cent rise in mortgages, offset by the impact of lower pricing
  - average consumer lending up 20 per cent as demand remained strong
  - market share gained in UK consumer lending and mortgages
- Strong growth in current, savings and deposit account balances *
  - HSBC recruited over 488,000 net new current accounts
  - significant growth in UK *Premier* Savings accounts
- Acquisition of Marks and Spencer Retail Financial Services Holdings Limited ('M&S Money') in November 2004 will place HSBC as one of the top credit card issuers in the UK

UK Commercial Banking – profit up £140 million, or 24 per cent
- Strong growth in current account customers
- Over 100,000 start up business accounts were opened in 2004
- Favourable economic conditions boosted the demand for credit in the UK
- 21 Corporate Banking Centres were launched in the UK to service top tier customers
- A further 209 Commercial Centres were established in the UK
- Awarded 'Best Clearing Bank for Small Businesses' by the Forum of Private Business

UK Corporate, Investment Banking and Markets – profit down £206 million, or 26 per cent
- Subdued demand for corporate loans and bond issues
- Reduced level of corporate activity
- Strong growth in foreign exchange and derivatives revenues
- Significant restructuring expenditure on IT systems and people

France – profit up £114 million, or 42 per cent
- Lower provisions for bad debts and contingent liabilities
- Mortgage lending up 15 per cent and consumer lending up 9 per cent
- Strong growth in sight deposits
- Growth in life assurance and brokerage fees

Private Banking – profit up £51 million, or 18 per cent
- Strong demand for credit with clients borrowing to leverage their investments
- Funds under management up 9 per cent to £78.9 billion
- £1.6 billion of clients' monies invested in Household European commercial paper
- New unified brand launched

Costs – up by £387 million, or 7 per cent
- Flat staff costs in both UK personal and commercial banking
- £134 million of additional costs, primarily for the expansion of Corporate, Investment Banking and Markets capabilities in the UK
- Prior year included the benefit of a £43 million write-back of negative goodwill in respect of Merrill Lynch HSBC
- £37 million from the write-off of goodwill on three small subsidiaries in France
- £44 million increase in IT related costs included systems development for the UK credit card and banking systems, preparation for International Financial Reporting Standards (IFRS), and Basel 2 capital adequacy requirements in France
- £21 million from the inclusion of M&S Money
- £20 million increase in costs in Private Banking reflecting front office recruitment and higher performance-related bonuses in line with revenue growth
- Additional marketing costs to support product promotions and expand TV brand advertising in the UK

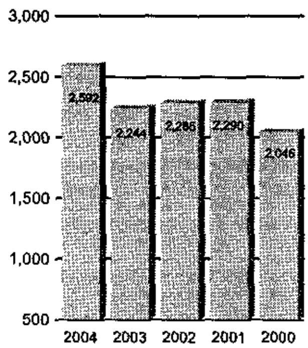
Provisions for bad and doubtful debts – down £58 million, or 13 per cent
- Releases and recoveries in the corporate sector partly offset by rising provisions in both consumer lending and the commercial sector

** Balances quoted exclude the impact of the acquisition of M&S Money*

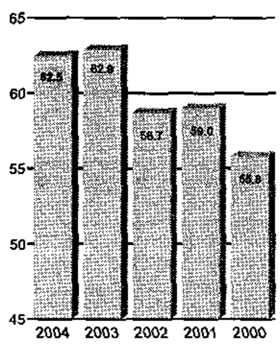
Financial Highlights

	2004	2003	2002	2001	2000
For the year (excluding goodwill amortisation) (£m)					
Profit on ordinary activities before tax	**3,145**	2,810	2,773	2,757	2,163
Profit attributable to shareholders	**2,207**	2,046	1,867	1,937	1,503
For the year (as reported) (£m)					
Profit on ordinary activities before tax	**2,592**	2,244	2,285	2,290	2,046
Profit attributable to shareholders	**1,654**	1,480	1,379	1,470	1,386
At year-end (£m)					
Shareholders' funds	**17,961**	17,064	16,455	15,648	14,873
Capital resources	**16,424**	14,603	12,768	12,209	11,527
Customer accounts and deposits by banks	**193,799**	175,390	155,234	147,665	131,329
Total assets	**289,975**	246,104	218,378	202,309	185,426
Ratios (%)					
Return on average shareholders' funds (equity)	**9.2**	8.5	8.5	9.3	18.7
Capital ratios					
— total capital	**10.5**	10.7	10.3	10.7	10.7
— tier 1 capital	**7.4**	7.4	7.1	6.8	6.5
Cost:income ratio (excluding goodwill amortisation)	**62.5**	62.9	58.7	59.0	55.8

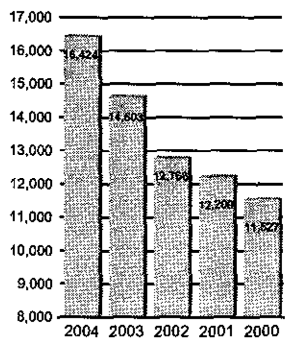
Profit on ordinary activities before tax (as reported) (£m)



Cost:income ratio (%)



Capital resources (£m)



The financial highlights are influenced by changes in the group structure over the five years. The most significant acquisitions are as follows: in 2001, HSBC Investment Bank Asia Limited, Banque Hervet, Demirbank TAS, HSBC Guyerzeller Bank AG; in 2002, HSBC Trinkaus & Burkhardt KGaA, HSBC Republic Bank (UK) Limited and activities of HSBC Investment Bank plc ; in 2004, Marks and Spencer Retail Financial Services Holdings Limited.

Financial Review

Summary of Financial Performance

Consolidated Profit and Loss Account

	2004 £m	2003 £m
Net interest income	4,474	4,272
Other operating income	4,637	4,276
Operating income	9,111	8,548
Administrative expenses	(5,167)	(4,886)
Depreciation and amortisation		
— tangible fixed assets	(526)	(491)
— intangible fixed assets	(1)	(1)
— goodwill	(553)	(482)
Operating profit before provisions	2,864	2,688
Provisions		
— provisions for bad and doubtful debts	(378)	(436)
— provisions for contingent liabilities and commitments	(36)	(45)
Amounts written off fixed asset investments	(11)	(28)
Operating profit	2,439	2,179
Share of operating profit/(loss) in joint ventures and associates	15	(57)
Gains/(losses) on disposal of		
— interests in joint ventures and associates	(1)	1
— investments	134	137
— tangible fixed assets	5	(16)
Profit on ordinary activities before tax	2,592	2,244
Tax on profit on ordinary activities	(766)	(641)
Profit on ordinary activities after tax	1,826	1,603
Minority interests		
— equity	(50)	(43)
— non-equity	(122)	(80)
Profit attributable to shareholders	1,654	1,480

Profit/(loss) on ordinary activities before tax

	2004 £m	2003 £m
UK Personal Banking	789	687
UK Commercial Banking	726	586
UK Corporate, Investment Banking and Markets	576	782
International Banking	258	144
France	385	271
Private Banking	341	290
HSBC Trinkaus & Burkhardt	70	50
Amortisation of goodwill including goodwill on joint ventures	(553)	(566)
	2,592	2,244

The **UK** economy expanded by 3.0 per cent during 2004 though, after a strong first half, growth decelerated sharply in the third quarter across most sectors. The rate of growth in consumer spending also slowed during the year. Growing uncertainty surrounding the outlook for house prices contributed to a slowdown in housing transactions in the second half of the year and an associated easing in domestic appetite for further credit. However, HSBC expects an increase in real income growth compared with 2003 and stability in levels of employment to continue to provide support for resilient consumer spending in the coming months. In the UK industrial sector, companies were generally cautious about their employment and investment intentions, with some nervousness over the state of the global and domestic recovery and the outlook for oil prices. Although confidence within the industrial sector appeared to be growing, the official data showed that manufacturing activity continued to contract, lagging the global recovery.

The **euro zone** recovery, which got under way in the middle of 2003, continued in the first half of 2004. However, the year-on-year growth rate began to fall in the latter six months of 2004 from an expected peak of 2.1 per cent in the second quarter to 1.8 per cent in the third quarter. Exports were strong, particularly in the first half of 2004, with year-on-year growth of 7.6 per cent in the second quarter, but export growth slowed in the second half when there was little evidence of benefits feeding through into consumer spending and fixed investment. Companies were reluctant to take on extra workers and, in Germany, concerns about the economic reform process seemed to encourage higher household savings. Companies also appeared reluctant to invest, possibly because of the debt build-up in the late 1990s. Euro zone inflation moved back above the European Central Bank's ('ECB') 2 per cent target in the spring, reaching 2.5 per cent by May and remaining above 2 per cent in the remainder of the year. However, the headline inflation rate was boosted by higher oil prices, health charges and tobacco duties. Excluding these factors, underlying inflation was little changed at around 1.6 per cent.

The ECB kept its key interest rate constant at 2 per cent throughout the year. On a trade weighted basis, the euro fell back in February and March but rose sharply in the autumn, and by December had moved above its January 2004 peak. Also in December, the euro reached record highs against the US dollar since its introduction in 1999. Euro zone bond yields fell during 2004 for 10-year bonds from 4.3 per cent to 3.7 per cent.

Profit on ordinary activities before tax increased by £348 million or 16 per cent compared with last year, as the benefits of the stable economic environment, strong growth in the housing market, and low interest rates flowed through to strong demand for consumer credit and an upturn for commercial clients.

Net interest income increased by 5 per cent as strong growth in personal and commercial lending during the year amplified the benefit of four interest rate rises on higher levels of UK current, savings and deposit accounts. While growth in UK consumer lending, credit cards and mortgages, in a buoyant housing market, was partly offset by lower pricing, strong recruitment of both personal and commercial customers was reflected in the growth in both loans and current accounts, generating new cross-sales opportunities. Treasury earnings in the UK declined as run-off of higher-yielding assets were replaced by investments at lower prevailing money market rates. Concerns over interest rate rises, the Iraq crisis and oil prices at recent highs muted the demand for corporate credit, while corporate and institutional account balances fell as the level of customer activity reduced. The acquisition of M&S Money in November 2004 contributed £19 million to the overall increase in net interest income.

Expansion of HSBC's *Premier* banking service in the UK saw significant growth in *Premier* savings accounts following a series of marketing and pricing initiatives. The number of *Premier* customers increased by 29 per cent and overall UK savings balances grew by 7 per cent to £22.8 billion. Commercial current account customers in the UK increased by 8 per cent in 2004, following a number of successful marketing promotions and a rise in customer recommendations. Average business current account balances increased by 17 per cent, but the benefit was partly offset by narrower spreads as customers migrated to interest bearing accounts. HSBC's popular business money manager account benefited from a combination of strong growth in volumes and widening spreads as interest rates rose.

Consumer lending revenues grew strongly as the introduction of new risk-based pricing initiatives and an increase in the average loan size contributed to a 22 per cent rise in UK personal loans. Market share increased by 66 basis points to 6.92 per cent. HSBC's credit card businesses benefited from the continued strength of consumer expenditure combined with highly competitive pricing, successful promotional campaigns and cross-sales coming from new mortgages and current accounts. Excluding the addition of M&S Money's credit card portfolio, average credit card balances increased by 19 per cent. UK residential mortgage balances grew by 20 per cent to £27.5 billion and gross new lending by 23 per cent to £13.5 billion as HSBC increased its market share to 4.2 per cent. A number of new products, including two fixed rate mortgages, were launched during the year, but pricing remained competitive despite the interest rate rises and the impact more than offset the benefit of volume growth.

Commercial lending benefited from the economic upturn in the UK and loans increased by 22 per cent to £11.3 billion, comfortably ahead of the 13 per cent rise in the general market. The income benefit, however, was partly offset by narrower spreads as competitive pressure on new lending business intensified. Commercial mortgages increased by £226 million, with record monthly sales achieved in December, following a relaunch early in the year. Overall, UK commercial lending added £27 million to the increase in net interest income.

Private banking lending grew by 20 per cent as clients in the UK and Switzerland leveraged their positions and borrowed to reinvest in higher-yielding securities and alternative investments. This, combined with a shift in proprietary investments from corporates to higher-yielding HSBC Finance Corporation (formerly Household International, Inc.) paper, contributed to the £2 million rise in net interest income.

Overall interest spread reduced by 15 basis points to 1.87 per cent as spreads on UK lending products fell and customers moved from interest free to interest bearing accounts. As a result, the margin fell by 18 basis points to 2.05 per cent.

Other operating income increased by 8 per cent. Strong growth in UK personal lending, mortgages and credit cards was reflected in an increase in fee income,

Financial Review (continued)

while cross-sales opportunities boosted sales of protection products by 9 per cent. Volume growth and price increases in UK commercial banking led to a £15 million, or 42 per cent, increase in loan fee income while commercial credit card fee income benefited from higher consumer spending in the UK, rising by £24 million as transaction volumes increased. Card income also benefited from a reduction in the interchange rate and the recruitment of new customers. Revised fee charging and improved collection processes contributed to the 14 per cent increase in commercial overdraft fees, while sales of commercial wealth management products added £75 million to income, a rise of 18 per cent on 2003.

Asset management and private banking fees in France and Switzerland rose sharply as clients moved liquidity to higher-yielding investment products in the low interest rate environment, and rising equity markets increased the value of the extant book. Performance fees also benefited from £18 million of income from the Hermitage Fund. Funds under management grew by 13 per cent to £145.8 billion with net new money invested of £15.5 billion. New funds launched in 2004, included a private equity fund and several hedge funds, and private banking clients invested over £1.6 billion in the Household European Commercial Paper and Floating Rate Notes programmes.

In the UK, sales of investment products declined, however, reflecting uncertain market conditions, but customer preference for liquidity was reflected in the rise in current account balances. Foreign exchange and derivatives revenue in the UK increased due to higher customer volumes, driven in part by the expansion of business capabilities which commenced in the second half of 2003. However, fixed income revenues fell, reflecting lower volatility in credit spreads, and a reduced level of corporate debt issuance. These were partly mitigated by growth in volumes as HSBC increased its market share.

Operating expenses increased by £387 million, or 7 per cent, with M&S Money adding £21 million. Staff costs in both personal and commercial banking were held flat as a result of operating efficiencies and the further migration of processing activities to HSBC Group Service Centres. These were offset by significant restructuring costs in Corporate, Investment Banking and Markets as substantial expenditure was incurred on systems and people to improve client coverage. Four global sector heads were appointed for the industry teams based in the UK and 15 senior staff recruited in Investment Banking Advisory, while 63 additional staff were recruited to support the expansion of the cash equities, options, structured products and derivatives businesses. Overall the restructuring saw the departure of 856 staff and the recruitment of 1,051 during the year.

Other expenses grew by 9 per cent. Advertising and marketing expenditure increased in support of product promotions in a number of markets, TV brand advertising and, to a lesser extent, the rebranding of HSBC Private Bank. Development of the new Worldwide Household International Revolving Lending (WHIRL) credit card system by HSBC Finance Corporation added £13 million to costs in the UK while France also saw an increase in IT expenditure. Depreciation increased by 7 per cent reflecting a rise in assets leased to customers in the UK and the write-off of capitalised software costs in France, while the write-off of goodwill arising on three small CCF subsidiaries added £37 million to goodwill amortisation compared with a write back of £43 million of negative goodwill in respect of Merrill Lynch HSBC in 2003.

The **charge for bad and doubtful debts** was £58 million, or 13 per cent, lower than in 2003 as the effects of strong growth in unsecured personal lending, higher levels of UK personal bankruptcies following legislative changes in 2004, weakening credit quality as interest rates rose and an upturn in commercial bad debts was more than offset by corporate releases and recoveries. An increase in Commercial Banking bad debts reflected the collapse of an engineering group in the UK and a small number of delinquent accounts in the UK. Corporate lending weakness in the UK power generation sector which adversely affected 2003, was not repeated and there were a number of recoveries and releases of provisions made in 2003. Recoveries included a single name in the industrial sector in France. M&S Money added £33 million to the overall charge.

A number of provisions were raised against potential compensation claims for the mis-selling of mortgage endowment policies and investment products adding £27 million to **provisions for contingent liabilities and charges.**

In 2003, **income from joint ventures and associates** included a provision for impairment of goodwill on a UK fund management company acquired in 2000 as part of CCF.

Capital measurement and allocation

The Financial Services Authority (FSA) is the supervisor of the bank and the group and, in this capacity, receives information on capital adequacy and sets minimum capital requirements. Individual banking subsidiaries are directly regulated by the appropriate local banking supervisors, which set and monitor capital adequacy requirements for them.

Under the European Union's Banking Consolidation and Amending Directive (Directive 98/31/EC) to the Capital Adequacy Directive (CAD2), the FSA requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets.

The group's capital resources policy is to maintain its capital base through the diversification of its sources of capital and the efficient allocation of capital. It seeks to maintain at all times a prudent relationship between its total capital, as measured according to the criteria used by the FSA for supervisory purposes, and the varied risks of its business.

Capital adequacy is measured by the ratio of capital to risk-weighted assets, taking into account balance sheet assets and off-balance-sheet transactions, calculated for both the bank and the group on a consolidated basis.

The group's capital is divided into two tiers: tier 1, comprising shareholders' funds, innovative tier 1 securities and minority interests in tier 1 capital, but excluding revaluation reserves; and tier 2, comprising general loan loss provisions, property revaluation reserves, qualifying subordinated loan capital and minority and other interests in tier 2 capital. The amount of innovative tier 1 securities cannot exceed 15 per cent of overall tier 1 capital, qualifying tier 2 capital cannot exceed tier 1 capital, and term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of general provisions which may be included in tier 2 capital. The book values of goodwill, own shares held and intangible assets are deducted in arriving at tier 1 capital. Total capital is calculated by deducting the book values of unconsolidated investments, investments in the capital of banks, and certain regulatory items from the total of tier 1 and tier 2 capital.

In October 2004, the FSA published a consultation paper CP04/17 "Implications of a changing accounting framework". This paper sets out the FSA's proposed approach to assessing banks' capital adequacy after the implementation of IFRS. In the absence of the FSA's final rules on capital adequacy reporting under IFRS, which may be different from the proposals set out in CP04/17, HSBC will follow its proposals with effect from 1 January 2005.

Under the consultation paper, there will be changes to the measurement of banks' capital adequacy in a number of ways, the most significant of which for HSBC are set out below.

- The capital treatment for collective impairment provisions will be the same as previously for general provisions, i.e. they will be included in tier 2 capital. This is expected to have a positive impact on HSBC's total capital ratio.
- Under IFRS, dividends will not be recognised on the balance sheet until they are declared. This will give rise to an increase in shareholders' funds at the year-end which will reverse out when the dividend is declared. Banks will take the benefit of this increase to their regulatory capital until the dividend is declared, in line with the accounting treatment.

The remainder of the proposals in CP04/17 will have a smaller impact on HSBC. They include the reversal of the recognition of the assets and liabilities of defined benefit pension schemes. Instead, banks will deduct from capital their best estimate of the funds that will need to be paid into the schemes in addition to normal contributions over the next five years.

Financial Review (continued)

Regulatory capital position

The table below sets out the analysis of regulatory capital.

Composition of capital	2004 £m	2003 £m
Tier 1:		
Shareholders' funds	17,961	17,064
Minority interests	451	460
Innovative tier 1 securities	1,635	1,335
Less: property revaluation reserves	(134)	(69)
goodwill capitalised and intangible assets	(8,331)	(8,688)
Total qualifying tier 1 capital	11,582	10,102
Tier 2:		
Property revaluation reserves	134	69
General provisions	380	464
Perpetual subordinated loan	1,177	1,247
Term subordinated loan	3,717	3,407
Minority and other interests in tier 2 capital	711	716
Total qualifying tier 2 capital	6,119	5,903
Unconsolidated investments	(1,023)	(901)
Investments in other banks and other financial institutions	(225)	(462)
Other deductions	(29)	(39)
Total capital	16,424	14,603
Total risk-weighted assets	156,972	136,305
Capital ratios (per cent):		
Total capital	10.5	10.7
Tier 1 capital	7.4	7.4

The figures were computed in accordance with the EU Banking Consolidation Directive.

The increase of £1.5 billion in tier 1 capital was largely due to the issue of share capital of £0.7 billion, the issue of innovative tier 1 capital of £0.3 billion, retained profit of £0.2 billion and goodwill amortisation net of goodwill on acquisitions of £0.2 billion.

The increase of £0.2 billion in tier 2 capital in 2004 mainly reflects the proceeds of capital issues, net of redemptions and regulatory amortisation.

Total risk-weighted assets increased by £21 billion mainly due to growth in customer lending as well as the purchase of Marks and Spencer Retail Financial Services Holdings Limited.

Board of Directors and Senior Executives

Directors

S K Green, *Chairman*

Age 56. Chairman from 1 January 2005 and a Director since 1995. Deputy Chairman from 2003 to December 2004. Joined HSBC in 1982. Group Chief Executive of HSBC Holdings plc since 2003. Executive Director, Corporate, Investment Banking and Markets from 1998 to 2003. Group Treasurer of HSBC Holdings plc from 1992 to 1998. Chairman of HSBC Bank Middle East Limited and HSBC Private Banking Holdings (Suisse) S.A. A Director of The Bank of Bermuda Limited, CCF S.A., The Hongkong and Shanghai Banking Corporation Limited, Grupo Financiero HSBC, S.A. de C.V., HSBC North America Holdings Inc. and HSBC Trinkaus & Burkhardt KGaA.

M F Geoghegan CBE, *Chief Executive*

Age 51. A Director and Chief Executive since January 2004. Joined HSBC in 1973. An executive Director of HSBC Holdings plc since 1 March 2004. Group General Manager, HSBC Holdings plc, and President of HSBC Bank Brasil S.A.-Banco Múltiplo from 1997 to 2003. Responsible for all of HSBC's business throughout South America from 2000 to 2003. General Manager and Head of International of HSBC Bank plc from 1994 to 1997. A Director of CCF S.A. and HSBC Private Banking Holdings (Suisse) S.A. A non-executive Director and Chairman of Young Enterprise.

D D J John, *Chief Operating Officer*

Age 54. A Director and Chief Operating Officer since 2003. Joined HSBC in 1972. A Group General Manager of HSBC Holdings plc from 2000. Deputy Chairman and Chief Executive of HSBC Bank Malaysia Berhad from 1999 to 2002. Chief Executive Officer, The Hongkong and Shanghai Banking Corporation Limited in India from 1997 to 1999. General Manager for Wales from 1993 to 1997. Chairman of HSBC Bank A.S. and a Director of HSBC Bank Malta p.l.c.

C-H Filippi

Age 52. A Director since 2000. Joined CCF S.A. in 1987. A Group Managing Director of HSBC Holdings plc since March 2004. Chairman and Chief Executive Officer of CCF S.A. since March 2004. A Group General Manager of HSBC Holdings plc and Global Head of Corporate and Institutional Banking from 2001 to March 2004. Administrateur Directeur Général of CCF S.A. from 1998 until 2001.

J D Fishburn*

Age 58. A Director since 2003. Chairman of HFC Bank Limited and an independent non-executive Director of HSBC Finance Corporation.

C M S Jones*

Age 61. A Director since 2001. Chairman of James Beattie PLC.

A R D Monro-Davies*

Age 64. A Director since January 2004. Formerly Chief Executive Officer of Fitch Ratings.

H A Rose*

Age 64. A Director since 1997. Formerly Deputy Chairman of The Rover Group Limited.

P M Shawyer*

Age 54. A Director since November 2004. Formerly a Managing Partner of Deloitte and Touche LLP.

J Singh*

Age 53. A Director since 2001. Chairman and Chief Executive Officer of Edwardian Group Limited. Member of the Board of Warwick Business School.

J F Trueman*

Age 62. A Director since September 2004. Formerly Deputy Chairman of S G Warburg & Co. Ltd.

**Independent non-executive Director.*

Secretary

J H McKenzie

Age 51. Joined HSBC in 1987.

Registered Office: 8 Canada Square, London E14 5HQ

Board of Directors and Senior Executives (continued)

Senior Executives

I M Dorner
Age 50. General Manager, Northern, Scotland and Northern Ireland Division. Joined HSBC in 1986.

J D Garner
Age 35. General Manager, Customer Propositions. Joined HSBC in 2004.

G D Harvey-Samuel
Age 47. General Manager, Midlands Division. Joined HSBC in 1978.

A R Hill
Age 46. General Manager, Direct Businesses. Chief Executive Officer and Managing Director, HFC Bank Limited. Joined HFC in 1989.

A M Keir
Age 46. General Manager, Commercial Banking. Joined HSBC in 1981.

C G F Laughton-Scott
Age 48. Global Head of Corporate and Institutional Banking. Joined HSBC in 1986.

A M Mahoney
Age 42. General Manager, Western and Wales Division. Joined HSBC in 1983.

I D F Ogilvie
Age 45. Head of Human Resources. Joined HSBC in 1981.

M J Powell
Age 43. Treasurer and Head of Global Markets Europe and the Middle East. Joined HSBC in 1984.

G A Ronning
Age 57. Chief Financial Officer. Joined HSBC in 1991.

R G Spence
Age 45. General Manager, Southern Division. Joined HSBC in 1978.

R M Walker
Age 52. General Manager, Credit and Risk. Joined HSBC in 1975.

G F Williams
Age 56. Head of HSBC Technical Services Europe. Joined HSBC in 1986.

C P M Wills
Age 47. General Manager, Customer Service Delivery. Joined HSBC in 1978.

Report of the Directors

Results for 2004

The consolidated profit for the year attributable to the shareholders of the bank was £1,654 million.

A first interim dividend of £700 million was paid on the ordinary share capital during the year and the Directors have resolved to pay a second interim dividend for 2004 of £700 million.

Further information about the results is given in the consolidated profit and loss account on page 26.

Principal Activities and Business Review

The group provides a comprehensive range of banking and related financial services.

The bank divides its activities into the following business segments: UK Personal Banking; UK Commercial Banking; UK Corporate, Investment Banking and Markets; International Banking; France; HSBC Private Banking; and HSBC Trinkaus & Burkhardt.

UK Personal Banking provides current accounts, savings, personal lending, mortgages, cards and wealth management services to customers through a number of channels under the HSBC and First Direct brands.

UK Commercial Banking provides products and services to a broad range of commercial organisations from sole proprietors to major companies.

Corporate, Investment Banking and Markets, formed out of the alignment of Corporate and Institutional Banking, Global Markets UK and Investment Banking, provides tailored financial solutions to major government, corporate and institutional clients.

International Banking provides a range of retail financial services, primarily across Europe, to local and expatriate customers and wholesale banking to corporate and institutional clients.

In France, CCF offers a wide range of retail, commercial and asset management products to individuals, companies and institutional customers through a network of regional banks. During 2005, the HSBC brand will be rolled out across CCF's branches, including Banque de Picardie, Union Bancaire Privée and Banque Hervet's branches in the Paris region.

HSBC Private Banking offers an array of client services to high net worth customers, including advisory portfolio management, discretionary asset management, tax, trust and estate planning, mutual funds and currency and securities transactions.

HSBC Trinkaus & Burkhardt, based in Düsseldorf, Germany, offers a comprehensive range of services to wealthy private clients and medium sized companies, institutional investors, public corporations and financial institutions.

The bank has 1,576 branches in the United Kingdom. Outside the United Kingdom, it has branches in Australia, Belgium, Cyprus, the Czech Republic, France, Greece, Guernsey, the Hong Kong Special Administrative Region, Ireland, the Isle of Man, Israel, Italy, Jersey, the Netherlands, South Africa, Spain and Sweden; it has representative offices in Angola, Argentina, Bahrain, Côte d'Ivoire, Uganda and Venezuela; and it has subsidiaries in Armenia, France, Germany, Greece, Kazakhstan, Luxembourg, Malta, Poland, Russia, Spain, Switzerland and Turkey. Through these undertakings, the bank provides a comprehensive range of banking and related financial services.

In November 2004, the bank acquired 100 per cent of Marks and Spencer Retail Financial Services Holdings Limited for a consideration of £546 million.

The 'Financial Review' is given on pages 4 to 8.

Share Capital

In March 2004, HSBC Holdings plc subscribed £700 million for one additional ordinary share of £1 credited as fully paid in the ordinary share capital of the bank.

Save for this, there have been no other changes to the authorised or issued share capital of the bank in the year ended 31 December 2004.

Valuation of Freehold and Leasehold Land and Buildings

Freehold and long leasehold properties were revalued in September 2004 in accordance with the HSBC Group's policy of annual valuation. As a result of this revaluation, the net book value of land and buildings has increased by £71 million.

Further details are included in Note 21 'Tangible fixed assets' in the Notes on the Accounts.

Report of the Directors (continued)

Board of Directors

The objectives of the management structures within the bank, headed by the Board of Directors and led by the Chairman, are to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the bank's Executive Committee under the leadership of the Chief Executive.

The Board meets regularly and Directors receive information between meetings about the activities of committees and developments in the bank's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on page 9.

C F W de Croisset retired as a Director on 25 February 2004 and A C Reed retired as a non-executive Director on 26 May 2004. Sir John Bond retired as a Director and Chairman on 31 December 2004 and S K Green was appointed as Chairman on 1 January 2005.

M F Geoghegan was appointed as a Director and Chief Executive on 1 January 2004 and A R D Monro-Davies was appointed as a non-executive Director on the same date. J F Trueman and P M Shawyer were appointed as non-executive Directors on 29 September 2004 and 1 November 2004, respectively. Having been appointed since the last Annual General Meeting, P M Shawyer and J F Trueman will retire at the forthcoming Annual General Meeting and offer themselves for election.

Non-executive Directors are appointed for three year terms, subject to their re-election by shareholders at the subsequent Annual General Meeting. Independent non-executive Directors have no service contract and are not eligible to participate in the HSBC Group's share plans.

S K Green, D D J John and C M S Jones will retire by rotation at the forthcoming Annual General Meeting and they will offer themselves for re-election.

None of the Directors had, during the year or at the end of the year, a material interest, directly or indirectly, in any contract of significance with the bank or any of its subsidiary undertakings.

Board Committees

The Board has appointed a number of committees consisting of certain Directors and senior executives. The following are the principal committees:

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board. The members of the Executive Committee are M F Geoghegan (Chairman), D D J John, both of whom are executive Directors and A R Hill, A M Keir, C G F Laughton-Scott, M J Powell, G A Ronning and R M Walker, all of whom are senior executives.

Audit Committee

The Audit Committee meets regularly with the bank's senior financial, internal audit and compliance management and the external auditor to consider the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee are H A Rose (Chairman), A R D Monro-Davies, P M Shawyer and J F Trueman. A C Reed resigned as a Director and a member of the Audit Committee on 26 May 2004. P M Shawyer and J F Trueman were appointed as members of the Audit Committee on 29 September 2004 and 1 November 2004 respectively. All of the members of the Audit Committee who served during 2004 are, or were, independent non-executive Directors.

Remuneration Committee

The functions of the Remuneration Committee are fulfilled by the Remuneration Committee of the Board of the bank's parent company, HSBC Holdings plc.

Internal Control

The Directors are responsible for internal control in the group and for reviewing its effectiveness. Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material errors, losses or fraud. The procedures also enable the bank to discharge its obligations under the Handbook of Rules and Guidance issued by the Financial Services Authority, the bank's lead regulator.

The key procedures that the Directors have established are designed to provide effective internal control within the HSBC Group and accord with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales. Such procedures have been in place throughout the year and up to 28 February 2005, the date of approval of the *Annual Report and Accounts*. In the case of companies acquired during the year, the internal controls in place are being reviewed against the HSBC Group's benchmarks and they are being integrated into the HSBC Group's systems. The HSBC Group's key internal control procedures include the following:

- Authority to operate the bank is delegated to the Chief Executive who has responsibility for overseeing the establishment and maintenance of appropriate systems and controls and has authority to delegate such duties and responsibilities as he deems fit among the Directors and senior management. The appointment of executives to the most senior positions within the group requires the approval of the Board of Directors.
- Functional, operating, financial reporting and certain management reporting standards are established by HSBC Holdings' management for application across the whole HSBC Group. These are supplemented by operating standards set by the bank's management, as required.
- Systems and procedures are in place in the group to identify, control and report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error, unauthorised activities and fraud. Exposure to these risks is monitored by the bank's or major subsidiaries' executive committees, risk management committees and the asset and liability management committees.
- Comprehensive annual financial plans are prepared, reviewed and approved by the Board of Directors. Results are monitored regularly and reports on progress as compared with the related plan are prepared monthly.
- Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in the bank and major subsidiaries and aggregated for review of risk concentrations on an HSBC Group-wide basis.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in HSBC Holdings has been given responsibility to set policies, procedures and standards in the areas of: finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain global product lines.
- Policies and procedures have been established to guide the bank, subsidiary companies and management at all levels in the conduct of business to avoid reputational risk which can arise from social, ethical or environmental issues, or as a consequence of operational risk events. As a banking group, the HSBC Group's good reputation depends upon the way in which it conducts its business but it can also be affected by the way in which clients, to which it provides financial services, conduct their business.
- The internal audit function, which is centrally controlled, monitors compliance with policies and standards and the effectiveness of internal control structures across the HSBC Group. The work of the internal audit function is focused on areas of greatest risk to the HSBC Group as determined by a risk management approach. The head of this function reports to the Group Chairman and the HSBC Group Audit Committee.

The Audit Committee has kept under review the effectiveness of this system of internal control and has reported regularly to the Board of Directors. The key processes used by the Committee in carrying out its reviews include: regular reports from the heads of key risk functions; the production and regular updating of summaries of key controls measured against HSBC Group benchmarks which cover all internal controls, both financial and non-financial; annual confirmations from senior executives that there have been no material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

Reputational, Strategic and Operational Risk

The HSBC Group regularly updates its policies and procedures for safeguarding against reputational, strategic and operational risks. This is an evolutionary process.

The safeguarding of the HSBC Group's reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff. The HSBC Group has always aspired to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business.

Reputational risks are considered and assessed by the Board, its committees and senior management in adherence with the HSBC Group standards. Standards on all major aspects of business are set for the HSBC Group and for individual subsidiary companies, businesses and functions. These policies, which form an integral part of the internal control systems, are communicated through manuals and statements of policy and are promulgated through internal communications. The policies cover social, ethical and

Report of the Directors (continued)

environmental issues and set out operational procedures in all areas of reputational risk, including money laundering deterrence, environmental impact, anti-corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between head office departments and businesses is required to ensure a strong adherence to the HSBC Group's risk management system and its corporate social responsibility practices.

Internal controls are an integral part of how the HSBC Group conducts its business. The HSBC Group's manuals and statements of policy are the foundation of these internal controls. There is a strong process in place to ensure controls operate effectively. Any significant failings are reported through the control mechanisms, internal audit and compliance functions to the Audit Committee, which keeps under review the effectiveness of the system of internal controls and reports regularly to the Board.

Directors' Emoluments

The emoluments of the Directors of the bank for 2004 are shown below. Sir John Bond and S K Green received no emoluments from the bank or from its subsidiary undertakings.

	Fees	Salary and other remuneration	Benefits in kind	Discretionary bonuses[1]	Total 2004	Total 2003
	£000	£000	£000	£000	£000	£000
Executive Directors						
M F Geoghegan[2]	6[3]	584	16	—[4]	606	—
D D J John	35	296	1	279	611	512
Non-executive Directors						
C F W de Croisset[5]	—	71	—	2,116[6]	2,187	1,299
C-H Filippi	35	362	—	487[7]	884	782
J D Fishburn	35	—	—	—	35	15
C M S Jones	35	—	—	—	35	25
A R D Monro-Davies[2]	53[8, 9]	—	—	—	53	—
A C Reed[10]	18[8]	—	—	—	18	33
H A Rose	50[11]	—	—	—	50	35
P M Shawyer[12]	7[8]	—	—	—	7	—
J Singh	35	—	—	—	35	25
J F Trueman[13]	11[8]	—	—	—	11	—
Total	320	1,313	17	2,882	4,532	3,335[14]

1 *These discretionary bonuses are in respect of 2004 and will be paid in 2005.*

2 *Appointed a Director on 1 January 2004.*

3 *It is the HSBC Group policy that each HSBC Group Executive may only retain one fee paid by the HSBC Group. The sum shown represents the bank Director's fee payable to Mr Geoghegan from 1 January 2004 to 29 February 2004. Mr Geoghegan was appointed a Director of HSBC Holdings plc on 1 March 2004 and, from this date, elected to receive the fee payable as a Director of that company.*

4 *In return for the prior waiver of bonus, the employer contribution into the pension scheme has been increased by the amount of £1,200,000 (2003: nil) which would otherwise have been paid*

5 *Retired as a Director on 25 February 2004.*

6 *Retired as a Director on 25 February 2004. Mr de Croisset had a contract of employment dated 7 January 1980 that was in force before he joined the Board of CCF. The contract had no set term but provided for three months' notice to be given by either party. Under the terms of the contract Mr de Croisset would be entitled to receive one month's salary for each year of service with CCF on termination of his employment with CCF. In accordance with French legal requirements and practice, this contract was suspended while he served as an executive Director of CCF. In consideration of M de Croisset's early retirement from the Group and in light of French legal requirements, a review of market practice was undertaken and a one-off payment of €2,633,742 was made to Mr de Croisset, which was considered to be appropriate in all the circumstances.*

7 *In return for the prior waiver of part of the bonus, the employer contribution into the pension scheme has been increased by £259,000 (2003: £400,000) which would otherwise have been paid.*

8 *Member of the Audit Committee, for which a fee of £7,500 per annum is payable.*

9 *Member of the Corporate Investment Banking and Markets Audit Committee, for which a fee of £15,000 per annum is payable.*

10 *Retired as a Director on 26 May 2004.*

11 *Chairman of the Audit Committee, for which a fee of £15,000 per annum is payable.*

12 *Appointed a Director on 1 November 2004.*

13 *Appointed a Director on 29 September 2004.*

14 *Represents the total cost of the Board of Directors for 2003, and includes emoluments in respect of Directors who retired during 2003 and are not reflected within the table.*

Long-Term Incentive Plans

Long-term incentive plans are designed to reward the delivery of sustained financial growth of the HSBC Group. So as to align the interests of the Directors and senior employees more closely with those of shareholders, the vesting of Performance Share awards is subject to the attainment of predetermined performance criteria.

The Remuneration Committee has generally provided, on a discretionary basis and reflective of individual performance, long-term share incentives to executive Directors and members of Senior Management through conditional awards of Performance Shares under the HSBC Holdings

Restricted Share Plan 2000, rather than through the HSBC Holdings Group Share Option Plan.

As part of a comprehensive review of share-based remuneration, the Remuneration Committee considered whether the continued use of Performance Shares was appropriate. The Committee considered several other types of arrangement but concluded that Performance Shares remain the most appropriate vehicle for the HSBC Group's executive Directors and Senior Management. However, the Committee recognised that there were a number of aspects to the current plan that could be improved to ensure the plan encouraged and rewarded growth and outperformance.

Accordingly, the adoption of The HSBC Share Plan, to replace the HSBC Holdings Restricted Share Plan 2000 and the HSBC Holdings Group Share Option Plan, will be proposed at the forthcoming Annual General Meeting of HSBC Holdings plc. For executive Directors and members of senior management, the HSBC Share Plan will:

- introduce absolute growth in earnings per share as a performance measure in addition to relative total shareholder return; and
- require higher levels of performance for full vesting of the conditional awards.

The effect of these proposals is that the vesting of Performance Share awards will be more challenging and highly geared to performance than under the previous arrangements.

Further details of the performance conditions and vesting arrangements for The HSBC Share Plan are set out below. A summary of the arrangements relevant to previous awards of Performance Shares under The HSBC Holdings Restricted Share Plan 2000 is also given. Subject to approval at the forthcoming HSBC Holdings' Annual General Meeting, all future awards of Performance Shares, including the 2005 awards, will be made under The HSBC Share Plan.

2005 Awards

The Remuneration Committee has proposed to the Trustee that the following conditional awards should be made to Directors in 2005:

	£000
Sir John Bond	4,000
M F Geoghegan	2,000
S K Green	2,500
D D J John	425
	8,925

The Trustee to the Plan will be provided with funds to acquire HSBC Holdings plc ordinary shares of US$0.50 each at an appropriate time after the announcement of the annual results.

In addition, the Remuneration Committee has proposed that a conditional award of Performance Shares be made to C-H Filippi in 2005 with a total value of £500,000. This award will take the form of an option to acquire shares after three years, subject to the performance conditions described below. At the time when the right to acquire those shares becomes exercisable, it has been agreed that a bonus of £500,000 will be paid to C-H Filippi. Following exercise, the resultant shares will be subject to a retention period ending in June 2009.

Performance conditions

Subject to approval of The HSBC Share Plan at the forthcoming Annual General Meeting of HSBC Holdings plc, awards of Performance Shares, commencing in 2005, will be divided into two equal parts to be subject to separate performance conditions measured over a three-year performance period:

"The Total Shareholder Return (TSR) award": one half of the award will be subject to a relative TSR measure. TSR is defined as the growth in share value and declared dividend income, measured in sterling, during the relevant period. In calculating TSR, dividend income is assumed to be reinvested in the underlying shares; and

"The earnings per share (eps) award": the other half of the award will be based upon the absolute growth in eps achieved by the HSBC Group over the three-year performance period.

The TSR element of the award will be based on the HSBC Group's ranking against a comparator group of 28 major banks. The comparator group will generally comprise the largest banks in the world measured in terms of market capitalisation, having regard to the geographic spread and the nature of the activities of each bank. The Remuneration Committee will use this criterion in selecting any replacements to the comparator group that may be necessary during the performance period, for example because a bank ceases to exist or to be quoted or if its relevance to HSBC as a comparator significantly diminishes.

The comparator group at 28 February 2005 comprises ABN AMRO Holding N.V., Banco Bilbao Vizcaya Argentaria S.A, Banco Santander Central Hispano S.A., Bank of America Corporation, The Bank of New York Company, Inc., Barclays PLC, BNP PARIBAS S.A., Citigroup Inc., Credit Agricole S.A., Credit Suisse Group, Deutsche Bank AG, HBOS plc, JPMorgan Chase & Co., Lloyds TSB Group plc, Mitsubishi Tokyo Financial Group, Inc., Mizuho Financial Group, Inc., Morgan Stanley, National Australia Bank Limited, Royal Bank of Canada, The Royal Bank of Scotland plc, Société Générale, Standard Chartered PLC, UBS AG, UniCredito Italiano Bank plc, US Bancorp, Wachovia Corporation, Wells Fargo & Company and Westpac Banking Corporation.

The extent to which awards will vest will be determined by reference the HSBC Group's TSR measured against the comparator TSR. The calculation of the share price component within the HSBC Group's TSR will be the average market price over the 20 trading days commencing on the day when the annual results are announced, which in 2005 is 28 February. The starting point will be, therefore, the average over the period 28 February to 29 March inclusive. TSR for comparator group constituents will be based on their published share prices for 29 March 2005.

For TSR performance in line with the bank ranked 14th, only 30 per cent of the conditional award will vest; if the HSBC Group's performance is in line with or above the bank ranked 7th in the ranked list all of the TSR award shares will vest.

Vesting between the 14th and 7th ranked banks will be based on the HSBC Group's position against the ranked list. In simple terms, the percentage vesting will rise in 10 per cent increments for each position that the HSBC Group achieves higher than the 14th bank in the ranked list until full vesting is achieved for TSR performance equal to or greater than the 7th bank in the ranked list. Where the HSBC Group's performance falls between these incremental steps, account will be taken of how far above or below the next ranked bank the HSBC Group's TSR performance is positioned.

For example, if the HSBC Group's TSR falls half way between the bank ranked 12th (where a release of 50 per cent of the award would occur) and the bank ranked 13th (where a release of 40 per cent of the award would occur), then the actual award released would be 45 per cent, i.e. half way between 40 per cent and 50 per cent.

For the eps element of the award, the base measure shall be eps for the financial year preceding that in which the award is made ("the base year"). Absolute growth in eps will then be compared with the base year over three consecutive financial years commencing with the year in which the award is made. The eps growth element will be the absolute level of eps achieved during the three-year performance period. For this purpose, eps means the profit attributable to the shareholders (expressed in US dollars), excluding goodwill amortisation, divided by the weighted average number of ordinary shares in issue and held outside the HSBC Group during the year in question. In the event that the 2004 published eps is restated to adjust for accounting standards changes during the performance period, the restated published eps will be used for the eps performance condition for awards made in 2005 under The HSBC Share Plan.

The percentage of the conditional award vesting will depend upon the absolute growth in eps achieved over the three-years ("the performance period"). 30 per cent of the conditional shares will vest if the incremental eps over the performance period is 24 per cent or more of eps in the base year.

The percentage of shares vesting will rise on a straight line proportionate basis to 100 per cent if HSBC's incremental eps over the performance period is 52 per cent or more of eps in the base year.

No element of the "TSR award" will vest if the HSBC Group's performance is below that of the bank ranked 14th in the ranked list and no element of the "eps award" will vest if the HSBC Group's incremental eps over the performance period is less than 24 per cent of eps achieved in the base year.

To the extent that the performance conditions have not been met at the third anniversary, the shares will be forfeited.

In addition, awards will only vest if the Remuneration Committee is satisfied that the HSBC Group's financial performance has shown a sustained improvement in the period since the date of grant.

In determining whether the HSBC Group has achieved a sustained improvement in performance the Remuneration Committee will take account of, among other factors, the comparison against history and the peer group in the following areas:

1. revenue growth;
2. revenue mix;
3. cost efficiency;
4. credit performance as measured by risk-adjusted revenues; and
5. cash return on cash invested, dividend performance and total shareholder return.

Following the three-year performance period, awards of Performance Shares under the HSBC Share Plan will be tested and vesting will take place shortly afterwards.

Where events occur which cause the Remuneration Committee to consider that the performance condition has become unfair or impractical, the right is reserved to the Remuneration Committee to make such adjustments as in its absolute discretion it deems appropriate to make.

Awards will vest immediately in cases of death. In the event of redundancy, retirement on grounds of injury or ill health, early retirement, normal retirement and where a participant ceases to be employed with the HSBC Group due to a company ceasing to be part of the HSBC Group, awards will normally vest at the end of the vesting period on a time-apportioned basis to the extent that performance conditions have been satisfied. Awards will normally be forfeited if the participant is dismissed or resigns from the HSBC Group. In all of these circumstances the Committee retains discretion to ensure fair and reasonable treatment.

Arrangements from 1999-2004

From 1999 to 2004, the vesting of awards of Performance Shares was linked to the attainment of predetermined TSR targets over a three-year period from date of grant as set out below.

The TSR performance condition for awards of Performance Shares remained the same from 1999 to 2003. For awards made in 2004, changes were made to the peer group and re-testing provisions were eliminated such that awards will lapse if the performance condition is not satisfied after the initial three-year performance period.

A benchmark for the HSBC Group's TSR, weighted by market capitalisation, was established which takes account of the TSR performance of:

1. a peer group of nine banks weighted by market capitalisation which were considered most relevant to HSBC in terms of size and international scope. For performance periods up to and including the one beginning in 2003, this group comprised ABN AMRO Holding N.V., The Bank of East Asia Limited, Citigroup Inc., Deutsche Bank AG, JPMorgan Chase & Co., Lloyds TSB Group plc, Mitsubishi Tokyo Financial Group Inc., Oversea-Chinese Banking Corporation Limited and Standard Chartered PLC. To be more relevant to HSBC in terms of size and international scope, this peer group was amended for conditional awards made in 2004 and onwards by the replacement of Lloyds TSB Group plc, Oversea-Chinese Banking Corporation Ltd., Mitsubishi Tokyo Financial Group Inc. and The Bank of East Asia Limited with Bank of America Corporation, The Royal Bank of Scotland plc, Banco Santander Central Hispano S.A. and UBS AG;
2. the five largest banks from each of the US, the UK, continental Europe and the Far East, other than any within paragraph 1 above, weighted by market capitalisation; and
3. the banking sector of the Morgan Stanley Capital International World Index, excluding any within paragraph 1 and paragraph 2 above, weighted by market capitalisation.

By combining the weighted average TSR for each of the above three groups and weighting that average so that 50 per cent is applied to paragraph 1, 25 per cent is applied to paragraph 2 and 25 per cent is applied to paragraph 3, a single TSR benchmark for market comparison was determined.

The extent to which each award will vest will be determined by reference to the HSBC Group's TSR measured against the TSR benchmark. For each award the calculation of the share price component within the HSBC Group's TSR was the average market price over the 20 trading days commencing on the day when the annual results were announced. TSR for the benchmark constituents was based on their published share prices on the 20th trading day after the annual results were announced.

If the HSBC Group's TSR over the performance period exceeds the benchmark TSR, awards with a value, at the date of grant, of up to 100 per cent of the individual's earnings, will vest. For higher value awards, the greater of 50 per cent of the award or the number of shares equating at the date of grant to 100 per cent of the individual's earnings (base salary and bonus in respect of the previous performance year), will vest at this level of performance. If the HSBC Group's TSR over the performance period places it within the upper quartile in the ranked list against the benchmark, these higher value awards will vest in full. For performance between the median and the upper quartile, vesting will be on a straight line basis.

For awards made in 2004, if the upper quartile performance target is achieved then, as before, an additional award equal to 20 per cent of the initial Performance Share award will be made and will vest at the same time as the original award to which it relates. However, regardless of whether the upper quartile is achieved, full vesting and transfer of the shares will not generally occur until the fifth anniversary of the date of grant. If the performance test is not passed at the third anniversary, the shares will be forfeited.

In addition to these performance conditions, none of the outstanding awards will vest unless the Remuneration Committee is satisfied that during the performance period, the HSBC Group has achieved a sustained improvement in performance. The Remuneration Committee retains discretion to recommend early release of shares awarded in certain circumstances, e.g. redundancy and ill health.

The Performance Shares awarded in 2000 passed their three-year TSR performance condition in March 2003 and will vest on the fifth anniversary of the award, 10 March 2005.

Report of the Directors (continued)

Other Directorships

Executive Directors, if so authorised by the Board, may accept appointments as non-executive Directors of suitable companies which are not part of the HSBC Group. Executive Directors normally would be permitted to take on no more than one such appointment. Any remuneration receivable in respect of this appointment is paid to the bank, unless otherwise approved by the Remuneration Committee.

Pensions

Pension arrangements for bank employees are provided by the HSBC Bank (UK) Pension Scheme, the assets of which are held in a separate trust fund. The Pension Scheme is administered by HSBC Bank Pension Trust (UK) Limited, whose Board of 19 Directors (eight of whom are elected by employees and one by pensioners) meets quarterly. It has three committees that monitor and review investment performance, discretionary benefits and administration and communications. The Pension Scheme does not invest in shares of the bank's parent company or in any of its subsidiary undertakings.

Pension arrangements to contractual retirement age of 60 for D D J John are provided under the HSBC Bank (UK) Pension Scheme.

Pension arrangements for M F Geoghegan are provided under the HSBC International Staff Retirement Benefits Scheme. Pension accrues at a rate of one twenty-seventh of pensionable salary per year of pensionable service.

In addition, Mr Geoghegan has joined the HSBC Asia Holdings Pension Plan, on a defined contribution basis, with an employer contribution in respect of 2004 of £1,200,000, arising entirely from a bonus sacrifice. There are no other employer contributions made to this plan.

Pension arrangements to contractual retirement age of 60 for C-H Filippi are provided under the HSBC Asia Holdings Pension Plan on a defined contribution basis, with an employer contribution in respect of 2004 of £1,423,000, including a bonus waiver of £259,000 (2003: £400,000).

C F W de Croisset was, until his retirement from CCF on 29 February 2004, and C-H Filippi is, eligible for pension benefits which are supplementary to those accrued under the French State and compulsory arrangements. The amount of these supplementary pensions, payable from age 60, accrue at the rate of €6,098 per annum for each year of service (maximum 18 years) as executive Directors of CCF. Consequent on Mr de Croisset's early retirement from CCF and following a review of market practice, it was agreed to provide a total pension of €341,467 per annum (equivalent to 32.5 per cent of his average total cash compensation over a three-year period) payable from 1 March 2004. In the case of C-H Filippi the supplementary pension is complimented by an agreement to provide a target pension at age 60 of €400,000 per annum (equivalent to 25 per cent of his total cash compensation in 2003), inclusive of French State and compulsory arrangements and the supplementary pension outlined above. The whole cost of these benefits is met by CCF.

The pension entitlements earned by these Directors during the year are shown below:

	Accrued annual pension at 31 December 2004	Transfer value of accrued pension at 1 January 2004[1]	Transfer value of accrued pension at 31 December 2004[1]
	£000	£000	£000
Executive Directors			
M F Geoghegan	185	3,652	4,042
D D J John	147	1,504	2,004
Non-executive Directors			
C F W de Croisset[2]	193	860	2,623
C-H Filippi	154	106	1,798

1 *The transfer value represents a liability of the HSBC Group's pension funds and not a sum paid or due to the individual; it cannot therefore meaningfully be added to annual remuneration.*
2 *Retired as a Director on 25 February 2004.*

Only basic salary is pensionable. Neither of the executive Directors of the bank is subject to the earnings cap introduced by the 1989 Finance Act.

Pension payments totalling £367,000 (2003: £379,000) were made to seven (2003: seven) former Directors of the bank.

Directors' Interests

According to the register of Directors' interests maintained by the bank pursuant to section 325 of the Companies Act 1985, the Directors of the bank at the year-end had the following beneficial interests in the shares and loan capital of HSBC Holdings plc:

Ordinary shares of US$0.50	At 1 January 2004	At 31 December 2004
Sir John Bond	404,602	451,531
C-H Filippi[1]	386,000	326,000
J D Fishburn	19,732[2]	19,732[2]
M F Geoghegan[1]	—	37,795
S K Green[1]	198,758[3]	243,659[3]
D D J John[1]	5,882	5,882
P M Shawyer	2,404[4]	2,404

1 *Details of additional interests in ordinary shares of US$0.50 each under the Share Option Plans and Restricted Share Plan are set out on pages 19 to 21.*
2 *Includes 4,054 shares held in the Deferred Phantom Stock Plan operated by Household International, Inc. and will be released to J D Fishburn when he retires as a Director of that company, which will be no later than May 2017.*
3 *Includes 45,000 shares as beneficiary of a trust holding these shares.*
4 *Interests at 1 November 2004 - date of appointment.*

S K Green has a beneficial interest in €75,000 of HSBC Holdings plc 5½ per cent Subordinated Notes 2009 and in £100,000 of HSBC Bank plc 9 per cent Subordinated Notes 2005, which he held throughout the year.

As Directors of CCF S.A. ('CCF'), C-H Filippi, S K Green and M F Geoghegan each had a beneficial interest in one share of €5 in that company, which Mr Filippi and Mr Green held throughout the year and Mr Geoghegan acquired during the year on his appointment as a Director of CCF. The Directors have waived their rights to receive dividends on these shares and have undertaken to transfer these shares to the bank on ceasing to be Directors of CCF.

As a Director of HSBC Private Banking Holdings (Suisse) S.A., M F Geoghegan had a beneficial interest in one share of CHF1,000 which he acquired during the year.

Following the acquisition of CCF in 2000, CCF shares issued following the exercise of options over CCF shares became exchangeable for HSBC Holdings plc ordinary shares of US$0.50 each in the same ratio as the exchange offer for CCF (13 HSBC Holdings plc ordinary shares of US$0.50 each for each CCF share). HSBC Holdings plc ordinary shares of US$0.50 each, which may be used to satisfy the exchange of CCF shares for HSBC Holdings plc ordinary shares of US$0.50 each following exercise of these options, were purchased by The HSBC Holdings Employee Benefit Trust 2001 (No.1). C-H Filippi has options over CCF shares that are exchangeable for 598,000 HSBC Holdings plc ordinary shares of US$0.50, further details of which are set out on page 20. However, as a potential beneficiary of the Trust, C-H Filippi is deemed to have a technical interest in all 26,787,515 HSBC Holdings plc ordinary shares of US$0.50 each held by the Trust at 31 December 2004.

Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings plc or any of its subsidiary undertakings at the beginning or at the end of the year and none of the Directors, or members of their immediate families, was awarded or exercised any right to subscribe for any shares or debentures during the year.

Since the end of the year, the beneficial interests of S K Green increased by 28 HSBC Holdings plc ordinary shares of US$0.50 each, which were acquired by Computershare Trustees Limited using monthly contributions to the HSBC UK Share Ownership Plan and the reinvestment of dividend income.

The scrip dividend paid on 20 January 2005 has increased the total beneficial interests in HSBC Holdings plc ordinary shares of US$0.50 each of the following Directors: S K Green 125 shares; and M F Geoghegan 289 shares.

Apart from the increases in the interests of Directors as a result of the scrip dividend paid on 20 January 2005 on awards of HSBC Holdings plc ordinary shares of US$0.50 each under the HSBC Restricted Share Plan, as detailed on page 21, there have been no other changes in Directors' interests from 31 December 2004 to the date of this report.

Share options

At 31 December 2004, the undernamed Directors held options to acquire the number of HSBC Holdings ordinary shares of US$0.50 each set against their respective names. The options were awarded for nil consideration at exercise prices equivalent to the market value at the date of award, except that options awarded under the HSBC Holdings savings-related share option plans before 2001 are exercisable at a 15 per cent discount to the market value at the date of award and those awarded since 2001 at a 20 per cent discount. Except as otherwise indicated, no options were exercised or lapsed during the year and there are no remaining performance criteria conditional upon which the outstanding options are exercisable. Save as stated below, none of the Directors or members of their immediate families was awarded or exercised any right to subscribe for any shares or debentures during the year.

Report of the Directors (continued)

Options over ordinary shares of US$0.50 each

	Options held at 1 January 2004	Options awarded during year	Options exercised during year	Options held at 31 December 2004	Exercise price in £	Date of award	Exercisable from[1]	Exercisable until
Executive Directors								
M F Geoghegan[2]	1,248[3]	—	1,248	—	5.3980	1 Apr 1999	1 Aug 2004	31 Jan 2005
	559	—	—	559[3]	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006
	573[3]	—	573	—	6.7536	11 Apr 2001	1 Aug 2004	31 Jan 2005
D D J John	21,000	—	—	21,000[4]	6.2767	16 Mar 1998	16 Mar 2001	16 Mar 2008
	1,248[3]	—	1,248	—	5.3980	1 Apr 1999	1 Aug 2004	31 Jan 2005
	1,119	—	—	1,119[3]	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006
	499[3]	—	—	499	6.7536	11 Apr 2001	1 Aug 2006	31 Jan 2007
	—	1,010	—	1,010[3]	6.4720	21 Apr 2004	1 Aug 2009	31 Jan 2010
Non-executive Directors								
Sir John Bond[5]	2,798	—	—	2,798[3]	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006
C F W de Croisset[6]	206,000	—	—	206,000[7]	8.7120	23 Apr 2001	23 Apr 2004	23 Apr 2011
	206,000	—	—	206,000[7]	8.4050	7 May 2002	7 May 2005	7 May 2012
	206,000	—	—	206,000[8]	6.9100	2 May 2003	2 May 2006	2 May 2013
C-H Filippi	202,000			202,000[4]	8.7120	23 Apr 2001	23 Apr 2004	23 Apr 2011
	202,000	—	—	202,000[4]	7.4550	30 Aug 2002	30 Aug 2005	30 Aug 2012
	202,000	—	—	202,000[9]	6.9100	2 May 2003	2 May 2006	2 May 2013
	—	202,000	—	202,000[9]	8.2830	30 Apr 2004	30 Apr 2007	30 Apr 2014
S K Green	3,070	—	—	3,070[3]	5.3496	23 Apr 2003	1 Aug 2008	31 Jan 2009

1 *May be advanced to an earlier date in certain circumstances, e.g. retirement.*
2 *Appointed a Director on 1 January 2004.*
3 *Options held under the HSBC Holdings Savings-Related Share Option Plan.*
4 *Options held under HSBC Holdings Group Share Option Plan.*
5 *Retired as a Director on 31 December 2004.*
6 *Retired as a Director on 25 February 2004.*
7 *Options held under the HSBC Holdings Group Share Option Plan at date of retirement as a Director (25 February 2004).*
8 *Options held under the HSBC Holdings Group Share Option Plan at date of retirement as a Director (25 February 2004). In accordance with the transitional arrangements agreed with CCF in 2000, vesting of 50 per cent of the award is subject to the performance tests set out in the section headed 'Performance Conditions' on page 17.*
9 *Options held under the HSBC Holdings Group Share Option Plan. In accordance with the transitional arrangements agreed with CCF in 2000, vesting of 50 per cent of the award is subject to the performance tests set out in the section headed 'Performance Conditions' on page 17.*

C-H Filippi and C F W de Croisset held the following options to acquire CCF shares of €5 each. On exercise of these options, each CCF share will be exchanged for 13 HSBC Holdings plc ordinary shares of US$0.50 each. The options were granted by CCF for nil consideration at a 5 per cent discount to the market value at the date of award. There are no remaining performance criteria conditional upon which the outstanding options are exercisable. No options over CCF shares of €5 each were awarded to or exercised by either C F W de Croisset or C-H Filippi during the year, except as otherwise indicated.

Options over CCF S.A. shares of €5 each

	Options Held at 1 January 2004	Exercise price per share (€)	Options held at 31 December[1] 2004	Equivalent HSBC Holdings ordinary shares of US$0.50 each at 31 December 2004	Date of award	Exercisable from	Exercisable until
C F W de Croisset							
	10,000	32.78	10,000	130,000	23 Jun 1994	23 Jun 1996	23 Jun 2004
	30,000	34.00	30,000	390,000	22 Jun 1995	22 Jun 1997	22 Jun 2005
	30,000	35.52	30,000	390,000	9 May 1996	9 May 1998	9 May 2006
	30,000	37.05	30,000	390,000	7 May 1997	7 Jun 2000	7 May 2007
	30,000	73.50	30,000	390,000	29 Apr 1998	7 Jun 2000	29 Apr 2008
	28,000	81.71	28,000	364,000	7 Apr 1999	7 Jun 2000	7 Apr 2009
	28,000	142.50	28,000	364,000	12 Apr 2000	1 Jan 2002	12 Apr 2010
C-H Filippi							
	23,000	81.71	23,000	299,000	7 Apr 1999	7 Jun 2000	7 Apr 2009
	23,000	142.50	23,000	299,000	12 Apr 2000	1 Jan 2002	12 Apr 2010

1 *In the case of C F W de Croisset, as at 25 February 2004 - the date of his retirement as a Director.*

Restricted Share Plan

In addition to the interests in shares disclosed on page 19, at 31 December 2004, the undernamed Directors had the following interests in HSBC Holdings ordinary shares awarded under the HSBC Holdings Restricted Share Plan 2000:

HSBC Holdings Ordinary shares of US$0.50 each

	Awards held at 1 January 2004	Awards made during the year	Monetary value of awards made during the year £000	Awards vested during the year[1]	Monetary value of awards vested during the year £000	Awards held at 31 December 2004[1]	Date of award	Year in which awards may vest
Sir John Bond[2]	71,386	–	–	71,948	613	–	4 Mar 1999	2004
	89,621	–	–	–	–	93,405	10 Mar 2000	2005
	83,988	–	–	–	–	87,535	12 Mar 2001	2006
	125,767	–	–	–	–	131,077	8 Mar 2002	2007
	167,843	–	–	–	–	174,929	5 Mar 2003	2008
	–	244,445	2,100	–	–	252,771	4 Mar 2004	2009
M F Geoghegan	35,975	–	–	35,974	306	–	4 Mar 1999	2004
	32,846	–	–	–	–	33,965	10 Mar 2000	2005
	36,280	–	–	–	–	37,515	12 Mar 2001	2006
	40,030	–	–	–	–	41,393	8 Mar 2002	2007
	53,827	–	–	–	–	55,661	5 Mar 2003	2008
	–	90,794	780	–	–	93,887	4 Mar 2004	2009
S K Green	41,643	–	–	41,969	357	–	4 Mar 1999	2004
	40,738	–	–	–	–	42,458	10 Mar 2000	2005
	83,988	–	–	–	–	87,535	12 Mar 2001	2006
	99,290	–	–	–	–	103,482	8 Mar 2002	2007
	114,438			–	–	119,270	5 Mar 2003	2008
	–	166,455	1,430	–	–	172,125	4 Mar 2004	2009
D D J John	17,338	–	–	17,474	141	–	4 Mar 1999	2004
	13,179	–	–	–	–	33,965	10 Mar 2000	2005
	17,999	–	–	–	–	75,030	12 Mar 2001	2006
	26,478	–	–	–	–	96,584	8 Mar 2002	2007
	38,148	–	–	–	–	119,270	5 Mar 2003	2008
	–	37,831	325	–	–	125,182	4 Mar 2004	2009

Unless otherwise indicated, vesting of these shares is subject to the performance tests set out in the section headed "Performance Conditions" on page 17.

1 *Includes additional shares arising from scrip dividends.*
2 *Retired as a Director on 31 December 2004.*

Following the dividend paid on 20 January 2005, the awards held by Directors have increased as follows: Sir John Bond 5,658 shares; M F Geoghegan 2,296 shares; S K Green 4,013 shares; and D D J John 1,064 shares.

Employee Involvement

HSBC continues to regard communication with its employees as a key aspect of its policies. Information is given to employees about employment matters and about the financial and economic factors affecting HSBC's performance through management channels, intranet sites, in-house magazines and by way of attendance at internal seminars and training programmes. Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance.

The involvement of employees in the performance of the bank is further encouraged through participation in bonus and share option plans.

About half of all HSBC employees now participate in one or more of the HSBC Group's employee share plans.

Diversity Policy: Employees with Disabilities

The bank continues to be committed to providing equal opportunities to employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes of the individual. Should employees become disabled during employment, every effort is made to continue their employment and, if necessary, appropriate training is provided.

Report of the Directors (continued)

Health and Safety

The maintenance of appropriate health and safety standards throughout the bank remains a key responsibility of all managers and the bank is committed actively to managing all health and safety risks associated with its business. The bank's objectives are to identify, remove, reduce or control material risks of fires and of accidents or injuries to employees and visitors.

Health and safety policies and Group standards and procedures are set by the bank's Fire and Safety Department and are implemented by Coordinators based in each country in which the bank operates.

The HSBC Group faces a range of threats from terrorists and criminals across the world. In particular, over recent years the threat from international terrorism has become signficant in a number of areas where the HSBC Group operates. This threat has mainly manifested itself in bomb attacks such as the one in Istanbul in 2003 in which HSBC's Turkish headquarters building was attacked. Despite suffering tragic loss of life and major damage, existing security measures and well-managed contingency procedures enabled the business to be up and running again the following day.

HSBC Group Security provides regular risk assessments in areas of increased risk to assist management in judging the level of terrorist threat and regular security reviews are conducted to ensure measures to protect HSBC Group staff, buildings, assets and information are appropriate for the level of threat.

Community Involvement and Donations

During the year, the bank made charitable donations of £2 million, and made gifts in kind in support of community activities in the United Kingdom. Many staff also gave their time in voluntary activities for the benefit of others.

The bank continued to build its support for the communities in which it operates through activities focused on its commitment to education, particularly for under-privileged primary and secondary school students, and the environment. This commitment to education is led by Dame Mary Richardson, whose primary role within the HSBC Group is as Chief Executive of the HSBC Education Trust in the United Kingdom.

The Trust will consider charitable payments relating to education. Among the initiatives the Trust will support are funding for business and enterprise, sports and language colleges and primary and secondary school programmes for underprivileged children.

The bank's staff and customers made contributions through a number of events and raised more than £450,000 for BBC Children in Need, being named one of the largest corporate fundraisers for that event. Staff raised a further £70,000 for The Children's Heart Federation with sponsored walks.

In addition, the HSBC Group continued its policy of making donations to charities instead of sending Christmas cards. In 2004, this totalled £210,000, the beneficiaries being: The Red Crescent Thallassaemia Blood Transfusion Centre in Bangladesh; Associacao Paranaense Alegria de Viver in Brazil assisting children afftected by HIV/AIDS; The British Association for Adoption and Fostering; The Children's Society; Operation Smile, an international charity providing reconstructive surgery for children; and CARE International's work in the Middle East working to alleviate poverty and improve the lives of children.

HSBC's five-year partnership 'Investing in Nature' with three charities – WWF; Botanic Gardens Conservation International (BGCI); and Earthwatch – under which US$50 million will be donated to fund conservation projects around the world, continues. To date, 1,000 HSBC employees from 45 countries have joined Earthwatch scientists in the field, contributing nearly 50 years' worth of vital environmental research to 62 research projects. These employees, whom we call HSBC Environmental Fellows, each go on to involve an average of 66 more people in environmental issues and to give 52 hours of additional voluntary work – 60 per cent more than they did before they took part.

Earthwatch and HSBC have also trained more than 90 scientists in developing countries, providing them with the research skills they need to manage local environmental issues.

Our work with BGCI aims to protect 20,000 plant species from extinction. HSBC's contribution has enabled almost 400 botanic gardens from 78 countries to take on key conservation roles as participants in the International Agenda for Botanic Gardens.

WWF and HSBC are working to breathe new life into three of the world's major rivers. Work on the Yangtze, Amazon and Rio Grande concentrates on developing sustainable river management involving stakeholder groups at a national and local level. As a result of the campaign in Brazil, a judge has decreed that fines levied for environmental abuses should be used to improve water quality in local springs.

The Group has pledged to match the donations of thousands of HSBC colleagues around the world with

US$1,000,000 in respect of their support of appeals related to the Tsunami in South East Asia. To date colleagues in the UK have donated £182,000 for long-term rebuilding efforts around the region.

HSBC joined with British Airways in their Change For Good campaign to collect foreign currency across its UK branch counters in aid of Unicef. The funds raised through this initiative will directly help Unicef's work in those areas affected by the Boxing Day Tsunami.

During December, HSBC branches and offices across the UK collected gifts for local needy people through the 'Neighbours in Need' scheme. Over 12,000 gifts were donated through some 500 charitable organisations.

No political donations were made during the year.

At the HSBC Holdings plc Annual General Meeting in 2003 shareholders gave authority for the bank to make EU political donations and incur EU political expenditure up to a maximum aggregate sum of £50,000 over a four-year period as a precautionary measure in light of the wide definitions in the Political Parties, Elections and Referendums Act 2000. This authority has not been used.

Supplier Payment Policy

The bank subscribes to the Better Payment Practice Code for all suppliers, the four principles of which are: to agree payment terms at the outset and stick to them; to explain payment procedures to suppliers; to pay bills in accordance with any contract agreed with the supplier or as required by law; and to tell suppliers without delay when an invoice is contested and settle disputes quickly.

Copies of, and information about, the Code are available from: The Department of Trade and Industry, 1 Victoria Street, London SW1H 0ET and on the internet, www.dti.gov.uk/publications.

The amount due to the bank's trade creditors at 31 December 2004 represented 16 days' average daily purchases of goods and services received from those creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

Auditor

KPMG Audit Plc has expressed its willingness to continue in office and the Board recommends that it be reappointed. A resolution proposing the reappointment of KPMG Audit Plc as auditor of the bank and giving authority to the Directors to determine its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board
J H McKenzie, *Secretary*

28 February 2005

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the Auditors' statement of their responsibilities set out in their report on the next page, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the bank and its subsidiary undertakings as at the end of the financial year and of the profit or loss for the financial year. The Directors are required to prepare these financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group and the bank have the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors consider that, in preparing the financial statements (on pages 26 to 97), the bank has used appropriate accounting policies, consistently applied save as disclosed in the Notes on the Accounts and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the bank keeps accounting records which disclose with reasonable accuracy, at any time, the financial position of the bank and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

On behalf of the Board
J H McKenzie, *Secretary*

28 February 2005

Independent Auditors' Report to the Member of HSBC Bank plc

We have audited the financial statements on pages 26 to 97.

This report is made solely to the bank's member in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the bank's member those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the bank and the bank's member for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Directors' report and, as described on page 24, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the bank and the group as at 31 December 2004 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

28 February 2005

Consolidated Profit and Loss Account for the Year Ended 31 December 2004

	Note	2004 £m	2003 £m
Interest receivable			
— interest receivable and similar income arising from debt securities		1,728	1,631
— other interest receivable and similar income		7,859	6,636
Interest payable		(5,113)	(3,995)
Net interest income		4,474	4,272
Dividend income	3	305	88
Fees and commissions receivable		4,001	3,657
Fees and commissions payable		(790)	(657)
Dealing profits	4	569	680
Other operating income		552	508
Other income		4,637	4,276
Operating income		9,111	8,548
Administrative expenses	5	(5,167)	(4,886)
Depreciation and amortisation			
— tangible fixed assets	21	(526)	(491)
— intangible fixed assets	20	(1)	(1)
— goodwill	20	(553)	(482)
Operating expenses		(6,247)	(5,860)
Operating profit before provisions		2,864	2,688
Provisions			
— provisions for bad and doubtful debts	13	(378)	(436)
— provisions for contingent liabilities and commitments	27	(36)	(45)
Amounts written off fixed asset investments		(11)	(28)
Operating profit		2,439	2,179
Share of operating profit/(loss) in joint ventures and associates		15	(57)
Gains/(losses) on disposal of			
— interests in joint ventures and associates		(1)	1
— investments		134	137
— tangible fixed assets		5	(16)
Profit on ordinary activities before tax	6	2,592	2,244
Tax on profit on ordinary activities	7	(766)	(641)
Profit on ordinary activities after tax		1,826	1,603
Minority interests			
— equity		(50)	(43)
— non-equity		(122)	(80)
Profit for the financial year attributable to shareholders		1,654	1,480
Dividends (*including amounts attributable to non-equity shareholders*)	9	(1,436)	(1,440)
Retained profit for the year		218	40

Movements in reserves are set out in Note 31 'Reserves'. All of the above represents continuing operations.

Consolidated Balance Sheet at 31 December 2004

	Note	2004 £m	2003 £m
Assets			
Cash and balances at central banks		**1,275**	1,210
Items in the course of collection from other banks		**1,495**	1,819
Treasury bills and other eligible bills	*10*	**5,882**	2,197
Loans and advances to banks	*11*	**34,884**	33,642
Loans and advances to customers	*12*	**139,831**	116,298
Debt securities	*15*	**60,008**	49,556
Equity shares	*16*	**8,105**	5,837
Interests in joint ventures			
— gross assets		**57**	49
— gross liabilities		**(50)**	(43)
	17	**7**	6
Interests in associates	*18*	**218**	125
Intangible fixed assets	*20*	**8,004**	8,315
Tangible fixed assets	*21*	**5,186**	4,916
Other assets	*22*	**21,254**	18,965
Prepayments and accrued income		**3,826**	3,218
Total assets		**289,975**	246,104
Liabilities			
Deposits by banks	*23*	**32,587**	29,287
Customer accounts	*24*	**161,212**	146,103
Items in the course of transmission to other banks		**907**	1,144
Debt securities in issue	*25*	**24,945**	9,769
Other liabilities	*26*	**38,487**	30,168
Accruals and deferred income		**3,816**	3,073
Provisions for liabilities and charges	*27*		
— deferred taxation		**795**	693
— other provisions for liabilities and charges		**1,221**	1,151
Subordinated liabilities	*28*		
— undated loan capital		**1,200**	1,268
— dated loan capital		**4,170**	3,991
Minority interests			
— equity		**333**	351
— non-equity	*29*	**2,341**	2,042
Called up share capital	*30*	**797**	797
Share premium account	*31*	**12,820**	12,157
Revaluation reserves	*31*	**134**	69
Profit and loss account	*31*	**4,210**	4,041
Shareholders' funds (including non-equity interests)		**17,961**	17,064
Total liabilities		**289,975**	246,104
Memorandum items			
Contingent liabilities	*35*		
— acceptances and endorsements		**641**	455
— guarantees and assets pledged as collateral security		**16,293**	15,368
		16,934	15,823
Commitments	*35*	**101,610**	73,581

S K Green, *Chairman*
M F Geoghegan, *Chief Executive and Director*
D D J John, *Chief Operating Officer and Director*
J H McKenzie, *Secretary*

SKGreen

Balance Sheet of HSBC Bank plc at 31 December 2004

	Note	2004 £m	2003 £m
Assets			
Cash and balances at central banks		**587**	616
Items in the course of collection from other banks		**1,327**	1,400
Treasury bills and other eligible bills	*10*	**5,498**	1,635
Loans and advances to banks	*11*	**22,982**	20,942
Loans and advances to customers	*12*	**100,590**	84,320
Debt securities	*15*	**25,038**	22,320
Equity shares	*16*	**4,617**	2,850
Interests in associates	*18*	**107**	7
Investments in subsidiary undertakings	*19*	**15,959**	15,369
Intangible fixed assets	*20*	**53**	33
Tangible fixed assets	*21*	**1,669**	1,650
Other assets	*22*	**11,375**	9,219
Prepayments and accrued income		**2,394**	2,166
Total assets		**192,196**	162,527
Liabilities			
Deposits by banks	*23*	**26,880**	22,237
Customer accounts	*24*	**104,222**	94,222
Items in the course of transmission to other banks		**781**	901
Debt securities in issue	*25*	**13,076**	2,930
Other liabilities	*26*	**19,602**	16,524
Accruals and deferred income		**2,089**	1,596
Provisions for liabilities and charges	*27*		
— deferred taxation		**4**	3
— other provisions for liabilities and charges		**303**	270
Subordinated liabilities	*28*		
— undated loan capital		**1,101**	1,168
— dated loan capital		**6,177**	5,612
Called up share capital	*30*	**797**	797
Share premium account	*31*	**12,820**	12,157
Revaluation reserves	*31*	**1,261**	1,115
Profit and loss account	*31*	**3,083**	2,995
Shareholders' funds (including non-equity interests)		**17,961**	17,064
Total liabilities		**192,196**	162,527
Memorandum items			
Contingent liabilities	*35*		
— acceptances and endorsements		**446**	328
— guarantees and assets pledged as collateral security		**9,461**	9,242
		9,907	9,570
Commitments	*35*	**73,152**	59,025

S K Green, *Chairman*
M F Geoghegan, *Chief Executive and Director*
D D J John, *Chief Operating Officer and Director*
J H McKenzie, *Secretary*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 2004

	2004 £m	2003 £m
Profit for the financial year attributable to shareholders	**1,654**	1,480
Unrealised surplus/(deficit) on revaluation of land and buildings	**73**	(56)
Exchange and other movements	**(94)**	625
Total recognised gains and losses for the year	**1,633**	2,049

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 2004

	2004 £m	2003 £m
Profit for the financial year attributable to shareholders	**1,654**	1,480
Dividends	**(1,436)**	(1,440)
	218	40
Other recognised gains and losses relating to the year	**(21)**	569
New share capital subscribed	**700**	—
Net addition to shareholders' funds	**897**	609
Shareholders' funds at 1 January	**17,064**	16,455
Shareholders' funds at 31 December	**17,961**	17,064
Shareholders' funds are analysed as follows:		
Equity interests	**17,509**	16,575
Non-equity interests	**452**	489
	17,961	17,064

Non-equity interests in shareholders' funds comprise proceeds of the issue of US$ non-cumulative preference shares and the £1 preferred ordinary share (Note 30), including share premium and after deducting unamortised issue costs.

No note of historical cost profits and losses has been presented as there is no material difference between the group's results as disclosed in the consolidated profit and loss account and the results on an unmodified historical cost basis.

Notes on the Accounts

1 Basis of preparation

a The accounts have been prepared under the historical cost convention, as modified by the revaluation of certain investments and land and buildings, and in accordance with applicable accounting standards.

The consolidated accounts are prepared in accordance with the special provisions of Part VII Chapter II of the Companies Act 1985 ('the Act') relating to banking groups.

As permitted by Section 230 of the Act, no profit and loss account is presented for the bank.

In accordance with Financial Reporting Standard ('FRS') 8, 'Related Party Disclosures', no disclosure is presented of transactions with entities that are part of the HSBC Group as all voting rights are controlled by HSBC Holdings plc which publishes its own publicly available accounts. The group has also taken advantage of the exemption under FRS 1 (revised), 'Cash flow statements', allowing wholly-owned subsidiary undertakings to be excluded from the requirement to prepare a cash flow statement.

The accounts have been prepared in accordance with the Statements of Recommended Practice ('SORPs') issued by the British Bankers' Association ('BBA') and Irish Bankers' Federation ('IBF') and with the SORP 'Accounting issues in the asset finance and leasing industry' issued by the Finance & Leasing Association ('FLA').

The SORP issued by the Association of British Insurers ('ABI'), 'Accounting for insurance business' contains recommendations on accounting for insurance business for insurance companies and insurance groups. The group is primarily a banking group, rather than an insurance group, and, consistent with previously established practice for such groups preparing consolidated accounts complying with Schedule 9 to the Act, places a value on its long-term assurance businesses using a valuation of the discounted future earnings expected to emerge from business currently in force, taking into account factors such as recent experience and general economic conditions, together with the surplus retained in the long-term assurance funds.

b The preparation of financial information requires the use of estimates and assumptions about future conditions. This is particularly so in the development of provisions for bad and doubtful debts. Making reliable estimates of customers' and other counterparties' abilities to repay is often difficult even in periods of economic stability and becomes more difficult in periods of economic uncertainty such as exists in some of the group's overseas exposures. Therefore, while management believes it has employed all available information to estimate adequate allowances for all identifiable risks in the current portfolios, there can be no assurance that the provisions for bad and doubtful debts or other provisions will prove adequate for all losses ultimately realised.

c The consolidated accounts of the group comprise the accounts of HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). Accounts of subsidiary undertakings are made up to 31 December. The consolidated accounts include the attributable share of the results and reserves of joint ventures and associates, based on accounts made up to dates not earlier than six months prior to 31 December.

All significant intra-group transactions are eliminated on consolidation.

2 Principal accounting policies

a *Income recognition*

Interest income is recognised in the profit and loss account as it accrues, except in the case of doubtful debts (Note 2b).

Fee and commission income is accounted for in the period when receivable, except where it is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, it is recognised on an appropriate basis over the relevant period.

b *Loans and advances and doubtful debts*

It is the HSBC Group's policy that each operating company will make provisions for bad and doubtful debts promptly where required and on a consistent basis in accordance with established HSBC Group guidelines.

Loans are designated as non-performing as soon as management has doubts as to the ultimate collectability of principal or interest, or when contractual payments of principal or interest are 90 days overdue. When a loan is designated as non-performing, interest will be suspended (see below) and a specific provision raised if required.

2 Principal accounting policies *(continued)*

b *Loans and advances and doubtful debts (continued)*

However, the suspension of interest may exceptionally be deferred for up to 12 months past due in the following situations:

— where cash collateral is held covering the total of principal and interest due and a legal right of set-off exists; or

— where the value of net realisable tangible security is considered more than sufficient to cover the full repayment of all principal and interest due and credit approval has been given to the rolling-up or capitalisation of interest payments.

There are two basic types of provision, specific and general, each of which is considered in terms of the charge and the amount outstanding.

Specific provisions

Specific provisions represent the quantification of actual and inherent losses from identified accounts and are deducted from loans and advances in the balance sheet.

Other than where provisions on smaller balance homogeneous loans are assessed on a portfolio basis, the amount of specific provision raised is assessed on a case-by-case basis. The amount of specific provision raised is the group's estimate of the amount needed to reduce the carrying value of the asset to the expected ultimate net realisable value, and in reaching a decision consideration is given, among other things, to the following factors:

— the financial standing of the customer, including a realistic assessment of the likelihood of repayment of the loan within an acceptable period and the extent of the group's other commitments to the same customer;

— the realisable value of any security for the loan;

— the costs associated with obtaining repayment and realisation of the security; and

— if loans are not in local currency, the ability of the borrower to obtain the relevant foreign currency.

Where specific provisions are raised on a portfolio basis, the level of provisioning takes into account management's assessment of the portfolio's structure, past and expected credit losses, business and economic conditions, and any other relevant factors. The principal portfolios evaluated on a portfolio basis are credit cards and other consumer lending products.

General provisions

General provisions augment specific provisions and provide cover for loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future. HSBC requires operating companies to maintain a general provision, which is determined after taking into account:

— historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

— the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of a specific provision against that loss; and

— management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The estimated period between a loss occurring and its identification (as evidenced by the establishment of a specific provision for that loss) is determined by local management for each identified portfolio.

Loans on which interest is being suspended

Provided that there is a realistic prospect of interest being paid at some future date, interest on non-performing loans is charged to the customer's account. However, the interest is not credited to the profit and loss account but to an interest suspense account in the balance sheet which is netted against the relevant loan. On receipt of cash (other than from the realisation of security), suspended interest is recovered and taken to the profit and loss account. A specific provision of the same amount as the interest receipt is then raised against the principal balance. Amounts received from the realisation of security are applied to the repayment of outstanding indebtedness, with any surplus used to recover any specific provisions and then suspended interest.

Notes on the Accounts (continued)

2 Principal accounting policies *(continued)*

b *Loans and advances and doubtful debts (continued)*

Non-accrual loans

Where the probability of receiving interest payments is remote, interest is no longer accrued and any suspended interest balance is written off.

Loans are not reclassified as accruing until interest and principal payments are up-to-date and future payments are reasonably assured.

Loan write-offs

Loans and suspended interest are written off, either partially or in full, when there is no prospect of recovery of these amounts.

Assets acquired in exchange for advances

Assets acquired in exchange for advances in order to achieve an orderly realisation continue to be reported as advances. The asset acquired is recorded at the carrying value of the advance disposed of at the date of the exchange and subsequent provisions are based on any further deterioration in its value.

c *Treasury bills, debt securities and equity shares*

Treasury bills, debt securities and equity shares intended to be held on a continuing basis are disclosed as investment securities and are included in the balance sheet at cost less provision for any permanent diminution in value.

Where dated investment securities have been purchased at a premium or discount, these premiums and discounts are amortised through the profit and loss account over the period from the date of purchase to the date of maturity so as to give a constant rate of return. If the maturity is at the borrowers' option within a specified range of years, the earliest maturity is adopted. These securities are included in the balance sheet at cost adjusted for the amortisation of premiums and discounts arising on acquisition. The amortisation of premiums and discounts is included in 'Interest receivable'. Any profit or loss on realisation of these securities is recognised in the profit and loss account as it arises and included in 'Gains on disposal of investments'.

Other treasury bills, debt securities, equity shares and short positions in securities are included in the balance sheet at market value. Changes in the market value of such assets and liabilities are recognised in the profit and loss account as 'Dealing profits' as they arise. For liquid portfolios market values are determined by reference to independently sourced mid-market prices. In certain less liquid portfolios securities are valued by reference to bid or offer prices as appropriate. Where independent prices are not available, market values may be determined by discounting the expected future cash flows using an appropriate interest rate adjusted for the credit risk of the counterparty. In addition, adjustments are made for illiquid positions where appropriate.

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers'.

d *Subsidiary undertakings, joint ventures and associates*

The bank's investments in subsidiary undertakings are stated at net asset values including attributable goodwill, where this has been capitalised, with the exception of the group's interest in long-term assurance business as explained in Note 2(g). Changes in net assets of subsidiary undertakings are accounted for as movements in the revaluation reserve.

Interests in joint ventures are stated at the group's share of gross assets, including attributable goodwill, less the group's share of gross liabilities.

Interests in associates are stated at the group's share of net assets, including attributable goodwill.

Goodwill arises on the acquisition of subsidiary undertakings, joint ventures or associates when the cost of acquisition exceeds the fair value of the group's share of separable net assets acquired. Negative goodwill arises on the acquisition of subsidiary undertakings, joint ventures and associates when the fair value of the group's share of separable net assets acquired exceeds the cost of acquisition.

2 Principal accounting policies *(continued)*

d *Subsidiary undertakings, joint ventures and associates (continued)*

For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets' in respect of subsidiary undertakings, in 'Interests in joint ventures' in respect of joint ventures and in 'Interests in associates' in respect of associates. Capitalised goodwill is amortised over its estimated life on a straight-line basis. For acquisitions prior to 1 January 1998, goodwill was charged against reserves in the year of acquisition. Capitalised goodwill is tested for impairment when necessary by comparing the present value of the expected future cash flows from an entity with the carrying value of its net assets, including attributable goodwill. Negative goodwill is credited in the profit and loss account in the periods expected to be benefited.

At the date of disposal of subsidiary undertakings, joint ventures or associates, any unamortised goodwill or goodwill charged directly to reserves is included in the group's share of net assets of the undertaking in the calculation of the gain or loss on disposal of the undertaking.

e *Tangible fixed assets*

Land and buildings are stated at valuation or cost less depreciation calculated to write off the assets over their estimated useful lives as follows:

— freehold land and land held on leases with more than 50 years to expiry are not depreciated;

— land held on leases with 50 years or less to expiry is depreciated over the unexpired terms of the leases; and

— buildings and improvements thereto are depreciated on cost or valuation at the greater of 2 per cent per annum on the straight-line basis or over the unexpired terms of the leases or over the remaining useful lives.

Equipment, fixtures and fittings are stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 5 and 20 years.

Operating lease assets (Note 2f) are depreciated over their useful economic lives such that, for each asset, rentals less depreciation are recognised at a constant periodic rate of return on the net cash invested in that asset.

f *Finance and operating leases*

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the group is a lessor under finance leases the amounts due under the leases, and under hire purchase contracts that are in the nature of finance leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers'. Finance charges receivable are recognised over the periods of the leases so as to give a constant rate of return on the net cash investment in the leases, taking into account tax payments and receipts associated with the leases.

Where the group is a lessee under finance leases the leased assets are capitalised and included in 'Equipment, fixtures and fittings' and the corresponding liability to the lessor is included in 'Other liabilities'. Finance charges payable are recognised over the periods of the leases, based on the interest rates implicit in the leases.

All other leases are classified as operating leases and, where the group is the lessor, are included in 'Tangible fixed assets'. The residual values of equipment on operating leases are regularly monitored. Provision is made to the extent that the carrying value of equipment is impaired through residual values not being fully recoverable. Rentals payable and receivable under operating leases are accounted for on the straight-line basis over the periods of the leases and are included in 'Administrative expenses' and 'Other operating income' respectively.

g *Long-term assurance business*

The value placed on the group's interest in long-term assurance business includes a valuation of the discounted future earnings expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as recent experience and general economic conditions, together with the surplus retained in the long-term assurance funds. These are determined annually in consultation with independent actuaries and are included in 'Other assets'.

Changes in the value placed on the group's interest in long-term assurance business are calculated on a post-tax basis and reported in the profit and loss account as part of 'Other operating income' after adjusting for taxation.

Long-term assurance assets and liabilities attributable to policyholders are recognised in the group's accounts in 'Other assets' and 'Other liabilities'.

Notes on the Accounts (continued)

2 Principal accounting policies *(continued)*

h *Deferred taxation*

Deferred tax is recognised in full on timing differences between the accounting and taxation treatment of income and expenditure, subject to assessment of the recoverability of deferred tax assets. Deferred tax balances are not discounted.

i *Pension and other post-retirement benefits*

The group operates a number of pension and other post-retirement benefit schemes.

For UK defined benefit pension schemes, annual contributions are made, on the advice of qualified actuaries, for funding of retirement benefits in order to build up reserves for each scheme member during the employee's working life and used to pay a pension to the employee or dependant after retirement. The costs of providing these benefits are charged to the profit and loss account on a systematic basis over employees' service lives.

Arrangements for staff retirement benefits in overseas locations vary from country to country and are made in accordance with local regulations and custom. The pension cost of the major overseas schemes is assessed in accordance with the advice of qualified actuaries so as to recognise the cost of pensions on a systematic basis over employees' service lives.

The cost of providing post-retirement health-care benefits, which is assessed in accordance with the advice of qualified actuaries, is recognised on a systematic basis over employees' service lives.

j *Foreign currencies*

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the year-end. The results of overseas branches and subsidiary undertakings, joint ventures and associates are translated into sterling at the average rates of exchange for the year.

Exchange differences arising from the retranslation of opening foreign currency net investments and the related cost of hedging and exchange differences arising from retranslation of the result for the year from the average rate to the exchange rate ruling at the year-end are accounted for in reserves.

Other exchange differences are recognised in the profit and loss account.

k *Off-balance-sheet financial instruments*

Off-balance-sheet financial instruments comprise futures, forward, swap and option transactions undertaken by the group in the foreign exchange, interest rate, equity, credit derivative and commodity markets. Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with netting shown separately.

Accounting for these instruments is dependent upon whether the transactions are undertaken for trading or non-trading purposes.

Trading transactions

Trading transactions include transactions undertaken for market-making, to service customers' needs and for proprietary purposes, as well as any related hedges.

Transactions undertaken for trading purposes are marked-to-market and the net present value of any gain or loss arising is recognised in the profit and loss account as 'Dealing profits', after appropriate deferrals for unearned credit margin and future servicing costs. Off-balance-sheet trading transactions are valued by reference to an independent liquid price where this is available. For those transactions where there are no readily quoted prices, which predominately relates to over the counter transactions, market values are determined by reference to independently sourced rates, using valuation models. Adjustments are made for illiquid positions where appropriate.

Assets, including gains, resulting from off-balance-sheet exchange rate, interest rate, equities, credit derivative and commodity contracts that are marked-to-market are included in 'Other assets'. Liabilities, including losses, resulting from such contracts, are included in 'Other liabilities'.

2 Principal accounting policies *(continued)*

k *Off-balance-sheet financial instruments (continued)*

Non-trading transactions

Non-trading transactions are those which are held for hedging purposes as part of the group's risk management strategy against assets, liabilities, positions or cash flows measured on an accruals basis. Non-trading transactions include qualifying hedges and positions that synthetically alter the characteristics of specified financial instruments.

Non-trading transactions are accounted for on an equivalent basis to the underlying assets, liabilities or net positions. Any gain or loss arising is recognised on the same basis as that arising from the related assets, liabilities or positions.

To qualify as a hedge, a derivative must effectively reduce the price, foreign exchange or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative must be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. If these criteria are met, the derivative is accounted for on the same basis as the underlying hedged item. Derivatives used for hedging purposes include swaps, forwards and futures.

Interest rate swaps are also used to alter synthetically the interest rate characteristics of financial instruments. In order to qualify for synthetic alteration, a derivative instrument must be linked to specific individual, or pools of similar, assets or liabilities by the notional principal and interest rate risks of the associated instruments, and must achieve a result that is consistent with defined risk management objectives. If these criteria are met, accruals based accounting is applied, i.e. income or expense is recognised and accrued to the next settlement date in accordance with the contractual terms of the agreement.

Any gain or loss arising on the termination of a qualifying derivative is deferred and amortised to earnings over the original life of the terminated contract. Where the underlying asset, liability or position is sold or terminated, the qualifying derivative is immediately marked-to-market and any gain or loss arising is taken to the profit and loss account.

3 Dividend income

	2004	2003
	£m	£m
Income from equity shares	**305**	88

4 Dealing profits

	2004	2003
	£m	£m
Foreign exchange	**475**	398
Interest rate derivatives	**196**	144
Debt securities	**30**	84
Equities and other trading	**(132)**	54
	569	680

Notes on the Accounts (continued)

5 Administrative expenses

a *Analysis of expenses*

	2004 £m	2003 £m
Staff costs		
— wages and salaries	**2,648**	2,537
— social security costs	**359**	330
— other pension costs (Note 5b below)	**272**	274
	3,279	3,141
Premises and equipment (excluding depreciation)	**595**	582
Other administrative expenses	**1,293**	1,163
	5,167	4,886

The average number of persons employed by the group during the year was made up as follows:

	2004	2003
UK Personal, Commercial, Corporate and Institutional Banking	**44,957**	46,609
Global Markets UK	**713**	964
Investment Banking	**2,186**	1,778
International Banking	**6,801**	7,116
CCF	**14,066**	14,162
Private Banking	**3,858**	3,587
HSBC Trinkaus & Burkhardt	**1,643**	1,578
	74,224	75,794

The average numbers of persons for acquisitions and transfers have been weighted in proportion to the time that the relevant subsidiaries have been owned by the group.

b *Retirement benefits*

The group has continued to account for pensions in accordance with Statement of Standard Accounting Practice ('SSAP') 24, 'Accounting for pension costs' and the disclosures given in (i) are those required by that standard. FRS 17, 'Retirement benefits' was issued in November 2000. Phased transitional disclosures are required from 31 December 2001. These disclosures, to the extent not given in (i), are set out in (ii).

i *Pension schemes*

Within the group, the HSBC Bank (UK) Pension Scheme, assets of which are held in a separate trust fund, covers 94 per cent of UK employees. The HSBC Bank (UK) Pension Scheme comprises a funded defined benefit scheme ('the Principal Scheme') and a defined contribution scheme which was established on 1 July 1996 for new employees.

Actuarial valuations of the assets and liabilities of the Principal Scheme are carried out triennially by professionally qualified actuaries to determine its financial position and to enable the bank to determine the level of contributions to be made to the Principal Scheme.

The latest valuation of the Principal Scheme was made at 31 December 2002 by C G Singer, Fellow of the Institute of Actuaries, of Watson Wyatt LLP. At that date, the market value of the Principal Scheme's assets was £5,772 million. The actuarial value of the assets represented 88 per cent of the benefits accrued to members, after allowing for expected future increases in earnings, and the resulting deficit amounted to £788 million. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 6.85 per cent per annum, salary increases of 3.0 per cent per annum and post-retirement pension increases of 2.5 per cent per annum.

5 Administrative expenses *(continued)*

b *Retirement benefits (continued)*

i *Pension schemes (continued)*

As previously advised, in anticipation of the above valuation result, HSBC made a payment into the scheme, in February 2003, amounting to £500 million. In addition, following receipt of the valuation results, a further payment of £84 million was made in August 2003 into the scheme. HSBC has decided to continue ongoing contributions to the scheme at the rate of 20.0 per cent of pensionable salaries, until completion of the next actuarial valuation, due as at 31 December 2005.

The deficit as at 31 December 2002 is being amortised over a 13 year period, the average remaining service life of the existing employed members. The amortisation is net of the interest benefit from the £584 million payments made during 2003.

The group's total pension cost for the year ended 31 December 2004 was £248 million (2003: £272 million), which includes £157 million (2003: £174 million) in respect of the Principal Scheme. This comprises:

	Year ended 31 December 2004
	£m
Regular cost	**113**
Amortisation of deficit	**44**
Total cost for the year	**157**

A prepayment of £459 million (2003: £502 million) for the group entities participating in the Principal Scheme is included in Prepayments and accrued income.

For CCF, retirement provision for employees in France is provided via both State and compulsory supplementary pension funds founded (via Government decree) on agreements between Employer Organisations and Unions. These 'compulsory supplementary' arrangements cover some 14,214 employees.

ii *FRS 17*

The financial assumptions used to calculate scheme liabilities for the group's main defined benefit schemes under FRS 17 are:

2004	*Discount rate*	*Inflation assumption*	*Rate of increase for pensions in payment and deferred pension*	*Rate of pay Increase*
	%	**%**	**%**	**%**
United Kingdom*	**5.3**	**2.7**	**2.7**	**3.2**
France	**4.5**	**2.0**	**2.0**	**3.5**
Switzerland	**3.25**	**1.5**	**0 - 0.5**	**2.25**

2003	*Discount rate*	*Inflation assumption*	*Rate of increase for pensions in payment and deferred pension*	*Rate of pay increase*
	%	%	%	%
United Kingdom*	5.5	2.5	2.5	3.0
France	5.25	2.0	2.0	3.5
Switzerland	3.5	1.5	0 - 1.5	2.5

** United Kingdom disclosure in this section mostly relates to the bank.*

5 **Administrative expenses** *(continued)*

b *Retirement benefits (continued)*

ii FRS 17 (continued)

2002	Discount rate	Inflation assumption	Rate of increase for pensions in payment and deferred pension	Rate of pay increase
	%	%	%	%
United Kingdom*	5.6	2.25	2.25	2.75
France	5.5	2.0	2.0	3.5
Switzerland	3.75	1.5	0 - 1.5	2.5

* *United Kingdom disclosure in this section mostly relates to the bank.*

The assets in the defined benefit schemes and the expected rates of return are:

	Expected rate of return at 31 December 2004	Value at 31 December 2004	Expected rate of return at 31 December 2003	Value at 31 December 2003	Expected rate of return at 31 December 2002	Value at 31 December 2002
	%	£m	%	£m	%	£m
Equities	**8.1**	**4,362**	8.5	3,916	8.5	3,395
Bonds	**4.7**	**2,139**	4.9	1,992	4.9	1,293
Property	**6.5**	**754**	7.0	621	7.0	659
Other	**3.5**	**397**	3.84	515	3.65	263
Total market value of assets		**7,652**		7,044		5,610
Present value of scheme liabilities		**(10,041)**		(9,066)		(7,484)
Deficit in the schemes*		**(2,389)**		(2,022)		(1,874)
Related deferred tax asset		**699**		588		540
Net pension liability		**(1,690)**		(1,434)		(1,334)
* Analysis of the deficit is as follows:						
The Principal Scheme		**(2,151)**		(1,794)		(1,636)
Other schemes — unfunded		**(225)**		(224)		(199)
Other schemes — funded		**(13)**		(4)		(39)
		(2,389)		(2,022)		(1,874)

Of the deficit in unfunded schemes, £218 million has been provided (2003: £219 million).

The net pension liability would have a consequent effect on reserves if recognised.

The Principal Scheme is closed to new entrants. For this scheme the current service cost under the projected unit credit method will increase as the members of the scheme approach retirement.

The Principal Scheme mostly relates to the bank.

5 Administrative expenses *(continued)*

b *Retirement benefits (continued)*

ii FRS 17 (continued)

If FRS 17 had been implemented in full, the following amounts would be reflected in the consolidated profit and loss account and statement of total consolidated recognised gains and losses:

	Year ended 31 December 2004	*Year ended 31 December 2003*	*Year ended 31 December 2002*
	£m	£m	£m
Amount that would be charged to operating profit			
Current service cost	**209**	169	
Past service cost	**8**	9	
Total operating charge	**217**	178	
Amount that would be credited to other finance income			
Expected return on pension scheme assets	**491**	424	
Interest on pension scheme liabilities	**(487)**	(404)	
Net return	**4**	20	
Amount that would be recognised in the statement of total consolidated recognised gains and losses			
Actual return less expected return on pension scheme assets	**260**	614	
Experience gains and losses arising on the scheme liabilities	**88***	(129)	
Changes in assumptions underlying the present value of the scheme liabilities	**(672)**	(1,168)	
Actuarial loss	**(324)**	(683)	
Movement in pension schemes deficit during the year			
Deficit in the pension schemes at 1 January	**(2,022)**	(1,874)	
Movement in the year:			
Total operating charge	**(217)**	(178)	
Contributions	**172**	711	
Other finance income	**4**	20	
Actuarial loss	**(324)**	(683)	
Acquisitions	**—**	—	
Exchange and other movements	**(2)**	(18)	
Deficit in the pension schemes at 31 December	**(2,389)**	(2,022)	
History of experience gains and losses			
Difference between expected and actual return on scheme assets:			
Amount	**260**	614	(853)
Percentage of scheme assets	**3%**	9%	(15%)
Experience gains and losses arising on scheme liabilities:			
Amount	**88**	(129)	(347)
Percentage of the present value of scheme liabilities	**1%**	(1%)	(5%)
Total amount recognised in the statement of total consolidated recognised gains and losses:			
Amount	**(324)**	(683)	(949)
Percentage of the present value of scheme liabilities	**(3%)**	(8%)	(13%)

** Includes £100 million increase in pension liability relating to termination benefits attributable to members of the HSBC Bank (UK) Pension Scheme. If FRS 17 were implemented this amount would be recognised in the profit and loss account but not as part of pension costs. A further amount of £32.5 million attributable to members scheduled to cease employment in 2005 is not included in the liability for this scheme as at 31 December 2004.*

The Principal Scheme covers both UK employees of the group and UK employees of other HSBC Group companies.

Notes on the Accounts (continued)

5 Administrative expenses *(continued)*

b *Retirement benefits (continued)*

iii *Post-retirement health-care benefits*

The group also provides post-retirement health-care benefits for certain pensioners and employees together with their dependent relatives. An actuarial assessment of the liabilities of the schemes, which is unfunded, is carried out on a regular basis by qualified actuaries. The liabilities are evaluated by discounting the expected future claims to a net present value.

The charge relating to post-retirement health-care is £24 million for the year (2003: £2 million).

The latest actuarial assessment was carried out at between 31 December 2000 and 31 December 2004, and updated to 31 December 2004 where necessary. At 31 December 2004, the estimated present value of the post-retirement benefit obligation was £146 million (2003: £121 million) for the group and £122 million (2003: £121 million) for the bank, of which £134 million (2003: £115 million) has been provided for by the group and £110 million (2003: £115 million) has been provided for by the bank. The actuarial assumptions used to estimate the obligation vary according to the claims experience and economic conditions of the countries in which the schemes are situated. For the UK scheme, the main financial assumptions used to estimate the obligation at 31 December 2004 were price inflation of 2.7 per cent per annum (2003: 2.5 per cent, 2002: 2.5 per cent), health-care claims cost escalation of 7.7 per cent per annum (2003: 7.5 per cent, 2002: 7.5 per cent) and a discount rate of 5.3 per cent per annum (2003: 5.3 per cent, 2002: 5.6 per cent). Under FRS 17, the deferred tax asset related to the unprovided liability of £12 million (2003: £6 million) would be £4 million (2003: £2 million).

The movement in the FRS 17 liability is as follows:

	Year ended 31 December 2004 **£m**	*Year ended 31 December 2003* £m
Deficit at 1 January	**(121)**	(120)
Contributions	**6**	—
Interest cost on liabilities	**(6)**	(7)
Change in assumptions underlying the present value of scheme liabilities	**(24)**	6
Exchange and other movements	**(1)**	—
Deficit at 31 December	**(146)**	(121)

c *Directors' emoluments*

The aggregate emoluments of the Directors of the bank, computed in accordance with Part I of Schedule 6 of the Act were:

	2004 £000	2003 £000
Fees	**320**	196
Salaries and other emoluments	**1,330**	1,629
Discretionary bonuses	**2,882**	1,510
	4,532	3,335

In addition, there are annual commitments under retirement benefit agreements with former Directors of £595,539 (2003: £460,980).

5 Administrative expenses *(continued)*

c *Directors' emoluments (continued)*

Retirement benefits accrue to five Directors under defined benefit schemes and to two Directors under a money purchase scheme.

During the year, aggregate contributions to money purchase pension schemes were £2,623,000 (2003: £1,779,000).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Group Remuneration Committee of HSBC Holdings.

Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 14.

d *Auditors' remuneration*

Auditors' remuneration for statutory audit amounted to £7.7 million (2003: £7.3 million) including £3.2 million (2003: £2.9 million) which relates to the bank. The following remuneration was paid to the group's principal auditor (KPMG):

	2004	2003
	£m	£m
Audit services		
Statutory audit	**7.1**	6.9
Audit-related regulatory reporting	**2.2**	1.2
	9.3	8.1
Further assurance services	**1.2**	1.5
Tax services		
Advisory services	**0.3**	0.4
Other services		
Other services	**0.6**	0.5
Total fees paid to principal auditor	**11.4**	10.5

Fees paid in respect of auditors other than the principal auditor for audits were £0.6 million (2003: £0.4 million).

The following is a description of the type of services included within the categories listed above.

Audit-related services include services for assurance and other services that are reasonably related to the performance of the audit or review of the accounts including comfort letters and interim reviews.

Further assurance services include services for advice on accounting matters, reporting on internal controls not connected with the accounts (such as Section 166 reports), due diligence work, and environmental audits.

Tax services include services for tax advice.

Notes on the Accounts (continued)

6 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after:

a *Income*

	2004 £m	2003 £m
Aggregate rentals receivable, under		
— finance leases	260	230
— hire purchase contracts	575	656
— operating leases	343	335
Increase in the value of long-term assurance business	63	53
Profits less losses on debt securities and equities dealing	52	102
Gain on disposal of investment securities	89	119

b *Charges on income*

	2004 £m	2003 £m
Charges incurred with respect to subordinated liabilities	273	262
Finance charges in respect of finance leases and similar hire purchase contracts	18	15
Rentals payable on premises held under operating leases	159	198

c *Gains on disposal of investments and tangible fixed assets*

Gains on disposal of investments and tangible fixed assets attracted a tax charge of £35 million (2003: £24 million).

7 Tax on profit on ordinary activities

The charge for taxation comprises:

	2004 £m	2003 £m
United Kingdom corporation tax charge	540	590
Adjustment in respect of prior periods	(34)	(123)
	506	467
Relief for overseas taxation	(155)	(186)
	351	281
Overseas taxation (including £(24) million (2003: £(15) million) in respect of previous periods)	239	275
Joint ventures and associates	11	6
Current taxation	601	562
Origination and reversal of timing differences	192	75
Adjustment in respect of previous periods	(27)	4
Deferred taxation (Note 27a)	165	79
Total charge for taxation	766	641

During the year, the group provided for UK corporation tax at 30 per cent (2003: 30 per cent).

The tax charge includes £14 million (2003: £11 million) in respect of the tax attributable to the increase in the value of long-term assurance business attributable to shareholders.

7 Tax on profit on ordinary activities *(continued)*

Analysis of overall tax charge

	2004 £m	2003 £m
Taxation at UK corporation tax rate of 30% (2003: 30%)	**777**	673
Other non-deductible items including unrelieved losses	**20**	15
Tax-free gains	**(12)**	(1)
Impact of differently taxed overseas profits in principal locations	**(61)**	(90)
Amortisation of goodwill	**170**	164
Prior year adjustments	**(86)**	(121)
Other items	**(42)**	1
Timing differences impact on current tax	**(165)**	(79)
Current tax charge	**601**	562
Deferred tax charge	**165**	79
Overall tax charge	**766**	641

8 Profit of the bank

The profit of the bank for the year attributable to shareholders was £1,536 million (2003: £1,650 million).

9 Dividends

	2004 £m	2003 £m
Equity		
Ordinary dividends		
— paid	**700**	700
— proposed	**700**	700
	1,400	1,400
Non-equity		
Preference dividends	**36**	40
	1,436	1,440

10 Treasury bills and other eligible bills

	group				*bank*			
	Book value	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*
	2004 £m	**2004 £m**	2003 £m	2003 £m	**2004 £m**	**2004 £m**	2003 £m	2003 £m
Investment securities								
— treasury bills and similar securities	**5,410**	**5,407**	1,560	1,562	**5,070**	**5,064**	1,045	1,047
— other eligible bills	**363**	**363**	438	438	**363**	**363**	438	438
	5,773	**5,770**	1,998	2,000	**5,433**	**5,427**	1,483	1,485
Other securities								
— treasury bills and similar securities	**109**		199		**65**		152	
	5,882		2,197		**5,498**		1,635	

Notes on the Accounts (continued)

10 Treasury bills and other eligible bills *(continued)*

Investment securities:	*Cost and book value*
group	**£m**
At 1 January 2004	**1,998**
Additions	**14,763**
Disposals and amounts repaid	**(11,122)**
Amortisation of discounts and premiums	**98**
Exchange and other movements	**36**
At 31 December 2004	**5,773**
bank	**£m**
At 1 January 2004	**1,483**
Additions	**14,301**
Disposals and amounts repaid	**(10,498)**
Amortisation of discounts and premiums	**98**
Exchange and other movements	**49**
At 31 December 2004	**5,433**

The maturities of investment treasury bills and other eligible bills at 31 December 2004 are analysed as follows:

	group		*bank*	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	**£m**	**£m**
Due within 1 year	**5,595**	**5,588**	**5,423**	**5,417**
Due 1 year and over	**178**	**182**	**10**	**10**
	5,773	**5,770**	**5,433**	**5,427**

The net unamortised discounts on investment securities were:

group	*bank*
2004	**2004**
£m	**£m**
34	**25**

11 Loans and advances to banks

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Remaining maturity				
— repayable on demand	**5,855**	8,084	**5,599**	7,388
— 3 months or less but not repayable on demand	**23,767**	21,757	**13,676**	11,612
— 1 year or less but over 3 months	**4,429**	2,937	**2,895**	1,223
— 5 years or less but over 1 year	**590**	587	**722**	512
— over 5 years	**250**	288	**94**	211
Specific bad and doubtful debt provisions (Note 13)	**(7)**	(11)	**(4)**	(4)
	34,884	33,642	**22,982**	20,942
Amounts include:				
Subordinated	**67**	61	**—**	—
Due from subsidiary undertakings				
— unsubordinated			**3,340**	2,348
Due from fellow subsidiary undertakings				
— unsubordinated	**5,698**	3,438	**5,087**	2,875

12 Loans and advances to customers

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Remaining maturity				
— repayable on demand or at short notice	**21,297**	20,199	**14,903**	20,388
— 3 months or less but not repayable on demand or at short notice	**28,328**	21,098	**18,793**	9,035
— 1 year or less but over 3 months	**12,893**	11,694	**8,212**	6,696
— 5 years or less but over 1 year	**34,237**	29,321	**24,738**	21,618
— over 5 years	**45,430**	36,366	**35,236**	27,929
General and specific bad and doubtful debt provisions (Note 13)	**(2,354)**	(2,380)	**(1,292)**	(1,346)
	139,831	116,298	**100,590**	84,320
Amounts include:				
Subordinated	**133**	134	**5**	15
Due from subsidiary undertakings				
— unsubordinated			**8,045**	6,882
Due from fellow subsidiary undertakings				
— unsubordinated	**1,000**	864	**982**	831
Due from joint ventures				
— unsubordinated	**434**	211	**397**	175

Notes on the Accounts (continued)

12 Loans and advances to customers *(continued)*

Securitisation transactions

Loans and advances to customers include balances that have been securitised. Certain of these balances meet the requirements for linked presentation under FRS 5, 'Reporting the substance of transactions'.

The non-recourse finance has been netted against loans and advances to customers as follows:

	2004	2003
	£m	£m
Customer loans	**676**	1,202
Non-recourse finance	**(570)**	(1,054)
Funding provided by the bank	**106**	148

The bank has securitised a designated portion of its corporate loan portfolio. The transaction was effected through a declaration of trust in favour of Clover Securitisation Limited. Clover Securitisation Limited holds its beneficial interest in the trust for Clover Funding No. 1 plc, Clover Funding No. 3 plc, Clover Funding No. 4 plc (collectively 'Clover Funding') and the bank.

To fund the acquisition of this beneficial interest, Clover Funding has issued £1,039 million (2003: £1,423 million) floating rate notes ('FRNs'). Clover Funding No.1 plc is in scheduled accumulation and has collected £363 million (2003: Clover Funding No. 2 plc £221 million) to repay its outstanding Notes in April 2005. The offering circulars for the FRNs stated that they are the obligations of Clover Funding only and are not guaranteed by, or the responsibility of, any other party.

Non-returnable proceeds of £570 million (2003: £1,054 million) received by the bank from Clover Funding have been deducted from 'Loans and advances to customers'. Clover Securitisation Limited has entered into swap agreements with the bank under which Clover Securitisation Limited pays the floating rate of interest on the loans and receives interest linked to three-month London Interbank Offered Rate ('LIBOR'). The proceeds generated from the loans are used in priority to meet the claims of the FRN holders, and amounts payable in respect of the interest rate swap arrangements after the payment of trustee and administration expenses.

There is no provision whatsoever, either in the financing arrangements or otherwise, whereby the bank or any part of the group has a right or obligation either to keep the loans and advances on repayment of the finance or to repurchase them at any time other than in certain circumstances where the bank is in breach of warranty.

The bank is not obliged to support any losses that may be suffered by the FRN holders and does not intend to provide such support.

The bank has taken up £30 million (2003: £41 million) of subordinated FRNs that are repayable after payments in respect of senior FRNs. The bank has made subordinated loans of £19 million (2003: £26 million) to Clover Funding that are repayable after all other payments. Interest is payable on the subordinated FRNs and subordinated loans conditional upon Clover Funding having funds available.

Clover Securitisation Limited's entire share capital is held by Clover Holdings Limited. Clover Funding's entire share capital is held by Clover Holdings Limited. Clover Holdings Limited's entire share capital is held by trustees under the terms of a trust for charitable purposes.

The bank recognised net income of £4 million (2003: £4 million) which comprised £62 million (2003: £66 million) interest receivable by Clover Funding and £58 million (2003: £62 million) of interest on FRNs and other third-party expenses payable by Clover Funding.

13 Provisions for bad and doubtful debts

a *Movements on provisions for bad and doubtful debts*

	Specific	*General*	*Total*	*Specific*	*General*	*Total*
	2004	**2004**	**2004**	2003	2003	2003
	£m	**£m**	**£m**	£m	£m	£m
group						
At 1 January	**1,927**	**464**	**2,391**	1,739	527	2,266
Amounts written off	**(551)**	**—**	**(551)**	(437)	—	(437)
Recoveries of amounts written off in previous years	**48**	**—**	**48**	70	—	70
Charge/(release) to the profit and loss account	**463**	**(85)**	**378**	509	(73)	436
Acquisitions	**105**	**2**	**107**	—	—	—
Exchange and other movements	**(11)**	**(1)**	**(12)**	46	10	56
At 31 December	**1,981**	**380**	**2,361**	1,927	464	2,391
Bank						
At 1 January	**1,076**	**274**	**1,350**	991	334	1,325
Amounts written off	**(439)**	**—**	**(439)**	(354)	—	(354)
Recoveries of amounts written off in previous years	**38**	**—**	**38**	60	—	60
Charge/(release) to the profit and loss account	**363**	**(11)**	**352**	393	(60)	333
Exchange and other movements	**(4)**	**(1)**	**(5)**	(14)	—	(14)
At 31 December	**1,034**	**262**	**1,296**	1,076	274	1,350

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Included in:				
Loans and advances to banks (Note 11)	**7**	11	**4**	4
Loans and advances to customers (Note 12)	**2,354**	2,380	**1,292**	1,346
	2,361	2,391	**1,296**	1,350

b *Movements on suspended interest account*

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
At 1 January	**81**	80	**32**	35
Amounts written off	**(30)**	(13)	**(13)**	(10)
Interest suspended during the year	**25**	27	**16**	17
Suspended interest recovered	**(18)**	(17)	**(11)**	(9)
Acquisition of subsidiary undertakings	**9**	—	**—**	—
Exchange and other movements	**(3)**	4	**(2)**	(1)
At 31 December	**64**	81	**22**	32

Notes on the Accounts (continued)

13 Provisions for bad and doubtful debts *(continued)*

c *Non-performing loans*

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Loans on which interest has been suspended (net of suspended interest)	**1,324**	1,449	**533**	900
Provisions	**(746)**	(793)	**(321)**	(486)
	578	656	**212**	414
Other non-performing loans	**1,607**	1,594	**973**	898
Provisions	**(1,235)**	(1,134)	**(713)**	(590)
	372	460	**260**	308
Total non-performing loans (net of provisions)	**950**	1,116	**472**	722

14 Concentrations of exposure

The group has the following concentrations of loans and advances to customers:

	2004	2003
	£m	£m
Total gross advances to customers:		
Residential mortgages	**36,560**	29,028
Other personal	**26,537**	20,606
Commercial, industrial and international trade	**28,045**	27,517
Commercial real estate	**9,839**	8,751
Other property related	**3,568**	3,070
Government	**1,916**	1,430
Other commercial	**18,991**	15,630
Non-bank financial institutions	**16,791**	12,385
	142,247	118,417

The analysis of concentration of exposure is based on the categories used by the group to manage the associated risks. Of total loans and advances to customers gross of provisions, £103,060 million (2003: £83,939 million) was advanced by operations located in the United Kingdom.

Other commercial includes advances in respect of transport, energy and agriculture.

15 Debt securities

	group				bank			
	Book value	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*
	2004	**2004**	2003	2003	**2004**	**2004**	2003	2003
Issued by public bodies	**£m**	**£m**	£m	£m	**£m**	**£m**	£m	£m
Investment securities								
— government securities and US government agencies	**9,434**	**9,528**	7,276	7,377	**4,487**	**4,496**	2,609	2,610
— other public sector securities	**623**	**683**	785	845	**104**	**107**	105	108
	10,057	**10,211**	8,061	8,222	**4,591**	**4,603**	2,714	2,718
Other debt securities								
— government securities and US government agencies	**13,325**		9,938		**3,805**		2,100	
— other public sector securities	**83**		58		**30**		22	
	13,408		9,996		**3,835**		2,122	
Issued by other bodies								
Investment securities								
— bank and building society certificates of deposit	**883**	**883**	106	106	**620**	**620**	66	66
— other securities	**15,938**	**16,145**	14,042	14,348	**3,406**	**3,473**	3,327	3,374
	16,821	**17,028**	14,148	14,454	**4,026**	**4,093**	3,393	3,440
Other debt securities								
— bank and building society certificates of deposit	**3,833**		3,882		**3,486**		3,748	
— other securities	**15,889**		13,469		**9,100**		10,343	
	19,722		17,351		**12,586**		14,091	
	60,008		49,556		**25,038**		22,320	
Due within 1 year	**19,587**		12,426		**8,814**		7,247	
Due 1 year and over	**40,421**		37,130		**16,224**		15,073	
	60,008		49,556		**25,038**		22,320	
Amounts include:								
Subordinated debt securities	**304**		145		**273**		107	
Unamortised net premiums on investment securities	**210**		139		**123**		83	
Investment securities								
— listed	**17,666**	**20,319**	17,376	17,826	**5,549**	**5,610**	4,080	4,127
— unlisted	**9,212**	**6,920**	4,833	4,850	**3,068**	**3,086**	2,027	2,031
	26,878	**27,239**	22,209	22,676	**8,617**	**8,696**	6,107	6,158
Other debt securities								
— listed	**21,650**		17,727		**10,470**		9,258	
— unlisted	**11,480**		9,620		**5,951**		6,955	
	33,130		27,347		**16,421**		16,213	
	60,008		49,556		**25,038**		22,320	

Notes on the Accounts (continued)

15 Debt securities *(continued)*

Where securities are carried at market valuation, and the market valuation is higher than cost, the difference between cost and market valuation is not disclosed as it cannot be determined without unreasonable expense.

The above market valuations do not take account of transactions entered into to hedge the value of the group's investment securities. If these transactions were included, the market valuation of investment securities would be £27,121 million for the group (2003: £22,496 million) and £8,696 million (2003: £6,158 million) for the bank.

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
group			
At 1 January 2004	**22,230**	**(21)**	**22,209**
Additions	**22,132**	**(9)**	**22,123**
Disposals and amounts repaid	**(16,747)**	**6**	**(16,741)**
Amortisation of discounts and premiums	**(46)**	**—**	**(46)**
Exchange and other movements	**(668)**	**1**	**(667)**
At 31 December 2004	**26,901**	**(23)**	**26,878**
Bank			
At 1 January 2004	**6,107**	—	**6,107**
Additions	**4,692**	—	**4,692**
Disposals and amounts repaid	**(2,038)**	—	**(2,038)**
Amortisation of discounts and premiums	**(38)**	—	**(38)**
Exchange and other movements	**(106)**	—	**(106)**
At 31 December 2004	**8,617**	—	**8,617**

16 Equity shares

	group				*bank*			
	Book value	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*
	2004	**2004**	2003	2003	**2004**	**2004**	2003	2003
	£m	**£m**	£m	£m	**£m**	**£m**	£m	£m
Investment securities								
— listed	**411**	**560**	524	649	**32**	**54**	61	88
— unlisted	**951**	**1,149**	1,195	1,397	**87**	**98**	95	106
	1,362	**1,709**	1,719	2,046	**119**	**152**	156	194
Other securities								
— listed	**6,731**		4,098		**4,498**		2,694	
— unlisted	**12**		20		**—**		—	
	6,743		4,118		**4,498**		2,694	
	8,105		5,837		**4,617**		2,850	

16 Equity shares *(continued)*

Where securities are carried at market valuation, and the market valuation is higher than cost, the difference between cost and market valuation is not disclosed as it cannot be determined without unreasonable expense.

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
group			
At 1 January 2004	**1,987**	**(268)**	**1,719**
Additions	**1,165**	**—**	**1,165**
Disposals	**(1,367)**	**70**	**(1,297)**
Provisions made	**—**	**(23)**	**(23)**
Exchange and other movements	**(259)**	**57**	**(202)**
At 31 December 2004	**1,526**	**(164)**	**1,362**
bank			
At 1 January 2004	**191**	**(35)**	**156**
Additions	**38**	**—**	**38**
Disposals	**(33)**	**6**	**(27)**
Provisions made	**—**	**(4)**	**(4)**
Exchange and other movements	**(43)**	**(1)**	**(44)**
At 31 December 2004	**153**	**(34)**	**119**

Included in investment securities is £0.8 million, after amortisation, of HSBC Holdings' shares (2003: £2 million) held in trust for the purposes of conditional awards under the Restricted Share Plan, details of which are provided in the 'Report of the Directors' on page 21. At 31 December 2004, the trust held 1,324,856 ordinary shares (2003: 1,418,000) of nominal value US$0.50 each with a market value at that date of £12 million (2003: £13 million) in respect of these conditional awards.

Also included within investment securities is £16 million of HSBC Holdings' shares (2003: £24 million) held in trust which may be used in respect of the exercise of share options. At 31 December 2004, the trust held 1,908,332 ordinary shares (2003: 2,719,256) of US$0.50 each with a market value of £17 million (2003: £24 million) in respect of these option holders.

17 Interests in joint ventures

a *Movements in interests in joint ventures*

	group
	£m
At 1 January 2004	**6**
Retained profits and losses	**1**
At 31 December 2004	**7**

The joint venture is not listed and not a bank.

Notes on the Accounts (continued)

17 Interests in joint ventures *(continued)*

b *Principal joint venture as at 31 December 2004*

	Country of incorporation	*Principal activity*	*Interest in equity capital*
Framlington Group Limited	UK	Asset management	51%

Framlington Group Limited prepares its financial statements up to 31 December and its principal country of operation is the United Kingdom.

The group's share of total operating income in joint ventures is £24 million (2003: £15 million).

The group's share of contingent liabilities in joint ventures is £nil (2003: £nil).

18 Interests in associates

a *Movements in interests in associates*

	group	*bank*
	£m	£m
At 1 January 2004	**125**	7
Retained profits	**(3)**	—
Additions	**109**	109
Disposals	**(8)**	(1)
Write-up of associates to net asset value, including attributable goodwill	**—**	(8)
Exchange and other movements	**(5)**	—
At 31 December 2004	**218**	107

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Shares in banks	**2**	9	**—**	—
Other	**216**	116	**107**	7
	218	125	**107**	7

None of the associates are listed.

On the historical cost basis, the bank's interests in associates would have been included as follows:

	2004	2003
	£m	£m
Cost	**113**	15
Provisions	**(1)**	(10)
	112	5

18 Interests in associates *(continued)*

b *Principal associates as at 31 December 2004*

	Country of incorporation	*Principal activity*	*Interest in equity capital*
Erisa	France	Insurance	49.99%
AEA Investors LP	United States	Private Equity investment fund	—[1]

[1] *Limited Partnership*

19 Investments in subsidiary undertakings

a *Movements in investments in subsidiary undertakings*

	£m
At 1 January 2004	**15,369**
Acquisitions	**546**
Increases in share capital	**97**
Disposals	**(3)**
Provisions for permanent diminution in value	**(14)**
Write-up to net asset value including attributable goodwill	**74**
Redemption of shares	**(73)**
Exchange and other movements	**(37)**
At 31 December 2004	**15,959**

The above amount represents the direct interests of the bank in its subsidiary undertakings. Interests in subsidiary undertakings include £8,372 million (2003: £8,019 million) representing interests in banks.

On the historical cost basis, the bank's interests in subsidiary undertakings would have been included as follows:

	2004 £m	2003 £m
Cost	**14,807**	14,278
Provisions	**(14)**	(1)
	14,793	14,277

b *Principal subsidiary undertakings as at 31 December 2004*

	Country of incorporation
CCF S A. (99.99% owned) (directly owned)	France
HSBC Asset Finance (UK) Limited (directly owned)	England
HSBC Bank A.S. (directly owned)	Turkey
HSBC Bank International Limited	Jersey
HSBC Bank Malta p.l.c. (70.03% owned)	Malta
HSBC Guyerzeller Bank AG	Switzerland
HSBC Invoice Finance (UK) Limited	England
HSBC Life (UK) Limited (directly owned)	England
HSBC Rail (UK) Limited	England
HSBC Private Bank (Guernsey) Limited (97.82% owned)	Guernsey
HSBC Private Bank (Suisse) S.A. (97.82% owned)	Switzerland
HSBC Private Bank (UK) Limited (formerly HSBC Republic Bank (UK) Limited) (97.82% owned)	England
HSBC Trinkaus & Burkhardt KGaA (73.47% owned)	Germany
HSBC Trust Company (UK) Limited (directly owned)	England

19 Investments in subsidiary undertakings *(continued)*

Details of all subsidiary undertakings will be annexed to the next Annual Return of the bank. All of the above subsidiary undertakings are engaged in the business of banking or other financial services.

Except where indicated otherwise, the issued equity capital of the above undertakings is wholly owned by the group and is held by subsidiaries of the bank.

c *Acquisitions*

HSBC Bank plc made the following acquisitions of subsidiary undertakings in 2004, which were accounted for on an acquisition basis:

Marks and Spencer Retail Financial Services Holdings Limited

On 9 November 2004, the group acquired 100 per cent of Marks and Spencer Retail Financial Services Holdings Limited and its subsidiary companies for a cash consideration of £546 million. Goodwill of £266 million arose on this acquisition.

The assets and liabilities at the date of the acquisition and the total consideration paid are set out in the following table:

	Book value	*Revaluations*	*Fair value*
At the date of acquisition:	**£m**	**£m**	**£m**
Cash and balances at central banks	25	—	25
Loans and advances to customers	2,472	(5)	2,467
Tangible fixed assets	13	—	13
Other asset categories	297	8	305
Prepayments and accrued income	7	—	7
Deposits by banks	(6)	—	(6)
Customer accounts	(1,145)	(1)	(1,146)
Debt securities in issue	(454)	5	(449)
Other liability categories	(745)	(21)	(766)
Accruals and deferred income	(48)	—	(48)
Provision for liabilities & charges			
– other provisions for liabilities and charges	(8)	—	(8)
Subordinated liabilities			
– dated loan capital	(114)	—	(114)
Net assets acquired	294	(14)	280
Goodwill attributable			266
Total consideration including costs of acquisition			546

The adjustments in the above table represent the following:

Revaluations, reflecting the recognition of:
- the fair value of financial instruments acquired;
- the fair value of the pension scheme deficit;
- *the fair value of discounted recoveries;*
- ISA deposits restated to fair value: and
- the deferred tax impact of the fair value adjustments

The fair values of the assets and liabilities acquired have been determined on a provisional basis pending completion of the fair value appraisal process.

19 Investments in subsidiary undertakings *(continued)*

Other acquisitions

On 20 April and 9 July 2004, the group increased its stake in HSBC Guyerzeller Bank AG by 3.36 per cent for a cash consideration of £10 million and 12.65 per cent for a cash consideration of £35 million. Goodwill of £14 million arose on these acquisitions.

On 1 October 2004, the group acquired the business of Bank of Bermuda Trust (Jersey) Limited for a cash consideration of £3 million. Goodwill of £2 million arose on the acquisition.

On 19 November 2004, the group acquired the HSS Banking Business of Bank of Bermuda (Europe) plc in Ireland for a cash consideration of £9 million. Goodwill of £8 million arose on the acquisition.

On 10 December 2004, the group acquired the HSS Banking Business of HSBC Securities Services Luxembourg SA for a cash consideration of £12 million. Goodwill of £12 million arose on the acquisition.

On 30 December 2004, the group acquired the business of Bank of Bermuda Limited (Hong Kong Branch) for a cash consideration of £6 million. Goodwill of £6 million arose on the acquisition.

On 31 December 2004, the group acquired 100 per cent of Bermuda International (Dublin) Limited for a cash consideration of £51 million. Goodwill of £20 million arose on the acquisition.

	Fair value
	£m
Net assets acquired	**64**
Goodwill attributable	**62**
Total consideration including costs of acquisition	**126**

There are no fair value adjustments in relation to the other acquisitions.

20 Intangible fixed assets

	Goodwill	*Intangible fixed assets*	*Total*
	2004	**2004**	**2004**
	£m	**£m**	**£m**
group			
Cost at 1 January 2004	**9,924**	**—**	**9,924**
Additions (positive goodwill of £271 million)	**328**	**—**	**328**
Disposal of subsidiary undertaking	**(3)**	**—**	**(3)**
Exchange and other movements	**(104)**	**14**	**(90)**
Cost at 31 December 2004	**10,145**	**14**	**10,159**
Accumulated amortisation at 1 January 2004	**1,609**	**—**	**1,609**
Charge to the profit and loss account (net of negative goodwill of £2 million)	**553**	**1**	**554**
Disposal of subsidiary undertaking	**(3)**	**—**	**(3)**
Exchange and other movements	**(7)**	**2**	**(5)**
Accumulated amortisation at 31 December 2004	**2,152**	**3**	**2,155**
Net book value at 31 December 2004 (net of negative goodwill of £6 million)	**7,993**	**11**	**8,004**
Net book value at 31 December 2003 (net of negative goodwill of £8 million)	8,315	—	8,315

Notes on the Accounts (continued)

20 Intangible fixed assets *(continued)*

	Goodwill 2004 £m	*Intangible fixed assets* 2004 £m	*Total* 2004 £m
bank			
Cost at 1 January 2004	44	—	44
Additions (positive goodwill of £21m)	21	—	21
Exchange and other movements	2	—	2
Cost at 31 December 2004	**67**	—	**67**
Accumulated amortisation at 1 January 2004	11	—	11
Charge to the profit and loss account	3	—	3
Accumulated amortisation at 31 December 2004	**14**	—	**14**
Net book value at 31 December 2004	**53**	—	**53**
Net book value at 31 December 2003	33	—	33

Additions for the group represent goodwill arising on the acquisition of and increased holdings in subsidiaries and businesses during 2004.

Positive goodwill on the acquisition of CCF S.A. and HSBC Private Banking Holdings (Suisse) SA and their subsidiaries is being amortised over 20 years. Other positive goodwill is being amortised over periods of up to 15 years. Negative goodwill is being credited to the profit and loss account over 5 years, the period to benefit.

21 Tangible fixed assets

a *Movements on tangible fixed assets*

group	*Freehold land and buildings* £m	*Long leasehold land and buildings* £m	*Short leasehold land and buildings* £m	*Equipment, fixtures and fittings* £m	*Equipment on operating leases* £m	*Total* £m
Cost or valuation						
At 1 January 2004	1,119	469	269	2,708	2,838	7,403
Additions	9	(5)	10	271	546	831
Disposals	(40)	—	(3)	(149)	(235)	(427)
Acquisition of subsidiary undertakings	—	—	—	13	—	13
Disposal of subsidiary undertakings	—	—	—	(1)	—	(1)
Transfer of accumulated depreciation arising on revaluation	(11)	(1)	—	—	—	(12)
Surplus on revaluation	54	17	—	—	—	71
Exchange and other movements	—	(1)	(12)	15	—	2
At 31 December 2004	1,131	479	264	2,857	3,149	7,880
Accumulated depreciation						
At 1 January 2004	(45)	(4)	(164)	(1,690)	(584)	(2,487)
Disposals	7	—	3	145	154	309
Transfer of accumulated depreciation arising on revaluation	11	1	—	—	—	12
Charge to the profit and loss account	(26)	(9)	(12)	(310)	(169)	(526)
Exchange and other movements	(3)	—	10	(10)	1	(2)
At 31 December 2004	(56)	(12)	(163)	(1,865)	(598)	(2,694)
Net book value						
At 31 December 2004	1,075	467	101	992	2,551	5,186
At 31 December 2003	1,074	465	105	1,018	2,254	4,916

Notes on the Accounts (continued)

21 Tangible fixed assets *(continued)*

a *Movements on tangible fixed assets (continued)*

	Freehold land and buildings	*Long leasehold land and buildings*	*Short leasehold land and buildings*	*Equipment, fixtures and fittings*	*Total*
Bank	**£m**	**£m**	**£m**	**£m**	**£m**
Cost or valuation					
At 1 January 2004	**472**	**456**	**210**	**1,666**	**2,804**
Additions	**1**	**14**	**7**	**162**	**184**
Disposals	**(19)**	**—**	**(3)**	**(70)**	**(92)**
Transfer of accumulated depreciation arising on revaluation	**(7)**	**(1)**	**—**	**—**	**(8)**
Surplus on revaluation	**66**	**15**	**—**	**—**	**81**
Exchange and other movements	**(1)**	**—**	**2**	**5**	**6**
At 31 December 2004	**512**	**484**	**216**	**1,763**	**2,975**
Accumulated depreciation					
At 1 January 2004	**(37)**	**(5)**	**(148)**	**(964)**	**(1,154)**
Disposals	**2**	**—**	**2**	**64**	**68**
Transfer of accumulated depreciation arising on revaluation	**7**	**1**	**—**	**—**	**8**
Charge to the profit and loss account	**(14)**	**(9)**	**(10)**	**(192)**	**(225)**
Exchange and other movements	**—**	**—**	**1**	**(4)**	**(3)**
At 31 December 2004	**(42)**	**(13)**	**(155)**	**(1,096)**	**(1,306)**
Net book value					
At 31 December 2004	**470**	**471**	**61**	**667**	**1,669**
At 31 December 2003	435	451	62	702	1,650

b *Assets held under finance leases*

The net book amount of equipment, fixtures and fittings included assets held under finance leases of £11 million (2003: £12 million) for the group and £nil (2003: £nil) for the bank, on which the depreciation charge was £27 million (2003: £6 million) for the group and £nil (2003: £nil) for the bank. The net book amount of equipment on operating leases included assets held under finance leases of £108 million (2003: £111 million) for the group on which the depreciation charge was £3 million (2003: £5 million).

21 Tangible fixed assets *(continued)*

c *Valuations*

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Cost or valuation of freehold and long leasehold land and buildings:				
At valuation	**1,593**	1,566	**992**	917
At cost	**17**	22	**4**	11
	1,610	1,588	**996**	928
On the historical cost basis, freehold and long leasehold land and buildings would have been included as follows:				
Cost	**1,627**	1,652	**1,007**	1,009
Accumulated depreciation	**(296)**	(275)	**(155)**	(139)
Net book value	**1,331**	1,377	**852**	870

The group values its freehold and long leasehold properties on an annual basis. In September 2004, the group's freehold and long leasehold properties were revalued on an existing use basis or open market value as appropriate or, in the case of a few specialised properties, at depreciated replacement cost. The properties were revalued either by professional external valuers or by professionally qualified staff. The valuation has been updated for any material changes at 31 December 2004.

As a result of the revaluation, there was a surplus over the net book value of land and buildings of £71 million (bank: £81 million), of which £73 million, net of minority interests of £(2) million (bank: £81 million) has been included in the revaluation reserve at 31 December 2004.

d *Land and buildings occupied for own activities*

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Net book value	**1,595**	1,586	**981**	925

Land and buildings with a net book value of £13 million (2003: £4 million) are occupied by HSBC Holdings plc or its subsidiaries other than the group.

Notes on the Accounts (continued)

21 Tangible fixed assets *(continued)*

e *Residual values of equipment on operating leases*

Included in the net book value of equipment on operating leases are residual values at the end of current lease terms, which will be recovered through re-letting or disposal in the following periods:

	2004 £m	2003 £m
Within 1 year	**89**	707
Between 1 and 2 years	**250**	68
Between 2 and 5 years	**522**	387
Over 5 years	**1,192**	652
	2,053	1,814

Residual value risk arises in relation to an operating lease transaction to the extent that the actual value of the leased asset at the end of the lease term (the residual value) recovered through disposing of or re-letting the asset at the end of the lease term, could be different to that projected at the inception of the lease. Residual value exposure is regularly monitored by the business through reviewing the recoverability of the residual value projected at lease inception. This entails considering the re-lettability and projected disposal proceeds of operating lease assets at the end of their lease terms. Provision is made to the extent that the carrying values of leased assets are impaired through residual values not being fully recoverable.

22 Other assets

	group		*bank*	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Bullion	**5**	8	**—**	1
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	**13,287**	11,119	**10,696**	8,368
Deferred taxation (Note 27a)	**72**	98	**91**	88
Long-term assurance assets attributable to policyholders (Note 26)	**4,231**	3,714	**—**	—
Other	**3,659**	4,026	**588**	762
	21,254	18,965	**11,375**	9,219
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market:				
Due from subsidiary undertakings			**2,607**	1,429
Due from fellow subsidiary undertakings	**2,077**	1,171	**1,804**	1,014

'Other' also includes the surplus retained in long-term assurance funds and the net present value of policies in force. These assets form part of the total value of the group's interest in long-term assurance business as follows:

	2004 £m	2003 £m
Net tangible assets of long-term assurance subsidiaries	**64**	43
Surplus retained in long-term assurance funds and net present value of policies in force	**789**	659
Total long-term assurance business attributable to shareholders	**853**	702

22 Other assets *(continued)*

The increase in the value of long-term assurance business attributable to shareholders which is included in the consolidated profit and loss account amounts to £63 million (2003: £53 million) before tax and £49 million (2003: £42 million) after tax.

The key assumptions used in determining the value of policies in force are:

	2004	2003
	%	%
Risk discount rate (net of tax)	**8.0**	8.0
Economic assumptions (gross of tax)		
Return on equities	**7.0**	7.0
Return on fixed interest securities	**4.5**	4.5
Expense inflation	**3.2**	3.2

The composition of the net tangible assets relating to long-term assurance funds is analysed as follows:

	2004	2003
	£m	£m
Loans and advances to banks	**141**	121
Debt securities	**1,060**	1,054
Equity shares	**2,556**	2,001
Other assets	**538**	578
Prepayments and accrued income	**16**	19
Other liabilities	**(80)**	(59)
Long-term assurance net assets attributable to policyholders	**4,231**	3,714

23 Deposits by banks

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Repayable on demand	**8,289**	8,166	**6,789**	4,789
With agreed maturity dates or periods of notice by remaining maturity				
— 3 months or less but not repayable on demand	**19,048**	16,750	**17,008**	15,061
— 1 year or less but over 3 months	**2,963**	2,180	**2,717**	1,803
— 5 years or less but over 1 year	**1,553**	1,386	**265**	356
— over 5 years	**734**	805	**101**	228
	32,587	29,287	**26,880**	22,237

	group		*bank*	
	2004	2003	**2004**	2003
Amounts include:	**£m**	£m	**£m**	£m
Due to subsidiary undertakings			**8,220**	7,984
Due to fellow subsidiary undertakings	**3,706**	2,960	**914**	1,778

Notes on the Accounts (continued)

24 Customer accounts

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Repayable on demand	**100,344**	89,603	**72,684**	65,763
With agreed maturity dates or periods of notice by remaining maturity				
— 3 months or less but not repayable on demand	**53,351**	49,454	**25,758**	24,884
— 1 year or less but over 3 months	**3,999**	3,651	**1,908**	1,849
— 5 years or less but over 1 year	**2,520**	2,938	**2,723**	1,375
— over 5 years	**998**	457	**1,149**	351
	161,212	146,103	**104,222**	94,222
Amounts include:				
Due to joint ventures	**500**	246	**491**	232
Due to associates	**—**	3	**—**	3
Due to subsidiary undertakings			**3,773**	3,177
Due to fellow subsidiary undertakings	**1,582**	1,276	**1,107**	878
Due to parent undertaking	**2,237**	2,612	**2,220**	1,708

25 Debt securities in issue

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Bonds and medium-term notes, by remaining maturity				
— within 1 year	**1,807**	961	**942**	91
— between 1 and 2 years	**1,532**	673	**1,247**	613
— between 2 and 5 years	**1,222**	710	**398**	228
— over 5 years	**1,146**	588	**213**	39
	5,707	2,932	**2,800**	971
Other debt securities in issue, by remaining maturity				
— 3 months or less	**16,690**	6,251	**8,385**	1,769
— 1 year or less but over 3 months	**2,318**	355	**1,890**	190
— 5 years or less but over 1 year	**210**	216	**1**	—
— over 5 years	**20**	15	**—**	—
	19,238	6,837	**10,276**	1,959
	24,945	9,769	**13,076**	2,930

26 Other liabilities

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Short positions in securities:				
Debt securities				
— government securities	**11,265**	7,735	**4,077**	4,420
— other debt securities	**2,385**	1,410	**1,590**	789
Equity shares	**1,332**	794	**1,185**	765
	14,982	9,939	**6,852**	5,974
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked-to-market	**13,611**	11,273	**10,948**	8,495
Current taxation	**453**	513	**238**	283
Obligations under finance leases	**320**	296	**—**	—
Dividend payable	**706**	706	**706**	706
Long-term assurance liabilities attributable to policyholders (Note 22)	**4,231**	3,714	**—**	—
Other	**4,184**	3,727	**858**	1,066
	38,487	30,168	**19,602**	16,524
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked-to-market include amounts:				
Due to subsidiary undertakings			**1,968**	1,015
Due to fellow subsidiary undertakings	**3,450**	1,585	**2,924**	1,569
Obligations under finance leases fall due as follows				
— within 1 to 5 years	**—**	—	**—**	—
— over 5 years	**684**	635	**—**	—
	684	635	**—**	—
— less future finance charges	**(364)**	(339)	**—**	—
	320	296	**—**	—

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Short positions in debt securities are in respect of securities				
— due within 1 year	**304**	411	**137**	353
— due 1 year and over	**13,346**	8,734	**5,530**	4,856
	13,650	9,145	**5,667**	5,209
— listed	**12,522**	7,403	**5,265**	3,784
— unlisted	**1,128**	1,742	**402**	1,425
	13,650	9,145	**5,667**	5,209

Notes on the Accounts (continued)

27 Provisions for liabilities and charges

a *Deferred taxation*

	group	*bank*
	£m	**£m**
At 1 January 2004	**595**	**(85)**
Charge to the profit and loss account (Note 7)	**165**	**(2)**
Exchange and other movements	**(37)**	**—**
At 31 December 2004	**723**	**(87)**

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Included in 'Provisions for liabilities and charges'	**795**	693	**4**	3
Included in 'Other assets' (Note 22)	**(72)**	(98)	**(91)**	(88)
	723	595	**(87)**	(85)

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Short-term timing differences	**(61)**	(66)	**(30)**	(32)
Accelerated capital allowances	**63**	70	**61**	71
Leasing transactions	**865**	772	**—**	—
Provisions for bad and doubtful debts	**(141)**	(172)	**(88)**	(86)
Relief for tax losses	**(1)**	(10)	**(1)**	—
Other items	**(2)**	1	**(29)**	(38)
	723	595	**(87)**	(85)

There is no material deferred taxation liability not provided for.

At 31 December 2004, there were potential future tax benefits of approximately £128 million (2003: £110 million) in respect of capital losses that have not been recognised because recoverability of the potential benefits is not considered likely.

No provision has been made for deferred taxation on gains recognised on revaluing property to its market value or on the sale of properties where potentially taxable gains will be covered by available tax losses.

27 Provisions for liabilities and charges *(continued)*

b *Other provisions for liabilities and charges*

	Provisions for pensions and other post-retirement obligations	*Provisions for contingent liabilities and commitments*	*Premises-related provisions*	*Insurance and other provisions*	*Total*
	£m	**£m**	**£m**	**£m**	**£m**
group					
At 1 January 2004	**364**	**200**	**114**	**473**	**1,151**
Additional provisions/increase in provisions	**22**	**95**	**17**	**151**	**285**
Provisions released	—	**(59)**	—	**(16)**	**(75)**
Provisions utilised	**(23)**	**(31)**	**(33)**	**(67)**	**(154)**
Acquisitions	—	—	—	**7**	**7**
Exchange and other movements	**(2)**	**4**	**7**	**(2)**	**7**
At 31 December 2004	**361**	**209**	**105**	**546**	**1,221**
bank					
At 1 January 2004	**119**	**36**	**106**	**9**	**270**
Additional provisions/increase in provisions	**2**	**87**	**18**	**6**	**113**
Provisions released	—	**(16)**	—	**(2)**	**(18)**
Provisions utilised	**(7)**	**(25)**	**(31)**	**(1)**	**(64)**
Exchange and other movements	—	**2**	**5**	**(5)**	**2**
At 31 December 2004	**114**	**84**	**98**	**7**	**303**

Included within 'Provisions for contingent liabilities and commitments' are provisions:

- for the costs of possible redress relating to the sales of certain personal pension plans and endowments of £42 million (2003: £24 million);
- against possible payments to be made under guarantee contracts of £44 million (2003: £56 million); and
- other claims made in the course of business of £108 million (2003: £118 million).

The personal pension provision is the result of an actuarial calculation extrapolated from a sample of cases and the timing of the expenditure depends on settlement of the individual claims.

The 'Premises-related provisions' relate to discounted future costs associated with vacant and sub-let short leasehold properties, including those that have become vacant as a consequence of the move of the group's head office and most of its London-based operations to Canary Wharf in 2002, and to discounted future costs to make good dilapidations upon the expiry of leases. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared to rent payable and costs of refurbishing the building to attract tenants or make good dilapidations. Uncertainties relate to movements in market rents, the delay in finding new tenants, timing of rental reviews and the estimation of costs of refurbishment.

Included within 'Insurance and other provisions' are provisions of £445 million (2003: £415 million) relating to the general insurance business.

Notes on the Accounts (continued)

28 Subordinated liabilities

	2004 £m	2003 £m
Undated subordinated loan capital		
— bank	**1,101**	1,168
— subsidiary undertakings	**99**	100
	1,200	1,268
Dated subordinated loan capital		
— bank	**3,836**	3,570
— subsidiary undertakings	**334**	421
	4,170	3,991
Total subordinated liabilities		
— bank	**4,937**	4,738
— subsidiary undertakings	**433**	521
	5,370	5,259
Dated subordinated loan capital is repayable		
— within 1 year	**273**	306
— between 1 and 2 years	**266**	278
— between 2 and 5 years	**236**	591
— over 5 years	**3,395**	2,816
	4,170	3,991

Undated subordinated loan capital

		2004 £m	2003 £m
bank			
US$750 million	Undated Floating Rate Primary Capital Notes	**388**	420
US$500 million	Undated Floating Rate Primary Capital Notes	**258**	280
US$300 million	Undated Floating Rate Primary Capital Notes (Series 3)	**155**	168
£150 million	9.25% Step-up Undated Subordinated Notes	**150**	150
£150 million	8.625% Step-up Undated Subordinated Notes	**150**	150
		1,101	1,168
subsidiary undertakings			
¥10,000 million	Undated Subordinated Variable Rate Medium Term Notes	**50**	52
Other undated subordinated liabilities individually less than £50 million		**49**	48
		99	100

The undated subordinated loan capital of the bank has characteristics which render it similar in certain circumstances to preference shares. These borrowings are unsecured obligations of the bank. Claims in respect of principal and interest are subordinated to the claims of all creditors of the bank, other than claims of any creditors in respect of subordinated indebtedness ranking *pari passu* or junior to claims in respect of undated subordinated loan capital.

28 Subordinated liabilities *(continued)*

Dated subordinated loan capital

		2004 £m	2003 £m
bank			
£200 million	9% Subordinated Notes 2005	**199**	200
US$500 million	7.625% Subordinated Notes 2006	**259**	280
US$300 million	6.95% Subordinated Notes 2011	**155**	168
€600 million	4.25% Callable Subordinated Notes 2016	**423**	424
£350 million	Callable Subordinated Variable Coupon Notes 2017	**350**	350
£350 million	5% Callable Subordinated Notes 2023	**350**	350
£300 million	6.5% Subordinated Notes 2023	**298**	298
US$300 million	7.65% Subordinated Notes 2025	**155**	168
£350 million	5.375% Callable Subordinated Step-up Notes 2030	**350**	—
£500 million	5.375% Subordinated Notes 2033	**498**	500
£225 million	6.25% Subordinated Notes 2041	**223**	223
US$400 million	8.625% Subordinated Notes 2004	—	223
US$375 million	Subordinated Step-up Coupon Floating Rate Notes 2009	—	209
		3,260	3,393
Amounts owed to parent undertaking			
€250 million	Floating Rate Subordinated Loan 2015	**176**	177
£400 million	Floating Rate Subordinated Loan 2020	**400**	—
		3,836	3,570
Amounts owed to subsidiary undertakings			
€1,000 million	Floating Rate Subordinated Loan 2012	**706**	707
€900 million	7.75% Non-cumulative Subordinated Notes 2040	**635**	635
£700 million	5.844% Fixed / Floating Rate Subordinated Note 2048	**700**	700
£300 million	5.862% Fixed / Floating Rate Subordinated Note 2049	**300**	—
		6,177	5,612
subsidiary undertakings			
$100 million	Floating Rate Subordinated Loan 2014	**52**	—
€152 million	Subordinated Callable Floating Rate Notes 2008	—	107
Other dated subordinated liabilities individually less than £50 million		**282**	314
		334	421

The dated subordinated loan capital of the bank represents unsecured obligations of the bank. Claims in respect of principal and interest are subordinated to the claims of all creditors of the bank, other than claims of any creditors in respect of subordinated indebtedness ranking *pari passu* or junior to claims in respect of dated subordinated loan capital.

Interest rates on floating rate subordinated loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 9.25 per cent.

Generally, subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, subject to the prior consent of the Financial Services Authority. The US$300 million 7.65% Subordinated Notes 2025 are repayable in May 2007 at par at the option of the holders.

Notes on the Accounts (continued)

28 Subordinated liabilities *(continued)*

The interest rate on the 9.25% Step-up Undated Subordinated Notes changes in December 2006 to become, for each successive five-year period, the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 2.15 per cent. The interest rate on the 8.625% Step-up Undated Subordinated Notes changes in December 2007 to become, for each successive five-year period, the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 1.87 per cent. In both cases, the issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rates on the €250 million Floating Rate Subordinated Loan 2015 and £400 million Floating Rate Subordinated Loan 2020 increase by 0.50 per cent five years prior to their maturity dates. In both cases, the issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rates on the Callable Subordinated Variable Coupon Notes 2017 and the 5% Callable Subordinated Notes 2023 change five years prior to their maturity date to become the rate per annum which is the sum of the yield on the then five-year benchmark UK gilt plus 1.70 per cent and 1.80 per cent respectively. The issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

The interest rate on the 4.25% Callable Subordinated Notes 2016 changes to a floating rate plus a margin of 1.05 per cent five years prior to its maturity date, and the interest rate on 5.375% Callable Subordinated Step-up Notes 2030 changes to a floating rate plus a margin of 1.50 per cent. The issues are then repayable at the option of the borrower, subject to the prior consent of the Financial Services Authority.

29 Minority interests — non-equity

		2004	2003
		£m	£m
€900 million	First capital contribution	**635**	635
€1,000 million	Second capital contribution	**706**	707
£700 million	5.844% Non-Cumulative Step-up Perpetual Preferred Securities	**700**	700
£300 million	5.862% Non-Cumulative Step-up Perpetual Preferred Securities	**300**	—
		2,341	2,042

Capital Contributions

HSBC Capital Funding 1 (UK) Limited Partnership was established by a subsidiary undertaking of the bank as General Partner, and a fellow subsidiary undertaking of HSBC Holdings plc, as Limited Partner.

The Limited Partner's first capital contribution of €900 million qualifies as innovative tier 1 capital for both the bank and the group on a consolidated basis. The proceeds of the first capital contribution were on-lent by the Limited Partnership to the bank's Paris branch by issue of 7.75% Non-cumulative Subordinated Notes 2040 (the 'Notes'). The Notes may be redeemed at the option of the bank's Paris branch on the interest payment date in October 2010, or any interest payment date thereafter, subject to the prior consent of the Financial Services Authority.

The Limited Partner made a second capital contribution to the Limited Partnership of €1,000 million by way of assignment to the Limited Partnership of a €1,000 million Floating Rate Subordinated Loan 2012 (the 'Loan') made by the Limited Partner to the bank's Paris branch. The Limited Partner's second capital contribution qualifies as tier 2 capital for both the bank and the group on a consolidated basis. The interest rate on the Loan is related to interbank offered rates and increases by 0.50 per cent from the interest payment date in October 2007. The Loan is repayable at par on maturity, and also at the option of the bank's Paris branch on the interest payment date in October 2007, or any interest payment date thereafter, subject to the prior consent of the Financial Services Authority.

The Limited Partner's profit share for each distribution period is calculated as (i) the lower of (a) the amount of interest received by the Limited Partnership in respect of the Loan and (b) the profit of the Limited Partnership available for that distribution period, and (ii) the lower of (a) €69,750,000 and (b) the profit of the Limited Partnership available for that distribution period less amounts paid under (i).

29 Minority interests — non-equity *(continued)*

There are limitations on the payment of the Limited Partner's profit share if the bank is prohibited under UK banking regulations or other requirements from paying distributions on its Parity Obligations, or if the bank has insufficient distributable reserves.

The Limited Partnership will be dissolved only upon the occurrence of (i) the redemption of the Notes, provided certain redemption conditions are satisfied, or (ii) the passing of a resolution for the winding-up of the bank. In the event of a dissolution of the Limited Partnership, before any substitution event (see below), the Limited Partner shall be entitled to receive (a) the Limited Partner's share of the Loan (if any) and (b) the liquidating distribution to which the Limited Partner is entitled in respect of its €900 million capital contribution, which amount shall not exceed the amount per security that would have been paid as the liquidating distribution from the assets of the bank had the Limited Partner's interest in the Limited Partnership been substituted by the Substitute Securities (see below).

If (i) the total capital ratio of the bank or the group on a consolidated basis has fallen below the regulatory minimum ratio required, or (ii) in view of the bank's deteriorating financial condition, the bank's Board of Directors expect (i) to occur in the near term, then the Limited Partner's interest in the Limited Partnership, in respect of its first €900 million capital contribution, shall be substituted with fully paid ordinary shares issued by the bank ('Substitute Securities') and, as to the remainder, with an appropriate portion of the Loan.

Step-up Perpetual Preferred Securities

The two issues of Non-cumulative Step-up Perpetual Preferred Securities (the 'Preferred Securities') were issued by Jersey limited partnerships, and are guaranteed, on a subordinated basis, by the bank. The proceeds of the issues were on-lent to the bank by the limited partnerships by issue of subordinated notes. The Preferred Securities qualify as innovative tier 1 capital for the bank and the group on a consolidated basis. The Preferred Securities, together with the guarantees, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of the bank that are equivalent to the rights they would have had if they had purchased non-cumulative perpetual preference shares of the bank.

The Preferred Securities are perpetual, but redeemable in November 2031 and April 2020 respectively or on each distribution date thereafter at the option of the General Partner of the Limited Partnerships. If not redeemed the distributions payable step-up and change to a floating rate plus margins of 1.76 per cent and 1.85 per cent respectively. There are limitations on the payment of distributions if the bank is prohibited under UK banking regulations or other requirements, if a payment would cause a breach of the bank's capital adequacy requirements, or if the bank has insufficient distributable reserves (as defined in the Limited Partnership Agreements).

The bank has covenanted that if it has been prevented under certain circumstances from paying distributions on the Preferred Securities in full, it will not pay dividends or other distributions in respect of its ordinary shares, or effect repurchase or redemption of its ordinary shares, until after a distribution has been paid in full.

If (i) any Preferred Securities are outstanding in November 2048 and April 2049 respectively, or (ii) the total capital ratio of the bank and the group on a consolidated basis falls below the regulatory minimum ratio required, or (iii) in view of the deteriorating financial condition of the bank, the Directors expect (ii) to occur in the near term, then the Preferred Securities will be substituted by Preference Shares of the bank having economic terms which are in all material respects equivalent to those of the Preferred Securities and the guarantees taken together.

Notes on the Accounts (continued)

30 Called up share capital

	Non-cumulative preference shares of £1 each	*Non-cumulative preference shares of US$0.01 each*	*Ordinary shares of £1 each*	*Total*
At 31 December 2003 and 2004	£m	£m	£m	£m
Authorised share capital	150	1	1,000	1,151
Allotted, called up and fully paid share capital	—	—	797	797

The issued, allotted and fully paid share capital of the bank comprises 796,969,096 ordinary shares of nominal value £1 each; 35,000,000 Third US$ non-cumulative preference shares of nominal value US$0.01 each; and one preferred ordinary share of nominal value £1.

The bank issued the following ordinary shares of nominal value £1 each during the year, all of which are held by HSBC Holdings plc:

	Ordinary shares of £1 each	*Share Premium*
	£	£
17 March 2004	1	699,999,999

The March issue of shares was to support asset growth and for general corporate purposes.

Third preference shares are redeemable at the option of the bank, at any time after 5 years and 1 day from date of issue, at a redemption price of US$25 per share. Dividends on Third preference shares are payable annually on 31 October at a rate of 7.5 per cent per annum.

In the event of a winding-up, Third preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$25 per share, plus an amount equal to any dividends declared but unpaid in respect of the previous dividend for the period and any accrued and unpaid dividends for the period to the date of the commencement of winding-up. With the exception of the above, the preference shares do not carry any right to participate in any surplus of assets on a winding-up.

Holders of Third preference shares are not entitled to vote at general meetings of the shareholders, except in certain limited circumstances, such as the variation of the rights attaching to those shares, or in the event of a reduction of the preference share capital. In addition, Third preference shareholders are entitled to vote at general meetings of the shareholders if any resolution is proposed for a winding-up or sale of the whole business of the bank, or in the event of a failure to pay in full the dividend payable on the Third preference shares for the most recent dividend period.

31 Reserves

	group	bank	Joint ventures and associates
	£m	£m	£m
Share premium account			
At 1 January 2004	12,157	12,157	
New share capital subscribed	700	700	
Exchange movements	(37)	(37)	
At 31 December 2004	12,820	12,820	
Revaluation reserves			
At 1 January 2004	69	1,115	
Realisation on disposal of properties	(8)	—	
Unrealised surplus on revaluation of freehold and long leasehold properties	73	81	
Net increase in attributable net assets of subsidiaries and associates	—	65	
At 31 December 2004	134	1,261	
Profit and loss account			
At 1 January 2004	4,041	2,995	24
Retained profit for the year	218	100	(2)
Realisation on disposal of properties	8	—	—
Exchange and other movements	(57)	(12)	1
At 31 December 2004	4,210	3,083	23

Cumulative goodwill amounting to £75 million (2003: £84 million) has been charged against reserves in respect of acquisitions prior to 1 January 1998.

The reserves of the bank include distributable reserves of £3,068 million (2003: £2,980 million).

Some of the group's banking subsidiary undertakings operate under local regulatory jurisdictions which could potentially restrict the amount of reserves that can be remitted to the bank in order to maintain local regulatory capital ratios.

Advantage has been taken of the exemptions applicable to Inland Revenue approved SAYE share option schemes and equivalent overseas schemes under Urgent Issues Task Force Abstract 17 (revised 2003) 'Employee share schemes'.

Notes on the Accounts (continued)

32 Analysis of total assets and total liabilities

a *Assets subject to sale and repurchase transactions*

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Total assets subject to sale and repurchase transactions	**9,676**	5,179	**293**	878

b *Assets leased to customers*

Amounts relating to assets leased to customers for the group are included under the following balance sheet headings:

	2004	2003
	£m	£m
Loans and advances to customers		
— finance leases	**3,114**	2,719
— hire purchase contracts	**1,024**	1,010
Tangible fixed assets		
— equipment on operating leases (Note 21)	**2,551**	2,255
	6,689	5,984

The cost of assets acquired during 2004 for letting under finance leases and hire purchase contracts by the group amounted to £593 million (2003: £410 million) and £520 million (2003: £449 million), respectively.

c *Assets charged as security for liabilities*

Assets have been pledged as security for liabilities included under the following headings:

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Deposits by banks	**746**	355	**727**	336
Customer accounts	**1,038**	932	**1,038**	932
Debt securities in issue	**76**	107	**76**	107
Other liabilities	**365**	480	**108**	347
	2,225	1,874	**1,949**	1,722

The total assets pledged to secure the above liabilities are as follows:

	group		bank	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Assets pledged to secure liabilities	**12,774**	12,441	**12,134**	11,488

The above amounts are mainly made up of items included in 'Debt securities' of £10,914 million (2003: £11,478 million) for the group and £10,274 million (2003: £10,551 million) for the bank.

33 Risk management

All of the group's activities involve analysis, evaluation and management of some degree of risk or combination of risks. The most important types of risk are market risk (which includes foreign exchange, interest rate, equity and commodity price risks), liquidity risk, operational risk and credit risk (which includes cross-border risk).

a *Market Risk Management*

Market risk is the risk that interest rates, credit spreads, foreign exchange rates or equity and commodity prices will move and result in profits or losses to the group. Market risk arises on financial instruments which are valued at current market prices (mark-to-market basis) and those valued at cost plus accrued interest (accruals basis). The main valuation sources are securities prices, foreign exchange rates, and interest rate yield curves and volatilities.

The group makes markets in interest rate, exchange rate and equity derivative instruments, as well as in debt, equities and other securities. Trading risks arise either from customer-related business or from position taking. Trading positions are valued on a mark-to-market basis.

The group manages market risk through risk limits approved by the HSBC Bank Executive Committee. Traded Markets Development and Risk, an independent unit within the Corporate, Investment Banking and Markets operation, develops risk management policies and measurement techniques and reviews limit utilisation on a daily basis.

Risk limits are determined for each location and, within location, for each portfolio. Limits are set by product and risk type, with market liquidity being a principal factor in determining the level of limits set. Only those offices which management deem to have sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

i Trading value at risk (VAR)

One of the principal tools used by HSBC to monitor and limit market risk exposure in its trading portfolios is VAR. 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 (normally 10 days) and to a given level of confidence (for HSBC, 99 per cent). HSBC calculates VAR daily. During the year, HSBC refined its basis of calculating VAR from one predominantly based on variance / co-variance (VCV) to one predominantly based on historic simulation (HS). This latter calculation was introduced because it better captures the non-linear characteristics of certain market risk positions. Historic simulation uses scenarios derived from historical market rates, and takes account of the relationships between different markets and rates, for example, interest rates and foreign exchange rates. Movements in market prices are calculated by reference to market data from the last two years.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- The use of historic 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 10-day holding period assumes that all positions can be liquidated or hedged in 10 days. This may not fully reflect the market risk arising from times of severe illiquidity, when a 10-day period may be insufficient to liquidate or hedge all positions fully.
- The use of a 99 per cent confidence level, by definition, does not take account of any 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.

The group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, HSBC applies a wide range of stress testing, both on individual portfolios and on the group's consolidated positions. The group's stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the group.

Notes on the Accounts (continued)

33 Risk management *(continued)*

a *Market Risk Management (continued)*

i *Trading value at risk (VAR) (continued)*

Consequently, the trading VAR for 2004, shown below, is based on 10 months VCV and two months HS. By way of comparison, average trading VAR for the six month period to 31 December 2004 under HS (£37.2m) was 1.4% more than that under VCV (£36.7m). At 31 December 2004 the trading VAR under HS (£38.7m) was 6.9% more than that under VCV (£36.2m).

Trading VAR for December 2004 is set out below:

	At 31 December 2004	*Minimum during the year*	*Maximum during the year*	*Average for the year*
	£m	**£m**	**£m**	**£m**
Total trading activities	**38.7**	**22.9**	**56.7**	**35.2**
Foreign exchange trading positions	**9.2**	**1.7**	**15.3**	**7.2**
Interest rate trading positions	**35.5**	**20.0**	**51.1**	**31.2**
Equities trading positions	**6.3**	**5.1**	**11.6**	**7.7**

Trading VAR for June 2004 is set out below:

	At 30 June 2004	*Minimum during the half year*	*Maximum during the half year*	*Average for the year*
	£m	£m	£m	£m
Total trading activities	29.3	22.9	56.7	33.1
Foreign exchange trading positions	7.4	1.7	14.1	7.2
Interest rate trading positions	25.2	20.0	51.1	29.0
Equities trading positions	6.8	5.7	10.3	7.7

Trading VAR for 2003 is set out below:

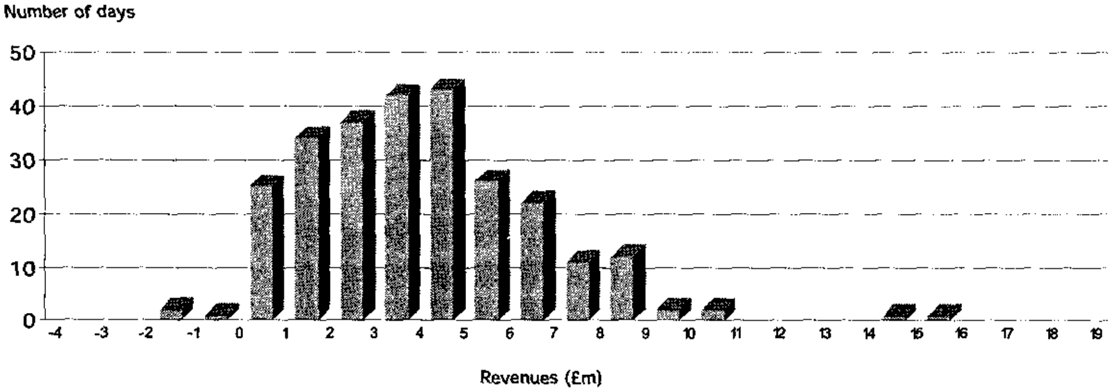
	At 31 December 2003	*Minimum during the year*	*Maximum during the year*	*Average for the year*
	£m	£m	£m	£m
Total trading activities	26.5	20.3	44.4	28.1
Foreign exchange trading positions	4.9	2.9	14.2	6.3
Interest rate trading positions	22.6	14.3	42.8	24.5
Equities trading positions	7.4	3.7	12.1	6.6

33 Risk management *(continued)*

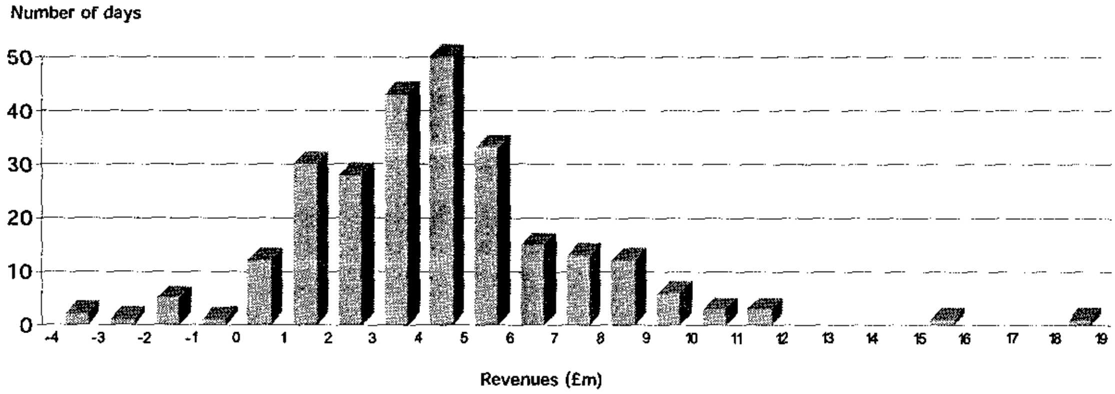
a *Market Risk Management (continued)*

i *Trading value at risk (VAR) (continued)*

Daily distribution of market risk revenues 2004



Daily distribution of market risk revenues 2003



The average daily revenue earned from market-risk-related treasury activities in 2004, including accrual book net interest income and funding related to dealing positions, was £4.0 million, (2003: £4.3 million). The standard deviation of this daily revenue was £2.5 million (2003: £2.9 million). An analysis of the frequency distribution of daily revenues shows that negative revenues were reported on only three days during 2004. The most frequent result was a daily revenue of between £4 million and £5 million, with 43 occurrences. The highest daily revenue was £15.9 million (2003: £18.6 million).

Notes on the Accounts (continued)

33 Risk management *(continued)*

a *Market Risk Management (continued)*

i Trading value at risk (VAR) (continued)

Foreign exchange exposure

The group's foreign exchange exposure comprises trading exposures and structural foreign currency translation exposure.

Trading value at risk

The foreign exchange exposures comprise those which arise from foreign exchange dealing within the group's treasury centres and currency exposures originated within the group's commercial banking businesses. The latter exposures are transferred to local treasury units where they are managed together with exposures which result from dealing within approved limits. VAR on foreign exchange trading positions is shown in the table on page 74.

ii Interest rate exposure

The group's interest rate exposures comprise those originating in its treasury trading activities and structural interest rate exposures; both are managed under limits described above. Interest rate risk arises on both trading positions and accrual books. The interest rate risk on interest rate trading positions is set out in the trading VAR table on page 74.

Structural interest rate risk

Structural interest rate risk arises from the differing repricing characteristics of commercial banking assets and liabilities, including non-interest-bearing liabilities such as shareholders' funds and some current accounts.

The bank and each major subsidiary undertaking assess the structural interest rate risks which arise in their businesses and either transfer such risks, usually by a series of internal deals, to their local treasury unit for management or transfer the risks to separate books managed by their local Asset and Liability Management Committee (ALCO). When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitors all such behavioural assumptions and interest rate risk positions, to ensure they comply with established interest rate risk limits agreed with HSBC Holdings plc. In the course of managing interest rate risk, quantitative techniques and simulation models are used where appropriate to identify the potential net interest income and market value effects of these interest rate positions in different interest scenarios. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income whilst balancing the effect on the current net revenue stream.

In accordance with FRS 13, 'Derivatives and Other Financial Instruments: Disclosures', the table on page 77 discloses the mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rate on a contractual basis, or, if earlier, the dates on which the instruments mature. Actual reset dates may differ from contractual dates owing to prepayments and the exercise of options. In addition, contractual terms may not be representative of the behaviour of assets and liabilities. For these reasons, the group manages its interest rate risk on a different basis from that presented below, taking into account behavioural characteristics of the relevant assets and liabilities.

A positive interest rate sensitivity gap exists where more assets than liabilities re-price during a given period. Although a positive gap position tends to benefit net interest income in a rising interest rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rates within re-pricing periods and among currencies. Similarly, a negative interest rate sensitivity gap exists where more liabilities than assets re-price during a given period. In this case, a negative gap position tends to benefit net interest income in a declining interest rate environment, but again the actual effect will depend on the same factors as for positive interest rate gaps, as described above.

33 Risk management *(continued)*

a *Market Risk Management (continued)*

ii Interest rate exposure (continued)

Interest rate sensitivity gap table

2004	*Not more than three months*	*More than three months but not more than six months*	*More than six months but not more than one year*	*More than one year but not more than five years*	*More than five years*	*Non-interest bearing*	*Banking Book Total*	*Trading book*	*Total*
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets									
Treasury bills and other eligible bills	5,338	133	32	259	11	—	5,773	109	5,882
Loans and advances to banks	20,036	1,421	478	229	230	657	23,051	11,833	34,884
Loans and advances to customers	82,321	6,416	5,582	17,417	10,561	5,291	127,588	12,243	139,831
Debt securities and equity shares	9,826	565	2,232	9,354	4,877	1,386	28,240	39,873	68,113
Other assets	615	—	—	—	—	26,815	27,430	13,835	41,265
Total assets	118,136	8,535	8,324	27,259	15,679	34,149	212,082	77,893	289,975
Liabilities									
Deposits by banks	(23,735)	(1,995)	(382)	(1,235)	(104)	(1,251)	(28,702)	(3,885)	(32,587)
Customer accounts	(127,981)	(1,650)	(1,294)	(1,283)	(415)	(17,024)	(149,647)	(11,565)	(161,212)
Debt securities in issue	(15,479)	(3,306)	(867)	(2,563)	(939)	(5)	(23,159)	(1,786)	(24,945)
Other liabilities	(152)	—	—	(150)	(18)	(16,173)	(16,493)	(28,733)	(45,226)
Loan capital and other subordinated liabilities	(1,137)	(316)	(77)	(573)	(3,266)	(1)	(5,370)	—	(5,370)
Minority interests and shareholders' funds	—	—	—	—	—	(20,635)	(20,635)	—	(20,635)
Internal funding of the trading book	31,263	1,066	434	(288)	(184)	(367)	31,924	(31,924)	—
Total liabilities	(137,221)	(6,201)	(2,186)	(6,092)	(4,926)	(55,456)	(212,082)	(77,893)	(289,975)
Net on-balance-sheet items	(19,085)	2,334	6,138	21,167	10,753	(21,307)	—	—	—
Off-balance-sheet items	(9,302)	(404)	2,480	13,390	(6,164)	—	—	—	—
Interest rate sensitivity gap	(28,387)	1,930	8,618	34,557	4,589	(21,307)	—	—	—
Cumulative interest rate sensitivity gap	(28,387)	(26,457)	(17,839)	16,718	21,307	—	—	—	—

Notes on the Accounts (continued)

33 Risk management *(continued)*

a *Market Risk Management (continued)*

ii *Interest Rate Exposure (continued)*

Interest rate sensitivity gap table (continued)

2003	Not more than three months	More than three months but not more than six months	More than six months but not more than one year	More than one year but not more than five years	More than five years	Non-interest bearing	Banking Book Total	Trading book	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Treasury bills and other eligible bills	1,562	181	47	208	—	—	1,998	199	2,197
Loans and advances to banks	20,061	939	663	163	157	571	22,554	11,088	33,642
Loans and advances to customers	76,178	4,025	4,318	14,127	5,764	1,893	106,305	9,993	116,298
Debt securities and equity shares	6,785	777	1,085	9,438	4,106	1,737	23,928	31,465	55,393
Other assets	644	—	—	—	—	26,322	26,966	11,608	38,574
Total assets	105,230	5,922	6,113	23,936	10,027	30,523	181,751	64,353	246,104
Liabilities									
Deposits by banks	(17,873)	(1,450)	(398)	(1,295)	(613)	(1,954)	(23,583)	(5,704)	(29,287)
Customer accounts	(120,363)	(1,784)	(824)	(1,530)	(421)	(13,438)	(138,360)	(7,743)	(146,103)
Debt securities in issue	(5,179)	(675)	(172)	(2,473)	(584)	(4)	(9,087)	(682)	(9,769)
Other liabilities	(133)	—	—	(144)	(19)	(14,610)	(14,906)	(21,323)	(36,229)
Loan capital and other subordinated liabilities	(887)	(630)	(332)	(552)	(2,858)	—	(5,259)	—	(5,259)
Minority interests and shareholders' funds	—	—	—	—	—	(19,457)	(19,457)	—	(19,457)
Internal funding of the trading book	27,515	1,050	129	342	(2)	(133)	28,901	(28,901)	—
Total liabilities	(116,920)	(3,489)	(1,597)	(5,652)	(4,497)	(49,596)	(181,751)	(64,353)	(246,104)
Net on-balance-sheet items	(11,690)	2,433	4,516	18,284	5,530	(19,073)	—	—	—
Off-balance-sheet items	(17,449)	1,772	4,309	12,601	(1,233)	—	—	—	—
Interest rate sensitivity gap	(29,139)	4,205	8,825	30,885	4,297	(19,073)	—	—	—
Cumulative interest rate sensitivity gap	(29,139)	(24,934)	(16,109)	14,776	19,073	—	—	—	—

33 Risk management *(continued)*

a *Market Risk Management (continued)*

iii *Assets and liabilities denominated in foreign currency*

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Denominated in sterling	**124,751**	104,981	**114,249**	98,344
Denominated in currencies other than sterling	**165,224**	141,123	**77,947**	64,183
Total assets	**289,975**	246,104	**192,196**	162,527
Denominated in sterling	**127,081**	112,619	**109,510**	97,709
Denominated in currencies other than sterling	**162,894**	133,485	**82,686**	64,818
Total liabilities	**289,975**	246,104	**192,196**	162,527

iv *Structural foreign currency exposures*

The main operating (or functional) currencies of the group's subsidiaries are sterling, euros, US dollars, Swiss francs, Turkish lira and Maltese lira.

Since the currency in which the group prepares its consolidated financial statements is sterling, the group's consolidated balance sheet is affected by movements in the exchange rates between these functional currencies and sterling. These currency exposures are referred to as structural foreign currency exposures. Revaluation gains and losses arising from these exposures are recognised in the statement of total consolidated recognised gains and losses.

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in its branches, subsidiary undertakings, joint ventures and associates. Gains or losses on structural foreign currency exposures are taken to reserves.

The group mitigates the effect of structural foreign currency exposures by financing a proportion of its net investment in its operations with borrowings in the same currencies as the functional currencies involved.

The group's structural foreign currency exposures are managed with the primary objective of ensuring, where practical, that the group's and individual banking subsidiaries' tier 1 capital ratios are protected from the effect of changes in exchange rates. This is usually achieved by denominating tier 1 capital broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets at a subsidiary bank level. The group considers hedging structural foreign currency exposures only in limited circumstances, to protect the tier 1 capital ratio or the value of capital invested. Such hedging would be undertaken using forward foreign exchange contracts or by financing with borrowings in the same currencies as the functional currencies involved.

As subsidiaries are generally able to balance adequately foreign currency tier 1 capital with foreign currency risk-weighted assets, the group's structural foreign currency exposures are usually unhedged, including exposures due to foreign-currency-denominated profits arising during the year. There were no material effects from foreign currency exchange rate movements on group or subsidiary tier 1 capital ratios during the year.

Notes on the Accounts (continued)

33 Risk management *(continued)*

a *Market Risk Management (continued)*

iv *Structural currency exposure (continued)*

The group's structural currency exposures as at the year-end were as follows:

2004

Functional currency of the operation involved	*Net investments in operations*	*Borrowing taken out in the functional currencies of operations in order to hedge the net investment in such operations*	*Remaining structural currency exposures*
	£m	**£m**	**£m**
Euro	**9,668**	**(1,341)**	**8,327**
US dollars	**1,300**	**(452)**	**848**
Swiss francs	**1,412**	**(419)**	**993**
Turkish lira	**364**	**—**	**364**
Maltese lira	**143**	**—**	**143**
Other	**85**	**—**	**85**
Total	**12,972**	**(2,212)**	**10,760**

2003

Functional currency of the operation involved	*Net investments in operations*	*Borrowing taken out in the functional currencies of operations in order to hedge the net investment in such operations*	*Remaining structural currency exposures*
	£m	£m	£m
Euro	9,751	(1,341)	8,410
US dollars	1,468	(490)	978
Swiss francs	1,410	(415)	995
Turkish lira	307	—	307
Maltese lira	142	—	142
Other	44	—	44
Total	13,122	(2,246)	10,876

b *Liquidity Management*

Together with its capital resources, a surplus of stable retail deposits over loans to the group's customers is placed with the treasury units where the group's funding and liquidity is managed by Global Markets in London, CCF in Paris and Private Banking in Geneva, to ensure this complies with the different local regulatory requirements. In addition, all sites operate within the HSBC Group's liquidity policy. This process includes:

- projecting cash flows by major currency and consideration of the level of liquid assets in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- monitoring of depositor concentration both in terms of the overall funding mix and to avoid undue reliance on large individual depositors; and
- maintenance of liquidity and funding contingency plans.

33 Risk management *(continued)*

b *Liquidity Management (continued)*

Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of the group's overall funding. Considerable importance is attached to this core deposit base which, over the years, has been stable and predictable. The HSBC Group prefers to grow its balance sheet through increasing core retail deposits where possible.

Global Markets is an important player in the money markets and debt capital markets. As a leading market maker in loans and deposits, the group routinely accepts deposits, often of a short-term nature, from banks and other institutions and makes advances to similar organisations. In addition, the funding of capital markets activities, by repo arrangements for example, will often result in funding directly in the wholesale market.

Approximately two thirds of the bank's asset base is sterling-based with the remainder mostly denominated in euros and US dollars. The non-sterling asset base is partially funded through currency-denominated capital issues and loan stock, supplemented by time deposits taken from the eurocurrency interbank market, from central banks, corporate customers and other financial institutions.

The sources of such deposits, by type of institution and country, are monitored in order to avoid an undesirable dependence on any particular institution or category of depositor.

Global Markets in London has, for some years, operated a liquidity management policy based on consolidated net cash flows that conforms to the FSA's arrangements for the supervision of major UK banks' sterling liquidity. Central to these arrangements is the requirement for banks to be able to survive five working days without the renewal of any maturing net wholesale liabilities, and after the leakage of 5 per cent of the gross retail deposit base, for which purpose a minimum coverage ratio of specified liquid assets must be maintained. This ratio is computed daily, with the position being managed so as to exceed the minimum ratio. In addition to complying with these FSA requirements on sterling liquidity, the bank also adopts the same consolidated cash flow methodology for managing its all-currency 0-5 working day liquidity exposures.

It is, however, the HSBC Group's policy that on an all-currency basis all professional deposits with residual maturities up to 30 days, plus 5 per cent of deposit liabilities should be backed by liquid assets. This means that, in a crisis, the group would be able to meet its obligations as they fall due for at least 30 days without recourse to the wholesale markets. This requirement is significantly more stringent than the regulatory requirement.

In France, CCF complies with the regulatory liquidity ratio requirements of the Banque de France, overseen and monitored by the Commission Bancaire. Banks are required to submit quarterly returns which are used to compute a liquidity ratio for the coming month, and for the following two months. Banks simultaneously submit a future forecast of liquidity positions called 'observation ratios'. The ratios are derived by dividing liquid assets (which are subject to discount factors) by liabilities (which include a proportion of customer accounts, 5 per cent of off-balance-sheet commitments and all borrowings and subordinated loan stock maturing within one month). Banks are required to maintain, at all times, a ratio in excess of 100 per cent.

In Switzerland, Private Banking complies with the liquidity requirements of the Swiss Federal Banking Commission. 'Cash liquidity ' applies to Swiss currency only and requires that liquid assets are, on the basis of a monthly average, at least equal to 2.5% of the amounts due to banks/clients maturing within 3 months and of 20% of the savings and deposit clients' liabilities. 'Total liquidity 1' embraces all currencies and requires that liquid and easily realisable assets are continuously at least equal to one third of the short-term liabilities.

Other non-UK units maintain sufficient liquidity to meet their day-to-day needs and local regulatory requirements unless specific arrangements are made for Global Markets in London to provide the necessary support. Both CCF and Private Banking are required to maintain high-quality liquid assets at least equal to 0-30 days' cumulative refinancing exposures on an all-currency basis for HSBC Group liquidity management purposes.

33 Risk management *(continued)*

c *Operational Risk Management*

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, systems failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues.

The HSBC Group manages this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by internal audit, and by monitoring external operational risk events, which ensures that the HSBC Group stays in line with best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

The HSBC Group has codified its operational risk management process by issuing a high level standard. This explains how the HSBC Group manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The processes undertaken to manage operational risk are determined by reference to the scale and nature of each HSBC Group operation. The HSBC Group standard covers the following:

- Operational risk management responsibility is assigned at a senior management level within the business operation.
- Information systems are used to record the identification and assessment of operational risks and generate appropriate, regular management reporting.
- Operational risks are identified by risk assessments covering operational risks facing each business and risks inherent in processes, activities and products. Risk assessment incorporates a regular review of risks identified to monitor significant changes.
- Operational risk loss data is collected and reported to senior management. This report covers aggregate operational risk losses and details of incidents above a materiality threshold.
- Risk mitigation, including insurance, is considered where this is cost-effective.

Local management within the group is responsible for implementation of the HSBC Group standard on operational risk, throughout their operation and where deficiencies are evident, these are rquired to be rectified within a reasonable timeframe.

The HSBC Group maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests were conducted following the terrorist events of 11 September 2001 and the two bomb blasts which damaged two of HSBC's buildings in Istanbul in 2003, to incorporate lessons learned in the operational recovery from those circumstances.

d *Credit Risk Management*

Credit risk is the risk that a customer or counterparty of the group will be unable or unwilling to meet a commitment into which it has entered with a member of the group. It arises from lending, trade finance, treasury and other activities. The group has in place standards, policies and procedures for the control and monitoring of all such risks.

HSBC Holdings plc is responsible for the formulation of high-level credit policies. It also reviews the application of the HSBC Group's universal facility grading system. The HSBC Group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. Cross-border risk is controlled through the imposition of country limits, which are determined by taking into account economic and political factors, and local business knowledge, with sub-limits by maturity and type of business. Transactions with counterparties in higher risk countries are considered on a case-by-case basis.

33 **Risk management** *(continued)*

d *Credit Risk Management (continued)*

Within the overall framework of the HSBC Group policy, the bank has an established risk management process encompassing credit approvals, the control of exposures (including those to borrowers in financial difficulty), credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis. Local management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products.

Special attention is paid to the management of problem loans. Where deemed appropriate, specialist units are established to provide intensive management and control to maximise recoveries of doubtful debts.

Geographical concentrations of credit risk

The group restricts its exposure to the risk of payment difficulties arising with respect to individual countries and regions through a central HSBC Group system of internally determined country limits that relate to both economic and political risks. Exposures to individual countries and cross-border exposures in aggregate are kept under continuous review.

The following table shows total outstandings to counterparties in countries and regions which individually represent in excess of 5 per cent of total outstandings. Classification is based upon the country of residence of the borrower but recognises the transfer of country risk in respect of third party guarantees, eligible collateral held or residence of the head office where the borrower is a branch. In accordance with the Bank of England Country Exposure Report (Form CE) guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit, and debt and equity securities (net of short positions), and exclude accrued interest and intra group exposures. Comparative figures for 2003 were calculated under the requirements of the Bank of England's Form C1 which was replaced by Form CE for 31 December 2004 reporting.

As shown in the table below, the group's credit risk exposures are predominantly with countries and regions with developed economies.

	2004	2003
	%	%
United Kingdom	**49**	47
France	**12**	15
Germany	**8**	8
Rest of Continental Europe	**18**	16
Continental Europe	**38**	39
United States	**6**	5
Rest of world	**7**	9
	100	100

Concentrations of credit risk

Information relating to industry concentrations, gross of specific provisions, is disclosed in Note 14.

The group provides a diverse range of financial services both in the United Kingdom and internationally. As a result, its portfolio of financial instruments with credit risk is highly diversified with no exposures to individual industries or economic groupings totalling more than 10 per cent of consolidated total assets, except as follows:

33 Risk management *(continued)*

d *Credit Risk Management (continued)*

- the bank's position as one of the principal UK clearing banks means that the majority of the group's exposure to credit risk is concentrated in the United Kingdom. Within the United Kingdom, the group's credit risk is diversified over a wide range of industrial and economic groupings; and
- the group's position as part of a major international banking group means, that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2004 and 31 December 2003 was concentrated in Europe (including the United Kingdom). Concentrations of credit risk arising from off-balance-sheet transactions are discussed in Note 34(a).

There are no special collateral requirements relating to industrial concentrations, with the exception of exposures to the property sector. The majority of exposures to the property and construction industry and the residential mortgage market are secured on the underlying property.

34 Financial instruments

a *Derivatives*

Off-balance-sheet financial instruments, commonly referred to as derivatives, are contracts the characteristics of which are derived from those of the underlying assets, interest and exchange rates, credit spreads, equity indices or commodity prices. They include futures, forwards, swap and options transactions in the foreign exchange, interest rate, equity, credit and commodity markets. Transactions are negotiated directly with customers, with the group acting as a counterparty, or can be dealt with through exchanges.

Users of derivatives typically want to convert an unwanted risk generated by their business to a more acceptable risk, or cash. Derivatives provide an effective tool for companies to manage the financial risks associated with their business and, as a consequence, there has been a significant growth in derivatives transactions in recent years.

The group, through its dealing operations, takes positions in the market and acts as an intermediary between a broad range of users, structuring deals to produce risk management products to suit individual customer needs. As a result, the group can accumulate significant open positions in derivatives portfolios. These positions are managed constantly to ensure that they are within acceptable risk levels, with offsetting deals being undertaken to achieve this where necessary. As well as acting as a dealer, the group also uses derivatives (principally interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

Risks associated with derivatives

Derivative instruments are subject to both market risk and credit risk, discussed in Note 33.

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than required in cash markets. Recognising this, only certain offices with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. The management of market risk arising from derivatives business is monitored daily by the market risk control unit in each office and on a regular basis by Traded Markets Development and Risk, in combination with market risks arising from on-balance-sheet instruments, discussed in Note 33(a).

Unlike assets recorded on the balance sheet, where the credit risk is typically the full amount of the principal value, together with any unrealised interest accrued or mark-to-market gain ('Credit risk management' in Note 33(d), the credit risk relative to a derivative is principally the replacement cost of any contract with a positive mark-to-market gain and an estimate for the potential future change in value, reflecting the volatilities affecting the contract. Credit risk on contracts having a negative mark-to-market value is restricted to the potential future change in value. Credit risk on derivatives is, therefore, small in relation to a comparable balance sheet risk. In addition, credit exposure with individual counterparties can be reduced by the receipt of collateral and close-out netting agreements, which allow for positive and negative mark-to-market values on different transactions to be offset and settled by a single payment in the event of default by either party. Such agreements are enforceable in the jurisdictions of the major market makers and the group has executed close-out netting agreements with the majority of its significant counterparties, notwithstanding the fact that the group deals only with the most creditworthy counterparties.

34 Financial instruments *(continued)*

a *Derivatives (continued)*

To reduce credit risk, management may deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on management's credit evaluation of the customer. Collateral held varies but will generally be in the form of liquid securities or cash.

The credit risk profile generated by the use of credit derivatives has an additional dimension. Where the group purchases protection, credit risk arises through the cost of replacing the contract and it is managed and reduced in the same way as for other derivative contracts. Selling protection through credit derivatives gives rise to additional credit risk. This credit risk arises as a direct consequence of the obligation of the group as the protection seller to make a payment to the protection buyer following a credit event on a reference name. The group manages the credit risk with regard to reference names by including any such exposures arising from credit derivatives with its overall credit limits structure. In addition the trading of credit derivatives is restricted to a number of small offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

The following table analyses the replacement cost of all third-party exchange rate, interest rate and equities contracts with positive mark-to-market gains, after netting where available, by maturity and by category of counterparty at 31 December 2004 and 31 December 2003. The table shows that the replacement cost of derivatives is predominately with banks and under five years.

Replacement cost	*Residual maturity*					
	Less than one year	*One to five years*	*Over five years*	*Netting*	*Total 2004*	*Total 2003*
	£m	£m	£m	£m	**£m**	£m
Government	**2**	**49**	**139**	**(15)**	**175**	15
Banks	**6,611**	**7,315**	**6,542**	**(11,194)**	**9,274**	7,445
Non-bank financial institutions						
Exchanges*	**105**	**80**	**8**	**—**	**193**	129
Other	**1,518**	**900**	**1,551**	**(1,203)**	**2,766**	1,935
Other sectors	**612**	**363**	**328**	**(617)**	**686**	1,318
Total 2004	**8,848**	**8,707**	**8,568**	**(13,029)**	**13,094**	
Total 2003	8,283	7,694	3,875	(9,010)		10,842

** Exchanges with margining requirement.*

The following table analyses the maturity profile of the contract amounts of third-party derivative contracts outstanding at 31 December 2004 and 31 December 2003.

Contract amount	*Residual maturity*				
	Less than one year	*One to five years*	*Over five years*	*Total 2004*	*Total 2003*
	£m	£m	£m	**£m**	£m
Exchange rate, interest rate and equities contracts					
Exchanges*	**179,950**	**82,882**	**44,082**	**306,914**	147,026
Other	**789,453**	**575,565**	**305,348**	**1,670,366**	1,174,270
Total 2004	**969,403**	**658,447**	**349,430**	**1,977,280**	
Total 2003	726,604	401,197	193,495		1,321,296

** Exchanges with margining requirement.*

34 Financial instruments *(continued)*

a *Derivatives (continued)*

i Derivatives used for trading purposes

Contracts for trading purposes are undertaken both for the group's own account and to service its corporate customer base, including designing structured products to meet the specific requirements of customers. Derivatives are used for trading purposes in order to generate income from customer-driven business and dealing income from market fluctuations.

Trading positions are valued on a mark-to-market basis.

In liquid portfolios, the market values are determined by reference to independently sourced mid-market prices where it is reasonable to assume the positions could be sold at that price. In those instances where markets are less liquid and/or where positions have been held for extended periods, portfolios will be valued by reference to bid or offer prices as appropriate.

In relation to certain products, such as over-the-counter derivative instruments, there are no independent prices quoted in the markets. In these circumstances market values are determined by reference to standard industry models, which typically utilise discounted cash flow techniques to derive the market value. The models may be in-house developed or software vendor packages.

In valuing transactions, prices may be amended in respect of those positions considered illiquid, having recognition of the size of the position *vis à vis* the normal market trading volumes in that product.

The main valuation sources are volatilities, securities prices, foreign exchange rates, and interest rate yield curves.

The group's derivative transactions are predominantly in plain vanilla instruments, primarily comprising interest rate and foreign exchange contracts, where the mark-to-market values are readily determinable by reference to independent prices and valuation quotes, as described above.

There are a limited number of structured transactions which have been performed, primarily to meet specific customer demand, where standard industry models are not routinely available, and where there is no market quotation. For these products, the group has developed its own proprietary models for the purposes of performing valuations. These models are rigorously checked by Finance and Operations departments on an ongoing basis to ensure that the model assumptions are, and remain, valid over the transaction life, which is generally less than five years.

Trading derivatives are valued at mark-to-market based on quoted market prices or on internally developed models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates. If market observable data are not available, the initial increase in fair value indicated by the valuation model, but based on unobservable inputs, is not realised immediately in the profit and loss account. This amount is held back and recognised over the life of the transaction where appropriate, or released to the profit and loss account when the inputs become observable, or, when the transaction matures or is closed out.

34 Financial instruments *(continued)*

a *Derivatives (continued)*

i *Derivatives used for trading purposes (continued)*

The average mark-to-market values for the years ended 31 December 2004 and 31 December 2003 are analysed in the following table. Positive amounts represent replacement cost values, while negative amounts represent current mark-to-market losses.

	2004	2003
	Average Mark-to-market values	*Average Mark-to-market values*
	£m	£m
Exchange rate contracts		
— assets	**8,413**	7,473
— liabilities	**(8,620)**	(7,869)
Interest rate contracts		
— assets	**9,706**	12,301
— liabilities	**(9,359)**	(11,914)
Equities		
— assets	**1,295**	1,142
— liabilities	**(1,315)**	(1,498)

Asset and liability balances arising from derivative contracts are not netted, except where a legal right of set-off exists.

Assets, including gains, resulting from derivatives that are marked-to-market, are included within 'Other assets' in the consolidated balance sheet. Liabilities, including losses, resulting from such contracts, are included in 'Other liabilities'.

The following tables summarise the contract amount, replacement cost and mark-to-market values of third-party and internal trading derivatives by product type. The replacement cost shown is the positive mark-to-market value and represents the accounting loss the group would incur if the counterparty to a derivative contract failed to perform according to the terms of the contract and the collateral, if any, for the amount due proved to be of no value.

Because all derivative instruments used for trading purposes are marked-to-market, carrying values are equal to market values. Mark-to-market values are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows and include netted internal positions, except where otherwise indicated.

The notional or contractual amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

34 Financial instruments *(continued)*

a *Derivatives (continued)*

i Derivatives used for trading purposes (continued)

Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with allowable netting shown separately.

	2004		2003	
	Contract amount	*Replacement cost*[1]	*Contract amount*	*Replacement cost*[1]
	£m	**£m**	£m	£m
Spot and forward foreign exchange	**302,079**	**5,487**	235,702	5,823
Currency swaps, futures and options purchased	**139,251**	**4,049**	98,499	3,036
Currency options written	**68,797**	**—**	49,622	—
Credit derivatives	**43,355**	**191**	10,846	102
Commodity contracts	**773**	**3**	521	3
Total exchange rate contracts	**554,255**	**9,730**	395,190	8,964
Interest rate swaps	**1,013,214**	**12,412**	734,452	7,957
Interest rate futures, forward rate agreements, and options purchased	**276,733**	**2,338**	186,155	1,104
Interest rate options written	**131,953**	**—**	64,956	—
Total interest rate contracts	**1,421,900**	**14,750**	985,563	9,061
Equities, futures and options purchased	**18,091**	**1,239**	17,302	1,507
Equities options written	**8,277**	**—**	7,837	—
Total equities contracts	**26,368**	**1,239**	25,139	1,507
Netting		**(13,029)**		(9,010)
Total	**2,002,523**	**12,690**	1,405,892	10,522

[1] *Third-party contracts only*

	2004	2003
	Mark-to-market values	*Mark-to-market values*
	£m	£m
Exchange rate		
— assets	**10,323**	9,556
— liabilities	**(11,086)**	(9,908)
Interest rate		
— assets	**14,753**	9,066
— liabilities	**(14,042)**	(9,164)
Equities		
— assets	**1,239**	1,507
— liabilities	**(1,507)**	(1,211)
Total		
— assets	**26,315**	20,129
— liabilities	**(26,635)**	(20,283)
Netting	**(13,029)**	(9,010)

34 Financial instruments *(continued)*

a *Derivatives (continued)*

i *Derivatives used for trading purposes (continued)*

Included in the amounts in the previous table is cash collateral meeting the offset criteria of FRS 5 "Reporting the substance of transactions" as follows:

	2004	2003
	£m	£m
Offset against assets	**568**	427
Offset against liabilities	**283**	281

ii *Derivatives used for risk management purposes*

The majority of the transactions undertaken for risk management purposes are between business units within the group, one of which is a trading desk, which may then lay off the resulting position by trading in the external market. Internal positions are integral to the group's asset and liability management and are included within analyses of non-trading positions in the tables below.

The table below summarises the contract amount and replacement cost of derivatives used for risk management purposes by product type. The replacement cost shown represents the accounting loss the group would incur if the counterparty to a derivative contract failed to perform according to the terms of the contract and the collateral, if any, for the amount due proved to be of no value.

	2004		2003	
	Contract amount	*Replacement cost*[1]	*Contract amount*	*Replacement cost*[1]
	£m	**£m**	£m	£m
Spot and forward foreign exchange	**971**	**4**	3,961	3
Currency swaps, futures and options purchased	**4,053**	**87**	6,676	111
Total exchange rate contracts	**5,024**	**91**	10,637	114
Interest rate swaps	**140,119**	**313**	137,226	206
Interest rate futures, forward rate agreements and options purchased	**425**	**—**	1,141	—
Total interest rate contracts	**140,544**	**313**	138,367	206

[1] *Third-party contracts only*

The table below summarises the carrying value and mark-to-market value of derivative contracts held for risk management purposes. Mark-to-market values for assets and liabilities arising from derivatives held for non-trading purposes are determined in the same way as those set out for trading derivatives above including internal positions.

	2004		2003	
	Carrying value	*Mark-to-market values*	*Carrying value*	*Mark-to-market values*
	£m	**£m**	£m	£m
Exchange rate				
— assets	**98**	**101**	87	164
— liabilities	**(788)**	**(805)**	(792)	(1,078)
Interest rate				
— assets	**754**	**1,704**	528	2,298
— liabilities	**(296)**	**(1,171)**	(138)	(1,671)

34 Financial instruments *(continued)*

b *Other financial instruments*

i *Financial instruments held for trading purposes*

	2004	2003
	Mark-to-market values	*Mark-to-market values*
	£m	£m
Assets		
Treasury bills and other eligible bills	**109**	199
Loans and advances to banks and customers	**24,076**	21,081
Debt securities	**33,130**	27,347
Equity shares	**6,743**	4,118
	64,058	52,745
Liabilities		
Short positions in securities	**14,982**	9,939
Debt securities in issue	**1,786**	682
Deposits by banks and customer accounts	**15,450**	13,447
	32,218	24,068

The net trading assets above are funded by liabilities whose fair value is not materially different from their carrying value.

ii *Financial instruments not held for trading purposes and for which a liquid and active market exists*

	2004		2003	
	Carrying value	*Mark-to-market values*	*Carrying value*	*Mark-to-market values*
	£m	£m	£m	£m
Assets				
Treasury bills and other eligible bills	**5,773**	**5,770**	1,998	2,000
Debt securities	**26,878**	**27,239**	22,209	22,676
Equity shares	**1,362**	**1,709**	1,719	2,046
	34,013	**34,718**	25,926	26,722
Liabilities				
Debt securities in issue	**16,925**	**15,316**	4,356	4,362
Subordinated liabilities	**4,591**	**4,698**	4,765	4,856
Non-equity minority interest	**1,000**	**1,000**	700	700
	22,516	**21,014**	9,821	9,918

34 Financial instruments *(continued)*

b *Other financial instruments (continued)*

Where possible, mark-to-market values have been estimated using market prices for these financial instruments. Where market prices are not available, values have been estimated using quoted prices for financial instruments with similar characteristics, or otherwise using a suitable valuation technique where practicable to do so.

The valuation techniques used are:

— *Treasury bills and other eligible bills*

The mark-to-market value approximates to carrying value because these are mainly short-term in maturity with a carrying value not materially different from mark-to-market value.

— *Loans and advances to banks and customers*

For variable rate loans and advances with no significant change in credit risk, the carrying value is considered to represent mark-to-market value. The mark-to-market values of other loans and advances are estimated by discounting future cash flows using market interest rates.

— *Debt securities and equity shares*

Listed securities are valued at middle-market prices and unlisted securities at management's valuation, which takes into consideration future earnings streams, valuations of equivalent quoted securities and other relevant techniques.

— *Debt securities in issue, short positions in securities, subordinated liabilities and preference shares*

Mark-to-market values are estimated using quoted market prices at the balance sheet date.

— *Deposits by banks and customer accounts*

Deposits by banks and customer accounts that mature or re-price after six months are grouped by residual maturity. Fair value is estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar repricing maturities.

c *Gains and losses on hedges*

Gains and losses on instruments used for hedging are recognised in line with the underlying items that are being hedged. The unrecognised gains on instruments used for hedging as at 31 December 2004 were £1,205 million (2003: £1,638 million) and the unrecognised losses were £1,144 million (2003: £1,610 million).

Unrecognised gains of £624 million and unrecognised losses of £580 million are expected to be recognised in 2005.

Of the gains and losses included in the profit and loss account in 2004, £799 million gains and £703 million losses were unrecognised at 1 January 2004.

Notes on the Accounts (continued)

35 Memorandum items

a *Contingent liabilities and commitments*

	2004			2003		
	Contract amount	*Credit equivalent amount*	*Risk-weighted amount*	*Contract amount*	*Credit equivalent amount*	*Risk-weighted amount*
	£m	**£m**	**£m**	£m	£m	£m
group						
Contingent liabilities						
Acceptances and endorsements	**641**	**289**	**187**	455	197	137
Guarantees and assets pledged as collateral security						
— guarantees and irrevocable letters of credit	**16,290**	**12,240**	**10,186**	15,364	11,338	9,374
— other	**3**	**3**	**3**	4	4	4
	16,934	**12,532**	**10,376**	15,823	11,539	9,515
Commitments						
Documentary credits and short-term trade-related transactions	**1,216**	**740**	**330**	1,550	730	379
Forward asset purchases and forward forward deposits placed	**289**	**289**	**196**	130	130	116
Undrawn note issuance and revolving underwriting facilities	**37**	**18**	**18**	59	30	30
Undrawn formal standby facilities, credit lines and other commitments to lend						
— over 1 year	**27,943**	**13,972**	**12,496**	19,568	9,781	8,710
— 1 year or less	**72,125**	**—**	**—**	52,274	—	—
	101,610	**15,019**	**13,040**	73,581	10,671	9,235

	2004	2003
	£m	£m
Incurred on behalf of parent and fellow subsidiary undertakings (contract amount)		
— contingent liabilities	**153**	147

35 Memorandum items *(continued)*

a *Contingent liabilities and commitments (continued)*

	2004			2003		
	Contract amount	*Credit equivalent amount*	*Risk-weighted amount*	*Contract amount*	*Credit equivalent amount*	*Risk-weighted amount*
	£m	£m	£m	£m	£m	£m
bank						
Contingent liabilities						
Acceptances and endorsements	**446**	**90**	**51**	328	67	44
Guarantees and assets pledged as collateral security						
— guarantees and irrevocable letters of credit	**9,461**	**7,887**	**5,856**	9,242	7,326	5,574
	9,907	**7,977**	**5,907**	9,570	7,393	5,618
Commitments						
Documentary credits and short-term trade-related transactions	**765**	**573**	**206**	1,006	433	214
Forward asset purchases and forward forward deposits placed	**32**	**32**	**32**	23	23	19
Undrawn note issuance and revolving underwriting facilities	**—**	**—**	**—**	21	10	10
Undrawn formal standby facilities, credit lines and other commitments to lend						
— over 1 year	**18,138**	**9,069**	**7,877**	11,961	5,978	5,133
— 1 year or less	**54,217**	**—**	**—**	46,014	—	—
	73,152	**9,674**	**8,115**	59,025	6,444	5,376

	2004	2003
	£m	£m
Incurred on behalf of subsidiary undertakings (contract amount)		
— contingent liabilities	**40**	7
Incurred on behalf of parent and fellow subsidiary undertakings (contract amount)		
— contingent liabilities	**29**	—

The preceding tables give the nominal principal amounts, credit equivalent amounts and risk-weighted amounts of off-balance-sheet transactions. The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Financial Services Authority's guidelines, which implement the 1988 Basel Capital Accord on capital adequacy and depend on the status of the counterparty and the maturity characteristics.

Contingent liabilities and commitments are credit-related instruments that include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Notes on the Accounts (continued)

35 Memorandum items *(continued)*

b *Concentrations of contingent liabilities and commitments*

The group has the following concentration of exposure to contingent liabilities and commitments, based on the location of the office recording the transaction:

	United Kingdom	*Continental Europe*	*Rest of the world*	*Total*
	£m	£m	£m	£m
Contract amounts				
Contingent liabilities				
2004	**8,915**	**7,670**	**349**	**16,934**
2003	8,216	7,259	348	15,823
Commitments				
2004	**77,617**	**18,203**	**5,790**	**101,610**
2003	55,871	13,288	4,422	73,581

36 Litigation

The bank and certain subsidiary undertakings are named in, and are defending, legal actions in various jurisdictions arising from their normal business. No material adverse impact on the financial position of the group is expected to arise from these proceedings.

37 Capital commitments

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Expenditure contracted for	**412**	708	**127**	131

38 Lease commitments

The group was committed to various non-cancellable operating leases on Leasehold land and buildings, which require aggregate future rental payments as follows:

	2004	2003
	£m	*£m*
Payable within 1 year	**97**	86
Payable between 1 and 2 years	**91**	79
Payable between 2 and 3 years	**86**	75
Payable between 3 and 4 years	**80**	69
Payable between 4 and 5 years	**74**	63
Payable in over 5 years	**377**	372
	805	744

38 Lease commitments *(continued)*

At the year-end, annual commitments under non-cancellable operating leases were:

	group		*bank*	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Leasehold land and buildings				
Operating leases which expire				
— within 1 year	**3**	3	**2**	2
— between 1 and 5 years	**31**	20	**25**	13
— in over 5 years	**63**	62	**58**	57
	97	85	**85**	72

39 Segmental analysis

As the group is not required to disclose turnover, no segmental analysis of turnover is included. Turnover of non-banking businesses is included in other operating income in the table below. The allocation of earnings reflects the benefit of shareholders' funds to the extent that these costs are actually allocated to businesses in the segment by way of intra-group capital and funding structures. Common costs are included in segments on the basis of the actual recharges made.

a *By geographical region*

In the analysis set out below, net assets include an appropriate amount of shareholders' funds, based on the proportion of risk-weighted assets in each segment. Geographical information has been classified by the location of the principal operations of the subsidiary undertaking or, in the case of the bank, by the location of the branch responsible for reporting the results or for advancing the funds.

	United Kingdom	*Continental Europe*	*Rest of the world*	*Total*
2004	**£m**	**£m**	**£m**	**£m**
Gross income				
Interest receivable	**6,534**	**2,756**	**297**	**9,587**
Dividend income	**285**	**20**	**—**	**305**
Fees and commissions receivable	**2,549**	**1,358**	**94**	**4,001**
Dealing profits	**222**	**253**	**94**	**569**
Other operating income	**468**	**77**	**7**	**552**
Total gross income	**10,058**	**4,464**	**492**	**15,014**
Profit on ordinary activities before tax	**2,146**	**374**	**72**	**2,592**
Attributable profit	**1,480**	**119**	**55**	**1,654**
Net assets	**11,914**	**5,582**	**465**	**17,961**
Total assets	**178,064**	**101,226**	**10,685**	**289,975**
2003	£m	£m	£m	£m
Gross income				
Interest receivable	5,395	2,636	236	8,267
Dividend income	60	28		88
Fees and commissions receivable	2,338	1,241	78	3,657
Dealing profits	374	219	87	680
Other operating income	446	56	6	508
Total gross income	8,613	4,180	407	13,200
Profit on ordinary activities before tax	1,896	304	44	2,244
Attributable profit/(loss)	1,469	(17)	28	1,480
Net assets	10,804	5,699	561	17,064
Total assets	145,869	90,552	9,683	246,104

39 Segmental analysis *(continued)*

b *By class of business*

	2004 £m	2003 £m
Profit/(loss) on ordinary activities before tax		
UK Personal Banking	**789**	687
UK Commercial Banking	**726**	586
UK Corporate, Investment Banking and Markets	**576**	782
International Banking	**258**	144
France	**385**	271
Private Banking	**341**	290
HSBC Trinkaus & Burkhardt	**70**	50
Amortisation of goodwill	**(553)**	(566)
	2,592	2,244
Net assets		
UK Personal Banking	**1,528**	1,333
UK Commercial Banking	**1,199**	1,048
UK Corporate, Investment Banking and Markets	**2,267**	2,240
International Banking	**745**	873
France	**7,981**	7,632
Private Banking	**4,007**	3,707
HSBC Trinkaus & Burkhardt	**234**	231
	17,961	17,064
Total assets		
UK Personal Banking	**54,400**	41,927
UK Commercial Banking	**26,756**	22,636
UK Corporate, Investment Banking and Markets	**92,136**	76,463
International Banking	**16,307**	15,151
France	**63,920**	55,213
Private Banking	**27,541**	26,980
HSBC Trinkaus & Burkhardt	**8,915**	7,734
	289,975	246,104

The amortisation of goodwill includes £352 million (2003: £334 million) in respect of France and £164 million (2003: £173 million) in respect of Private Banking. In 2004 various changes were made in the way the business was managed. UK Corporate and Institutional Banking, Global Markets, UK and Investment Banking were brought together as UK Corporate, Investment Banking and Markets; management of offshore business was transferred from International Banking to the UK; and France business was separately identified. The figures for 2003 have been restated on a comparable basis.

40 Related party transactions

a *Transactions, arrangements and agreements involving Directors and others*

Particulars of transactions, arrangements and agreements entered into by subsidiary undertakings of the bank with Directors and connected persons and companies controlled by them and with officers of the bank disclosed pursuant to section 232 of the Companies Act 1985 are as follows:

	2004		2003	
	Number	*£000*	*Number*	*£000*
Directors and connected persons and companies controlled by them:				
Loans and credit card transactions (including £52,000 in credit card transactions (2003: £94,000))	**21**	**15,644**	19	210,457
Officers:				
Loans and credit card transactions (including £95,430 in credit card transactions (2003: £136,000))	**22**	**6,793**	27	7,823

b *Joint ventures and associates*

Information relating to joint ventures and associates can be found in the Notes on the Accounts, where the following are disclosed:

— Note 12: amounts due from joint ventures

— Note 17: interests in joint ventures

— Note 18: interests in associates

— Note 24: amounts due to joint ventures and associates

c *Transactions with other related parties of the group*

Pension funds

At 31 December 2004, the HSBC Bank (UK) Pension Scheme had deposits of £126 million (2003: £103 million) with the bank.

41 Approval of the accounts

These accounts were approved by the Board of Directors on 28 February 2005.

42 Ultimate parent company

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

HSBC Holdings plc is the only undertaking for which consolidated accounts that include the consolidated accounts of the group are drawn up.

HSBC Holdings plc is HSBC Bank plc's direct and ultimate controlling party as defined under Financial Reporting Standard 8, 'Related Party Disclosures'.

Copies of HSBC Holdings plc's *Annual Review 2004* and *Annual Report and Accounts 2004* can be obtained from its registered office at 8 Canada Square, London E14 5HQ, or on the HSBC Group's web site, www.hsbc.com.