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SAMUEL MONTAGU & CO. LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 1999

Registered number: 499482

12/10/00 449

Samuel Montagu & Co. Limited
Report of the directors
for the year ended 31 December 1999

Activities and review

The Company is authorised as a bank under the Banking Act 1987. The principal activity of the Company continues to be private banking.

The profit of the Company amounted to £14,484,000 before tax and £9,119,000 after tax.

The directors have declared an interim dividend of £6,000,000.

Directors

The directors who served during the year were as follows:

C C R Bannister	Chairman
M J Gregson	Chief Executive
M A Bussey	
I C Cotterill	
C Kirby	(appointed 2 February 1999)
N V Moss	(appointed 18 October 1999)
A J S Ross	
K B Chandrasekar	(resigned 26 February 1999)
K R Harris	(resigned 24 March 1999)

Directors' interests

All the directors' interests in the share and loan capital of HSBC Holdings plc, the ultimate parent undertaking, required to be disclosed under the Companies Act 1985, are set out below. As a result of a share capital reorganisation implemented on 2 July 1999, each ordinary share of 75p each was replaced with three ordinary shares of US$0.50 each.

	HSBC Holdings plc		
	Ordinary shares of US$0.50 each 31 December 1999	Ordinary Shares of 75p each 1 January 1999 (or date of appointment if later)	Ordinary shares of US$0.50 each 1 January 1999 (or date of appointment if later)
M J Gregson	35,368	10,294	-
C Kirkby	31,591	9,321	-
N V Moss	35,179	-	39,179

C Kirkby held 1,907 HSBC Holdings plc 11.69% Subordinated Bonds 2002 of £1 throughout the year.

As a consequence of the share capital reorganisation, all awards under the Share Option Schemes, made in ordinary shares of 75p each, were adjusted by multiplying the number of shares by three and dividing the relevant exercise price by three. During the year options over shares were granted/exercised as follows (adjusted numbers shown):

	Granted Ordinary shares of US$0.50 each	Exercised Ordinary shares of US$0.50 each
M A Bussey	15,000	19,428
M J Gregson	1,875	4,428
C Kirkby	16,875	4,428
N V Moss	1,875	4,428
A J S Ross	5,000	-

Supplier payment policy

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

The amount due to the Company's trade creditors at 31 December 1999 represents 24 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.

Year 2000

There has been no disruption to the Company's operations, during or since the turn of the millennium, as a result of the Company's systems not being Year 2000 compliant. No disruption is expected and the directors continue to monitor the position.

The costs of the Year 2000 modifications have been assessed on a group basis and are incorporated within the report of HSBC Holdings plc.

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 page 4, is made with a view to distinguishing for the shareholder 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 Company as at the end of the financial year and of the profit or loss for the financial year. The directors are required to prepare the financial statements on the going concern basis unless it is not appropriate. Since the directors are satisfied that the Company has resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

The directors consider that in preparing the financial statements on pages 5 to 27, the Company has used appropriate accounting policies, consistently applied 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 Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company 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 Company and to prevent and detect fraud and other irregularities.

Samuel Montagu & Co. Limited
Report of the directors
for the year ended 31 December 1999 (continued)

Auditors

Pursuant to a shareholder's resolution, the Company is not obliged to reappoint its auditors annually and therefore KPMG Audit Plc will continue in office.

By order of the Board

E A Hobley EA Hobley
Secretary

22 February 2000

Registered Office
10 Lower Thames Street
London
EC3R 6AE

Registered in England and Wales no. 499482

Samuel Montagu & Co. Limited

Report of the auditors, KPMG Audit Plc, to the members of Samuel Montagu & Co. Limited

We have audited the financial statements on pages 5 to 27.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 2, 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 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. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company 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 company is not disclosed.

Basis of 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 Company'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 Company's affairs as at 31 December 1999 and of its profit 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

22 February 2000

Samuel Montagu & Co. Limited

Profit and loss account
for the year ended 31 December 1999

	Notes	1999 £'000	1998 £'000
Interest receivable and similar income	3	69,755	72,540
Interest payable		(46,902)	(50,371)
Net interest income		22,853	22,169
Fees and commissions receivable		4,236	4,380
Fees and commissions payable		(9)	(56)
Dealing profits/(losses)	4	95	(180)
Other operating income		31	2,421
		4,353	6,565
Operating income		27,206	28,734
Administrative expenses	5	(9,774)	(8,702)
Depreciation and amortisation	17	(16)	(10)
		(9,790)	(8,712)
Operating profit before provisions		17,416	20,022
Provisions for bad and doubtful debts	13	(1,208)	(1,790)
Provisions for contingent liabilities and commitments	22	(3,047)	-
Operating profit		13,161	18,232
Profit on disposal of fixed assets and investments		1,323	2,141
Profit on ordinary activities before tax	6	14,484	20,373
Tax on profit on ordinary activities	8	(5,365)	(7,499)
Profit on ordinary activities after tax		9,119	12,874
Dividends	9	(6,000)	(11,000)
Retained profit for the financial year	24	3,119	1,874

Total recognised gains and losses

There were no recognised gains or losses other than the profit for the year.

Historical cost profits and losses

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

Continuing operations

None of the Company's activities were acquired or discontinued during the year.

The notes on pages 8 to 27 form part of these financial statements.

Samuel Montagu & Co. Limited
Balance sheet
at 31 December 1999

	Notes	1999 £'000	1998 £'000
Assets			
Cash and balances at central banks		12	12
Loans and advances to banks	11	311,421	384,564
Loans and advances to customers	12	804,792	548,722
Tangible fixed assets	17	34	50
Other assets	18	1,459	811
Prepayments and accrued income		10,736	9,086
Total assets	28	1,128,454	943,245
Liabilities			
Deposits by banks	19	456,665	401,170
Customer accounts	20	495,633	376,239
Other liabilities	21	33,640	34,656
Accruals and deferred income		7,040	1,870
Provisions for liabilities and charges	22	3,047	-
Called up share capital	23	112,250	112,250
Share premium account		3,277	3,277
Profit and loss account	24	16,902	13,783
Shareholder's funds – equity	25	132,429	129,310
Total liabilities	28	1,128,454	943,245

The notes on pages 8 to 27 form part of these financial statements.

Samuel Montagu & Co. Limited
Balance sheet
at 31 December 1999 (continued)

	Notes	1999 £'000	1998 £'000
Memorandum items	27		
Contingent liabilities:-			
- guarantees and assets pledged as collateral security		34,218	42,110
Commitments		152,437	89,908

Approved by the Board and signed on its behalf
on 22 February 2000

C C R Bannister
Chairman

The notes on pages 8 to 27 form part of these financial statements.

Samuel Montagu & Co. Limited
Notes to the financial statements
for the year ended 31 December 1999

1. Basis of preparation

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

These financial statements have been prepared in accordance with the special provisions of Part VII Chapter II of the Companies Act 1985 relating to banking companies.

The Company is not required to prepare consolidated financial statements by virtue of the exemption conferred by Section 228 of the Companies Act 1985. The results of the Company are included within the consolidated financial statements of HSBC Holdings plc, which is incorporated in England.

These financial statements present information about the undertaking as an individual undertaking and not about its group.

The Company has adopted the provisions of the following Financial Reporting Standards ("FRS"): FRS 12, "Provisions, contingent liabilities and contingent assets" and FRS 13 "Derivatives and other financial instruments: Disclosures".

As the cash flow statement included in the consolidated financial statements for the ultimate parent company complies with the conditions of Financial Reporting Standard No. 1 ("FRS1") (Revised 1996) "Cash Flow Statements" the Company is exempt under FRS1 from the requirement to prepare a separate cash flow statement.

The Company has taken advantage of the exemption under Financial Reporting Standard 8 "Related Party Disclosures" not to disclose details of transactions with HSBC Holdings plc or Group subsidiaries, on the grounds that it is a wholly owned subsidiary undertaking of HSBC Investment Bank plc, which is wholly owned by HSBC Holdings plc.

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 2 (b)).

Fee and commission income is accounted for in the period when receivable, except where the fee 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, the fee is recognised on an appropriate basis over the relevant period.

(b) Loans and advances and doubtful debts

Specific provision is made for doubtful debts as and when they are so considered and, in addition, amounts have been set aside as general provisions for doubtful debts. The specific element relates to individual banking relationships; the general element relates to other exposures not separately identified but known from experience to exist in any portfolio of banking relationships. When there is no longer any realistic prospect of recovery, the outstanding debt is written off.

Interest on doubtful debts is credited to a suspense account which is netted in the balance sheet against the relevant balances.

2. Principal accounting policies (continued)

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

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 provisions are based on any subsequent deterioration in its value.

(c) Equity shares

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.

(d) Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation calculated on a straight-line basis to write off the assets over their estimated useful lives at rates ranging from 20% to 33% per annum.

(e) Deferred taxation

Deferred taxation is provided on timing differences, using the liability method, between the accounting and taxation treatment of income and expenditure. Provision is made for deferred taxation only to the extent that it is probable that an actual liability will crystallise.

(f) Pension and other post-retirement benefits

The Company operates money purchase and defined benefit pension schemes.

For money purchase schemes, the profit and loss account charge is the contributions payable for the year.

For 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 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 regular basis.

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.

(g) Foreign currencies

(i) Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the year end.

(ii) All trading transactions are translated into sterling at the exchange rate ruling at the time of the transaction.

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

2. **Principal accounting policies** (continued)

(h) Off-balance-sheet financial instruments

Off-balance-sheet financial instruments arise from futures, forward, swap and option transactions undertaken by the Company in the foreign exchange and interest rate markets.

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 to service customers' needs and for proprietary purposes, as well as any related hedges.

Transactions undertaken for trading purposes are marked to market value and the net present value of any gain or loss arising is recognised in the profit and loss account as "Dealing profits".

Assets, including gains, resulting from off-balance-sheet exchange rate and interest rate contracts which are marked to market are included in "Other assets". Liabilities, including losses, resulting from such contracts, are included in "Other liabilities".

Non-Trading Transactions

Non-trading transactions are those which are held for hedging purposes as part of the Company'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 profit or loss arising is recognised on the same basis as that arising from the related assets, liabilities or positions.

To qualify as a hedge, the derivative must effectively reduce the price 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 include swaps, forwards and futures.

Interest rate swaps are also used to synthetically alter 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, accrual 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.

2. **Principal accounting policies** (continued)

(h) Off-balance-sheet financial instruments (continued)

Any profit of 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 through the profit and loss account.

Derivatives that do not qualify as hedges or synthetic alterations at inception are marked to market through the profit and loss account, with profits and losses included within "Dealing profits".

3. **Other interest receivable and similar income**

Included within other interest receivable and similar income are amounts receivable from fellow group undertakings of £22,326,000 (1998: £32,323,000).

4. **Dealing profits/(losses)**

	1999 £'000	1998 £'000
Foreign exchange	248	199
Interest rate derivatives	(153)	(379)
	95	(180)

5. **Administrative expenses**

	1999 £'000	1998 £'000
Staff costs		
- salaries and bonus scheme provisions	5,056	3,286
- social security costs	429	275
- other pension costs	318	(128)
Other administrative costs	3,971	5,269
	9,774	8,702

The average number of persons employed by the Company during the year was 78 (1998: 62).

6. Profit on ordinary activities before tax

	1999 £'000	1998 £'000
Profit on ordinary activities before tax is stated after:-		
(i) Income:		
- Profits less losses on securities dealing	(153)	(379)
(ii) Charges:		
Auditors' remuneration		
- audit work	29	28
- non-audit work	39	3

7. Remuneration of directors

	1999 £'000	1998 £'000
Directors' emoluments	503	943
Amounts receivable under long term incentive schemes	30	98
	533	1,041

The aggregate of emoluments and amounts receivable under long term incentive schemes of the highest paid director was £312,000 (1998: £279,000). The director is a member of a defined benefit scheme, under which the accrued pension at the year end was £41,716 (1998: £nil) which includes an accrued lump sum of £82,092 (1998: £nil).

During the year the highest paid director exercised share options and received shares under long term incentive schemes.

	Number of directors	
	1999	1998
Retirement benefits are accruing to the following number of directors under:		
Defined benefit schemes	1	2
The number of directors who exercised share options was:	4	-
The number of directors in respect of whose qualifying services shares were received/receivable under long term incentive schemes was	1	2

8. Tax on profit on ordinary activities

	1999 £'000	1998 £'000
The charge for taxation comprises:-		
Current year		
United Kingdom corporation tax at 30.25% (1998: 31%)	5,365	8,729
Deferred tax	-	(1,230)
	5,365	7,499

9. Dividends

	1999 £'000	1998 £'000
Interim	6,000	11,000

10. Credit and risk management

Credit risk is the risk that a customer or counterparty of the Company will be unable or unwilling to meet a commitment that it has entered into with the Company. It is managed within limits approved by the board and delegated to individuals as appropriate. Credit & Risk, an independent unit, develops procedures for the control and monitoring of all such risk.

11. Loans and advances to banks

	1999 £'000	1998 £'000
Remaining maturity:		
- repayable on demand	3,466	5,737
- 3 months or less	236,038	285,150
- 1 year or less but over 3 months	1,917	11,542
- 5 years or less but over 1 year	-	2,135
- 5 years or more	70,000	80,000
	311,421	384,564
Amounts include:		
Due from parent and fellow subsidiary undertakings		
- subordinated	70,000	80,000
- unsubordinated	238,783	303,036
	308,783	383,036

12. Loans and advances to customers

	1999 £'000	1998 £'000
Remaining maturity:		
- repayable on demand	158,177	108,327
- 3 months or less	96,343	129,580
- 1 year or less but over 3 months	147,824	117,549
- 5 years or less but over 1 year	212,138	139,256
- over 5 years	197,662	68,716
General and specific bad and doubtful debt provisions (note 13)	(7,352)	(14,706)
	804,792	548,722

Amounts include:

	1999 £'000	1998 £'000
Due from parent and fellow subsidiary Undertakings - unsubordinated	752	785

13. Provisions for bad and doubtful debts

	1999 Specific £'000	1999 General £'000	1999 Total £'000	1998 Specific £'000	1998 General £'000	1998 Total £'000
At 1 January	11,417	3,289	14,706	13,568	2,165	15,733
Exchange Adjustments	-	-	-	62	-	62
Charge to profit and loss account	458	1,565	2,023	946	1,124	2,070
Recoveries of advances written off in previous years	(815)	-	(815)	(280)	-	(280)
Net charge for the year	(357)	1,565	1,208	666	1,124	1,790
Amounts written off	(8,562)	-	(8,562)	(2,879)	-	(2,879)
At 31 December	2,498	4,854	7,352	11,417	3,289	14,706

13. Provisions for bad and doubtful debts (continued)

Included in loans and advances to customers are the following movements in the suspended interest account:-

	1999 £'000	1998 £'000
At 1 January	1,812	644
Interest suspended in the year	553	875
Suspended interest (recovered)/released	(2,093)	311
Amounts written off	(32)	(18)
At 31 December	240	1,812

Total loans and advances to customers on which interest is being suspended at 31 December 1999 amounted to £5,816,000 (1998: £18,905,000) against which there are provisions of £2,427,000 (1998: £11,276,000).

14. Concentrations of exposure

Loans and advances to customers are concentrated in the personal loans sector.

15. Equity shares

	1999		1998	
	Book value £'000	Market value £'000	Book value £'000	Market value £'000
Investment securities - listed but not on a recognised UK exchange	-	-	-	1,044

Investment securities:	Cost £'000	Provisions £'000	Book value £'000
At 1 January 1999	5	(5)	-
Disposals	(5)	5	-
At 31 December 1999	-	-	-

16. Shares in group undertakings

Details of the Company's subsidiary undertakings at 31 December 1999 are as follows:

	Principal activity	Proportion held %	Class of shares held
Montagu Pension Trustees Limited	Pension Trustee	100	Ordinary
W. Greenwell & Co. Limited	Pension Trustee	100	Ordinary

All the Company's subsidiary undertakings are incorporated in England.

17. Tangible fixed assets

	Furniture, fittings and equipment £'000
Cost at 1 January 1999 and Cost at 31 December 1999	147
km	
Accumulated depreciation at 1 January 1999	97
Charge for year	16
Accumulated depreciation at 31 December 1999	113
Net book value at 31 December 1999	34
Net book value at 31 December 1998	50

18. Other assets

	1999 £'000	1998 £'000
Assets, including gains, resulting from off-balance sheet interest rate and exchange rate contracts which are marked to market	-	95
Other accounts	1,459	716
	1,459	811

Samuel Montagu & Co. Limited
Notes to the financial statements
for the year ended 31 December 1999 (continued)

19. Deposits by banks

	1999 £'000	1998 £'000
Repayable on demand	404,013	291,723
With agreed maturity dates or periods of notice, by Remaining maturity:		
- 3 months or less	36,081	39,669
- 1 year or less but over 3 months	16,037	69,276
- 5 years or less but over 1 year	534	502
	456,665	401,170
Amounts include:		
Due to fellow subsidiary undertakings	456,650	401,155

20. Customer accounts

	1999 £'000	1998 £'000
Repayable on demand	251,799	145,963
With agreed maturity dates or periods of notice, by remaining maturity:		
- 3 months or less	232,121	223,438
- 1 year or less but over 3 months	11,713	6,488
- 5 years or less but over 1 year	-	350
	495,633	376,239
Amounts include:		
Due to fellow subsidiary and group undertakings	-	1

21. Other liabilities

	1999 £'000	1998 £'000
Short positions in dealing securities:-		
Liabilities including losses resulting from off-balance sheet interest and exchange rate contracts which are marked to market	-	92
Interim dividend	6,000	11,000
Current taxation	11,961	13,857
Other liabilities	15,679	9,707
	33,640	34,656

22. Provisions for liabilities and charges

(a) Deferred tax

Deferred taxation is provided in accordance with the accounting policy in Note 2(e).

At 31 December 1999, there were potential future tax benefits of approximately £589,000 (1998 – £nil) in respect of allowable expenditure charged to the profit and loss account but not yet allowed for tax which have not been recognised because recoverability of the potential benefits is not considered certain.

(b) Other provisions for liabilities and charges

	1999 £'000
At 1 January 1999	-
Profit and loss account charge	3,047
At 31 December 1999	3,047

Other provisions for liabilities and charges comprise provisions raised in respect of a guarantee given on behalf of a customer that is expected to be called upon.

23. Called up share capital

	1999 £'000	1998 £'000
Authorised		
12,500,000 ordinary shares of £10 each	125,000	125,000
Issued, allotted and fully paid up		
11,225,016 ordinary shares of £10 each	112,250	112,250

24. Profit and loss account

	£'000
At 1 January 1999	13,783
Retained profit for the financial year	3,119
At 31 December 1999	16,902

25. Reconciliation of movements in shareholder's funds

	1999 £'000	1998 £'000
Profit for the financial year attributable to shareholder	9,119	12,874
Interim dividend	(6,000)	(11,000)
Retained profit for the financial year	3,119	1,874
Opening shareholder's funds	129,310	127,436
Closing shareholder's funds	132,429	129,310

26. 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 underlying assets, interest and exchange rates or indices. They include forwards, swap and option transactions in the foreign exchange and interest rate markets. Transactions are negotiated directly with customers, with the Company acting as a counterparty.

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.

Derivative instruments are subject to both market risk and credit risk.

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than is required in cash markets. The Company does not actively trade in derivative contracts. Derivative contracts are entered into for risk management purposes only.

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, 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.

The following table 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 Company 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.

	1999		**1998**	
	Contract Amount £'000	**Replacement cost £'000**	**Contract amount £'000**	**Replacement cost £'000**
Spot and forward foreign exchange contracts	60,540	113	50,249	95
Interest rate swaps	148,738	4,109	90,922	2,717
Interest rate futures, forward rate agreements and options purchased	7,290	29	7,171	8
Interest rate options written	7,290	-	7,171	-
Total interest rate contracts	163,318	4,138	105,264	2,725

26. Financial instruments (continued)

(a) Derivatives (continued)

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 asset and liabilities arising from derivatives held for non-trading purposes are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows. Mark-to-market assets and liabilities are not netted, except where a legal right of set-off exists.

		1999	
		Carrying Value £'000	**Mark-to-Market Values £'000**
Exchange rate	- assets	-	113
	- liabilities	-	(28)
Interest rate	- assets	-	4,138
	- liabilities	-	(899)

(b) Gains and losses on hedges

(i) Unrecognised gains and losses

Gains and losses on instruments used for hedging are recognised in line with the underlying items which are being hedged. The unrecognised gains on instruments used for hedging as at 31 December 1999 were £4,251,000 and the unrecognised losses were £927,000.

Unrecognised gains of £799,000 and unrecognised losses of £150,000 are expected to be recognised in 2000.

Of the gains and losses included in the profit and loss account in 1999, £592,000 losses were unrecognised at 1 January 1999.

(ii) Deferred gains and losses

There were no deferred gains or losses on instruments used for hedging as at 31 December 1999.

There were no gains or losses included in the profit and loss account in 1999 which were carried forward in the balance sheet at 1 January 1999.

27. Memorandum items

	1999			1998		
	Contract Amount £'000	**Credit equivalent amount**	**Risk weighted Amount £'000**	**Contract Amount £'000**	**Credit equivalent amount**	**Risk weighted amount £'000**
Contingent liabilities:-						
Guarantees and assets pledged as collateral security	34,218	34,218	18,123	42,110	42,110	22,952
Commitments:-						
Undrawn formal standby facilities, credit lines and other commitments to lend:-						
- 1 year and under	137,652	-	-	79,764	-	-
- over 1 year	14,785	7,393	6,608	10,144	5,072	4,479
	152,437	7,393	6,608	89,908	5,072	4,479

The table above gives the nominal principal amounts and risk-weighted amounts of off-balance sheet transactions. The risk-weighted amounts are assessed in accordance with the Bank of England's guidelines, which implement the Basle agreement on capital adequacy and depend on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments.

Contingent liabilities and commitments are credit-related instruments, which include acceptances, 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.

28. Market risk management

Market risk is the risk that interest rates, foreign exchange rates or equity and commodity prices will move and result in profits or losses to the Company. Market risk arises on financial instruments which are valued at current market prices (mark-to-market basis) and those valued at cost plus any accrued interest (accruals basis).

The Company manages market risk through risk limits approved by the Group Executive Committee. Group Market Risk, an independent unit within HSBC Holdings plc, develops risk management policies and measurement techniques, and reviews limit utilisation on a daily basis.

(a) Interest rate sensitivity gap table

In accordance with FRS 13, the table below 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 Company manages its interest rate risk on a different basis from that presented below.

28. Market risk management (continued)

(a) Interest rate sensitivity gap table (continued)

	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	Total
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Assets:							
Loans & advances to Banks	308,800	1,720	-	-	-	901	311,421
Loans & advances to customers	638,104	6,296	1,419	16,297	142,676	-	804,792
Other assets	-	-	-	-	-	12,241	12,241
Total assets	946,904	8,016	1,419	16,297	142,676	13,142	1,128,454
Liabilities:							
Deposits by banks	431,375	4,021	12,156	8,812	300	1	456,665
Customer accounts	483,920	9,650	2,063	-	-	-	495,633
Other liabilities	-	-	-	-	-	37,727	37,727
Minority interests & Shareholders' funds	-	-	-	-	-	138,429	138,429
Total liabilities	915,295	13,671	14,219	8,812	300	176,157	1,128,454
Off balance sheet Items	96,267	39,539	12,932	(6,362)	(142,376)	-	-
Interest rate sensitivity gap	127,876	33,884	132	1,123	-	(163,015)	-
Cumulative interest rate sensitivity gap	127,876	161,760	161,892	163,015	163,015	-	-

28. Market risk management (continued)

(a) Interest rate sensitivity gap table (continued)

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.

(b) Assets and liabilities denominated in foreign currency

	1999 **£'000**	**1998** **£'000**
Denominated in sterling	1,027,350	820,030
Denominated in currencies other than sterling	101,104	123,215
Total assets	1,128,454	943,245
Denominated in sterling	1,000,883	820,030
Denominated in currencies other than sterling	127,571	123,215
Total liabilities	1,128,454	943,245

29. Capital commitments

There are no capital commitments at 31 December 1999 (1998: £nil).

30. Related party transactions

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

	1999		1998	
	Number	**£'000**	**Number**	**£'000**
Loans (including housing loans) to, and guarantees on behalf of:-				
Directors and connected persons and companies controlled by them:-	3	596	2	375
Officers:-	4	318	-	-

Particulars of directors' transactions are recorded in a register held at the registered office of the Company.

Transactions or balances with entities, which form part of the HSBC Group, are not disclosed in accordance with the exemption contained in FRS 8 "Related Party Disclosures" described in note 1.

31. Retirement benefits

Defined benefit scheme

The Company participates in a funded pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of the Company with the exception of cash deposits up to a maximum of 5% of the total assets of the scheme, which may be held with HSBC Group companies from time to time.

Actuarial valuations of the assets and liabilities of the scheme are carried out triennially by external professional actuaries to determine the financial position of the scheme and to enable the Company to determine the level of contributions to be made to the scheme. This scheme was merged with the HSBC Bank (UK) Pension Scheme on 17 January 2000. A valuation of the newly merged scheme will be undertaken in the first quarter of 2000.

The latest actuarial valuation was made at 31 December 1996 by C. G. Singer of R. Watson & Sons, at which date the market value of the scheme's assets was £256,000,000. The actuarial valuation was prepared on the projected unit credit method and showed that the level of funding at that date was 113% of past service liabilities. Contributions to the scheme were resumed in 1995 and were subsequently suspended in 1996.

The main financial assumptions used in preparing the actuarial valuation were:-

	% per annum
Long term investment return	7.45
General salary increases	5.10
Inflation	3.00
Equity dividend increases	3.00
Post retirement pension increases	3.00

31. Retirement benefits (continued)

As at 31 December 1999 prepaid pension costs amounting to £nil (1998: £1,439,000) have been included within "Prepayments and accrued income" in the balance sheet. The prior year amount prepaid corresponds to the actuarial surplus recognised as at 1 January 1989, as a result of the implementation of SSAP 24 "Accounting for Pension Costs" less the subsequent excess of the accumulated pension costs over the contributions to the scheme.

Money purchase scheme

As at 31 December 1999 there were no outstanding or prepaid contributions (1998: £nil).

32. Segmental analysis

The Company has one main activity, private banking, which is carried out solely in the United Kingdom.

33. Ultimate and immediate parent company

The Company's immediate parent company is HSBC Investment Bank plc, which is registered in England. The Company's ultimate parent company is HSBC Holdings plc, also registered in England.

The Company's ultimate controlling party as defined under Financial Reporting Standard 8 "Related Party Disclosures" ("FRS 8") is HSBC Holdings plc. The Company is controlled, as defined in FRS 8, by its immediate parent company HSBC Investment Bank plc.

The largest and smallest group in which the financial statements of the Company are consolidated is that headed by HSBC Holdings plc. The consolidated financial statements of HSBC Holdings plc are available to the public and may be obtained from HSBC Holdings plc, Group Corporate Affairs, 10 Lower Thames Street, London EC3R 6AE.