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

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

Or

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

For the fiscal year ended December 31, 2013

Or

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

Or

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

Date of event requiring this shell company report __________

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

Commission file number: 001-14930

HSBC Holdings plc

(Exact name of Registrant as specified in its charter)

N/A	**United Kingdom**
(Translation of Registrant s name into English)	(Jurisdiction of incorporation or organisation)

8 Canada Square

London E14 5HQ

United Kingdom

(Address of principal executive offices)

Russell C Picot

8 Canada Square

London E14 5HQ

United Kingdom

Tel +44 (0) 20 7991 8888

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(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

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

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

6.5% Subordinated Notes 2037	New York Stock Exchange
6.8% Subordinated Notes Due 2038	New York Stock Exchange
6.100% Senior Unsecured Notes due 2042	New York Stock Exchange
8.125% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non-Cumulative Dollar Preference Shares	New York Stock Exchange
8.00% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non-Cumulative Dollar Preference Shares, Series 2	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

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

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

Ordinary Shares, nominal value US$0.50 each 18,830,007,039

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

þ Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes þ No.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

þ Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

¨ Yes ¨ No

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

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨ International Financial Reporting Standards as issued by the International Accounting Standards Board þ Other ¨

If Other has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes þ No

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

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HSBC HOLDINGS PLC

Annual Report and Accounts 2013

Certain defined terms

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

Financial statements

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

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

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

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Report of the Directors

Financial Review

Corporate Governance[1]

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1 *Detailed contents are provided on the referenced pages.*

Strategic Report

Who we are

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

Customers:

54 million

Served by:

254,000 employees

Through four global businesses:

Retail Banking and Wealth Management

Commercial Banking

Global Banking and Markets

Global Private Banking

Located in:

75 countries and territories

Across six geographical regions:

Europe

Hong Kong

Rest of Asia-Pacific

Middle East and North Africa

North America

Latin America

Offices:

Over 6,300

Global headquarters:

London

Market capitalisation:

US$207 billion

Listed on stock exchanges in:

London

Hong Kong

New York

Paris

Bermuda

Shareholders:

216,000 in 131 countries and territories

Cover images: internationalisation of the renminbi

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

Our purpose

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

Our strategic priorities

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

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

- grow the business and dividends;

- implement Global Standards; and

streamline processes and procedures.

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

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

How we measure performance

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

Rewarding performance

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

For further information on HSBC Values, see page 25.

Strategic Report (continued)

Highlights of 2013

- Ø Profit before tax was up 9% to US$22.6bn on a reported basis. Underlying profit before tax was up 41% to US$21.6bn.
- Ø Considerable progress in delivering on strategic priorities including the disposal or closure of a further 20 businesses and non-core investments announced in 2013, helping make HSBC easier to manage and control.
- Ø Reinforced HSBC s position as one of the best-capitalised banks in the world. Based on our current understanding of capital rules, we remain well-placed to meet expected future capital requirements.
- Ø Dividends to shareholders increased to US$9.2bn as capital strength creates capacity for organic growth and allows us to increase the dividends paid.

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

For footnotes, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Cautionary statement regarding forward-looking statements

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

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

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

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

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

- changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews, actions or litigation, including any additional compliance requirements; and the effects of competition in the markets where we operate including increased competition from non-bank financial services companies, including securities firms; and factors specific to HSBC, including discretionary RWA growth and our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges, notably compliance with the DPA.

Strategic Report (continued)

Group Chairman s Statement

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

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

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

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

Performance in 2013

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

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

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

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

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

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

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

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Strategic Report (continued)

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

Global Standards and regulatory change

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

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

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

Responding to heightened standards

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

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

Board changes

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

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

In his time on the Board, in addition to his measured contributions to Board discussions, John has brought a wealth of business and financial experience and expertise to the Group Audit Committee, which latterly he chaired, and to the Group Risk and Remuneration Committees. In these roles he has taken on a considerable workload and critical responsibilities throughout periods of significant economic and market uncertainty and major regulatory change. Upon his retirement it is proposed that John will be succeeded in his role as Chair of the Group Audit Committee by Renato Fassbind.

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

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

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

Strategic Report (continued)

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

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

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

Governance changes

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

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

Looking forward

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

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

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

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

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

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

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

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

D J Flint, *Group Chairman*

24 February 2014

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HSBC HOLDINGS PLC

Strategic Report (continued)

Group Chief Executive s Review

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

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

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

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

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

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

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

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

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

Strategic Report (continued)

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

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

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

Performance

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

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

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

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

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

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

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

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

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

Strategy next phase

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

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

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

Strategic Report (continued)

thus reduce the impact of our portfolio of legacy businesses.

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

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

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

Outlook

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

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

S T Gulliver, *Group Chief Executive*

24 February 2014

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HSBC HOLDINGS PLC

Strategic Report (continued)

Value creation and long-term sustainability

Through our principal activities making payments, holding savings, providing finance and managing risks we play a central role in society and in the economic system. Our target is to build and maintain a business which is sustainable in the long term.

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

How we create value

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

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

We also offer additional financial products and services including broking, asset management, financial advisory, life insurance, corporate finance, securities services and alternative investments. We make markets in financial assets so that investors have confidence in efficient pricing and the availability of buyers and sellers. We provide these products for clients ranging from governments to large and mid-market corporates, small and medium-sized enterprises, high net worth individuals and retail customers. We help customers raise financing from external investors in debt and equity capital markets. We create liquidity and price transparency in these securities allowing investors to buy and sell them on the secondary market. We exchange national currencies, helping international trade.

Value creation

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

Our operating income is primarily derived from:

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

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

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

Strategic Report (continued)

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

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

- using forward foreign currency contracts to hedge their income from export sales or costs of imported materials;
- using an inflation swap to hedge future inflation-linked liabilities, for example, for pension payments;
- transforming variable payments of debt interest into fixed rate payments, or vice versa; or
- providing investors with hedges against movements in markets or particular stocks.

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

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

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

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

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

Long-term sustainability

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

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

Our strategy

Long-term trends

Our strategy is aligned to two long-term trends:

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

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

Competitive advantages

What matters in this environment are:

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

- being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest.

HSBC s competitive advantages come from:

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

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

- our business network, which covers over 90% of global trade and capital flows; and our local balance sheet strength and trading capabilities in the most relevant financial hubs.

A two-part strategy

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

Our strategic priorities

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

Grow

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

Implement

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

Streamline

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

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Strategic Report (continued)

Strategic priority 1

Grow the business and dividends

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

Our targets are to:

1. grow risk-weighted assets (RWA s) in line with our organic investment criteria;
2. progressively grow dividends and introduce share buy-backs as appropriate; and
3. reduce the effect of legacy and non-strategic activities on our profit before tax and RWAs.

Business model

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

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

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

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

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

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

HSBC s market

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Strategic Report (continued)

Operating model

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

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

Holding company

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

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

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

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

Matrix management structure

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

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

Matrix management structure

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HSBC HOLDINGS PLC

Strategic Report (continued)

Global businesses

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

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

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

Main business activities by global business and reported revenue[5] in 2013

For footnotes, see page 46.

Investment criteria

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

Decisions over where to invest additional resources have three components:

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

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

Risk the investment must be consistent with our risk appetite.

Using the six filters in decision-making

Strategic Report (continued)

Financial performance

Performance reflected underlying momentum in areas of targeted investment

Reported results

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

For footnotes, see page 46.

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

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

Underlying performance

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

From reported results to underlying performance

To arrive at underlying performance,

- we adjust for the year-on-year effects of foreign currency translation;
- we eliminate the fair value movements on our long-term debt attributable to credit spread (own credit spread) where the net result of such movements will be zero upon maturity of the debt; and
- we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates and businesses, by eliminating the gain or loss on disposal in the year incurred and removing the operating profit or loss of the acquired and disposed of businesses from all years presented.

Reconciliations of our reported results to an underlying basis are provided in the Form 20-F filed with the Securities and Exchange Commission which is available on www.hsbc.com.

Underlying profit before tax	*Profit attributable to ordinary shareholders (US$m)*	*Earnings per share*
(US$bn)		*(US$)*

Strategic Report (continued)

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

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

The following commentary is on an underlying basis.

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

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

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

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

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

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

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

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

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

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

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

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

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HSBC HOLDINGS PLC

Strategic Report (continued)

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

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

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

Balance sheet strength

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

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

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

Total assets

(US$bn)

Post-tax return on average total assets

(%)

Loans and advances to

customers[14] (US$bn)

Customer accounts[14]

(US$bn)

Ratio of customer advances to customer

deposits (%)

For footnote, see page 46.

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HSBC HOLDINGS PLC

Strategic Report (continued)

Capital strength

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

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

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

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

Leverage ratio

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

Estimated leverage ratio

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

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

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

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

Core tier 1 ratio[1] *Total capital ratio* *Common equity tier 1 ratio*[15]

(%)	*(%)*	*(%)*

For footnotes, see page 46.

Strategic Report (continued)

Meeting our targets

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

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

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

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

Progressively grow dividends and introduce share buy-backs as appropriate

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

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

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

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

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

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

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

Risk-weighted assets (US$bn) *Return on risk-weighted assets (%)* *Dividend payout ratio (%)*

Strategic Report (continued)

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

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

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

Brand value

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

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

Brand value (US$bn)

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

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

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

Economic contribution

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

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

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

HSBC s net tax paid

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

For footnote, see page 46.

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Distribution of economic benefits

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

Pro-forma post-tax profit allocation[17]

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

For footnote, see page 46.

Market capitalisation and total shareholder return

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

2011: 17,868m	2011: US$136bn	2011: US$38.10

	Total shareholder return[19]		
	Over 1 year	Over 3 years	Over 5 years
To 31 December 2013	107	118	144
Benchmarks:			
FTSE 100[20]	119	128	183
MSCI World[20]	127	141	207
MSCI Banks[20]	125	132	186

For footnotes, see page 46.

Strategic priority 2

Implement Global Standards

Our target is to make significant progress in implementing Global Standards for the benefit of HSBC and the financial system as a whole.

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

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

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

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

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

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

We see the implementation of Global Standards as a source of competitive advantage. Global Standards allow us to:

- strengthen our response to the ongoing threat of financial crime;
- make consistent and therefore simplify the ways by which we monitor and enforce high standards at HSBC;
- strengthen policies and processes that govern how we do business and with whom; and
- ensure that we consistently apply our HSBC Values.

Implementing Global Standards

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

Governance framework

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

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

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

Strategic Report (continued)

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

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

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

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

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

Changes in day-to-day activities

Risk appetite

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

Enterprise-wide risk assessment

We completed enterprise-wide assessments of our

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

Incentives

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

Organisation

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

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

The Monitor

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

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

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

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

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HSBC Values

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

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

HSBC Values

Be dependable and do the right thing

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

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

Be open to different ideas and cultures

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

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

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

build connections, be externally focused, collaborate across boundaries;

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

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

Business principles

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

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

business responsibly and consistently adhere to HSBC Values.

Business principles

Financial strength maintain capital strength and liquidity

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

Speed be fast and responsive, make principles-led decisions

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

Efficiency focus on cost discipline and process efficiency

Quality pursue excellence

Customer-focus provide outstanding customer experience

Integrated align the Group and break down silos

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

Governance

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

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

Role of the Board and Committees

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

GMB executive committees

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

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The committee structure and governance framework of the HSBC Holdings Board

For footnotes, see page 46.

The terms of reference of the principal non-executive Board committees are available at www.hsbc.com/ boardcommittees.

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

Employees

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

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

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

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

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

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

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

Profile of leadership

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

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

Employment proposition

HSBC Values

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

Employee development

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

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

Employee engagement

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

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

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

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

Succession planning

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

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

Diversity and inclusion

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

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

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

Gender balance

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

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

Gender balance

	Male	Female	Total

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

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

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

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

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Unconscious bias

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

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

Health, welfare and safety

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

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

Whistleblowing

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

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

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

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Strategic priority 3

Streamline processes and procedures

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

Operational performance

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

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

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

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

Sustainable savings 2011 to 2013

	US$bn

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

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

- *people and structure* we implemented an 8x8 reporting structure, moved to a global operating model, and defined and introduced target business models across all global businesses and functions;
- *software development* we improved software development productivity and shifted the mix of employees towards lower-cost locations;
- *process optimisation* we improved the efficiency of our operational activities such as contact centres (including offshoring), trade and payments services; and
- *corporate real estate* we rationalised our property portfolio by leasing and launching facilities management initiatives.

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

- propositions, and sales channels;
- processes and servicing channels, including production management, multi-channel servicing, operational processes and the locations of activities; and
- infrastructure, including real estate, technology, supplier management and global functions.

Streamlining will be achieved through a combination of simplifying and globalising our processes, products, systems and operations. Simplifying involves identifying inefficiencies or excessive complexity and redesigning or rationalising processes to make them easier to understand and manage and more efficient. Globalising involves developing standard global processes and implementing them around the Group with minimal local variations.

Cost efficiency ratio

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

Customers

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

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

Customer service and satisfaction

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

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

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

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

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

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

Retail Banking and Wealth Management

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

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

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

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

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

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

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

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

Interacting with customers

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

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

Supporting home ownership

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

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

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

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

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

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

Supporting customers in financial difficulty

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

Across Europe, frontline specialists were trained to offer an income and expenditure review for customers who are likely to face difficulty in making repayments to HSBC in the near future. We also eliminated certain current account charges in the UK (unpaid transaction fees). We updated our restructure and payment programme suites in the Middle East and Mexico while collaborating with charities, associations and government loan relief programmes in the US, Canada and France. In the Philippines, we offer a General Restructuring Facility as a restructuring programme for both non-delinquent and delinquent customers, and responded to Typhoon Haiyan with targeted payment holidays to credit card customers affected by the catastrophe. In Australia, we offered hardship relief on mortgage repayments to customers affected by bushfires in New South Wales.

Commercial Banking

Supporting small and medium-sized entities

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

Strategic Report (continued)

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

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

Interacting with customers

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

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

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

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

- Relationship managers now update and validate customer information through regular routine discussions.
- Significant training is being provided for staff, including around the use of tools to help them support customers in completing required customer due diligence information.

New renminbi products and services

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

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

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

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

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

Client selection

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

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

Our risk profile is described on page 134.

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Strategic Report (continued)

Environmental, social and community obligations

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

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

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

Our sustainability risk framework

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

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

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

Climate business

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

Our sustainable operations strategy

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

1. factors provided by the data/service providers;

2. factors provided by the local public environmental authorities. For electricity, if specific factors cannot be obtained from the above two sources, we use the latest available carbon emission factors for national grid electricity from the International Energy Agency as recommended for use by the Greenhouse Gas Protocol; and

3. for other types of energy and travel, if no specific factors can be obtained from the first two sources, we use the latest available factors provided by the UK Department for Environment, Food and Rural Affairs and/or the Department of Energy and Climate Change in the UK.

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

Strategic Report (continued)

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

Carbon dioxide emissions in tonnes

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

Carbon dioxide emissions in tonnes per FTE

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

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

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

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

Our 10-point sustainable operations strategy

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

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

Community investment

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

Youth education

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

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

Staff volunteering

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

HSBC Water Programme

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

Strategic Report (continued)

Risk overview

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

Risk and our strategic priorities

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

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

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

Streamline processes and procedures during 2013, we initiated a comprehensive programme to reposition our portfolios in line with our updated risk appetite, and we made progress with programmes to make HSBC easier to manage and control. We also continued to simplify the Group structure through our disposal programme and to de-risk legacy portfolios. The steps we have taken to reshape HSBC have released around US$90bn in risk-weighted assets to date.

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

Risk in 2013

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

- we managed selectively our exposure to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;
- we regularly assessed higher risk countries and adjusted our risk appetite and exposures accordingly;
- we repositioned certain portfolios through our six filters process (see page 15) and our focus on certain products or customer segments;
- we made our client selection filters more robust in managing the risk of financial crime; and
- we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite.

The diversification of our lending portfolio across global businesses and regions, together with our broad range of products, ensured that we were not overly dependent on a limited number of countries or markets to generate income and growth.

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

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

For footnotes, see page 46.

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Strategic Report (continued)

Risks incurred in our business activities

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

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

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

Exposure to risks arising from the business activities of global businesses

For footnote, see page 46.

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

Top and emerging risks

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

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

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

We made a number of changes to our top and emerging risks to reflect revised assessment of their effect on HSBC during 2013. Threats to the global economy from a disorderly exit from quantitative easing, which emerged as a risk during the first half of 2013 following announcements that monetary stimuli may be scaled back, receded during the second half of the year. This followed announcements by central banks on the likely pace and scale of tapering together with an acceleration of economic growth in the US and UK.

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Strategic Report (continued)

Top and emerging risks /

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

Dispute risk	Model risk
HSBC is party to legal proceedings arising out of its normal business operations which could give rise to potential financial loss and significant reputational damage.	Regulatory requirements relating to models and assumptions in areas such as capital calculations and stress testing could potentially result in an increased and more volatile capital requirement.

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

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

Strategic Report (continued)

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

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

How we manage risk

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

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

Running risk like a business

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

- making systems compatible (for example, in Global Risk and Global Finance) so a complete picture of our risks is obtained;
- streamlining data production and re-engineering processes to create time to spend on risk management; and
- understanding the detail behind our risks and costs.

Organisation and structure

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

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

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

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

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

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

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

Three lines of defence

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

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

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

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

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

Strategic Report (continued)

People

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

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

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

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

Risk management processes and procedures

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

- risk identification;
- risk appetite;
- mapping our risk profile; and
- stress testing and scenario analysis.

Risk identification

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

Risk appetite

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

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

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

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

- guides underlying business activity, ensuring it is aligned to risk appetite statements;
- informs risk-adjusted remuneration;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identifies business decisions needed to mitigate risk.

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

Key risk appetite metrics

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

For footnotes, see page 46.

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

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

Our six filters are described on page 15.

Strategic Report (continued)

Mapping our risk profile

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

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

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

Stress testing and scenario analysis

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

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

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

How risk affects our performance

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

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

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

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

Operational losses declined significantly compared with 2012, although remained above historical trend. The decrease reflected the non-recurrence of fines and penalties paid in 2012 as part of the settlement of investigations into past inadequate compliance with AML and sanctions laws. Provisions related to UK customer redress, principally payment protection insurance and interest rate protection products, also declined. There are many factors which could affect these estimated liabilities and there remains a high degree of uncertainty as to the eventual cost of redress for these matters.

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

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

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

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

For details of operational losses, see page 246.

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

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Rewarding performance

Our remuneration strategy rewards commercial success and compliance with our risk management framework.

The quality of our people and their long-term commitment to the Group are fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a long-term career with HSBC, and who will perform their role in the long-term interests of shareholders.

Employee remuneration

HSBC s reward package comprises four key elements of remuneration:

- fixed pay;
- benefits;
- annual incentive; and
- the Group Performance Share Plan (GPSP).

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

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

Industry changes and key challenges

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

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

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

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

Variable pay pool determination

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

Variable pay pool

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

For footnote, see page 46.

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Strategic Report (continued)

Funding

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

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

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

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

Relative importance of spend on pay

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

Directors remuneration

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

Executive Directors

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

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

For footnote, see page 46.

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Strategic Report (continued)

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

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

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

For full details of Directors remuneration, see page 389.

Variable pay performance for 2013

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

For footnote, see page 46.

Remuneration policy going forward

In order to deal with the challenges of CRD IV we have introduced changes to our remuneration structure for executive Directors in 2014 as summarised in the table below, subject to shareholders approval at the 2014 AGM. If approved, the policy is intended to apply for three years to the conclusion of the AGM in 2017.

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

Changes in remuneration policy for 2014

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

For footnote, see page 46.

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

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

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

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Strategic Report (continued)

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

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

External reporting

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

On behalf of the Board 24 February 2014

D J Flint, *Group Chairman*

HSBC Holdings plc

Registered number 617987

HSBC HOLDINGS PLC

Strategic Report (continued)

Footnotes to Strategic Report

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

27 *Targets for 2014 to 2016 were announced at our Investor Update on 15 May 2013.*

28 *The percentage of variable pay deferred for the Code Staff population was 64%.*

29 *Dividends per ordinary share in respect of that year. For 2013, this includes the first, second and third interim dividends paid in 2013 of US$5.6bn (gross of scrip) and a fourth interim dividend of US$3.6bn.*

30 *60% of the 2012 annual incentive for Stuart Gulliver and Iain Mackay disclosed in the 2012 Directors Remuneration Report was deferred for five years. The vesting of these awards is subject to a service condition and satisfactory completion of the DPA. The DPA condition ends on the fifth anniversary of the award date unless the DPA is extended or otherwise continues beyond that date, in which case the awards will vest on the date on which the DPA expires and otherwise ceases to operate.*

31 *In its meeting of 15 January 2014, the Group Remuneration Committee used its discretion to reduce overall variable pay by £1.25m (equivalent to 18.5% of the total annual incentive and GPSP). This adjustment was considered appropriate in the context of overall Group-wide year-over-year profitability and incentive pool funding, Group-wide risk and compliance, market remuneration benchmarks and the remuneration recommendations for the Group CEO s direct reports.*

32 *Maximum award potentials for fixed pay allowances and variable pay awards are based on obtaining shareholder approval to increase the maximum variable pay award as a percentage of fixed pay under CRD IV from 100% to 200% at the Annual General Meeting on 23 May 2014. If shareholder approval is not obtained the maximum fixed pay allowance payable for each executive Director under the policy will be the difference between (i) 50% of maximum total remuneration of the executive Director under this policy as shown in the Remuneration scenarios chart on page 389 and (ii) the aggregate of the base salary and cash allowance in lieu of pension for that executive Director. Maximum variable pay award levels will be revised to 100% of fixed pay and the maximum annual incentive and GPSP awards will accordingly be reduced to 1/3 and 2/3 of this amount (i.e. 33% and 67% of fixed pay, respectively). The requested increase in the cap to 200% would enable us to minimise the increase in fixed remuneration costs and so help to maintain greater flexibility on total pay.*

Report of the Directors: Financial Review

Financial summary

The management commentary included in the Report of the Directors: Financial Review , together with the Employees and Corporate sustainability sections of Corporate Governance and the Directors Remuneration Report is presented in compliance with the IFRSs Practice Statement Management Commentary *issued by the IASB.*

Use of non-GAAP financial measures

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

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

Constant currency

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

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

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

Constant currency

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

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

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

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

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

Underlying performance

To arrive at underlying performance:

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

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

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Report of the Directors: Financial Review (continued)

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

we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses.

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

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency profit before tax

HSBC	2012 as reported US$m	Currency translation adjustment[1] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[2] %	Constant currency change[2] %
	2013 compared with 2012					
Net interest income	37,672	(682)	36,990	35,539	(6)	(4)
Net fee income	16,430	(203)	16,227	16,434		1
Net trading income	7,091	(164)	6,927	8,690	23	25
Own credit spread[3]	(5,215)	12	(5,203)	(1,246)	76	76
Other income/(expense) from financial instruments designated at fair value	2,989	(53)	2,936	2,014	(33)	(31)
Net income/(expense) from financial instruments designated at fair value	(2,226)	(41)	(2,267)	768		
Gains on disposal of US branch network, US cards business and Ping An	7,024		7,024		(100)	(100)
Gains less losses from financial investments	1,189	(17)	1,172	2,012	69	72
Net earned insurance premiums	13,044	(118)	12,926	11,940	(8)	(8)
Other operating income (including dividend income)	2,321	(200)	2,121	2,954	27	39
Total operating income	82,545	(1,425)	81,120	78,337	(5)	(3)
Net insurance claims incurred and movement in liabilities to policyholders	(14,215)	96	(14,119)	(13,692)	(4)	(3)
Net operating income[4]	68,330	(1,329)	67,001	64,645	(5)	(4)
Loan impairment charges and other credit risk provisions	(8,311)	201	(8,110)	(5,849)	30	28
Net operating income	60,019	(1,128)	58,891	58,796	(2)	
Operating expenses	(42,927)	683	(42,244)	(38,556)	10	9
Operating profit	17,092	(445)	16,647	20,240	18	22
Share of profit in associates and joint ventures	3,557	45	3,602	2,325	(35)	(35)
Profit before tax	20,649	(400)	20,249	22,565	9	11
By global business						
Retail Banking and Wealth Management	9,575	(26)	9,549	6,649	(31)	(30)
Commercial Banking	8,535	(96)	8,439	8,441	(1)	
Global Banking and Markets	8,520	(147)	8,373	9,441	11	13
Global Private Banking	1,009	(16)	993	193	(81)	(81)
Other	(6,990)	(115)	(7,105)	(2,159)	69	70
Profit before tax	20,649	(400)	20,249	22,565	9	11

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

For footnotes, see page 132.

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

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

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

Disposal gains/(losses) affecting underlying performance

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

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

For footnotes, see page 132.

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Acquisition gains/(losses) affecting underlying performance[6]

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

For footnote, see page 132.

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

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

Reconciliation of reported and underlying items

	2013 US$m	2012 US$m	Change[2] %
Net interest income			
Reported	**35,539**	37,672	(6)
Currency translation adjustment[1]		(682)	
Acquisitions, disposals and dilutions	**(273)**	(2,015)	
Underlying	**35,266**	34,975	1
Other operating income			
Reported	**2,632**	2,100	25
Currency translation adjustment[1]		(195)	
Acquisitions, disposals and dilutions	**(2,234)**	(811)	
Underlying	**398**	1,094	(64)
Revenue[4]			
Reported	**64,645**	68,330	(5)
Currency translation adjustment[1]		(1,341)	
Own credit spread[3]	**1,246**	5,215	
Acquisitions, disposals and dilutions	**(2,596)**	(10,607)	
Underlying	**63,295**	61,597	3
Loan impairment charges and other credit risk provisions			

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

For footnotes, see page 132.

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Report of the Directors: Financial Review (continued)

Consolidated income statement

Five-year summary consolidated income statement

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

Five-year financial information

	2013	2012	2011	2010	2009
	US$	US$	US$	US$	US$
Basic earnings per share[8]	0.84	0.74	0.92	0.73	0.34
Diluted earnings per share[8]	0.84	0.74	0.91	0.72	0.34
Dividends per ordinary share[9]	0.48	0.41	0.39	0.34	0.34

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

For footnotes, see page 132.

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

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

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Notable revenue items by geographical region

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

Notable revenue items by global business

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

For footnote, see page 132.

Notable cost items by geographical region

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

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

Notable cost items by global business

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

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HSBC HOLDINGS PLC

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Group performance by income and expense item

Net interest income

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

Summary of interest income by type of asset

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

Summary of interest expense by type of liability and equity

2013	2012	2011

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

For footnotes, see page 132.

Report of the Directors: Financial Review (continued)

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

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

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

Interest income

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

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

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

Interest expense

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

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

Repos and reverse repos

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

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

Report of the Directors: Financial Review (continued)

Net fee income

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

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

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

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

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

Net trading income

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

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

For footnotes, see page 132.

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

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

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

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Report of the Directors: Financial Review (continued)

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

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

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

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

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

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

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

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

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

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

Net income/(expense) from financial instruments designated at fair value	**768**	(2,226)	3,439

For footnote, see page 132.

Report of the Directors: Financial Review (continued)

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

	2013	2012	2011
	US$m	US$m	US$m
Financial assets designated at fair value at 31 December	**38,430**	33,582	30,856
Financial liabilities designated at fair value at 31 December	**89,084**	87,720	85,724
Including:			
Financial assets held to meet liabilities under:			
insurance contracts and investment contracts with DPF[24]	**10,717**	8,376	7,221
unit-linked insurance and other insurance and investment contracts	**25,423**	23,655	20,033
Long-term debt issues designated at fair value	**75,278**	74,768	73,808

For footnote, see page 132.

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

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

We reported net income from financial instruments designated at fair value of US$768m in 2013 compared with a net expense of US$2.2bn in 2012. This included credit spread-related movements in the fair value of our own long-term debt, on which we experienced adverse fair value movements of US$1.2bn in 2013 compared with US$5.2bn in 2012. Adverse fair value movements were less extensive in 2013 than in 2012 as HSBC spreads tightened significantly in Europe and North America, having widened during 2011.

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

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

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

Report of the Directors: Financial Review (continued)

Gains less losses from financial investments

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

For footnote, see page 132.

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

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

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

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

Net earned insurance premiums

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

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

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

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

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

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

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

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

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

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

For footnote, see page 132.

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

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

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

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

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

Other operating income

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

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

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

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

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

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

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

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

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

Net insurance claims incurred and movement in liabilities to policyholders

	2013	2012	2011
	US$m	US$m	US$m
Insurance claims incurred and movement in liabilities to policyholders:			
gross	**13,948**	14,529	11,631
reinsurers share	**(256)**	(314)	(450)
net[25]	**13,692**	14,215	11,181

For footnote, see page 132.

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

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

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

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

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

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Loan impairment charges and other credit risk provisions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Operating expenses

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

Staff numbers (full-time equivalents)

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

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

On a constant currency basis, operating expenses in 2013 were US$3.7bn or 9% lower than in 2012, primarily due to the non-recurrence of a

charge for US AML, BSA, and OFAC investigations of US$1.9bn, and a reduction in restructuring and other related costs of US$369m. UK customer redress programmes were also lower than in 2012. These included:

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

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

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

- The provision for the UK customer redress programmes at 31 December 2013 is US$2.1bn

The business disposals, primarily the disposal of the CRS business and the non-strategic branches in the US in 2012, resulted in a lower cost base in 2013.

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

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

During 2013:

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

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

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

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

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

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

Cost efficiency ratios[26]

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

For footnote, see page 132.

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Share of profit in associates and joint ventures

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

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

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

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

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

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

Tax expense

	2013	2012	2011

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

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

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

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

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

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

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

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2012 compared with 2011

Reconciliation of reported and constant currency profit before tax

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

For footnotes, see page 132.

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Reconciliation of reported and underlying items

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

For footnotes, see page 132.

Consolidated income statement

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

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

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

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Industrial Bank has now been classified as a financial investment.

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

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

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

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

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

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

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

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

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

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

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

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

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

Group performance by income and expense item

Net interest income

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

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

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

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

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

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

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

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

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

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

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

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

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

Net fee income

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

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

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

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

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

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

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

Net trading income

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

There were lower adverse fair value movements on non-qualifying hedges. These hedges are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, nor could be, applied. They are principally cross-currency and interest rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings and floating rate debt issued by HSBC Finance Corporation (HSBC Finance). The size and direction of the changes in the fair value of non-qualifying hedges that are recognised in the income statement can be volatile from year-to-year, but do not alter the cash flows expected as part of the documented interest rate management strategy for both the instruments and the underlying economically hedged assets and liabilities if the derivative is held to maturity. In North America, there were lower adverse fair value movements on non-qualifying hedges as US long-term interest rates declined to a lesser extent than in 2011. There were also lower adverse fair value movements on non-qualifying hedges in Europe. This was driven by favourable fair value movements in HSBC Holdings, compared with adverse fair value movements in 2011, reflecting the less pronounced decline in long-term US interest rates relative to sterling and euro interest rates compared with 2011. This was partly offset by adverse movements in European operating entities as interest rates fell.

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

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

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

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

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

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

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

Net income from financial instruments designated at fair value

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

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

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

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

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

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

Gains less losses from financial investments

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

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

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

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

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

Net earned insurance premiums

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

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

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

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

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

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

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

In December 2012, HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation agreed to sell to indirect wholly-owned subsidiaries of Charoen Pokphand Group Company Limited their entire shareholdings in Ping An, representing 15.57% of the issued share capital of Ping An, in two tranches. The first tranche was completed on 7 December 2012. The completion of the second tranche took place on 6 February 2013. The disposal of this associate resulted in a gain of US$3.0bn in 2012. Our remaining shareholding has been classified as a financial investment.

Other operating income

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

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

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

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

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

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

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

Net insurance claims incurred and movement in liabilities to policyholders

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

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

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

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

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

Loan impairment charges and other credit risk provisions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Operating expenses

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

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

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

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

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

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

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

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

Share of profit in associates and joint ventures

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

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

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

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

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

Tax expense

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

The higher tax charge in 2012 reflected the non-tax deductible effect of fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws, together with the non-recognition of the tax benefit in respect of the accounting charge associated with negative fair value movements on own debt. The lower tax charge in 2011 included the

benefit of US deferred tax recognised in 2011 in respect of foreign tax credits.

As a result of these factors, the reported effective tax rate for 2012 was 25.7 % compared with 18.0% for 2011.

In 2012, the tax paid by the Group was US$9.3bn (2011: US$8.0bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy included in the pre-tax profit and the timing of payments.

The Group also plays a major role as tax collector for governments in the jurisdictions in which we operate. In 2012, the Group collected US$8.5bn (2011: US$8.7bn).

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Consolidated balance sheet

Five-year summary consolidated balance sheet

	At 31 December				
	2013	2012	2011	2010	2009
	US$m	US$m	US$m	US$m	US$m
ASSETS					
Cash and balances at central banks	**166,599**	141,532	129,902	57,383	60,655
Trading assets	**303,192**	408,811	330,451	385,052	421,381
Financial assets designated at fair value	**38,430**	33,582	30,856	37,011	37,181
Derivatives	**282,265**	357,450	346,379	260,757	250,886
Loans and advances to banks	**211,521**	152,546	180,987	208,271	179,781
Loans and advances to customers[27]	**1,080,304**	997,623	940,429	958,366	896,231
Financial investments	**425,925**	421,101	400,044	400,755	369,158
Assets held for sale	**4,050**	19,269	39,558	1,991	3,118
Other assets	**159,032**	160,624	156,973	145,103	146,061
Total assets	**2,671,318**	2,692,538	2,555,579	2,454,689	2,364,452
LIABILITIES AND EQUITY					
Liabilities					
Deposits by banks	**129,212**	107,429	112,822	110,584	124,872
Customer accounts	**1,482,812**	1,340,014	1,253,925	1,227,725	1,159,034
Trading liabilities	**207,025**	304,563	265,192	300,703	268,130
Financial liabilities designated at fair value	**89,084**	87,720	85,724	88,133	80,092
Derivatives	**274,284**	358,886	345,380	258,665	247,646
Debt securities in issue	**104,080**	119,461	131,013	145,401	146,896
Liabilities under insurance contracts	**74,181**	68,195	61,259	58,609	53,707
Liabilities of disposal groups held for sale	**2,804**	5,018	22,200	86	3
Other liabilities	**117,377**	118,123	111,971	109,868	148,411
Total liabilities	**2,480,859**	2,509,409	2,389,486	2,299,774	2,228,791
Equity					
Total shareholders equity	**181,871**	175,242	158,725	147,667	128,299
Non-controlling interests	**8,588**	7,887	7,368	7,248	7,362
Total equity	**190,459**	183,129	166,093	154,915	135,661
Total equity and liabilities	**2,671,318**	2,692,538	2,555,579	2,454,689	2,364,452

Five-year selected financial information

Called up share capital	**9,415**	9,238	8,934	8,843	8,705
Capital resources[28,29]	**194,009**	180,806	170,334	167,555	155,729
Undated subordinated loan capital	**2,777**	2,778	2,779	2,781	2,785
Preferred securities and dated subordinated loan capital[30]	**48,114**	48,260	49,438	54,421	52,126

Risk-weighted assets and capital ratios[28]					
Risk-weighted assets	**1,092,653**	1,123,943	1,209,514	1,103,113	1,133,168
	%	%	%	%	%
Core tier 1 ratio	**13.6**	12.3	10.1	10.5	9.4
Total capital ratio	**17.8**	16.1	14.1	15.2	13.7
Financial statistics					
Loans and advances to customers as a percentage of customer accounts	**72.9**	74.4	75.0	78.1	77.3
Average total shareholders equity to average total assets	**6.55**	6.16	5.64	5.53	4.72
Net asset value per ordinary share at year-end[31] (US$)	**9.27**	9.09	8.48	7.94	7.17
Number of US$0.50 ordinary shares in issue (millions)	**18,830**	18,476	17,868	17,686	17,408
Closing foreign exchange translation rates to US$:					
US$1: £	**0.605**	0.619	0.646	0.644	0.616
US$1:	**0.726**	0.758	0.773	0.748	0.694

For footnotes, see page 132.

A more detailed consolidated balance sheet is contained in the Financial Statements on page 419.

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Movement in 2013

Total reported assets were US$2.7 trillion, 1% lower than at 31 December 2012, on both a reported and constant currency basis. Our balance sheet remains strong, with a ratio of customer advances to customer accounts of 72.9%.

During 2013, GB&M changed the way it manages repo and reverse repo activities. This led to an increase in 2013 in reverse repo agreements classified as Loans and advances to customers and Loans and advances to banks , and a decline in those included in Trading assets . Similarly, there was an increase in repo agreements classified in Deposits by banks and Customer accounts , with a decline in Trading liabilities . For further details of this change, see page 68.

Loans and advances to customers grew by more than US$34.2bn in 2013, notably in term and trade-related lending to corporate and commercial customers. Customer accounts increased by over US$56.3bn in 2013. These movements exclude reverse repo and repo transactions and the effect of currency movements.

The following commentary is on a constant currency basis.

Assets

Cash and balances at central banks increased by 17%, mainly in Europe, driven by the placement of surplus funds reflecting growth in deposits in excess of lending growth and, to a lesser extent, in North America.

Trading assets decreased by US$110bn or 27%, driven by a fall in reverse repos, reflecting the change in the way GB&M manages these activities noted above. Excluding this, trading assets were broadly in line with December 2012 levels.

Financial assets designated at fair value increased by 16%, in part due to favourable market movements in our European insurance operations coupled with higher investments from premium income received during the year in our insurance businesses, notably in Europe and Hong Kong.

Derivative assets decreased by 22%. Upward movements in yield curves in major currencies led to a decline in the fair value of interest rate contracts, largely in Europe. In North America, declines in fair values of interest rate contracts reflected the increase in swap rates during the year and increased netting.

Loans and advances to banks rose by US$61.4bn or 41%, including a US$56.4bn increase in reverse repos reflecting the change in the way

GB&M manages these activities. Excluding this, there was a US$5.0bn increase driven by higher placements with financial institutions in Hong Kong and Rest of Asia-Pacific.

Loans and advances to customers increased by US$87.0bn or 9%, including a US$52.8bn rise in reverse repo balances reflecting the change in the way GB&M manages these activities, which mainly affected balances in North America and the UK. We reclassified over US$9.5bn of customer lending balances mainly relating to our operations in Panama and first lien mortgage portfolios in the US to Assets held for sale . These were subsequently disposed of in the second half of the year.

Excluding these factors, customer lending balances grew by US$44.0bn as continued demand for financing led to a rise in term and trade-related lending to CMB and GB&M customers in Hong Kong and, to a lesser extent, in Rest of Asia-Pacific. Commercial real estate and other property-related lending also grew in Hong Kong and Rest of Asia-Pacific. Residential mortgages remained broadly in line with 2012. There was growth in Rest of Asia-Pacific and, to a lesser extent, in Hong Kong, although the rate of growth in Hong Kong fell in the second half of the year. We also continued to grow our portfolio in the UK, which reflected our competitive offering. These factors were broadly offset by the continued reduction in the US run-off portfolio. In addition, in the UK there was an increase in corporate overdraft balances, mainly in GB&M that did not meet the criteria for netting, with a corresponding rise in related customer accounts.

Financial investments were broadly in line with 2012 levels. We recorded net sales and maturities of available-for-sale government debt securities in North America. This was broadly offset by an increase in Hong Kong due to net new purchases, together with the re-classification of our shareholding in Industrial Bank.

Assets held for sale decreased by 79%, driven by the completion of the sales of our investment in Ping An and of the non-real estate personal lending portfolio in the US.

Liabilities

Deposits by banks rose by US$21.4bn or 20% and included an increase of US$30.5bn relating to repo balances, reflecting the change in the way GB&M manages these activities. Excluding this, balances fell in Europe and North America.

Report of the Directors: Financial Review (continued)

Customer accounts increased by US$148.6bn or 11%. This included a rise in repo funding of US$92.3bn reflecting the change in the way GB&M manages these activities, which mainly affected balances in North America and the UK. In addition, we reclassified over US$6.5bn of deposit balances, mainly relating to our operations in Panama, to Liabilities of disposal groups held for sale . These were subsequently disposed of in the second half of the year.

Excluding these factors, customer accounts increased by US$63.4bn, driven by a rise in the UK in RBWM reflecting customers continued preference for holding higher balances in readily-accessible current and savings accounts in the uncertain economic environment. This was coupled with higher balances in our Payments and Cash Management business in GB&M and CMB. Current accounts also grew in GB&M due to higher balances that did not meet the netting criteria and an increase in short-term deposits. In Hong Kong and Rest of Asia-Pacific, customer accounts rose, mainly in RBWM reflecting customer sentiment, but also in CMB reflecting deposit campaigns in the final quarter of the year. In North America, customer accounts grew, driven by higher balances in our CMB business although this was offset in part by a fall in RBWM, due to re-pricing.

Trading liabilities decreased by US$102.1bn or 33% and included a fall of US$114.3bn in repos reflecting the change in the way GB&M manages

these activities. Excluding this, trading liabilities increased by US$12.2bn driven by increases in Europe, reflecting client demand and volumes.

Financial liabilities designated at fair value remained broadly unchanged during 2013.

The reduction in the value of *Derivative liabilities* was in line with that of Derivative assets as the underlying risk is broadly matched.

Debt securities in issue fell by 12%. This was driven by a net redemption in debt securities in issue in Europe together with maturing debt that was not replaced in the US as funding requirements declined due to business disposals and the run-off of the CML portfolio. These factors were partly offset by an increase in Brazil as we substituted wholesale customer deposits for medium-term loan notes.

Liabilities under insurance contracts rose by 9% as a result of liabilities to policyholders established for new business, largely written in Hong Kong.

Liabilities of disposal groups held for sale decreased by US$1.9bn, driven by the disposal of non-strategic businesses in Latin America and North America.

Equity

Total shareholders equity rose by 4%, primarily driven by profits generated in the year, partly offset by dividends paid.

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency assets and liabilities

	31 December 2013 compared with 31 December 2012					
HSBC	31 Dec 12 as reported US$m	Currency translation adjustment[32] US$m	31 Dec 12 at 31 Dec 13 exchange rates US$m	31 Dec 13 as reported US$m	Reported change %	Constant currency change %
Cash and balances at central banks	141,532	565	142,097	166,599	18	17
Trading assets	408,811	4,379	413,190	303,192	(26)	(27)
Financial assets designated at fair value	33,582	(372)	33,210	38,430	14	16
Derivative assets	357,450	6,480	363,930	282,265	(21)	(22)
Loans and advances to banks	152,546	(2,420)	150,126	211,521	39	41
Loans and advances to customers	997,623	(4,367)	993,256	1,080,304	8	9
Financial investments	421,101	(3,132)	417,969	425,925	1	2
Assets held for sale	19,269	(303)	18,966	4,050	(79)	(79)
Other assets	160,624	3,215	163,839	159,032	(1)	(3)
Total assets	2,692,538	4,045	2,696,583	2,671,318	(1)	(1)
Deposits by banks	107,429	339	107,768	129,212	20	20
Customer accounts	1,340,014	(5,801)	1,334,213	1,482,812	11	11
Trading liabilities	304,563	4,605	309,168	207,025	(32)	(33)
Financial liabilities designated at fair value	87,720	1,155	88,875	89,084	2	-
Derivative liabilities	358,886	6,815	365,701	274,284	(24)	(25)
Debt securities in issue	119,461	(1,088)	118,373	104,080	(13)	(12)
Liabilities under insurance contracts	68,195	115	68,310	74,181	9	9
Liabilities of disposal groups held for sale	5,018	(280)	4,738	2,804	(44)	(41)
Other liabilities	118,123	(1,594)	116,529	117,377	-	1
Total liabilities	2,509,409	4,266	2,513,675	2,480,859	(1)	(1)
Total shareholders equity	175,242	(463)	174,779	181,871	4	4
Non-controlling interests	7,887	(43)	7,844	8,588	9	9
Total equity	183,129	(506)	182,623	190,459	4	4
Total equity and liabilities	2,692,538	3,760	2,696,298	2,671,318	(1)	(1)

For footnote, see page 132.

In 2013, GB&M changed the way it manages repo and reverse repo activities in the Credit and Rates businesses, which were previously being managed in a trading environment. During the year, the repo and reverse repo business activities were organised into trading and non-trading portfolios, with separate risk management procedures. This resulted in an increase in the amount of reverse repos classified as Loans and advances to customers and Loans and advances to banks , and a decline in the amount classified as Trading assets at 31 December 2013, compared with previous year-ends. Similarly, at 31 December 2013 there was an increase in the amount of repos classified as Customer accounts and Deposits by banks , with a

decline in the amount classified as Trading liabilities , compared with previous year-ends. The increase in amortised cost balances and the decrease in trading balances primarily occurred in Europe and North America, specifically the UK and the US.

The impact of repos and reverse repos on the balance sheet is set out in the table below. The table also provides a combined view of customer lending and customer deposits which, by taking into account loans and advances to customers and customer account balances reported as held for sale, more accurately reflects the overall size of our lending and deposit books.

Report of the Directors: Financial Review (continued)

Combined view of lending and deposits

	2013 US$m	2012 US$m	Change %
Customers amortised cost			
Loans and advances to customers	**1,080,304**	997,623	8
loans and other receivables	**992,089**	962,972	3
reverse repos	**88,215**	34,651	155
Loans and advances to customers reported in Assets held for sale[33]	**1,703**	6,124	(72)
Combined customer lending	**1,082,007**	1,003,747	8
Customer accounts	**1,482,812**	1,340,014	11
cash deposits and other accounts	**1,361,297**	1,311,396	4
repos	**121,515**	28,618	325
Customer accounts reported in Liabilities of disposal groups held for sale	**2,187**	2,990	(27)
Combined customer deposits	**1,484,999**	1,343,004	11
Banks amortised cost			
Loans and advances to banks	**211,521**	152,546	39
loans and other receivables	**120,046**	117,085	3
reverse repos	**91,475**	35,461	158
Deposits by banks	**129,212**	107,429	20
cash deposits and other accounts	**86,507**	95,480	(9)
repos	**42,705**	11,949	257
Customers and banks fair value			
Trading assets reverse repos	**10,120**	118,681	(91)
loans and advances to customers	**7,180**	73,666	(90)
loans and advances to banks	**2,940**	45,015	(93)
Trading liabilities repos	**17,421**	130,223	(87)
customer accounts	**9,611**	103,483	(91)
deposits by banks	**7,810**	26,740	(71)

For footnote, see page 132.

Financial investments

	At 31 December 2013			At 31 December 2012		
	Equity securities US$bn	**Debt securities US$bn**	**Total US$bn**	Equity securities US$bn	Debt securities US$bn	Total US$bn
Balance Sheet Management		**314.4**	**314.4**		293.4	293.4
Insurance entities		**46.4**	**46.4**		43.4	43.4
Structured entities	**0.1**	**22.6**	**22.7**		24.7	24.7
Principal investments	**2.7**		**2.7**	2.9		2.9

Other	**6.3**	**33.4**	**39.7**	2.9	53.8	56.7
	9.1	**416.8**	**425.9**	5.8	415.3	421.1

The table above analyses the Group s holdings of financial investments by business activity. Further information can be found in the following sections:

Balance Sheet Management (page 238) for a description of the activities and an analysis of third party assets in balance sheet management.

Risk management of insurance operations (page 249) includes an analysis of the financial investments within our insurance operations by the type of contractual liabilities that they back.

Structured entities (page 550) for further information about the nature of securities investment conduits in which the above financial investments are held.

Equity securities classified as available for sale (page 235) includes private equity holdings and other strategic investments.

Other represents financial investments held in certain locally managed treasury portfolios and other GB&M portfolios held for specific business activities.

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Average balance sheet

Average balance sheet and net interest income

Average balances and related interest are shown for the domestic operations of our principal commercial banks by geographical region. Other operations comprise the operations of our principal commerical banking and consumer finance entities outside their domestic markets and all other banking operations, including investment banking balances and transactions.

Average balances are based on daily averages for the principal areas of our banking activities with monthly or less frequent averages used elsewhere.

Balances and transactions with fellow subsidiaries are reported gross in the principal

commercial banking and consumer finance entities and the elimination entries are included within Other operations .

Net interest margin numbers are calculated by dividing net interest income as reported in the income statement by the average interest-earning assets from which interest income is reported within the Net interest income line of the income statement. Total interest-earning assets include loans where the carrying amount has been adjusted as a result of impairment allowances. In accordance with IFRSs, we recognise interest income on assets after the carrying amount has been adjusted as a result of impairment. Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in Interest income .

Assets

	2013			2012			2011		
	Average balance US$m	**Interest income US$m**	**Yield %**	Average balance US$m	Interest income US$m	Yield %	Average balance US$m	Interest income US$m	Yield %
Summary									
Interest-earning assets measured at amortised cost (itemised below)	**1,669,368**	**51,192**	**3.07**	1,625,068	56,702	3.49	1,622,658	63,005	3.88
Trading assets and financial assets designated at fair value[55,56]	**354,817**	**5,763**	**1.62**	368,406	6,931	1.88	410,038	8,671	2.11
Impairment provisions	**(15,954)**			(17,421)			(18,738)		
Non-interest-earning assets	**683,785**			730,901			752,965		
Total assets and interest income	**2,692,016**	**56,955**	**2.12**	2,706,954	63,633	2.35	2,766,923	71,676	2.59
Average yield on all interest-earning assets			**2.81**			3.19			3.53

Short-term funds and loans and advances to banks										
Europe	HSBC Bank	**104,187**	**938**	**0.90**	86,496	1,040	1.20	62,489	1,186	1.90
	HSBC Private Banking Holdings (Suisse)	**15,400**	**10**	**0.06**	2,072	9	0.43	1,886	14	0.74
	HSBC France	**36,874**	**127**	**0.34**	33,199	176	0.53	36,023	477	1.32
Hong Kong	Hang Seng Bank	**16,496**	**251**	**1.52**	16,396	283	1.73	17,761	334	1.88
	The Hongkong and Shanghai Banking Corporation	**16,294**	**192**	**1.18**	18,379	224	1.22	22,033	233	1.06
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**46,684**	**853**	**1.83**	42,814	805	1.88	41,692	920	2.21
	HSBC Bank Malaysia	**5,865**	**173**	**2.95**	5,375	157	2.92	6,049	174	2.88
MENA	HSBC Bank Middle East	**5,638**	**34**	**0.60**	5,922	41	0.69	4,467	42	0.94
North America	HSBC Bank USA	**25,105**	**87**	**0.35**	23,768	106	0.45	27,495	97	0.35
	HSBC Bank Canada	**3,174**	**30**	**0.95**	1,677	17	1.01	2,886	23	0.80
Latin America	HSBC Mexico	**2,979**	**114**	**3.83**	3,053	119	3.90	3,383	130	3.84
	Brazilian operations[57]	**11,076**	**788**	**7.11**	14,610	1,155	7.91	18,954	2,036	10.74
	HSBC Bank Argentina	**1,337**	**31**	**2.32**	396	45	11.36	341	33	9.68
Other operations		**10,158**	**27**	**0.27**	21,822	130	0.60	16,290	161	0.99
		301,267	**3,655**	**1.21**	275,979	4,307	1.56	261,749	5,860	2.24

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		2013 Average balance US$m	2013 Interest income US$m	2013 Yield %	2012 Average balance US$m	2012 Interest income US$m	2012 Yield %	2011 Average balance US$m	2011 Interest income US$m	2011 Yield %
Loans and advances to customers										
Europe	HSBC Bank	**306,065**	**10,686**	**3.49**	289,586	10,596	3.66	299,775	10,225	3.41
	HSBC Private Banking Holdings (Suisse)	**15,235**	**194**	**1.27**	12,591	199	1.58	14,631	255	1.74
	HSBC France	**67,062**	**1,670**	**2.49**	69,021	1,713	2.48	75,033	2,087	2.78
	HSBC Finance	**173**	**10**	**5.78**	886	42	4.74	1,486	98	6.59
Hong Kong	Hang Seng Bank	**72,537**	**2,179**	**3.00**	64,907	1,895	2.92	63,198	1,569	2.48
	The Hongkong and Shanghai Banking Corporation	**113,936**	**2,631**	**2.31**	100,203	2,410	2.41	91,209	1,975	2.17
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**126,095**	**5,427**	**4.30**	109,298	5,231	4.79	99,683	4,863	4.88
	HSBC Bank Malaysia	**13,928**	**683**	**4.90**	13,456	707	5.25	12,118	657	5.42
MENA	HSBC Bank Middle East	**25,537**	**1,124**	**4.40**	24,012	1,214	5.06	22,494	1,296	5.76
North America	HSBC Bank USA	**58,177**	**1,786**	**3.07**	59,806	1,742	2.91	67,817	3,226	4.76
	HSBC Finance	**34,146**	**3,064**	**8.97**	43,887	3,904	8.90	59,857	5,842	9.76
	HSBC Bank Canada	**45,646**	**1,497**	**3.28**	44,673	1,588	3.55	44,512	1,683	3.78
Latin America	HSBC Mexico	**15,335**	**1,658**	**10.81**	14,411	1,613	11.19	14,290	1,630	11.41
	Brazilian operations[57]	**25,732**	**4,608**	**17.91**	27,621	5,468	19.80	30,212	6,584	21.79
	HSBC Bank Argentina	**3,615**	**799**	**22.10**	3,644	718	19.70	3,320	524	15.78
Other operations		**23,537**	**704**	**2.99**	56,654	2,003	3.54	45,653	2,736	5.99
		946,756	**38,720**	**4.09**	934,656	41,043	4.39	945,288	45,250	4.79
Financial investments										
Europe	HSBC Bank	**88,406**	**1,223**	**1.38**	80,475	1,275	1.58	95,522	1,631	1.71
	HSBC Private Banking Holdings (Suisse)	**13,509**	**183**	**1.35**	5,722	107	1.87	13,521	247	1.83
	HSBC France	**13,733**	**94**	**0.68**	11,208	130	1.16	4,662	133	2.85
Hong Kong	Hang Seng Bank	**31,502**	**601**	**1.91**	29,319	590	2.01	26,095	596	2.28
	The Hongkong and Shanghai Banking Corporation	**56,325**	**291**	**0.52**	48,695	320	0.66	52,357	399	0.76
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**48,415**	**1,490**	**3.08**	46,095	1,501	3.26	40,033	1,422	3.55
	HSBC Bank Malaysia	**2,197**	**72**	**3.28**	1,798	59	3.28	1,013	33	3.26
MENA	HSBC Bank Middle East	**11,838**	**113**	**0.95**	10,266	113	1.10	10,944	150	1.37
North America	HSBC Bank USA	**56,302**	**884**	**1.57**	61,510	1,092	1.78	50,357	1,250	2.48
	HSBC Finance				941	67	7.12	2,956	104	3.52
	HSBC Bank Canada	**20,364**	**279**	**1.37**	21,179	297	1.40	17,821	307	1.72
Latin America	HSBC Mexico	**7,782**	**351**	**4.51**	8,021	379	4.73	9,767	473	4.84
	Brazilian operations[57]	**7,404**	**740**	**9.99**	9,527	1,019	10.70	10,072	1,206	11.97
	HSBC Bank Argentina	**451**	**71**	**15.74**	701	96	13.69	651	99	15.21
Other operations		**35,081**	**1,610**	**4.59**	51,872	2,033	3.92	48,288	2,179	4.51
		393,309	**8,002**	**2.03**	387,329	9,078	2.34	384,059	10,229	2.66

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Assets (continued)

		2013 Average balance US$m	2013 Interest income US$m	2013 Yield %	2012 Average balance US$m	2012 Interest income US$m	2012 Yield %	2011 Average balance US$m	2011 Interest income US$m	2011 Yield %
Other interest-earning assets										
Europe	HSBC Bank	**73,607**	**64**	**0.09**	119,175	153	0.13	53,394	101	0.19
	HSBC Private Banking Holdings (Suisse)	**7,441**	**69**	**0.93**	14,461	189	1.31	19,568	262	1.34
	HSBC France	**14,294**	**111**	**0.78**	13,107	121	0.92	10,037	160	1.59
Hong Kong	Hang Seng Bank	**2,088**	**14**	**0.67**	1,003	9	0.90	854	9	1.05
	The Hongkong and Shanghai Banking Corporation	**50,474**	**452**	**0.90**	43,871	441	1.01	32,917	383	1.16
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**11,895**	**46**	**0.39**	15,320	40	0.26	15,414	53	0.34
	HSBC Bank Malaysia	**456**	**2**	**0.44**	553	4	0.72	578	8	1.38
MENA	HSBC Bank Middle East	**1,888**	**87**	**4.61**	1,914	72	3.76	698	22	3.15
North America	HSBC Bank USA	**6,386**	**103**	**1.61**	12,324	872	7.08	15,187	903	5.95
	HSBC Finance	**6,821**	**19**	**0.28**	7,723	656	8.49	6,014	671	11.16
	HSBC Bank Canada	**1,691**	**42**	**2.48**	2,340	69	2.95	3,109	59	1.90
Latin America	HSBC Mexico	**265**	**6**	**2.26**	614	39	6.35	383	27	7.05
	Brazilian operations[57]	**2,394**	**107**	**4.47**	1,338	100	7.47	2,031	54	2.66
	HSBC Bank Argentina	**93**			106	4	4	88		
Other operations		**(151,757)**	**(307)**		(206,745)	(495)		(128,710)	(1,046)	
		28,036	**815**	**2.91**	27,104	2,274	8.39	31,562	1,666	5.28
Total interest-earning assets										
Europe	HSBC Bank	**572,265**	**12,911**	**2.26**	575,732	13,064	2.27	511,180	13,143	2.57
	HSBC Private Banking Holdings (Suisse)	**51,585**	**456**	**0.88**	34,846	504	1.45	49,606	778	1.57
	HSBC France	**131,963**	**2,002**	**1.52**	126,535	2,140	1.69	125,755	2,857	2.27
	HSBC Finance	**173**	**10**	**5.78**	889	42	4.72	1,486	98	6.59
Hong Kong	Hang Seng Bank	**122,623**	**3,045**	**2.48**	111,625	2,777	2.49	107,908	2,508	2.32
	The Hongkong and Shanghai Banking Corporation	**237,029**	**3,566**	**1.50**	211,148	3,395	1.61	198,516	2,990	1.51
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**233,089**	**7,816**	**3.35**	213,527	7,577	3.55	196,822	7,258	3.69
	HSBC Bank Malaysia	**22,446**	**930**	**4.14**	21,182	927	4.38	19,758	872	4.41
MENA	HSBC Bank Middle East	**44,901**	**1,358**	**3.02**	42,114	1,440	3.42	38,603	1,510	3.91
North America	HSBC Bank USA	**145,970**	**2,860**	**1.96**	157,408	3,812	2.42	160,856	5,476	3.40

	HSBC Finance	**40,967**	**3,083**	**7.53**	54,342	4,627	8.51	68,827	6,617	9.61
	HSBC Bank Canada	**70,875**	**1,848**	**2.61**	69,869	1,971	2.82	68,328	2,072	3.03
Latin America	HSBC Mexico	**26,361**	**2,129**	**8.08**	26,099	2,150	8.24	27,823	2,260	8.12
	Brazilian operations[57]	**46,606**	**6,243**	**13.40**	53,096	7,742	14.58	61,269	9,880	16.13
	HSBC Bank Argentina	**5,496**	**901**	**16.39**	4,847	863	17.80	4,400	656	14.91
Other operations		**(82,981)**	**2,034**		(78,191)	3,671		(18,479)	4,030	
		1,669,368	**51,192**	**3.07**	1,625,068	56,702	3.49	1,622,658	63,005	3.88

For footnotes, see page 133a.

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Equity and liabilities

		2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %	2011 Average balance US$m	2011 Interest expense US$m	2011 Cost %
Summary										
Interest-bearing liabilities measured at amortised cost (itemised below)		**1,426,180**	**15,653**	**1.10**	1,401,254	19,030	1.36	1,433,566	22,343	1.56
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)		**301,353**	**3,027**	**1.00**	318,883	3,445	1.08	355,345	4,564	1.28
Non-interest bearing current accounts		**184,370**			177,085			162,369		
Total equity and other non-interest bearing liabilities		**780,113**			809,732			815,643		
Total equity and liabilities		**2,692,016**	**18,680**	**0.69**	2,706,954	22,475	0.83	2,766,923	26,907	0.97
Average cost on all interest-bearing liabilities				**1.08**			1.31			1.50
Deposits by banks[58]										
Europe	HSBC Bank	**29,394**	**209**	**0.71**	27,738	435	1.57	33,764	529	1.57
	HSBC Private Banking Holdings (Suisse)	**379**	**1**	**0.26**	657	2	0.30	874	2	0.23
	HSBC France	**20,081**	**85**	**0.42**	26,026	171	0.66	29,329	396	1.35
Hong Kong	Hang Seng Bank	**1,101**	**15**	**1.36**	1,305	15	1.15	1,903	7	0.37
	The Hongkong and Shanghai Banking Corporation	**6,638**	**13**	**0.20**	7,648	12	0.16	8,389	13	0.15
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**9,701**	**103**	**1.06**	10,668	159	1.49	10,613	159	1.50
	HSBC Bank Malaysia	**865**	**20**	**2.31**	961	20	2.08	360	9	2.50
MENA	HSBC Bank Middle East	**1,488**	**4**	**0.27**	1,588	6	0.38	1,511	6	0.40
North America	HSBC Bank USA	**8,233**	**17**	**0.21**	7,587	19	0.25	7,730	18	0.23
	HSBC Bank Canada	**2,572**	**22**	**0.86**	1,613	9	0.56	760	15	1.97
Latin America	HSBC Mexico	**1,368**	**64**	**4.68**	1,103	52	4.71	1,167	62	5.31
	Brazilian operations[57]	**3,466**	**103**	**2.97**	4,323	194	4.49	6,433	331	5.15
	HSBC Bank Argentina	**20**	**2**	**10.00**	44	3	6.82	24	2	8.33
Other operations		**1,576**	**33**	**2.09**	1,542	63	4.09	3,242	42	1.30
		86,882	**691**	**0.80**	92,803	1,160	1.25	106,099	1,591	1.50
Financial liabilities designated at fair value own debt issued[59]										
Europe	HSBC Holdings	**19,719**	**366**	**1.86**	23,864	446	1.87	19,654	342	1.74
	HSBC Bank	**28,969**	**443**	**1.53**	28,046	556	1.98	26,504	462	1.74
	HSBC France	**9,173**	**67**	**0.73**	7,147	118	1.65	6,907	174	2.52
North America	HSBC Bank USA	**1,933**	**35**	**1.81**	1,853	38	2.05	1,642	38	2.31
	HSBC Finance	**8,878**	**80**	**0.90**	12,147	184	1.51	17,108	289	1.69

Other operations	**3,661**	**(24)**	**(0.66)**	1,959	(17)	(0.87)	1,820	8	0.44
	72,333	**967**	**1.34**	75,016	1,325	1.77	73,635	1,313	1.78

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Equity and liabilities (continued)

		2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %	2011 Average balance US$m	2011 Interest expense US$m	2011 Cost %
Customer accounts[60]										
Europe	HSBC Bank	**350,722**	**2,296**	**0.65**	309,808	2,445	0.79	306,060	2,387	0.78
	HSBC Private Banking Holdings (Suisse)	**16,453**	**70**	**0.43**	15,926	84	0.53	22,025	163	0.74
	HSBC France	**49,739**	**255**	**0.51**	47,974	403	0.84	49,363	650	1.32
Hong Kong	Hang Seng Bank	**91,778**	**360**	**0.39**	85,425	365	0.43	83,220	342	0.41
	The Hongkong and Shanghai Banking Corporation	**208,859**	**254**	**0.12**	190,654	250	0.13	177,336	231	0.13
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**136,212**	**2,300**	**1.69**	129,419	2,381	1.84	121,237	2,277	1.88
	HSBC Bank Malaysia	**13,737**	**296**	**2.15**	13,624	311	2.28	13,326	299	2.24
MENA	HSBC Bank Middle East	**18,387**	**106**	**0.58**	17,477	163	0.93	17,484	237	1.36
North America	HSBC Bank USA	**65,578**	**115**	**0.18**	68,134	224	0.33	83,988	340	0.40
	HSBC Bank Canada	**42,936**	**340**	**0.79**	45,116	344	0.76	44,833	358	0.80
Latin America	HSBC Mexico	**16,808**	**455**	**2.71**	17,735	528	2.98	18,139	538	2.97
	Brazilian operations[57]	**21,596**	**1,545**	**7.15**	30,352	2,411	7.94	41,194	4,471	10.85
	HSBC Bank Argentina	**3,318**	**343**	**10.34**	3,594	268	7.46	3,149	200	6.35
Other operations		**68,521**	**328**	**0.48**	77,574	701	0.90	76,972	963	1.25
		1,104,644	**9,063**	**0.82**	1,052,812	10,878	1.03	1,058,326	13,456	1.27
Debt securities in issue										
Europe	HSBC Bank	**64,528**	**768**	**1.19**	69,294	989	1.43	79,670	982	1.23
	HSBC France	**13,365**	**54**	**0.40**	14,801	118	0.80	18,043	260	1.44
Hong Kong	Hang Seng Bank	**1,393**	**12**	**0.86**	1,606	15	0.93	1,424	13	0.91
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**7,493**	**186**	**2.48**	7,732	241	3.12	7,918	263	3.32
	HSBC Bank Malaysia	**967**	**26**	**2.69**	1,016	25	2.46	568	18	3.17
MENA	HSBC Bank Middle East	**3,057**	**64**	**2.09**	3,769	83	2.20	3,870	77	1.99
North America	HSBC Bank USA	**14,012**	**415**	**2.96**	12,738	390	3.06	12,535	395	3.15
	HSBC Finance	**19,888**	**739**	**3.72**	29,198	1,059	3.63	40,629	1,413	3.48
	HSBC Bank Canada	**13,158**	**342**	**2.60**	12,675	390	3.08	12,061	392	3.25
Latin America	HSBC Mexico	**813**	**41**	**5.04**	897	51	5.69	1,074	57	5.31
	Brazilian operations[57]	**10,963**	**863**	**7.87**	9,114	732	8.03	6,825	708	10.37
	HSBC Bank Argentina	**52**	**10**	**19.23**	121	20	16.53	66	11	16.67

Other operations	**1,287**	**662**	**51.44**	(1,613)	642	(39.80)	(3,201)	671	(20.96)
	150,976	**4,182**	**2.77**	161,348	4,755	2.95	181,482	5,260	2.90

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		2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %	2011 Average balance US$m	2011 Interest expense US$m	2011 Cost %
Other interest-bearing liabilities										
Europe	HSBC Bank	**96,464**	**659**	**0.68**	126,279	671	0.53	66,449	595	0.90
	HSBC Private Banking Holdings (Suisse)	**7,869**	**13**	**0.17**	4,195	4	0.10	3,006	8	0.27
	HSBC France	**26,159**	**77**	**0.29**	20,853	28	0.13	20,294	170	0.84
	HSBC Finance	**23**			303	2	0.66	828	6	0.72
Hong Kong	Hang Seng Bank	**2,021**	**48**	**2.38**	1,715	39	2.27	1,422	25	1.76
	The Hongkong and Shanghai Banking Corporation	**14,280**	**76**	**0.53**	11,213	71	0.63	12,759	72	0.56
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**45,776**	**414**	**0.90**	40,827	406	0.99	35,562	361	1.02
	HSBC Bank Malaysia	**1,339**	**8**	**0.60**	1,069	16	1.50	1,121	17	1.52
MENA	HSBC Bank Middle East	**2,557**	**58**	**2.27**	1,681	76	4.52	1,506	50	3.32
North America	HSBC Bank USA	**17,793**	**176**	**0.99**	26,255	408	1.55	23,431	820	3.50
	HSBC Finance	**5,265**	**220**	**4.18**	3,196	162	5.07	4,345	29	0.67
	HSBC Bank Canada	**3,007**	**25**	**0.83**	772	4	0.52	360	2	0.56
	HSBC Markets Inc	**3,330**	**36**	**1.08**	1,202	36	3.00	2,193	40	1.82
Latin America	HSBC Mexico	**1,658**	**19**	**1.15**	1,305	19	1.46	1,379	22	1.60
	Brazilian operations[57]	**3,497**	**189**	**5.40**	4,705	362	7.69	4,223	335	7.93
	HSBC Bank Argentina	**29**	**3**	**10.34**	26	3	11.54	15	1	6.67
Other operations		**(219,722)**	**(1,271)**		(226,321)	(1,395)		(164,869)	(1,830)	
		11,345	**750**	**6.61**	19,275	912	4.73	14,024	723	5.16
Total interest-bearing liabilities										
Europe	HSBC Bank	**570,077**	**4,375**	**0.77**	561,165	5,096	0.91	512,447	4,955	0.97
	HSBC Private Banking Holdings (Suisse)	**24,701**	**84**	**0.34**	20,778	90	0.43	25,905	173	0.67
	HSBC France	**118,517**	**538**	**0.45**	116,801	838	0.72	123,936	1,650	1.33
	HSBC Finance	**23**			303	2	0.66	828	6	0.72
Hong Kong	Hang Seng Bank	**96,293**	**435**	**0.45**	90,051	434	0.48	87,969	387	0.44
	The Hongkong and Shanghai Banking Corporation	**229,777**	**343**	**0.15**	209,515	333	0.16	198,484	316	0.16
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**199,182**	**3,003**	**1.51**	188,646	3,187	1.69	175,330	3,060	1.75
	HSBC Bank Malaysia	**16,908**	**350**	**2.07**	16,670	372	2.23	15,375	343	2.23
MENA	HSBC Bank Middle East	**25,489**	**232**	**0.91**	24,515	328	1.34	24,371	370	1.52
North America	HSBC Bank USA	**107,549**	**758**	**0.70**	116,567	1,079	0.93	129,326	1,611	1.25
	HSBC Finance	**34,031**	**1,039**	**3.05**	44,541	1,405	3.15	62,082	1,731	2.79
	HSBC Bank Canada	**61,673**	**729**	**1.18**	60,176	747	1.24	58,014	767	1.32
	HSBC Markets Inc	**3,330**	**36**	**1.08**	1,202	36	3.00	2,193	40	1.82

Latin America	HSBC Mexico	**20,647**	**579**	**2.80**	21,040	650	3.09	21,759	679	3.12
	Brazilian operations[57]	**39,522**	**2,700**	**6.83**	48,494	3,699	7.63	58,675	5,845	9.96
	HSBC Bank Argentina	**3,419**	**358**	**10.47**	3,785	294	7.77	3,254	217	6.67
Other operations		**(124,958)**	**94**		(122,995)	440		(66,382)	193	
		1,426,180	**15,653**	**1.10**	1,401,254	19,030	1.36	1,433,566	22,343	1.56

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Net interest margin[61]

		2013	2012	2011
		%	%	%
Total		**2.13**	2.32	2.51
Europe	HSBC Bank	**1.49**	1.38	1.60
	HSBC Private Banking Holdings (Suisse)	**0.72**	1.19	1.22
	HSBC France	**1.11**	1.03	0.96
	HSBC Finance	**5.78**	4.50	6.19
Hong Kong	Hang Seng Bank	**2.13**	2.10	1.97
	The Hongkong and Shanghai Banking Corporation	**1.36**	1.45	1.35
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**2.06**	2.06	2.13
	HSBC Bank Malaysia	**2.58**	2.62	2.68
MENA	HSBC Bank Middle East	**2.51**	2.64	2.95
North America	HSBC Bank USA	**1.44**	1.74	2.40
	HSBC Finance	**4.99**	5.93	7.10
	HSBC Bank Canada	**1.58**	1.75	1.91
Latin America	HSBC Mexico	**5.88**	5.75	5.68
	Brazilian operations[57]	**7.60**	7.61	6.59
	HSBC Bank Argentina	**9.88**	11.74	9.98

Distribution of average total assets

		2013	2012	2011
		%	%	%
Europe	HSBC Bank	**40.1**	44.8	41.5
	HSBC Private Banking Holdings (Suisse)	**2.0**	1.7	2.1
	HSBC France	**11.4**	11.5	10.3
	HSBC Finance			0.1
Hong Kong	Hang Seng Bank	**5.3**	4.8	4.5
	The Hongkong and Shanghai Banking Corporation	**13.1**	12.0	11.0
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**11.9**	11.3	10.6
	HSBC Bank Malaysia	**1.0**	1.0	0.8
MENA	HSBC Bank Middle East	**2.0**	1.8	1.6
North America	HSBC Bank USA	**8.7**	10.2	9.7
	HSBC Finance	**1.7**	2.1	2.7
	HSBC Bank Canada	**3.2**	3.2	3.0
Latin America	HSBC Mexico	**1.5**	1.5	1.5
	Brazilian operations[57]	**2.3**	2.7	3.0
	HSBC Bank Argentina		0.2	0.2

Other operations (including consolidation adjustments)	**(4.2)**	(8.8)	(2.6)
	100.0	100.0	100.0

For footnotes, see page 133a.

Report of the Directors: Financial Review (continued)

Analysis of changes in net interest income and net interest expense

The following tables allocate changes in net interest income and net interest expense between volume and rate for 2013 compared with 2012, and for 2012 compared with 2011. We isolate volume variances and allocate any change arising from both volume and rate to rate.

Interest income

			Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011		
		2013 US$m	Volume US$m	Rate US$m	2012 US$m	Volume US$m	Rate US$m	2011 US$m
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	**938**	**212**	**(314)**	1,040	456	(602)	1,186
	HSBC Private Banking Holdings (Suisse)	**10**	**57**	**(56)**	9	1	(6)	14
	HSBC France	**127**	**19**	**(68)**	176	(37)	(264)	477
Hong Kong	Hang Seng Bank	**251**	**2**	**(34)**	283	(26)	(25)	334
	The Hongkong and Shanghai Banking Corporation	**192**	**(25)**	**(7)**	224	(39)	30	233
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**853**	**73**	**(25)**	805	25	(140)	920
	HSBC Bank Malaysia	**173**	**14**	**2**	157	(19)	2	174
MENA	HSBC Bank Middle East	**34**	**(2)**	**(5)**	41	14	(15)	42
North America	HSBC Bank USA	**87**	**6**	**(25)**	106	(13)	22	97
	HSBC Bank Canada	**30**	**15**	**(2)**	17	(10)	4	23
Latin America	HSBC Mexico	**114**	**(3)**	**(2)**	119	(13)	2	130
	Brazilian operations[57]	**788**	**(280)**	**(87)**	1,155	(467)	(414)	2,036
	HSBC Bank Argentina	**31**	**107**	**(121)**	45	5	7	33
Other operations		**27**	**(69)**	**(34)**	130	55	(86)	161
		3,655	**394**	**(1,046)**	4,307	319	(1,872)	5,860
Loans and advances to customers								
Europe	HSBC Bank	**10,686**	**603**	**(513)**	10,596	(347)	718	10,225
	HSBC Private Banking Holdings (Suisse)	**194**	**42**	**(47)**	199	(35)	(21)	255
	HSBC France	**1,670**	**(49)**	**6**	1,713	(167)	(207)	2,087
	HSBC Finance	**10**	**(34)**	**2**	42	(40)	(16)	98
Hong Kong	Hang Seng Bank	**2,179**	**223**	**61**	1,895	42	284	1,569
	The Hongkong and Shanghai Banking Corporation	**2,631**	**331**	**(110)**	2,410	195	240	1,975
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**5,427**	**805**	**(609)**	5,231	469	(101)	4,863
	HSBC Bank Malaysia	**683**	**25**	**(49)**	707	73	(23)	657
MENA	HSBC Bank Middle East	**1,124**	**77**	**(167)**	1,214	87	(169)	1,296
North America	HSBC Bank USA	**1,786**	**(47)**	**91**	1,742	(381)	(1,103)	3,226
	HSBC Finance	**3,064**	**(867)**	**27**	3,904	(1,559)	(379)	5,842
	HSBC Bank Canada	**1,497**	**35**	**(126)**	1,588	6	(101)	1,683
Latin America	HSBC Mexico	**1,658**	**103**	**(58)**	1,613	14	(31)	1,630
	Brazilian operations[57]	**4,608**	**(374)**	**(486)**	5,468	(565)	(551)	6,584
	HSBC Bank Argentina	**799**	**(6)**	**87**	718	51	143	524

Other operations	**704**	**(761)**	**(538)**	2,003	659	(1,392)	2,736
	38,720	**531**	**(2,854)**	41,043	(509)	(3,698)	45,250

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Interest income (continued)

			Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011		
		2013 US$m	Volume US$m	Rate US$m	2012 US$m	Volume US$m	Rate US$m	2011 US$m
Financial investments								
Europe	HSBC Bank	1,223	125	(177)	1,275	(257)	(99)	1,631
	HSBC Private Banking Holdings (Suisse)	183	146	(70)	107	(143)	3	247
	HSBC France	94	29	(65)	130	187	(190)	133
Hong Kong	Hang Seng Bank	601	44	(33)	590	74	(80)	596
	The Hongkong and Shanghai Banking Corporation	291	50	(79)	320	(28)	(51)	399
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	1,490	76	(87)	1,501	215	(136)	1,422
	HSBC Bank Malaysia	72	13		59	26		33
MENA	HSBC Bank Middle East	113	17	(17)	113	(9)	(28)	150
North America	HSBC Bank USA	884	(93)	(115)	1,092	277	(435)	1,250
	HSBC Finance		(67)		67	(71)	34	104
	HSBC Bank Canada	279	(11)	(7)	297	58	(68)	307
Latin America	HSBC Mexico	351	(11)	(17)	379	(85)	(9)	473
	Brazilian operations[57]	740	(227)	(52)	1,019	(65)	(122)	1,206
	HSBC Bank Argentina	71	(34)	9	96	8	(11)	99
Other operations		1,610	(658)	235	2,033	162	(308)	2,179
		8,002	140	(1,216)	9,078	87	(1,238)	10,229

Interest expense

			Increase/(decrease) in 2013 compared with 2012			Increase/(decrease) in 2012 compared with 2011		
		2013 US$m	Volume US$m	Rate US$m	2012 US$m	Volume US$m	Rate US$m	2011 US$m
Deposits by banks								
Europe	HSBC Bank	209	26	(252)	435	(95)	1	529
	HSBC Private Banking Holdings (Suisse)	1	(1)		2			2
	HSBC France	85	(39)	(47)	171	(45)	(180)	396
Hong Kong	Hang Seng Bank	15	(2)	2	15	(2)	10	7
	The Hongkong and Shanghai Banking Corporation	13	(2)	3	12	(1)		13
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	103	(14)	(42)	159	1	(1)	159
	HSBC Bank Malaysia	20	(2)	2	20	15	(4)	9
MENA	HSBC Bank Middle East	4		(2)	6			6

North America	HSBC Bank USA	**17**	**2**	**(4)**	19		1	18
	HSBC Bank Canada	**22**	**5**	**8**	9	17	(23)	15
Latin America	HSBC Mexico	**64**	**12**		52	(3)	(7)	62
	Brazilian operations[57]	**103**	**(39)**	**(52)**	194	(109)	(28)	331
	HSBC Bank Argentina	**2**	**(2)**	**1**	3	2	(1)	2
Other operations		**33**		**(30)**	63	(22)	43	42
		691	**(74)**	**(395)**	1,160	(199)	(232)	1,591

For footnote, see page 133a.

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		2013 US$m	Increase/(decrease) in 2013 compared with 2012 Volume US$m	Rate US$m	2012 US$m	Increase/(decrease) in 2012 compared with 2011 Volume US$m	Rate US$m	2011 US$m
Customer accounts								
Europe	HSBC Bank	**2,296**	**323**	**(472)**	2,445	29	29	2,387
	HSBC Private Banking Holdings (Suisse)	**70**	**3**	**(17)**	84	(45)	(34)	163
	HSBC France	**255**	**15**	**(163)**	403	(18)	(229)	650
Hong Kong	Hang Seng Bank	**360**	**27**	**(32)**	365	9	14	342
	The Hongkong and Shanghai Banking Corporation	**254**	**24**	**(20)**	250	17	2	231
Rest of Asia Pacific	The Hongkong and Shanghai Banking Corporation	**2,300**	**125**	**(206)**	2,381	154	(50)	2,277
	HSBC Bank Malaysia	**296**	**3**	**(18)**	311	7	5	299
MENA	HSBC Bank Middle East	**106**	**8**	**(65)**	163		(74)	237
North America	HSBC Bank USA	**115**	**(8)**	**(101)**	224	(63)	(53)	340
	HSBC Bank Canada	**340**	**(17)**	**13**	344	2	(16)	358
Latin America	HSBC Mexico	**455**	**(28)**	**(45)**	528	(12)	2	538
	Brazilian operations[57]	**1,545**	**(695)**	**(171)**	2,411	(1,176)	(884)	4,471
	HSBC Bank Argentina	**343**	**(21)**	**96**	268	28	40	200
Other operations		**328**	**(82)**	**(291)**	701	8	(270)	963
		9,063	**534**	**(2,349)**	10,878	(70)	(2,508)	13,456
Financial liabilities designated at fair value own debt issued		**967**	**(47)**	**(311)**	1,325	25	(13)	1,313
Debt securities in issue								
Europe	HSBC Bank	**768**	**(68)**	**(153)**	989	(128)	135	982
	HSBC France	**54**	**(11)**	**(53)**	118	(47)	(95)	260
Hong Kong	Hang Seng Bank	**12**	**(2)**	**(1)**	15	2		13
Rest of Asia Pacific	The Hongkong and Shanghai Banking Corporation	**186**	**(7)**	**(48)**	241	(6)	(16)	263
	HSBC Bank Malaysia	**26**	**(1)**	**2**	25	14	(7)	18
MENA	HSBC Bank Middle East	**64**	**(16)**	**(3)**	83	(2)	8	77
North America	HSBC Bank USA	**415**	**39**	**(14)**	390	6	(11)	395
	HSBC Finance	**739**	**(338)**	**18**	1,059	(398)	44	1,413
	HSBC Bank Canada	**342**	**15**	**(63)**	390	20	(22)	392
Latin America	HSBC Mexico	**41**	**(5)**	**(5)**	51	(9)	3	57
	Brazilian operations[57]	**863**	**148**	**(17)**	732	237	(213)	708
	HSBC Bank Argentina	**10**	**(11)**	**1**	20	9		11
Other operations		**662**	**(1,154)**	**1,174**	642	(333)	304	671
		4,182	**(306)**	**(267)**	4,755	(588)	83	5,260

For footnote, see page 133a.

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Report of the Directors: Financial Review (continued)

Short-term borrowings

We include short-term borrowings within customer accounts, deposits by banks, debt securities in issue and trading liabilities and do not show short-term borrowings separately on the balance sheet. Short-term borrowings are defined by the US Securities and Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

Our only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. For securities sold under agreements to repurchase, we run matched repo and reverse repo trading books. We generally observe lower year-end demand in our reverse repo lending business which results in lower repo balances at the balance sheet date. Additional information on these is provided in the table below.

Repos and short-term bonds

	2013 US$m	2012 US$m	2011 US$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**181,641**	170,790	135,239
Average amount outstanding during the year	**218,580**	206,352	236,290
Maximum quarter-end balance outstanding during the year	**210,452**	176,162	202,305
Weighted average interest rate during the year	**0.3%**	0.4%	0.6%
Weighted average interest rate at the year-end	**0.5%**	0.5%	1.0%
Short-term bonds			
Outstanding at 31 December	**40,667**	44,240	35,415
Average amount outstanding during the year	**46,455**	40,349	40,679
Maximum quarter-end balance outstanding during the year	**54,933**	44,240	42,785
Weighted average interest rate during the year	**1.4%**	1.4%	1.9%
Weighted average interest rate at the year-end	**0.7%**	1.3%	2.2%

Contractual obligations

The table below provides details of our material contractual obligations as at 31 December 2013.

	Payments due by period				
	Total US$m	Less than 1 year US$m	1 3 years US$m	3 5 years US$m	More than 5 years US$m
Long-term debt obligations	**210,509**	**59,855**	**56,428**	**28,467**	**65,759**
Term deposits and certificates of deposit	**129,172**	**122,673**	**4,328**	**1,142**	**1,029**
Capital (finance) lease obligations	**376**	**59**	**101**	**31**	**185**

Operating lease obligations	**5,496**	**971**	**1,482**	**1,031**	**2,012**
Purchase obligations	**402**	**212**	**12**	**178**	
Short positions in debt securities and equity shares	**74,052**	**53,030**	**5,469**	**4,271**	**11,282**
Current tax liability	**607**	**607**			
Pension/healthcare obligation	**18,959**	**1,618**	**3,328**	**3,605**	**10,408**
	439,573	**239,025**	**71,148**	**38,725**	**90,675**

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Loan maturity and interest sensitivity analysis

At 31 December 2013, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Maturity of 1 year or less							
Loans and advances to banks	67,104	32,242	49,476	6,037	29,982	12,244	197,085
Commercial loans to customers							
Manufacturing and international trade and services	94,400	44,139	45,007	9,222	8,407	14,356	215,531
Real estate and other property related	13,517	13,757	7,144	1,474	4,356	1,614	41,862
Non-bank financial institutions	64,616	5,980	7,535	238	38,694	864	117,927
Governments	2,204		102	1,280	169	319	4,074
Other commercial	41,448	3,314	10,083	2,245	2,904	2,736	62,730
	216,185	67,190	69,871	14,459	54,530	19,889	442,124
Maturity after 1 year but within 5 years							
Loans and advances to banks	6,187	1,706	1,125	406	157	549	10,130
Commercial loans to customers							
Manufacturing and international trade and services	28,981	9,731	9,841	1,989	13,306	5,652	69,500
Real estate and other property related	19,148	23,083	8,618	453	6,575	775	58,652
Non-bank financial institutions	8,576	1,592	987	2,294	3,512	495	17,456
Governments	344	187	143	163	387	197	1,421
Other commercial	15,445	7,729	5,576	1,372	5,968	2,548	38,638
	72,494	42,322	25,165	6,271	29,748	9,667	185,667
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	14,968	195	1,817	1,341	5,558	3,303	27,182
Variable interest rate	63,713	43,833	24,473	5,336	24,347	6,913	168,615
	78,681	44,028	26,290	6,677	29,905	10,216	195,797
Maturity after 5 years							
Loans and advances to banks	613	1,202	36		25	2,488	4,364
Commercial loans to customers							
Manufacturing and international trade and services	9,652	753	655	598	1,816	501	13,975
Real estate and other property related	5,969	8,064	1,041	45	3,685	360	19,164
Non-bank financial institutions	2,358	38			385	17	2,798
Governments	792	552	37		8	458	1,847
Other commercial	10,207	3,523	819	919	3,004	672	19,144
	28,978	12,930	2,552	1,562	8,898	2,008	56,928
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							

Fixed interest rate	**7,283**	**1,089**	**62**	**358**	**773**	**382**	**9,947**
Variable interest rate	**22,308**	**13,043**	**2,526**	**1,204**	**8,150**	**4,114**	**51,345**
	29,591	**14,132**	**2,588**	**1,562**	**8,923**	**4,496**	**61,292**

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Deposits

The following tables summarise the average amount of bank deposits, customer deposits and certificates of deposit (CD s) and other money market instruments (which are included within Debt securities in issue in the balance sheet), together

with the average interest rates paid thereon for each of the past three years. The geographical analysis of average deposits is based on the location of the office in which the deposits are recorded and excludes balances with HSBC companies. The Other category includes securities sold under agreements to repurchase.

Deposits by banks

	2013		2012		2011	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**63,213**		64,497		75,890	
Demand and other non-interest bearing	**13,198**		9,377		10,788	
Demand interest bearing	**5,154**	**0.5**	8,988	0.4	16,492	0.8
Time	**17,465**	**1.1**	24,698	1.5	19,893	2.2
Other	**27,396**	**0.4**	21,434	1.1	28,717	1.3
Hong Kong	**14,686**		13,355		13,222	
Demand and other non-interest bearing	**7,271**		4,727		3,047	
Demand interest bearing	**6,217**	**0.1**	5,643	0.1	6,052	0.1
Time	**1,072**	**0.7**	2,013	0.4	3,347	0.3
Other	**126**	**3.2**	972	0.6	776	0.1
Rest of Asia-Pacific	**12,919**		14,485		13,650	
Demand and other non-interest bearing	**2,334**		2,495		2,535	
Demand interest bearing	**5,965**	**1.0**	6,190	1.1	5,802	1.2
Time	**3,210**	**0.8**	3,879	1.5	4,218	1.6
Other	**1,410**	**2.5**	1,921	3.1	1,095	3.0
Middle East and North Africa	**2,546**		1,892		2,060	
Demand and other non-interest bearing	**1,058**		301		548	
Demand interest bearing	**12**		8	6.5	20	
Time	**1,422**	**0.2**	1,543	0.4	1,424	0.4
Other	**54**	**1.9**	40	1.8	68	1.6
North America	**15,820**		13,695		11,904	
Demand and other non-interest bearing	**3,488**		4,470		2,367	
Demand interest bearing	**2,787**	**0.1**	2,996	0.1	3,849	0.1

Time	**5,110**	**0.3**	4,756	0.4	4,797	0.4
Other	**4,435**	**0.5**	1,473	0.5	891	1.3
Latin America	**5,166**		6,463		8,819	
Demand and other non-interest bearing	**118**		212		161	
Demand interest bearing	**333**	**4.5**	333	3.9	545	3.7
Time	**2,783**	**3.1**	3,665	3.7	4,924	4.3
Other	**1,932**	**4.8**	2,253	6.1	3,189	6.0
Total	**114,350**		114,385		125,545	
Demand and other non-interest bearing	**27,467**		21,582		19,446	
Demand interest bearing	**20,468**	**0.5**	24,157	0.5	32,760	0.7
Time	**31,062**	**1.1**	40,553	1.4	38,603	2.0
Other	**35,353**	**0.7**	28,093	1.7	34,736	1.7

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Customer accounts

	2013 Average balance US$m	2013 Average rate %	2012 Average balance US$m	2012 Average rate %	2011 Average balance US$m	2011 Average rate %
Europe	**508,783**		467,472		467,393	
Demand and other non-interest bearing	**75,480**		71,342		72,743	
Demand interest bearing	**272,973**	**0.4**	242,769	0.4	220,314	0.4
Savings	**63,585**	**1.4**	62,626	1.8	57,070	1.7
Time	**50,010**	**1.1**	59,034	1.3	67,499	1.5
Other	**46,735**	**0.3**	31,701	0.5	49,767	0.7
Hong Kong	**351,790**		325,909		307,513	
Demand and other non-interest bearing	**36,336**		34,714		31,694	
Demand interest bearing	**264,508**		236,198		219,581	
Savings	**38,447**	**0.9**	39,752	0.8	38,283	0.7
Time	**11,396**	**0.8**	14,252	1.0	16,910	1.0
Other	**1,103**	**0.2**	993	0.3	1,045	0.3
Rest of Asia-Pacific	**181,386**		179,587		170,008	
Demand and other non-interest bearing	**22,687**		20,914		19,283	
Demand interest bearing	**83,019**	**0.8**	78,563	1.0	74,636	1.1
Savings	**65,652**	**2.9**	67,424	2.9	63,500	2.8
Time	**9,581**	**0.7**	12,381	1.0	11,815	1.0
Other	**447**	**2.0**	305	3.6	774	2.2
Middle East and North Africa	**40,451**		37,604		36,105	
Demand and other non-interest bearing	**16,801**		14,564		13,016	
Demand interest bearing	**13,248**	**0.4**	10,967	0.6	9,887	0.6
Savings	**9,981**	**2.6**	11,555	3.0	12,596	3.2
Time	**357**	**1.4**	452	2.2	530	2.5
Other	**64**		66	1.5	76	
North America	**157,549**		153,057		165,779	
Demand and other non-interest bearing	**27,992**		28,403		26,524	
Demand interest bearing	**37,837**	**0.3**	38,419	0.3	35,440	0.3
Savings	**63,565**	**0.6**	68,039	0.7	75,866	0.8
Time	**7,673**	**0.3**	9,587	0.4	13,835	0.4
Other	**20,482**	**0.1**	8,609	0.2	14,114	0.1
Latin America	**57,066**		73,323		89,603	
Demand and other non-interest bearing	**13,084**		14,203		14,815	
Demand interest bearing	**7,237**	**1.8**	8,258	2.2	8,374	1.7
Savings	**24,652**	**7.4**	35,294	7.5	47,197	9.8
Time	**9,459**	**4.4**	13,095	4.0	16,567	3.9
Other	**2,634**	**6.2**	2,473	4.7	2,650	7.2

Total	**1,297,032**		1,236,953		1,236,401	
Demand and other non-interest bearing	**192,388**		184,140		178,075	
Demand interest bearing	**678,821**	**0.3**	615,175	0.4	568,232	0.4
Savings	**265,882**	**2.1**	284,690	2.4	294,512	2.9
Time	**88,477**	**1.3**	108,801	1.5	127,156	1.6
Other	**71,464**	**0.4**	44,147	0.7	68,426	0.9

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Customer accounts by country

	At 31 December 2013	2012
	US$m	US$m
Europe	**644,816**	555,009
UK[34]	**504,984**	426,144
France[35]	**65,844**	55,578
Germany	**16,615**	15,611
Malta	**6,222**	5,957
Switzerland	**16,796**	20,211
Turkey	**7,795**	7,629
Other	**26,560**	23,879
Hong Kong	**365,993**	346,208
Rest of Asia-Pacific	**182,626**	183,621
Australia	**19,812**	20,430
India	**11,549**	10,415
Indonesia	**5,865**	6,512
Mainland China	**40,579**	35,572
Malaysia	**17,139**	17,641
Singapore	**43,988**	47,862
Taiwan	**12,758**	12,497
Vietnam	**2,426**	2,147
Other	**28,510**	30,545
Middle East and North Africa		
(excluding Saudi Arabia)	**38,683**	39,583
Egypt	**7,401**	7,548
Qatar	**2,861**	2,704
UAE	**18,433**	18,448
Other	**9,988**	10,883
North America	**196,495**	149,037
US[34]	**135,531**	90,627
Canada	**48,065**	47,049
Bermuda	**12,899**	11,361
Latin America	**54,199**	66,556
Argentina	**4,468**	5,351
Brazil	**24,353**	30,144
Mexico	**23,975**	22,724
Panama		5,940
Other	**1,403**	2,397

Total	**1,482,812**	1,340,014

For footnotes, see page 132.

Report of the Directors: Financial Review (continued)

Certificates of deposit and other money market instruments

	2013		2012		2011	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**28,680**	**0.5**	32,602	0.4	46,641	0.6
Hong Kong	**1,400**	**0.7**	1,458	0.9	932	1.0
Rest of Asia-Pacific	**1,799**	**2.9**	3,863	3.0	3,951	3.4
North America	**5,583**	**0.6**	9,339	0.6	10,936	0.5
Latin America	**9,335**	**8.3**	7,344	8.5	5,499	9.2
	46,797	**2.3**	54,606	1.8	67,959	1.4

Certificates of deposit and other time deposits

The maturity analysis of certificates of deposit (CD s) and other wholesale time deposits is expressed by remaining maturity. The majority of CDs and time deposits are in amounts of US$100,000 and over or the equivalent in other currencies.

	At 31 December 2013				
	3 months or less US$m	**After 3 months but within 6 months US$m**	**After 6 months but within 12 months US$m**	**After 12 months US$m**	**Total US$m**
Europe	**57,584**	**9,610**	**7,326**	**4,298**	**78,818**
Certificates of deposit	**8,910**	**5,070**	**1,779**		**15,759**
Time deposits:					
banks	**12,778**	**595**	**516**	**1,074**	**14,963**
customers	**35,896**	**3,945**	**5,031**	**3,224**	**48,096**
Hong Kong	**10,713**	**783**	**743**	**47**	**12,286**
Certificates of deposit		**21**	**5**		**26**
Time deposits:					
banks	**354**	**36**			**390**
customers	**10,359**	**726**	**738**	**47**	**11,870**
Rest of Asia-Pacific	**11,219**	**963**	**358**	**1,159**	**13,699**
Certificates of deposit	**1,582**	**317**	**111**	**617**	**2,627**
Time deposits:					

banks	**3,281**	**399**	**1**	**25**	**3,706**
customers	**6,356**	**247**	**246**	**517**	**7,366**
Middle East and North Africa	**1,372**	**45**	**122**	**36**	**1,575**
Time deposits:					
banks	**742**	**10**	**14**		**766**
customers	**630**	**35**	**108**	**36**	**809**
North America	**9,673**	**733**	**267**	**228**	**10,901**
Time deposits:					
banks	**3,747**	**3**			**3,750**
customers	**5,926**	**730**	**267**	**228**	**7,151**
Latin America	**9,169**	**1,087**	**906**	**731**	**11,893**
Certificates of deposit	**11**		**228**	**463**	**702**
Time deposits:					
banks	**784**	**583**	**404**	**244**	**2,015**
customers	**8,374**	**504**	**274**	**24**	**9,176**
Total	**99,730**	**13,221**	**9,722**	**6,499**	**129,172**
Certificates of deposit	**10,503**	**5,408**	**2,123**	**1,080**	**19,114**
Time deposits:					
banks	**21,686**	**1,626**	**935**	**1,343**	**25,590**
customers	**67,541**	**6,187**	**6,664**	**4,076**	**84,468**

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Report of the Directors: Financial Review (continued)

Reconciliation of RoRWA measures

Performance Management

We target a return on average ordinary shareholders equity of 12% 15%. For internal management purposes we monitor global businesses and geographical regions by pre-tax return on RWAs, a metric which combines return on equity and regulatory capital efficiency objectives.

In addition to measuring return on average risk-weighted assets (RoRWA) we measure our performance internally using the non-GAAP measure of underlying RoRWA, which is underlying profit before tax as a percentage of average risk-weighted assets adjusted for the effects of foreign currency translation differences and business disposals. Underlying RoRWA adjusts performance for certain items which distort year-on-year performance as explained on page 47.

We also present the non-GAAP measure of underlying RoRWA adjusted for the effect of operations which are not regarded as contributing to the longer-term performance of the Group. These include the run-off portfolios and the CRS business which was sold in 2012.

The CRS average RWAs in the table below represent the average of the associated operational risk RWAs that were not immediately released on disposal and have not already been adjusted as part of the underlying RoRWA calculation. The 2012 pre-tax loss for CRS primarily relates to litigation expenses incurred after the sale of the business that have not been adjusted as part of the underlying RoRWA calculation.

Reconciliation of underlying RoRWA (excluding run-off portfolios and Card and Retail Services)

	2013 Pre-tax return US$m	2013 Average RWAs[36] US$bn	2013 RoRWA[37] %	2012 Pre-tax return US$m	2012 Average RWAs[36] US$bn	2012 RoRWA[37] %
Reported	**22,565**	**1,104**	**2.0**	20,649	1,172	1.8
Underlying[37]	**21,586**	**1,088**	**2.0**	15,286	1,078	1.4
Run-off portfolios	**68**	**124**	**0.1**	(1,624)	166	(1.0)
Legacy credit in GB&M	**185**	**33**	**0.6**	(274)	45	(0.6)
US CML and other[38]	**(117)**	**91**	**(0.1)**	(1,350)	121	(1.1)
Card and Retail Services		**4**		(150)	5	(3.0)
	21,518	**960**	**2.2**	17,060	906	1.9

Underlying (excluding run-off portfolios and Card and Retail Services)

Reconciliation of reported and underlying average risk-weighted assets

	Year ended 31 December		
	2013	2012	Change
	US$bn	US$bn	%
Average reported RWAs[36]	**1,104**	1,172	(6)
Currency translation adjustment[32]		(6)	
Acquisitions, disposals and dilutions	**(16)**	(88)	
Average underlying RWAs[36]	**1,088**	1,078	1

For footnotes, see page 132.

Report of the Directors: Financial Review (continued)

Ratio of earnings to fixed charges[62]

	2013	2012	2011	2010	2009
Ratio of earnings to fixed charges					
excluding interest on deposits[63]	**3.84**	3.03	2.82	2.71	1.53
including interest on deposits	**2.09**	1.76	1.68	1.73	1.22
Ratio of earnings to combined fixed charges and preference share dividends					
excluding interest on deposits[63]	**3.50**	2.79	2.64	2.56	1.48
including interest on deposits	**2.01**	1.71	1.64	1.69	1.20

For footnotes, see page 133a.

Report of the Directors: Financial Review (continued)

Critical accounting policies

(Audited)

Introduction

The results of HSBC are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements. The significant accounting policies are described in Note 2 on the Financial Statements.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

Our accounting policy for losses arising from the impairment of customer loans and advances is described in Note 2g on the Financial Statements. Loan impairment allowances represent management s best estimate of losses incurred in the loan portfolios at the balance sheet date.

Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

The largest concentration of collectively assessed loan impairment allowances are in North America, where they were US$3.8bn, representing 47% (2012: US$5.2bn; 54%) of the Group s total collectively assessed loan impairment allowances and 25% of the Group s total impairment allowances. Of the North American collective impairment allowances approximately 79% (2012: 86%) related to the US CML portfolio.

The methods used to calculate collective impairment allowances on homogeneous groups of loans and advances that are not considered individually significant are disclosed in Note 2g on the Financial Statements. They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of

incurred losses is likely to be greater or less than that suggested by historical experience. Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

During 2013, we reviewed the impairment allowance methodology used for retail banking and small business portfolios across the Group to ensure that the assumptions used in our collective impairment assessment models continue to appropriately reflect the periods of time between a loss event occurring, the discovery of the loss event and the eventual write off. As a result of this review, the collective impairment allowances were increased by US$251m.

Where loans are individually assessed for impairment, management judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, which is not restricted to the consideration of whether payments are contractually past-due but includes broader consideration of factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly

Report of the Directors: Financial Review (continued)

where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer s business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

Under certain specified conditions, we provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default or repossession. Where forbearance activities are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation. Where collectively assessed loan portfolios include significant levels of loan forbearance, portfolios are segmented to reflect the different credit risk characteristics of forbearance cases, and estimates are made of the incurred losses inherent within the forbearance portfolio segments at the reporting date. Forbearance activities take place in both retail and wholesale loan portfolios, but our largest concentration is in the US, in HSBC Finance s CML portfolio.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive, though they are particularly sensitive to general economic and credit conditions in North America. For example, a 10% increase in impairment allowances on collectively assessed loans and advances in North America would have increased loan impairment allowances by US$0.4bn at 31 December 2013 (2012: US$0.5bn).

It is possible that the outcomes within the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

Our accounting policy for goodwill is described in Note 2p on the Financial Statements. Note 22 on the Financial Statements lists our cash generating units (CGU s) by geographical region and global business. HSBC s total goodwill amounted to US$21bn at 31 December 2013 (2012: US$21bn).

The review of goodwill for impairment reflects management s best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they necessarily reflect management s view of future business prospects at the time of the assessment; and

- the rates used to discount future expected cash flows are based on the costs of capital assigned to individual CGUs and the rates can have a significant effect on their valuation. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic

conditions beyond our control and are consequently subject to uncertainty and require the exercise of significant judgement.
A decline in a CGU s expected cash flows and/or an increase in its cost of capital reduces the CGU s estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill is recognised in our income statement for the year.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management s best estimate of future business prospects.

Report of the Directors: Financial Review (continued)

During 2013, no impairment of goodwill was identified (2012: nil). In addition to the annual impairment test which was performed as at 1 July 2013, management reviewed the current and expected performance of the CGUs as at 31 December 2013 and determined that there was no indication of impairment of the goodwill allocated to them, except for the GPB Europe CGU, for which reduced forecast profitability triggered the re-testing of the related goodwill as at 31 December 2013. Although the results of the goodwill impairment testing for this CGU are more sensitive to key assumptions used, the re-test of the goodwill concluded that there was no impairment.

Note 22 on the Financial Statements includes details of the CGUs with significant balances of goodwill, states the key assumptions used to assess the goodwill in each of those CGUs for impairment and provides a discussion of the sensitivity of the carrying value of goodwill to changes in key assumptions.

Interests in associates

Under the equity accounting method, investments in associates are initially stated at cost, and are adjusted thereafter for the post-acquisition change in HSBC s share of the net assets of the associate. An investment in an associate is tested for impairment when there is an indication that the investment may be impaired. At 31 December 2013, the fair value of HSBC s investment in BoCom had been below the carrying amount for approximately 20 months, apart from a short period in 2013. The conclusion of the impairment test, based on the assessment of the value in use, was that the investment is not impaired. The measurement of value in use involves significant judgement in estimating the present values of cash flows expected to arise from continuing to hold the investment. Note 21 on the Financial Statements includes detailed information on HSBC s investment in BoCom. It provides a description of the key assumptions used in estimating value in use, the sensitivity of the value in use calculation to different assumptions and a sensitivity analysis that shows the changes in key assumptions that would reduce the excess of value in use over the carrying amount (headroom) to nil.

Valuation of financial instruments

Our accounting policy for determining the fair value of financial instruments is described in Note 2d on the Financial Statements. The best evidence of fair value is a quoted price for the instrument being measured in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that include one or more significant inputs that are unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

Valuation techniques used to calculate fair values are discussed in Note 15 on the Financial Statements. The main assumptions and estimates which management consider when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are estimated based on the terms of the instrument, and judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;

- selecting an appropriate discount rate for the instrument. The determination of this rate is based on an assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in

Report of the Directors: Financial Review (continued)

the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm s length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even when unobservable inputs are significant.

The fair values of financial assets and liabilities of US$547bn (2012: US$718bn) and US$467bn (2012: US$622bn), respectively, were determined using valuation techniques and represented 53% (2012: 60%) and 82% (2012: 83%), respectively, of financial assets and liabilities measured at fair value.

The types and amounts of adjustments made in determining the fair value of financial instruments measured at fair value using valuation techniques, and a sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions, are described in Note 15 on the Financial Statements.

Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

HSBC does not include a funding spread in the discount rate applied to the fair value measurement of uncollateralised derivatives. The application of such a funding fair value adjustment is under consideration by the financial services industry, although no consensus has yet emerged. In the future, and possibly in 2014, HSBC may adopt a funding fair value adjustment to reflect funding of uncollateralised derivatives at rates other than interbank offer rates.

Deferred tax assets

Our accounting policy for the recognition of deferred tax assets is described in Note 2s on the Financial Statements. The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

The most significant judgements concern the US deferred tax asset, given the recent history of losses in our US operations. The net US deferred tax asset amounted to US$4.4bn or 59% (2012: US$4.6bn; 61%) of deferred tax assets recognised on the Group s balance sheet. These judgements take into consideration the reliance placed on the use of tax planning strategies.

The most significant tax planning strategy is the retention of capital in our US operations to ensure the realisation of the deferred tax assets. The principal strategy involves generating future taxable profits through the retention of capital in the US in excess of normal regulatory requirements in order to reduce deductible funding expenses or otherwise deploy such capital or increase levels of taxable income. Management expects that, with this strategy, the US operations will generate sufficient future profits to support the recognition of the deferred tax assets. If HSBC Holdings were to decide not to provide this ongoing support, the full recovery of the deferred tax asset may no longer be probable and could result in a significant reduction of the deferred tax asset which would be recognised as a charge in the income statement.

Provisions

The accounting policy for provisions is described in Note 2w on the Financial Statements. Note 31 on the Financial Statements discloses the major categories of provisions recognised. The closing balance of provisions amounted to US$5.2bn (2012: US$5.3bn), of which US$1.8bn

(2012: US$1.7bn) related to legal proceedings and regulatory matters and US$2.4bn (2012: US$2.4bn) related to customer remediation.

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Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on litigation provisions, property provisions (including onerous contracts) and similar liabilities.

Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress through various stages of development, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised and their estimated amounts, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically possible to make judgements and estimates around a better defined set of possible outcomes. However, such judgements can be very difficult and the amount of any provision can be very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of

possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. For a detailed description of the nature of uncertainties and assumptions and the effect on the amount and timing of possible cash outflows on material matters, see Note 43 on the Financial Statements.

Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, for example, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition and measurement of provisions, it is possible that the outcomes in the next financial year could differ from those on which management s estimates are based, resulting in materially different amounts of provisions recognised and outflows of economic benefits from those estimated by management for the purposes of the 2013 Financial Statements.

Report of the Directors: Financial Review (continued)

Global businesses

Summary

HSBC reviews operating activity on a number of bases, including by geographical region and by global business.

The commentaries below present global businesses followed by geographical regions (page 96). Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region.

All commentaries are on a constant currency basis (page 47) unless stated otherwise, while tables are on a reported basis.

Basis of preparation

The results of global businesses are presented in accordance with the accounting policies used in the preparation of HSBC s consolidated financial statements. Our operations are closely integrated and, accordingly, the presentation of global business data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and global functions, to the extent that these can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve some subjectivity.

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

The expense of the UK bank levy is included in the Europe geographical region as HSBC regards the levy as a cost of being headquartered in the UK. For the purposes of the segmentation by global business, the cost of the levy is included in Other .

Profit/(loss) before tax

	2013		2012		2011	
	US$m	**%**	US$m	%	US$m	%
Retail Banking and Wealth Management	**6,649**	**29.5**	9,575	46.4	4,270	19.6
Commercial Banking	**8,441**	**37.4**	8,535	41.3	7,947	36.3
Global Banking and Markets	**9,441**	**41.8**	8,520	41.3	7,049	32.2
Global Private Banking	**193**	**0.9**	1,009	4.9	944	4.3
Other[39]	**(2,159)**	**(9.6)**	(6,990)	(33.9)	1,662	7.6
	22,565	**100.0**	20,649	100.0	21,872	100.0

Total assets[40]

	At 31 December			
	2013		2012	
	US$m	**%**	US$m	%
Retail Banking and Wealth Management	**517,085**	**19.4**	536,244	19.9
Commercial Banking	**360,623**	**13.5**	363,659	13.5
Global Banking and Markets	**1,975,509**	**74.0**	1,942,470	72.1
Global Private Banking	**97,655**	**3.7**	118,440	4.4
Other	**171,812**	**6.4**	201,741	7.5
Intra-HSBC items	**(451,366)**	**(17.0)**	(470,016)	(17.4)
	2,671,318	**100.0**	2,692,538	100.0

For footnotes, see page 132.

Report of the Directors: Financial Review (continued)

Risk-weighted assets

	At 31 December			
	2013		2012	
	US$bn	**%**	US$bn	%
Retail Banking and Wealth Management	**233.5**	**21.4**	276.6	24.6
Commercial Banking	**391.7**	**35.8**	397.0	35.3
Global Banking and Markets	**422.3**	**38.6**	403.1	35.9
Global Private Banking	**21.7**	**2.0**	21.7	1.9
Other	**23.5**	**2.2**	25.5	2.3
	1,092.7	**100.0**	1,123.9	100.0

Selected items included in profit before tax by global business

The table below shows the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and the operating profit or loss of the

acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses which are eliminated from underlying results so that results can be viewed on a like-for-like basis.

Acquisitions, disposals and dilutions[41]

	2013	2012
	US$m	US$m
Retail Banking and Wealth Management	**264**	5,565
Commercial Banking	**541**	922
Global Banking and Markets	**404**	516
Global Private Banking	**1**	57
Other[39]	**1,015**	3,106
	2,225	10,166

For footnotes, see page 132.

Principal RBWM business

The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed of US CRS business. We believe that looking at the Principal RBWM business without the run-off and disposed of businesses allows management to more clearly discuss the cause of material changes from

year-to-year in the ongoing business and to assess the factors and trends in the business which are anticipated to have a material effect in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are provided in the Form 20-F filed with the SEC, which is available on www.hsbc.com.

Report of the Directors: Financial Review (continued)

Products and services

Retail Banking and Wealth Management

RBWM serves over 50 million personal customers. We take deposits and provide transactional banking services to enable customers to manage their day-to-day finances and save for the future. We selectively offer credit facilities to assist customers in their short or longer-term borrowing requirements; and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

Typically, customer offerings include:

- *liability-driven services*: deposits and account services;
- *asset-driven services*: credit and lending, both secured and unsecured; and
- *fee-driven and other services*: financial advisory, broking, life insurance manufacturing and asset management.

We deliver services through four principal channels: branches, self-service terminals, telephone service centres and digital (internet and mobile). Customers can transact with the bank via a combination of these channels, through the following offerings:

- HSBC Premier**:** we provide preferential banking services and global recognition to our mass affluent customers and their immediate families with a dedicated relationship manager, specialist wealth advice and tailored solutions. Customers can access emergency travel assistance, priority telephone banking and an online global view of their Premier accounts around the world.
- HSBC Advance**:** we provide a range of preferential products and services to simplify the banking needs of customers and to help them manage and plan their money to achieve their financial goals and ambitions.
- Wealth Solutions & Financial Planning**:** a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth through investment and wealth insurance products manufactured by Global Asset Management, Markets and HSBC Insurance and by selected third-party providers.
- Basic banking**:** we increasingly provide globally standardised but locally delivered, reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

Total RBWM comprises our Principal RBWM business and the US run-off portfolio.

Commercial Banking

Our CMB business is segmented into large corporates, mid-market companies and Business Banking. This allows us to provide an appropriate level of support to companies with more sophisticated needs and SMEs as they grow both domestically and internationally, and ensures a clear focus on internationally aspirant customers.

We place particular emphasis on international connectivity to meet the needs of our business customers. We aim to be recognised as the leading international trade and business bank by focusing on faster-growing markets, repositioning towards international business and enhancing collaboration across the Group. This will be underpinned by reducing complexity and operational risk and driving efficiency gains through adopting a global operating model.

Credit and Lending**:** we offer a broad range of domestic and cross-border financing, including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is also offered in selected countries.

Global Trade and Receivables Finance**:** we provide the services and finance our clients need throughout the trade cycle including; letters of credit, collections, guarantees; receivables finance; supply chain solutions; commodity and structured finance; and risk distribution. HSBC is supporting the development of renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Payments and Cash Management**:** we are a leading provider of domestic and cross-border payments, collections, liquidity management and account services offering local, regional and global solutions delivered via e-enabled platforms designed to address the current and future needs of our clients.

Insurance and Investments**:** we offer business and financial protection, trade insurance, employee benefits, corporate wealth management and a variety of other commercial risk insurance products in selected countries.

GB&M**:** our CMB franchise represents a key client base for GB&M products and services, including foreign exchange and interest rate products, together with capital raising on debt and equity markets and advisory services.

Report of the Directors: Financial Review (continued)

Global Banking and Markets

GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients financial requirements. Sector-focused client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With a presence in over 60 countries/territories and access to HSBC s worldwide presence and capabilities, this business serves subsidiaries and offices of our clients on a global basis.

In August 2013, GB&M was reshaped to more effectively focus resources on clients and enhance relationships, and to better capture growth opportunities which create greater value for our clients and our shareholders.

GB&M is managed within the following framework:

Client Coverage contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together HSBC s broad array of product capabilities.

Markets provides sales and trading services which are categorised as follows:

Credit and Rates sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They also offer clients risk management solutions.

Foreign Exchange provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of SMEs, MMEs and large corporates in GB&M and CMB, and the needs of RBWM customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.

Equities provides sales and trading services for clients, including direct market access and financing and hedging solutions.

Capital Financing offers financing and advisory services. Products include debt and equity capital raising, advisory, corporate lending, leveraged finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.

Payments and Cash Management products include non-retail deposit taking and international, regional and domestic payments and cash management services.

Securities Services provides custody and clearing services to corporate and institutional clients and funds administration to both domestic and cross-border investors.

Global Trade and Receivables Finance provides trade services for our clients.

Balance Sheet Management is responsible for the management of liquidity and funding. It also manages structural interest rate positions within the Markets limit structure.

Global Private Banking

GPB provides investment management and trustee solutions to high net worth individuals and their families in the Group s priority markets. We aim to meet the needs of our clients by providing excellent customer service and offering a comprehensive suite of solutions.

Drawing on the strength of the HSBC Group and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage, and preserve wealth for today and for the future.

Private Banking services comprise multicurrency and fiduciary deposits, account services, and credit and specialist lending. GPB also accesses HSBC s universal banking capabilities to offer products and services such as credit cards, internet banking, and corporate and investment banking solutions.

Investment Management comprises advisory and discretionary investment services, as well as brokerage across asset classes. This includes a complete range of investment vehicles, portfolio management, securities services and alternatives.

Private Trust Solutions comprise trusts and estate planning, designed to protect wealth and preserve it for future generations through structures tailored to meet the individual needs of each client.

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HSBC HOLDINGS PLC

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Retail Banking and Wealth Management

RBWM provides banking and wealth management services for our personal customers to help them secure their future prosperity and realise their ambitions.

	2013 US$m	2012 US$m	2011 US$m
Net interest income	**18,339**	20,298	24,101
Net fee income	**7,021**	7,205	8,226
Other income[7]	**1,380**	6,358	1,206
Net operating income[4]	**26,740**	33,861	33,533
LICs[42]	**(3,227)**	(5,515)	(9,319)
Net operating income	**23,513**	28,346	24,214
Total operating expenses	**(17,248)**	(19,769)	(21,202)
Operating profit	**6,265**	8,577	3,012
Income from associates[43]	**384**	998	1,258
Profit before tax	**6,649**	9,575	4,270
RoRWA[36]	**2.6%**	3.1%	1.2%

77%

of profit before tax from

Hong Kong, Rest of Asia-Pacific, Latin America

and Middle East and North Africa

Managing the US run-off portfolio

releasing over US$28bn **of RWAs**

Best Wealth Management Firm

(Banker Middle East Industry Awards, 2013)

Strategic direction

RBWM provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale in our target customer segments to do so cost effectively.

We focus on three strategic imperatives:

- building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our Insurance and Asset Management businesses;
- leveraging global expertise to improve customer service and productivity, to provide a high standard of banking solutions and service to our customers efficiently; and
- simplifying and re-shaping the RBWM portfolio of businesses globally, to focus our capital and resources on key markets.

Our three growth priorities are customer growth in target segments, deepening customer relationships through wealth management and relationship-led lending, and enhancing distribution capabilities, including digital.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

- RBWM reported profit before tax of US$6.6bn compared with US$9.6bn in 2012 on a reported basis and US$9.5bn on a constant currency basis. The decrease arose from lower net gains on sale, most notably following the sale of the CRS business and US branches (US$3.7bn) in 2012, and the absence of profits from non-strategic businesses sold or closed in that year, including Ping An.
- On an underlying basis, profit before tax increased by US$2.4bn, driven by a fall in loan impairment charges in the US run-off portfolio. In addition, operating expenses declined, mainly driven by a reduction in customer redress provisions in the UK.
- In the US run-off portfolio, the loss before tax decreased due to lower loan impairment charges reflecting improvements in housing market conditions, decreased lending balances, reduced new impaired loans and lower delinquency levels. Revenue reduced, reflecting lower average lending balances from the continued run-off of the CML portfolio, losses on early termination of cash flow hedges and portfolio disposals. These factors were partly offset by favourable movements in the fair value of non-qualifying hedges in HSBC Finance of US$315m, compared with adverse movements of US$227m in 2012.

The commentary that follows reflects performance in our Principal RBWM business (see page 78).

- Profit before tax fell by US$208m, reflecting lower net gains on sale of our non-strategic operations and the reduction in profit following these disposals. This was largely offset by a decrease in operating expenses which reflected lower customer redress provisions in the UK and sustainable cost savings resulting from our organisational effectiveness programmes.

Revenue declined by 4% reflecting lower net gains on sale of our non-strategic operations (most notably the US branches), the loss on sale of the HFC Bank UK secured lending portfolio and the consequent reduction in operating revenue. Excluding these, revenue grew by 1%, mainly in Hong Kong and Europe.

Net interest income increased by 1% despite lower revenue from businesses that had been disposed of or closed since the beginning of 2012. The increase was driven by improved mortgage spreads and growth in mortgage

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Report of the Directors: Financial Review (continued)

RBWM profit/(loss) before tax

	Total RBWM US$m	US CRS US$m	US run-off portfolio US$m	Principal RBWM US$m
2013				
Net interest income	**18,339**		**2,061**	**16,278**
Net fee income	**7,021**		**11**	**7,010**
Other income/(expense)[7]	**1,380**		**(400)**	**1,780**
Net operating income[4]	**26,740**		**1,672**	**25,068**
LICs[42]	**(3,227)**		**(705)**	**(2,522)**
Net operating income	**23,513**		**967**	**22,546**
Total operating expenses	**(17,248)**		**(1,166)**	**(16,082)**
Operating profit/(loss)	**6,265**		**(199)**	**6,464**
Income/(expense) from associates[43]	**384**		**(1)**	**385**
Profit/(loss) before tax	**6,649**		**(200)**	**6,849**
RoRWA[36]	**2.6%**		**(0.2%)**	**4.4%**
2012				
Net interest income	20,298	1,267	2,563	16,468
Net fee income	7,205	395	33	6,777
Other income/(expense)[7]	6,358	3,155	(200)	3,403
Net operating income[4]	33,861	4,817	2,396	26,648
LICs[42]	(5,515)	(322)	(2,569)	(2,624)
Net operating income/(expense)	28,346	4,495	(173)	24,024
Total operating expenses	(19,769)	(729)	(1,103)	(17,937)
Operating profit/(loss)	8,577	3,766	(1,276)	6,087
Income from associates[43]	998		2	996
Profit/(loss) before tax	9,575	3,766	(1,274)	7,083
RoRWA[36]	3.1%	14.7%	(1.1%)	4.2%
2011				
Net interest income	24,101	4,128	2,990	16,983
Net fee income/(expense)	8,226	1,273	(49)	7,002
Other income/(expense)[7]	1,206	61	(1,196)	2,341
Net operating income[4]	33,533	5,462	1,745	26,326
LICs[42]	(9,319)	(1,600)	(4,982)	(2,737)
Net operating income/(expense)	24,214	3,862	(3,237)	23,589
Total operating expenses	(21,202)	(1,801)	(1,238)	(18,163)

Operating profit/(expense)	3,012	2,061	(4,475)	5,426
Income from associates[43]	1,258		3	1,255
Profit/(loss) before tax	4,270	2,061	(4,472)	6,681
RoRWA[36]	1.2%	3.9%	(3.3%)	4.0%

For footnotes, see page 132.

balances in Hong Kong, the UK and France, although the rate of balance growth in Hong Kong began to slow in 2013 as transaction volumes in the property market reduced. In Hong Kong, the increase was also driven by growth in the insurance investment portfolio. Deposit balances increased, particularly in the UK and Hong Kong, though the benefit was more than offset by deposit spread compression, particularly in Hong Kong, reflecting the sustained low interest rate environment.

Net fee income grew by 5%, primarily due to higher sales of investment products in Hong Kong, where growth in unit trusts and brokerage income was driven by favourable market sentiment and strong customer demand. This was supported by increased foreign exchange revenue in the UK and higher management fees reflecting growth in average assets under management, most notably in North America and Hong Kong.

Other income declined by US$1.5bn as a result of portfolio rationalisations and other items described above. The decline also reflected a fall in sales of manufactured insurance products, which led to lower favourable value of new business movements in the PVIF asset in Europe, Hong Kong and Rest of Asia-Pacific. Lower favourable PVIF movements also reflected the non-recurrence of the recognition of a PVIF asset in Brazil in 2012 and adverse experience and assumption changes in Latin America in 2013.

LICs increased by 1%, mainly driven by higher collective provisions resulting from model changes and assumption revisions for restructured loans in Brazil and assumption changes to our emergence period methodology across all regions (see page 72). Impairments also increased in Mexico and Turkey reflecting higher lending balances. These increases were largely offset by better underlying credit quality in Brazil, improvements in housing market conditions, and lower charge-offs in North America and recoveries from debt sales in the UK.

Operating expenses decreased by US$1.4bn, mainly as a result of lower customer redress provisions in the UK of US$953m compared with US$1.8bn in 2012, sustainable cost savings of over US$300m from organisational effectiveness programmes, and the disposal and run-off of businesses in 2012 and 2013. In addition, we recorded an accounting gain of US$189m relating to changes in delivering ill-

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health benefits in 2013. These were partly offset by higher staff and premises costs in Latin America and Hong Kong, driven by inflationary pressures.

Income from associates and joint ventures decreased following the disposal of our associate Ping An in December 2012 and the reclassification of Industrial Bank as a financial investment in 2013. On an underlying basis, income from associates rose, primarily in BoCom reflecting balance sheet growth and increased fee income, and in Hong Kong due to the price appreciation of real estate properties.

Growth priorities

Grow in priority markets and deepen customer relationships

Our focus remains on growing the number of customers in our target segments and serving their domestic and international needs whilst de-risking the overall portfolio. HSBC Premier (Premier) is our core retail Wealth offering, and our strategy continues to be to grow the number of customers in this segment and generate more business from the existing client base. Growth and development of this area represents a significant opportunity and is key to reaching our US$3bn incremental Wealth revenue target by 2016, of which US$0.9bn has been achieved to date. In 2013, Wealth revenue of US$6.3bn remained broadly unchanged, with favourable investment sales in Hong Kong and higher foreign exchange income in the UK and Hong Kong being offset by lower insurance revenue, mainly in Latin America.

The total number of active customers in our Principal RBWM business decreased by 5% to 50.4m following business closures and disposals, most notably the sale of the UK HFC Bank lending portfolio and the business in Panama. However, we made good progress in refining and rebalancing the Premier portfolio towards quality long-term sustainable relationships and grew our Premier client base in mainland China, Hong Kong, France and Turkey. Overall, Premier customer numbers remained broadly unchanged at 4.2m as new account growth was offset by reclassification of non-qualifying customers.

At the beginning of the year we introduced a new incentive plan for our Wealth Management relationship managers (RM s) globally. This new plan removes the formulaic link between product sales and variable pay and is instead premised on RM activities that support meeting customer needs, improving customer experience and sales quality. This represents a significant shift in our approach to remuneration and we believe better aligns customer and staff interests, with a focus on building total relationship balances rather than product volume.

We provide our customers with access to a range of wealth management products and are able to leverage HSBC Group-wide capabilities in extending managed solutions, delivering research, expanding renminbi offerings and improving foreign exchange services online. We are also increasing the number of senior RMs dealing with our Premier customers to improve client contact.

Distribution

We continued to invest heavily in enhancing our digital capabilities. The global mobile application which was launched in the fourth quarter of 2012 was deployed in 25 markets by the end of 2013 as we migrated customers to digital channels. This application was downloaded by 2.5m customers, with over 1.1m downloads in the fourth quarter of 2013 alone. Benefits to customers include the ability to engage in stock trading and foreign exchange transactions, bill payment and fund transfers, and increased options to purchase products with improved speed and security.

We deployed digital tools to our front-line staff to raise financial planning standards and gain a more detailed understanding of clients aspirations, risk appetites and investment horizons. We invested significantly in our Wealth Platform with the aim of improving both RM efficiency and customer experience. We rolled out tablet-based tools and applications to RMs in France, UAE and Indonesia with plans to deploy these in 6 further markets in 2014.

We have made good progress in consolidating our Internet Banking systems, reducing the number from 59 to 41 with plans to implement a global solution by the end of 2015. In the third quarter of 2012, we launched the product range review programme and have subsequently reduced the number of retail banking products currently offered from just under 1,000 to 730. We will continue to review our product range to simplify and standardise our offering and to optimise customer choice, increase efficiencies and lower transactional costs.

Report of the Directors: Financial Review (continued)

Commercial Banking

CMB offers a full range of commercial financial services and tailored solutions to more than three million customers ranging from small and medium-sized enterprises to publicly quoted companies in almost 60 countries.

	2013 US$m	2012 US$m	2011 US$m
Net interest income	**10,200**	10,361	9,931
Net fee income	**4,717**	4,470	4,291
Other income[7]	**1,448**	1,720	1,389
Net operating income[4]	**16,365**	16,551	15,611
LICs[42]	**(2,384)**	(2,099)	(1,738)
Net operating income	**13,981**	14,452	13,873
Total operating expenses	**(7,049)**	(7,598)	(7,221)
Operating profit/(loss)	**6,932**	6,854	6,652
Income from associates[43]	**1,509**	1,681	1,295
Profit/(loss) before tax	**8,441**	8,535	7,947
RoRWA[36]	**2.2%**	2.2%	2.2%

5%

growth in customer lending balances

on a constant currency basis

11%

increase in gross revenues from sales

of GB&M products to CMB customers

Best Transaction Banking House

and Best Cash Management Bank

(Euromoney Poll 2013)

Strategic direction

CMB aims to be the banking partner of choice for international businesses by building on our rich heritage, international capabilities and relationships to enable connectivity and support trade and capital flows around the world, thereby strengthening our leading position in international business and trade.

We have three growth priorities:

- grow coverage in faster growing markets;
- drive revenue growth through our international network; and
- grow collaboration revenues.

Implementing Global Standards, enhancing risk management controls models and simplifying processes also remain top priorities for CMB.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

In 2013, CMB reported a profit before tax of US$8.4bn, which was marginally lower on a reported basis and was broadly unchanged on a constant currency basis compared with 2012. 2013 results included gains of US$470m mainly from the sale of our operations in Panama, compared with gains of US$468m in 2012 which included the sales of branches in the US. Share of profit in associates was lower due to the reclassification of Industrial Bank from an associate to a financial investment and the disposal of our investment in Ping An.

On an underlying basis, which excludes the disposal gains and associated operating results, profit before tax rose by 5%. This was driven by increased revenues, a reduction in operating expenses, and higher income from our associates, partly offset by a rise in loan impairment charges.

Revenue on a constant currency basis remained broadly unchanged compared with 2012. Disposal gains in Latin America and increased revenue in Europe were largely offset by the effect of business disposals in the US in 2012. On an underlying basis revenue increased by 2%, with growth in Hong Kong and Europe partly offset by falls in North America and Latin America. Higher net interest income from average balance sheet growth was partly offset by spread compression. Higher net fee income was driven by an increase in lending fees and enhanced collaboration with GB&M.

Management view of revenue

	2013	2012	2011
	US$m	US$m	US$m
Global Trade and Receivables Finance	**2,929**	2,968	2,019
Credit and Lending	**6,103**	6,246	6,329
Payments and Cash Management, current accounts and savings deposits	**5,287**	5,369	4,584
Other	**2,046**	1,968	2,679

Net operating income[4]	**16,365**	16,551	15,611

For footnote, see page 132.

Global Trade and Receivables Finance revenue was broadly unchanged compared with 2012. Double digit lending growth, primarily in Hong Kong and Rest of Asia-Pacific, was offset by spread compression, particularly in Hong Kong and Latin America, reflecting competition and increased liquidity in the markets.

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Credit and Lending revenue remained largely unchanged, as higher average balances in Hong Kong and increased net fee income were broadly offset by lower average balances in Latin America and spread compression in Europe, Middle East and North Africa and North America.

Payments and Cash Management revenue remained broadly unchanged compared with 2012. This reflected liability growth, notably in Hong Kong and the UK, which was driven by new mandates and increased transaction volumes and supported by our focus on international customers, offset by the effect of business disposals in the US.

The movement in Other reflected the gains on business disposals recorded in both 2012 and 2013.

LICs increased by US$344m, driven by higher individually assessed loan impairments in Latin America, in particular specific impairments in Mexico relating to homebuilders from a change in public housing policy and in Brazil relating to certain corporate exposures. In Europe, lower individual impairments, mainly in the UK and Greece, were partly offset by higher provisions in Spain due to the continued challenging economic conditions.

Operating expenses decreased by 5%, primarily in Europe due to an accounting gain arising from a change in the basis of delivering ill-health benefits in 2013 of US$161m and lower customer redress provisions of US$148m (2012: US$258m). Operating expenses also decreased due to the effects of business disposals. In 2013, we generated over US$80m of sustainable savings. These factors were partly offset by increased costs in Hong Kong and Rest of Asia-Pacific due to inflationary pressures and investment for growth.

Income from associates declined by 12%, reflecting the reclassification of Industrial Bank as an investment and the disposal of our investment in Ping An. Excluding these events, income from associates grew by 11% as BoCom benefited from a rise in lending and associated fee income.

Growth priorities

Grow coverage in faster-growing markets

Revenues in Hong Kong, Rest of Asia-Pacific, Latin America and Middle East and North Africa increased by 3% compared with 2012 and represented over 55% of our revenues in 2013. CMB s top 20 markets contributed around 90% of our profit before tax in 2013.

Our global network helps connect customers internationally. For example, we expanded our renminbi offering to Latin America as trade with mainland China gathered pace. In addition, we opened the first China desk in Argentina to support mainland Chinese businesses operating in Argentina as well as local companies interested in doing business in mainland China.

Drive revenue growth through our international network

HSBC has a competitive advantage by being present and able to capture business at both ends of the top twenty global trade corridors. The opportunities this presents to generate additional revenues has helped us grow underlying revenue faster than GDP growth in Europe, Hong Kong and Rest of Asia-Pacific.

In addition, we continue to invest in organic growth in city clusters with international business opportunities as we have done in the US, mainland China, Germany and other markets.

We continued to expand our international relationship managers (IRM) programme and now have almost 500 IRMs supporting SME clients with international growth ambitions, having extended our programme from three markets in 2012 to 12 in 2013. The new markets include Hong Kong, US, Canada, Egypt, Singapore, India, Argentina, UAE and Turkey. There are plans to expand the model into a further five key Business Banking markets next year.

We continued to support SMEs by launching funds to support those businesses that trade or aspire to trade internationally. SME funds were launched in the first half of 2013 in the UK,

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France and Mexico, and subsequently we launched two SME funds of US$1bn in US and Canada. In the UAE, a fourth SME fund of AED1bn (US$272m) targeted at international trade customers was also launched.

Grow collaboration revenues

CMB s ongoing collaboration with HSBC s other global businesses resulted in revenue growth of over US$0.3bn for the Group, a 9% increase compared with 2012. Our collaboration with global businesses has now delivered US$1.3bn in incremental revenue for the Group since 2010, achieving 65% of our medium-term target. Gross revenues from sales of GB&M products to CMB customers, which are shared by the two global businesses, grew by 11%,
mainly driven by sales of foreign exchange products and debt capital markets activities. Close collaboration across international borders and global businesses resulted in a number of high-profile deals in 2013.

To serve our clients in each segment better, and to further enhance the collaboration efforts with GB&M, we have created two senior management roles Global Head of Large Corporates and Global Head of Mid-market and Business Banking to focus on our largest clients who are internationally connected and prime candidates for collaboration activities with an emphasis on markets and capital financing. This should ensure better coverage of our target segments in the future.

Report of the Directors: Financial Review (continued)

Global Banking and Markets

GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide.

	2013 US$m	2012 US$m	2011 US$m
Net interest income	**6,766**	6,960	7,263
Net fee income	**3,482**	3,329	3,227
Net trading income[44]	**6,780**	5,690	5,204
Other income	**2,148**	2,294	1,363
Net operating income[4]	**19,176**	18,273	17,057
LICs[42]	**(207)**	(670)	(984)
Net operating income	**18,969**	17,603	16,073
Total operating expenses	**(9,960)**	(9,907)	(9,722)
Operating profit	**9,009**	7,696	6,351
Income from associates[43]	**432**	824	698
Profit before tax	**9,441**	8,520	7,049
RoRWA[36]	**2.3%**	2.1%	1.8%

Resilient performance in

a challenging environment

Increased client flows in the majority

of our customer-facing businesses

Best Global Emerging

Market Investment Bank

(Euromoney Awards for Excellence 2013)

Strategic direction

GB&M continues to pursue its emerging markets-led and financing-focused strategy, with the objective of being a top 5 bank to our priority clients. This strategy has evolved to include a greater emphasis on connectivity between the global businesses, across the regions and within GB&M, leveraging the Group s extensive distribution network.

We focus on four growth priorities:

- leveraging our distinctive geographical network which connects developed and faster-growing regions;
- connecting clients to global growth opportunities;
- continuing to be well positioned in products that will benefit from global trends; and
- enhancing collaboration with other global businesses to appropriately service the needs of our international client base.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for GB&M.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

GB&M reported profit before tax of US$9.4bn, 11% higher than in 2012. Reported results in 2013 included a number of gains on disposal, particularly of our business in Panama. Reported results in 2012 included income from associates Industrial Bank and Ping An. On an underlying basis, which excludes these items, the results of other disposed of operations and the effect of currency movements, profit before tax rose by 15%. This was driven by increased revenue and significantly lower impairment charges and other credit risk provisions.

Revenue rose by 6%, in part reflecting resilient performance in the majority of our customer facing businesses. 2013 revenue included a DVA of US$105m and a gain on disposal of our operations in Panama of US$316m. In 2012, revenue included a reported net charge of US$385m as a result of a change in estimation methodology in respect of CVAs of US$903m, and a DVA of US$518m to reflect evolving market practices.

LICs decreased significantly by US$458m or 69%. Credit risk provisions declined, driven by net releases on available-for-sale ABSs in our legacy portfolio compared with impairment charges in 2012, and the non-recurrence of impairments on certain available-for-sale debt securities in Principal Investments. Impairment charges in the legacy credit loans and advances portfolio also declined.

Operating expenses increased marginally by 2%, despite a decline in performance-related costs and sustainable savings of US$74m achieved from identifying savings and simplifying our processes. There was an increase in 2013 in litigation-related costs, primarily Madoff-related, of US$293m, coupled with an increase in investment in regulatory and compliance resources. These costs were offset in part by a lower customer redress provision relating to interest rate protection products of US$134m (2012: US$329m) and an accounting gain of US$81m relating to changes in delivering employee ill-health benefits.

Income from associates was lower, largely due to the reclassification of Industrial Bank as a financial investment and following the sale of our shareholding in Ping An.

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Management view of total operating income[45]

	2013	2012	2011
	US$m	US$m	US$m
Markets[46]	**6,935**	6,105	5,749
Credit	**796**	485	133
Rates	**1,653**	1,607	1,238
Foreign Exchange	**3,186**	3,215	3,269
Equities	**1,300**	798	1,109
Capital Financing	**3,994**	3,758	3,711
Payments and Cash Management	**1,770**	1,680	1,561
Securities Services	**1,662**	1,623	1,669
Global Trade and Receivables Finance	**741**	740	601
Balance Sheet Management	**3,110**	3,738	3,418
Principal Investments	**512**	188	277
Debit valuation adjustment	**105**	518	
Other[47]	**347**	(77)	71
Net operating income[4]	**19,176**	18,273	17,057

The management view of income above reflects the new management structure of GB&M which has been in place since 12 August 2013 (comparatives have been re-presented for this change).

For footnotes, see page 132.

Markets reported a resilient performance with revenue of US$6.9bn. Revenue in Credit increased, reflecting higher secondary market activity and improved investor appetite, along with revaluation gains from price appreciation on assets in the legacy portfolio. Despite competitive pressure, revenue in primary credit rose. We also increased market share and improved our league table position, particularly in the issue of sterling and Hong Kong dollar bonds in which we led the market.

Despite difficult market conditions, Equities revenue rose, in part, due to increased client flows and larger market share in Hong Kong. Equities also reported increased revaluation gains along with minimal fair value movements on own credit spreads on structured liabilities, compared with adverse movements in 2012.

Foreign Exchange income was broadly in line with 2012. Revenues rose due to increased client demand for foreign exchange hedging solutions, which benefited from GB&M s
collaboration with CMB. This was partly offset, however by margin compression and reduced market volatility in the second half of 2013.

Revenue in Rates in 2012 included a charge as a result of the change in estimation methodology in respect of CVAs, as noted above. In 2013, we won new client mandates and improved market share, despite price compression, particularly in European government bonds. This was coupled with smaller adverse fair value movements on our own credit spreads on structured liabilities compared with 2012. These factors were broadly offset, as revenue in 2012 benefited from the significant tightening of spreads following the ECB liquidity intervention. Revenue in 2013 was affected by uncertainty regarding the tapering of quantitative easing in the US.

Revenue in Capital Financing rose due to higher volumes and spreads in Credit and Lending and gains on sale of equity positions compared with losses on syndicated loans in 2012. In addition, income grew in Project and Export Finance, in part due to increased market share in export credit agency financing, and revenue rose, due to increased issuance demand in debt capital markets.

Payments and Cash Management revenue also grew, in part due to increased customer activity reflecting new mandates, with growth in deposit balances and transaction volumes compared with 2012.

As expected, Balance Sheet Management revenue decreased as proceeds from the sale and maturity of investments were reinvested at prevailing rates which were lower, together with reduced gains on the disposal of available-for-sale debt securities.

Revenue in Principal Investments rose during the year, mainly driven by lower equity impairments. In addition, there were higher gains on disposal of units held in third-party managed private equity funds than in 2012 due to increased refinancing and exit opportunities as market conditions improved.

Other included a gain on the disposal of our operations in Panama of US$316m in 2013.

Report of the Directors: Financial Review (continued)

Growth priorities

Leveraging our distinctive geographical network which connects developed and faster-growing regions

As a universal bank with a distinctive international network and business model, we have provided innovative solutions to multinational corporates including advisory, financing and foreign exchange services.

We advised on the largest M&A transaction by a foreign company in India for a stake enhancement in an India-listed subsidiary. Examples like this reinforce our ability to execute complex cross-border M&A transactions.

We also acted as sole bookrunner on a *dim sum* bond issuance for the first foreign government to issue in the mainland China market, highlighting our leading role in the internationalisation of the renminbi.

Connecting clients to global growth opportunities

GB&M s product expertise supports our clients in the growth of their business activities. In equity capital markets, we were joint lead manager and bookrunner for a large Chinese bank initial public offering (IPO) in Hong Kong and also led the Hong Kong advisory market. This demonstrated our strength in providing cross-border capital markets access and advisory services to clients in mainland China.

We were voted Best for Innovation in Securities Services by *The Banker* magazine following the redesign and development of our Securities Services web portal. This is now more intuitive, consistent across product lines, multi-lingual and accessible from tablets. The award recognised our commitment to innovation and connecting clients to information using new technology.

Continuing to be well positioned in products that will benefit from global trends

We continued to build on the strength of our product offering, with a particular focus on renminbi, which became the second most utilised trade finance currency in 2013. We were voted Best Overall for Products and Services by *Asiamoney* Offshore RMB Services Survey 2013, for the second consecutive year.

We also delivered a broad range of GB&M products in a number of transactions relating to resource and energy companies. This included providing advisory and financing services to a consortium in the acquisition of an energy from waste company, and to a liquified natural gas company.

We remain focused on opportunities in Project and Export Finance, which will benefit as emerging countries pursue economic growth through infrastructure investment and as institutional investors seek out long-term real assets. We were voted Best Project Finance House in Asia, Africa and Latin America by *Euromoney* and Best Global Export Finance Arranger by *Trade Finance* magazine.

With globalisation increasing the number of cross-border payment flows, our leadership in Payments and Cash Management was recognised by *Euromoney*, who named HSBC the Best Global Cash Manager for the second consecutive year.

Enhancing collaboration with other global businesses to appropriately service the needs of our customers

We continued to strengthen collaboration with other global businesses to better meet the needs of our customers across the Group. Gross revenues from sales of GB&M products to CMB customers, which are shared by the two global businesses, grew by 11% mainly driven by sales of foreign exchange products. Revenue from equity capital markets activities for CMB clients also increased significantly as a result of a larger number of deals.

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Global Private Banking

GPB serves high net worth individuals and families with complex and international needs within the Group s priority markets.

	2013 US$m	2012 US$m	2011 US$m
Net interest income	**1,146**	1,294	1,439
Net fee income	**1,150**	1,232	1,382
Other income	**143**	646	471
Net operating income[4]	**2,439**	3,172	3,292
LICs[42]	**(31)**	(27)	(86)
Net operating income	**2,408**	3,145	3,206
Total operating expenses	**(2,229)**	(2,143)	(2,266)
Operating profit	**179**	1,002	940
Income from associates[43]	**14**	7	4
Profit before tax	**193**	1,009	944
RoRWA[36]	**0.9%**	4.6%	3.9%

Profit before tax was significantly lower

as we continued to address legacy issues

and reposition the customer base

Approximately US$50m **of**

sustainable cost savings, on top of about

US$90m already delivered in 2011 and 2012

Best Private Bank in Hong Kong

(The Banker Global Private Banking Awards)

Strategic direction

GPB aims to build on HSBC s commercial banking heritage to be the leading private bank for high net worth business owners.

We have two growth priorities:

repositioning the business to concentrate on home and priority markets, particularly onshore, aligned with Group priorities; and

capturing growth opportunities from Group collaboration, particularly by accessing owners and principals of CMB and GB&M clients.

Implementing Global Standards, enhancing risk management controls, tax transparency and simplifying processes also remain top priorities for GPB.

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Review of performance

Reported profit before tax of US$193m was US$816m lower than in 2012 and US$800m lower on a constant currency basis.

On an underlying basis, which excludes the gain on the sale of our operations in Japan in 2012 of US$67m and associated operating results, profit before tax was US$744m lower, primarily due to reduced revenue.

Revenue declined by 23%, mainly due to the loss on write-off of goodwill relating to our Monaco business of US$279m and the non-recurrence of the sale of our operations in Japan and our headquarters building in Switzerland (US$120m) reported in 2012. Net interest income fell as higher-yielding positions matured and opportunities for reinvestment were limited by prevailing rates. Narrower lending spreads coupled with a decline in average deposit balances also contributed to the fall in net interest income. In addition, brokerage fees decreased, reflecting a fall in client transaction volumes due to lower volatility, and account services fees were lower due to the reduction in client numbers and client assets as we repositioned our client base. Trading income also fell, in part due to lower foreign exchange volumes and lower volatility in the market, notably in the second half of 2013.

Operating expenses increased by 4%, primarily due to regulatory investigation provisions of US$352m, partly offset by lower staff costs from a managed reduction in average staff numbers, reduced performance costs and the non-recurrence of customer redress provisions and costs relating to the merger of pension funds in Switzerland. We also delivered further sustainable savings of approximately US$50m in 2013.

Client assets[48]

	2013 US$bn	2012 US$bn
At 1 January	**398**	377
Net new money	**(26)**	(7)
Value change	**12**	17
Exchange and other	**(2)**	11
At 31 December	**382**	398

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Client assets, which include funds under management and cash deposits, decreased by US$16bn in 2013 primarily due to negative net new money, the effects of the disposal of our operations in Panama and ongoing client transfers in relation to the disposal of our HSBC Trinkaus & Burkhardt AG (HSBC Trinkaus) business in Luxembourg, partly offset by favourable market movements. Negative net new money was mainly driven by the repositioning of our business by moving from offshore to domestic banking, refocusing our client base towards higher net worth relationships, and adopting new compliance and tax transparency standards. There were also a large number of client withdrawals, notably in Switzerland. However, we attracted positive net new money of US$4.6bn from clients in Asia.

Our return on assets, defined as the percentage of revenue to average client assets, was 62bps in 2013 compared with 79bps in 2012. The reduction was primarily due to the write-off of goodwill noted above and the non-recurrence of the gains on the sale of our operations in Japan and our headquarters in Switzerland reported in 2012. Excluding the effect of these items, our return on assets was 69bps in 2013 compared with 76bps in 2012, primarily reflecting the fall in net interest income.

Growth priorities

Repositioning the business

The repositioning of GPB s business model and target client base that commenced in 2012 was accelerated in 2013. Our focus remained on home and priority growth markets where wealth creation is strong and where the Group s presence could be leveraged.

During 2013, we began to implement Global Standards and continued to reposition our business through the adoption of new compliance and tax transparency standards. In addition, we initiated a detailed review of our portfolio which will continue in 2014.

We also took actions to simplify and rationalise our portfolio. For example, we agreed to sell our HSBC Trinkaus private banking and related fund business in Luxembourg. We also reviewed our operations in Monaco following receipt of unsolicited expressions of interest, though it was decided in July to retain the business. Furthermore, to help integrate GPB with HSBC s other global businesses, we transferred the ownership of our operations in Asia and the Channel Islands into the main banking entities in these areas to more closely align management responsibility.

Capturing growth opportunities

Referral flows from collaboration with other global businesses generated net new money of US$5bn in 2013. An enhanced strategy based on closer alignment with CMB will focus on driving collaboration in 12 priority markets where both GPB and CMB have significant scale. Staff will be dedicated to focusing on identifying new prospects and an improved coverage model will be implemented in 2014 to pursue opportunities.

The Global Priority Clients initiative a collaborative venture between GPB, GB&M and CMB for the Group s most significant dual banked clients was redefined during the second half of 2013. By ensuring an effective and enhanced coverage model to meet the private and corporate needs of our most significant and complex clients, supported by dedicated senior management, we will deepen our client relationships and drive incremental revenue opportunities.

We continued to enhance our product offering to clients through the strengthening of the Alternatives platform, with six product launches during 2013 comprising three private equity funds, two real estate club deals and a fund of hedge funds.

In addition, we continued to focus on enhancing the service offering to clients. For example, recently we significantly upgraded the relationship management systems used by all front-office staff in Switzerland. We are also establishing a common banking platform which will provide consistent, tailored products and services globally. This will initially be implemented across continental Europe (including in Switzerland in 2015), and in other countries shortly thereafter.

In 2014, we will be developing our digital strategy to provide an upgraded multi-channel offering enabling us to keep pace with changing industry dynamics and competitor developments as well as meet clients growing digital expectations.

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Other[40]

Other contains the results of certain property transactions, unallocated investment activities, centrally held investment companies, movements in fair value of own debt, central support and functional costs with associated recoveries, HSBC s holding company and financing operations.

	2013 US$m	2012 US$m	2011 US$m
Net interest expense	**(737)**	(730)	(911)
Net fee income	**64**	194	34
Net trading income/(expense)[44]	**6**	(537)	(355)
Changes in fair value of long-term debt issued and related derivatives	**(1,228)**	(4,327)	4,161
Changes in other financial instruments designated at fair value	**(576)**	(1,136)	78
Net income/(expense) from financial instruments designated at fair value	**(1,804)**	(5,463)	4,239
Other income	**8,122**	8,868	6,138
Net operating income[4]	**5,651**	2,332	9,145
LICs[42]			
Net operating income	**5,651**	2,332	9,145
Total operating expenses	**(7,796)**	(9,369)	(7,492)
Operating profit/(loss)	**(2,145)**	(7,037)	1,653
Income/(expense) from associates[43]	**(14)**	47	9
Profit/(loss) before tax	**(2,159)**	(6,990)	1,662

For footnotes, see page 132.

The commentary is on a constant currency basis unless stated otherwise, while tables are on a reported basis.

Notes

Reported loss before tax of US$2.2bn compared with a loss of US$7.0bn in 2012. On a constant currency basis, the pre-tax loss decreased by US$5.0bn.

These results included lower adverse movements on the fair value of our own debt as credit spreads tightened to a lesser extent, notably in Europe and North America. Reported results also included a number of gains and losses on disposal totalling US$1.1bn (see page 49). These included a gain of US$1.1bn arising from the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties. Reported profits in 2012 included a gain of US$3.0bn on the disposal of our associate, Ping An, and a gain on disposal of US$130m from the sale of our shareholding in a property company in the Philippines.

On an underlying basis, excluding the gains and losses on disposal noted above and the associated operating results, the pre-tax loss of US$1.9bn decreased by US$3.1bn, driven by the non-recurrence of charges for US AML, BSA and OFAC investigations of US$1.9bn. In addition, we recognised a net gain of US$553m on completion of the sale of our investment in Ping An in 2013, compared with adverse fair value movements of US$553m on the Ping An contingent forward sale contract recorded in 2012.

Net fee income decreased by US$130m, reflecting the expiring of most of the transition services agreement entered into during 2012 following the sale of the CRS business in North America. We received fee income relating to the above agreement while the associated costs were reported in Operating expenses .

Net trading income of US$6m in 2013 compared with a net trading expense of US$538m in 2012, driven by foreign exchange gains of US$442m relating to sterling debt issued by HSBC Holdings. In addition, there were favourable fair value movements on non-qualifying hedges, notably in Europe, mainly related to the cross-currency swaps used to economically hedge fixed rate long-term debt, compared with adverse movements in 2012. This was partly offset by adverse fair value movements of US$682m on the contingent forward sale contract relating to Ping An in 2013 compared with US$553m in 2012.

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Net expense from financial instruments designated at fair value reduced by US$3.6bn. We reported adverse movements of US$1.2bn on the fair value of our own debt attributable to a tightening of credit spreads in 2013, notably in Europe and North America, compared with adverse movements of US$5.2bn in 2012. Excluding this, net expense increased due to higher adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt designated at fair value issued principally by HSBC Holdings and its European subsidiaries.

Gains less losses from financial investments increased by US$868m, driven by a gain of US$1.2bn on the disposal of our investment in Ping An, partly offset by the non-recurrence of gains of US$314m from the sale of our shares in four Indian banks in 2012.

Dividend income increased by US$124m on a reported basis, mainly due to dividends received from Industrial Bank following its reclassification as a financial investment.

Other operating income increased by US$1.5bn, driven by an accounting gain of US$1.1bn arising from the reclassification of Industrial Bank as a financial investment.

Operating expenses reduced by US$1.5bn, mainly from the non-recurrence of the US fines and penalties noted above, together with lower restructuring costs across all our regions. These factors were partly offset by the UK bank levy charge of US$904m in 2013, which was higher than the charge of US$571m in 2012, mainly due to an increase in the rate of the levy. In addition, operating expenses in both years included adjustments relating to the previous year s bank levy charge (2013: US$12m adverse adjustment; 2012: US$99m favourable adjustment).

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Report of the Directors: Financial Review (continued)

Reconciliation of reported to constant currency and underlying profit/(loss) before tax

Retail Banking and Wealth Management

2013 compared with 2012

	2012 as reported	Currency translation adjustment[1]	2012 at 2013 exchange rates	**2013 as reported**	**Reported change[2]**	**Constant currency change[2]**
	US$m	US$m	US$m	**US$m**	**%**	**%**
Net interest income	20,298	(368)	19,930	**18,339**	**(10)**	**(8)**
Net fee income	7,205	(113)	7,092	**7,021**	**(3)**	**(1)**
Net trading income	304	(18)	286	**686**	**126**	**140**
Net income from financial instruments designated at fair value	1,893	(26)	1,867	**1,638**	**(13)**	**(12)**
Gains on disposal of US branch network and cards business	3,735		3,735		**(100)**	**(100)**
Gains less losses from financial investments	96	(7)	89	**55**	**(43)**	**(38)**
Net earned insurance premiums	11,191	(68)	11,123	**10,543**	**(6)**	**(5)**
Other operating income (including dividend income)	1,496	(34)	1,462	**565**	**(62)**	**(61)**
Total operating income	46,218	(634)	45,584	**38,847**	**(16)**	**(15)**
Net insurance claims incurred and movement in liabilities to policyholders	(12,357)	44	(12,313)	**(12,107)**	**2**	**2**
Net operating income[4]	33,861	(590)	33,271	**26,740**	**(21)**	**(20)**
LICs[42]	(5,515)	135	(5,380)	**(3,227)**	**41**	**40**
Net operating income	28,346	(455)	27,891	**23,513**	**(17)**	**(16)**
Operating expenses	(19,769)	415	(19,354)	**(17,248)**	**13**	**11**
Operating profit	8,577	(40)	8,537	**6,265**	**(27)**	**(27)**
Income from associates[43]	998	14	1,012	**384**	**(62)**	**(62)**
Profit before tax	9,575	(26)	9,549	**6,649**	**(31)**	**(30)**

For footnotes, see page 132.

2012 compared with 2011

	2011 as reported	Currency translation adjustment[1]	2011 at 2012 exchange rates	2012 as reported	Reported change[2]	Constant currency change[2]
	US$m	US$m	US$m	US$m	%	%
Net interest income	24,101	(702)	23,399	20,298	(16)	(13)
Net fee income	8,226	(187)	8,039	7,205	(12)	(10)
Gains on disposal of US branch network and cards business				3,735		
Other income[7]	1,206	(100)	1,106	2,623	117	137
Net operating income[4]	33,533	(989)	32,544	33,861	1	4
LICs[42]	(9,319)	181	(9,138)	(5,515)	41	40
Net operating income	24,214	(808)	23,406	28,346	17	21
Operating expenses	(21,202)	712	(20,490)	(19,769)	7	4
Operating profit	3,012	(96)	2,916	8,577	185	194
Income from associates[43]	1,258	25	1,283	998	(21)	(22)
Profit before tax	4,270	(71)	4,199	9,575	124	128

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and underlying items

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Net interest income						
Reported	**18,339**	20,298	(10)	20,298	24,101	(16)
Currency translation adjustment[1]		(368)			(701)	
Acquisitions, disposals and dilutions	**(151)**	(1,735)		(1,504)	(4,611)	
Underlying	**18,188**	18,195		18,794	18,789	
Other operating income						
Reported	**544**	1,472	(63)	1,472	907	62
Currency translation adjustment[1]		(33)			(38)	
Acquisitions, disposals and dilutions	**(312)**	(395)		(363)	(159)	
Underlying	**232**	1,044	(78)	1,109	710	56
Revenue[4]						
Reported	**26,740**	33,861	(21)	33,861	33,533	1
Currency translation adjustment[1]		(590)			(989)	
Acquisitions, disposals and dilutions	**(494)**	(6,447)		(6,164)	(6,427)	
Underlying	**26,246**	26,824	(2)	27,697	26,117	6
LICs[42]						
Reported	**(3,227)**	(5,515)	41	(5,515)	(9,319)	41
Currency translation adjustment[1]		135			181	
Acquisitions, disposals and dilutions	**33**	377		339	1,616	
Underlying	**(3,194)**	(5,003)	36	(5,176)	(7,522)	31
Operating expenses						
Reported	**(17,248)**	(19,769)	13	(19,769)	(21,202)	7
Currency translation adjustment[1]		415			712	
Acquisitions, disposals and dilutions	**203**	1,176		873	2,429	
Underlying	**(17,045)**	(18,178)	6	(18,896)	(18,061)	(5)
Underlying cost efficiency ratio	**64.9%**	67.8%		68.2%	69.2%	
Share of profit in associates and joint ventures						
Reported	**384**	998	(62)	998	1,258	(21)
Currency translation adjustment[1]		14			25	
Acquisitions, disposals and dilutions	**(6)**	(670)		(622)	(946)	
Underlying	**378**	342	11	376	337	12
Profit before tax						
Reported	**6,649**	9,575	(31)	9,575	4,270	124
Currency translation adjustment[1]		(26)			(71)	
Acquisitions, disposals and dilutions	**(264)**	(5,565)		(5,574)	(3,328)	
Underlying	**6,385**	3,984	60	4,001	871	359

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Report of the Directors: Financial Review (continued)

Principal Retail Banking and Wealth Management business

2013 compared with 2012

	2012 as reported	Currency translation adjustment[1]	2012 at 2013 exchange rates	**2013 as reported**	**Reported change[2]**	**Constant currency change[2]**
	US$m	US$m	US$m	**US$m**	**%**	**%**
Net interest income	16,468	(368)	16,100	**16,278**	**(1)**	**1**
Net fee income	6,777	(113)	6,664	**7,010**	**3**	**5**
Other income[7]	3,403	(109)	3,294	**1,780**	**(48)**	**(46)**
Net operating income[4]	26,648	(590)	26,058	**25,068**	**(6)**	**(4)**
LICs[42]	(2,624)	135	(2,489)	**(2,522)**	**4**	**(1)**
Net operating income	24,024	(455)	23,569	**22,546**	**(6)**	**(4)**
Total operating expenses	(17,937)	415	(17,522)	**(16,082)**	**10**	**8**
Operating profit	6,087	(40)	6,047	**6,464**	**6**	**7**
Income from associates[43]	996	14	1,010	**385**	**(61)**	**(62)**
Profit before tax	7,083	(26)	7,057	**6,849**	**(3)**	**(3)**

For footnotes, see page 132.

Analysis of reported RBWM and Principal RBWM business

	2013	2012	Change[2]	2012	2011	Change[2]
	US$m	US$m	%	US$m	US$m	%
Net interest income						
Reported RBWM	**18,339**	20,298	(10)	20,298	24,101	(16)
US CRS		1,267	(100)	1,267	4,128	(69)
US run-off portfolio	**2,061**	2,563	(20)	2,563	2,990	(14)
Principal RBWM business	**16,278**	16,468	(1)	16,468	16,983	(3)
Net fee income						
Reported RBWM	**7,021**	7,205	(3)	7,205	8,226	(12)
US CRS		395	(100)	395	1,273	(69)
US run-off portfolio	**11**	33	(67)	33	(49)	
Principal RBWM business	**7,010**	6,777	3	6,777	7,002	(3)
Other income/(expense)[7]						

Reported RBWM	**1,380**	6,358	(78)	6,358	1,206	427
US CRS		3,155	(100)	3,155	61	5,072
US run-off portfolio	**(400)**	(200)	(100)	(200)	(1,196)	83
Principal RBWM business	**1,780**	3,403	(48)	3,403	2,341	45
Net operating income[4]						
Reported RBWM	**26,740**	33,861	(21)	33,861	33,533	1
US CRS		4,817	(100)	4,817	5,462	(12)
US run-off portfolio	**1,672**	2,396	(30)	2,396	1,745	37
Principal RBWM business	**25,068**	26,648	(6)	26,648	26,326	1
LICs[42]						
Reported RBWM	**(3,227)**	(5,515)	41	(5,515)	(9,319)	41
US CRS		(322)	100	(322)	(1,600)	80
US run-off portfolio	**(705)**	(2,569)	73	(2,569)	(4,982)	48
Principal RBWM business	**(2,522)**	(2,624)	4	(2,624)	(2,737)	4
Net operating income						
Reported RBWM	**23,513**	28,346	(17)	28,346	24,214	17
US CRS		4,495	(100)	4,495	3,862	16
US run-off portfolio	**967**	(173)		(173)	(3,237)	95
Principal RBWM business	**22,546**	24,024	(6)	24,024	23,589	2

Report of the Directors: Financial Review (continued)

	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Total operating expenses						
Reported RBWM	**(17,248)**	(19,769)	13	(19,769)	(21,202)	7
US CRS		(729)	100	(729)	(1,801)	60
US run-off portfolio	**(1,166)**	(1,103)	(6)	(1,103)	(1,238)	11
Principal RBWM business	**(16,082)**	(17,937)	10	(17,937)	(18,163)	1
Operating profit/(loss)						
Reported RBWM	**6,265**	8,577	(27)	8,577	3,012	185
US CRS		3,766	(100)	3,766	2,061	83
US run-off portfolio	**(199)**	(1,276)	84	(1,276)	(4,475)	71
Principal RBWM business	**6,464**	6,087	6	6,087	5,426	12
Income from associates[43]						
Reported RBWM	**384**	998	(62)	998	1,258	(21)
US CRS						
US run-off portfolio	**(1)**	2		2	3	(33)
Principal RBWM business	**385**	996	(61)	996	1,255	(21)
Profit/(loss) before tax						
Reported RBWM	**6,649**	9,575	(31)	9,575	4,270	124
US CRS		3,766	(100)	3,766	2,061	83
US run-off portfolio	**(200)**	(1,274)	84	(1,274)	(4,472)	72
Principal RBWM business	**6,849**	7,083	(3)	7,083	6,681	6

For footnotes, see page 132.

Retail Banking and Wealth Management   Reconciliation of reported and underlying items

HSBC Finance

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Revenue[4]						
Reported	**1,672**	7,251	(77)	7,251	7,216	
Acquisitions, disposals and dilutions	**105**	(4,888)		(4,830)	(5,462)	
Underlying	**1,777**	2,363	(25)	2,421	1,754	38
Profit/(loss) before tax						
Reported	**(200)**	2,443		2,443	(2,405)	
Acquisitions, disposals and dilutions	**120**	(3,889)		(3,916)	(2,061)	
Underlying	**(80)**	(1,446)	94	(1,473)	(4,466)	67

	US run-off			*Principal business*		
	Year ended 31 December			Year ended 31 December		
	2013	2012	Change[2]	**2013**	2012	Change[2]
	US$m	US$m	%	**US$m**	US$m	%
Revenue[4]						
Reported	**1,672**	2,396	(30)	**25,068**	26,648	(6)
Currency translation adjustment					(590)	
Acquisitions, disposals and dilutions	**105**			**(599)**	(1,630)	
Underlying	**1,777**	2,396	(26)	**24,469**	24,428	

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Report of the Directors: Financial Review (continued)

Commercial Banking

2013 compared with 2012

	2012 as reported	Currency translation adjustment[1]	2012 at 2013 exchange rates	2013 as reported	Reported change[2]	Constant currency change[2]
	US$m	US$m	US$m	US$m	%	%
Net interest income	10,361	(220)	10,141	**10,200**	**(2)**	**1**
Net fee income	4,470	(69)	4,401	**4,717**	**6**	**7**
Net trading income	633	(15)	618	**649**	**3**	**5**
Net income from financial instruments designated at fair value	250	(17)	233	**332**	**33**	**42**
Gains on disposal of US branch network and cards business	277		277		**(100)**	**(100)**
Gains less losses from financial investments	22	(2)	20	**1**	**(95)**	**(95)**
Net earned insurance premiums	1,786	(49)	1,737	**1,375**	**(23)**	**(21)**
Other operating income (including dividend income)	554	(10)	544	**636**	**15**	**17**
Total operating income	18,353	(382)	17,971	**17,910**	**(2)**	
Net insurance claims incurred and movement in liabilities to policyholders	(1,802)	53	(1,749)	**(1,545)**	**15**	**12**
Net operating income[4]	16,551	(329)	16,222	**16,365**	**(1)**	**1**
LICs[42]	(2,099)	59	(2,040)	**(2,384)**	**(14)**	**(17)**
Net operating income	14,452	(270)	14,182	**13,981**	**(3)**	**(1)**
Operating expenses	(7,598)	149	(7,449)	**(7,049)**	**7**	**5**
Operating profit	6,854	(121)	6,733	**6,932**	**1**	**3**
Income from associates[43]	1,681	25	1,706	**1,509**	**(10)**	**(12)**
Profit before tax	8,535	(96)	8,439	**8,441**	**(1)**	

For footnotes, see page 132.

2012 compared with 2011

	2011 as reported	Currency translation	2011 at 2012	2012 as reported	Reported change[2]	Constant currency

	US$m	adjustment[1] US$m	exchange rates US$m	US$m	%	change[2] %
Net interest income	9,931	(381)	9,550	10,361	4	8
Net fee income	4,291	(132)	4,159	4,470	4	7
Gains on disposal of US branch network				277		
Other income[7]	1,389	(58)	1,331	1,443	4	8
Net operating income[4]	15,611	(571)	15,040	16,551	6	10
LICs[42]	(1,738)	81	(1,657)	(2,099)	(21)	(27)
Net operating income	13,873	(490)	13,383	14,452	4	8
Operating expenses	(7,221)	288	(6,933)	(7,598)	(5)	(10)
Operating profit	6,652	(202)	6,450	6,854	3	6
Income from associates[43]	1,295	22	1,317	1,681	30	28
Profit before tax	7,947	(180)	7,767	8,535	7	10

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and underlying items

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Net interest income						
Reported	**10,200**	10,361	(2)	10,361	9,931	4
Currency translation adjustment[1]		(220)			(381)	
Acquisitions, disposals and dilutions	**(92)**	(211)		(83)	(139)	
Underlying	**10,108**	9,930	2	10,278	9,411	9
Other operating income						
Reported	**621**	536	16	536	483	11
Currency translation adjustment[1]		(10)			(10)	
Acquisitions, disposals and dilutions	**(470)**	(187)		(203)	6	
Underlying	**151**	339	(55)	333	479	(30)
Revenue[4]						
Reported	**16,365**	16,551	(1)	16,551	15,611	6
Currency translation adjustment[1]		(329)			(571)	
Acquisitions, disposals and dilutions	**(593)**	(762)		(605)	(232)	
Underlying	**15,772**	15,460	2	15,946	14,808	8
LICs[42]						
Reported	**(2,384)**	(2,099)	(14)	(2,099)	(1,738)	(21)
Currency translation adjustment[1]		59			81	
Acquisitions, disposals and dilutions	**(1)**			(1)	3	
Underlying	**(2,385)**	(2,040)	(17)	(2,100)	(1,654)	(27)
Operating expenses						
Reported	**(7,049)**	(7,598)	7	(7,598)	(7,221)	(5)
Currency translation adjustment[1]		149			288	
Acquisitions, disposals and dilutions	**63**	191		100	162	
Underlying	**(6,986)**	(7,258)	4	(7,498)	(6,771)	(11)
Underlying cost efficiency ratio	**44.3%**	46.9%		47.0%	45.7%	
Share of profit in associates and joint ventures						
Reported	**1,509**	1,681	(10)	1,681	1,295	30
Currency translation adjustment[1]		25			21	
Acquisitions, disposals and dilutions	**(10)**	(351)		(88)	(9)	
Underlying	**1,499**	1,355	11	1,593	1,307	22
Profit before tax						
Reported	**8,441**	8,535	(1)	8,535	7,947	7
Currency translation adjustment[1]		(96)			(180)	
Acquisitions, disposals and dilutions	**(541)**	(922)		(594)	(76)	
Underlying	**7,900**	7,517	5	7,941	7,691	3

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Report of the Directors: Financial Review (continued)

Global Banking and Markets

2013 compared with 2012

	2012 as reported	Currency translation adjustment[1]	2012 at 2013 exchange rates	**2013 as reported**	**Reported change[2]**	**Constant currency change[2]**
	US$m	US$m	US$m	**US$m**	**%**	**%**
Net interest income	6,960	(127)	6,833	**6,766**	**(3)**	**(1)**
Net fee income	3,329	(22)	3,307	**3,482**	**5**	**5**
Net trading income	5,690	(90)	5,600	**6,780**	**19**	**21**
Net income from financial instruments designated at fair value	1,094	(13)	1,081	**599**	**(45)**	**(45)**
Gains less losses from financial investments	730	(8)	722	**747**	**2**	**3**
Net earned insurance premiums	25	(3)	22	**6**	**(76)**	**(73)**
Other operating income (including dividend income)	461	9	470	**799**	**73**	**70**
Total operating income	18,289	(254)	18,035	**19,179**	**5**	**6**
Net insurance claims incurred and movement in liabilities to policyholders	(16)	1	(15)	**(3)**	**81**	**80**
Net operating income[4]	18,273	(253)	18,020	**19,176**	**5**	**6**
LICs[42]	(670)	5	(665)	**(207)**	**69**	**69**
Net operating income	17,603	(248)	17,355	**18,969**	**8**	**9**
Operating expenses	(9,907)	95	(9,812)	**(9,960)**	**(1)**	**(2)**
Operating profit	7,696	(153)	7,543	**9,009**	**17**	**19**
Income from associates[43]	824	6	830	**432**	**(48)**	**(48)**
Profit before tax	8,520	(147)	8,373	**9,441**	**11**	**13**

For footnotes, see page 132.

2012 compared with 2011

	2011 as reported	Currency translation	2011 at 2012	2012 as reported	Reported change[2]	Constant currency

	US$m	adjustment[1] US$m	exchange rates US$m	US$m	%	change[2] %
Net interest income	7,263	(197)	7,066	6,960	(4)	(2)
Net fee income	3,227	(92)	3,135	3,329	3	6
Net trading income	5,204	(116)	5,088	5,690	9	12
Other income[7]	1,363	(26)	1,337	2,294	68	72
Net operating income[4]	17,057	(431)	16,626	18,273	7	10
LICs[42]	(984)	14	(970)	(670)	32	31
Net operating income	16,073	(417)	15,656	17,603	10	12
Operating expenses	(9,722)	208	(9,514)	(9,907)	(2)	(4)
Operating profit	6,351	(209)	6,142	7,696	21	25
Income from associates[43]	698	9	707	824	18	17
Profit before tax	7,049	(200)	6,849	8,520	21	24

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency management view of total operating income of Global Banking and Markets

2013 compared with 2012

	2012 as reported US$m	Currency translation adjustment[1] US$m	2012 at 2013 exchange rates US$m	**2013 as reported US$m**	**Reported change[2] %**	**Constant currency change[2] %**
Markets[46]	6,105	(75)	6,030	**6,935**	**14**	**15**
Credit	485	(2)	483	**796**	**64**	**65**
Rates	1,607	(18)	1,589	**1,653**	**3**	**4**
Foreign Exchange	3,215	(54)	3,161	**3,186**	**(1)**	**1**
Equities	798	(1)	797	**1,300**	**63**	**63**
Capital Financing	3,758	(34)	3,724	**3,994**	**6**	**7**
Payments and Cash Management	1,680	(32)	1,648	**1,770**	**5**	**7**
Securities Services	1,623	(20)	1,603	**1,662**	**2**	**4**
Global Trade and Receivables Finance	740	(14)	726	**741**		**2**
Balance Sheet Management	3,738	(64)	3,674	**3,110**	**(17)**	**(15)**
Principal Investments	188	(3)	185	**512**	**172**	**177**
Debit valuation adjustment	518	(6)	512	**105**	**(80)**	**(79)**
Other[47]	(77)	(5)	(82)	**347**		
Total operating income	18,273	(253)	18,020	**19,176**	**5**	**6**

For footnotes, see page 132.

2012 compared with 2011

	2011 as reported US$m	Currency translation adjustment[1] US$m	2011 at 2012 exchange rates	2012 as reported US$m	Reported change[2] %	Constant currency change[2] %

			US$m			
Markets[46]	5,749	(138)	5,611	6,104	6	9
Credit	133	(6)	127	485	265	282
Rates	1,238	(16)	1,222	1,607	30	32
Foreign Exchange	3,269	(77)	3,192	3,214	(2)	1
Equities	1,109	(39)	1,070	798	(28)	(25)
Capital Financing	3,711	(114)	3,597	3,758	1	4
Payments and Cash Management	1,561	(27)	1,534	1,679	8	9
Securities Services	1,669	(44)	1,625	1,624	(3)	
Global Trade and Receivables Finance	601	(18)	583	740	23	27
Balance Sheet Management	3,418	(73)	3,345	3,738	9	12
Principal Investments	277	(7)	270	188	(32)	(31)
Debit valuation adjustment				518		
Other[47]	71	(10)	61	(76)		
Total operating income	17,057	(431)	16,626	18,273	7	10

The management view of income above reflects the new management structure of GB&M which has been in place since 12 August 2013 (comparatives have been re-presented for this change).

For footnotes, see page 132.

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Reconciliation of reported and underlying items

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Net interest income						
Reported	**6,766**	6,960	(3)	6,960	7,263	(4)
Currency translation adjustment[1]		(127)			(198)	
Acquisitions, disposals and dilutions	**(26)**	(56)		(24)	(31)	
Underlying	**6,740**	6,777	(1)	6,936	7,034	(1)
Other operating income						
Reported	**670**	313	114	313	577	(46)
Currency translation adjustment[1]		10			(10)	
Acquisitions, disposals and dilutions	**(407)**	(78)		(30)	7	
Underlying	**263**	245	7	283	574	(51)
Revenue[4]						
Reported	**19,176**	18,273	5	18,273	17,057	7
Currency translation adjustment[1]		(253)			(431)	
Acquisitions, disposals and dilutions	**(460)**	(219)		(107)	(81)	
Underlying	**18,716**	17,801	5	18,166	16,545	10
LICs[42]						
Reported	**(207)**	(670)	69	(670)	(984)	32
Currency translation adjustment[1]		5			14	
Acquisitions, disposals and dilutions						
Underlying	**(207)**	(665)	69	(670)	(970)	31
Operating expenses						
Reported	**(9,960)**	(9,907)	(1)	(9,907)	(9,722)	(2)
Currency translation adjustment[1]		95			208	
Acquisitions, disposals and dilutions	**54**	107		21	34	
Underlying	**(9,906)**	(9,705)	(2)	(9,886)	(9,480)	(4)
Underlying cost efficiency ratio	**52.9%**	54.5%		54.4%	57.3%	
Share of profit in associates and joint ventures						
Reported	**432**	824	(48)	824	698	18
Currency translation adjustment[1]		6			9	
Acquisitions, disposals and dilutions	**2**	(404)		(63)	(67)	
Underlying	**434**	426	2	761	640	19
Profit before tax						
Reported	**9,441**	8,520	11	8,520	7,049	21
Currency translation adjustment[1]		(147)			(200)	
Acquisitions, disposals and dilutions	**(404)**	(516)		(149)	(114)	
Underlying	**9,037**	7,857	15	8,371	6,735	24

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Balance sheet data significant to Global Banking and Markets

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
At 31 December 2013							
Trading assets[64]	**212,941**	**27,998**	**11,942**	**432**	**38,709**	**6,660**	**298,682**
Derivative assets[65]	**227,985**	**34,353**	**24,558**	**1,143**	**57,131**	**5,971**	**351,141**
Trading liabilities	**137,448**	**10,377**	**3,958**	**1,230**	**38,850**	**2,823**	**194,686**
Derivative liabilities[65]	**273,086**	**32,269**	**23,597**	**1,158**	**55,105**	**5,499**	**390,714**
At 31 December 2012							
Trading assets[64]	242,175	31,614	22,804	530	95,347	9,506	401,976
Derivative assets[65]	287,427	28,531	22,700	1,417	80,096	5,117	425,288
Trading liabilities	176,838	9,345	4,470	1,081	94,943	5,950	292,627
Derivative liabilities[65]	292,711	27,720	22,900	1,430	79,437	4,899	429,097
At 31 December 2011							
Trading assets[64]	180,790	38,637	19,167	938	69,568	14,370	323,470
Derivative assets[65]	272,756	25,203	23,056	1,275	86,619	4,825	413,734
Trading liabilities	157,934	8,282	3,781	757	70,288	5,014	246,056
Derivative liabilities[65]	274,803	25,186	23,877	1,245	86,697	4,469	416,277

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Global Private Banking

2013 compared with 2012

	2012 as reported US$m	Currency translation adjustment[1] US$m	2012 at 2013 exchange rates US$m	**2013 as reported US$m**	**Reported change[2] %**	**Constant currency change[2] %**
Net interest income	1,294	(6)	1,288	**1,146**	**(11)**	**(11)**
Net fee income	1,232	1	1,233	**1,150**	**(7)**	**(7)**
Net trading income	490	(1)	489	**394**	**(20)**	**(19)**
Net income from financial instruments designated at fair value				**4**		
Gains less losses from financial investments	(3)		(3)	**(3)**		
Net earned insurance premiums	42	2	44	**16**	**(62)**	**(64)**
Other operating income/(expense) (including dividend income)	157	(13)	144	**(231)**		
Total operating income	3,212	(17)	3,195	**2,476**	**(23)**	**(23)**
Net insurance claims incurred and movement in liabilities to policyholders	(40)	(2)	(42)	**(37)**	**8**	**12**
Net operating income[4]	3,172	(19)	3,153	**2,439**	**(23)**	**(23)**
LICs[42]	(27)	1	(26)	**(31)**	**(15)**	**(19)**
Net operating income	3,145	(18)	3,127	**2,408**	**(23)**	**(23)**
Operating expenses	(2,143)	2	(2,141)	**(2,229)**	**(4)**	**(4)**
Operating profit	1,002	(16)	986	**179**	**(82)**	**(82)**
Income from associates[43]	7		7	**14**	**100**	**100**
Profit before tax	1,009	(16)	993	**193**	**(81)**	**(81)**

For footnotes, see page 132.

2012 compared with 2011

	2011 as reported US$m	Currency translation adjustment[1]	2011 at 2012 exchange	2012 as reported US$m	Reported change[2] %	Constant currency change[2]

		US$m	rates US$m			%
Net interest income	1,439	(12)	1,427	1,294	(10)	(9)
Net fee income	1,382	(19)	1,363	1,232	(11)	(10)
Other income[7]	471	(4)	467	646	37	38
Net operating income[4]	3,292	(35)	3,257	3,172	(4)	(3)
LICs[42]	(86)	1	(85)	(27)	69	68
Net operating income	3,206	(34)	3,172	3,145	(2)	(1)
Operating expenses	(2,266)	26	(2,240)	(2,143)	5	4
Operating profit	940	(8)	932	1,002	7	8
Income from associates[43]	4		4	7	75	75
Profit before tax	944	(8)	936	1,009	7	8

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and underlying items

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Net interest income						
Reported	**1,146**	1,294	(11)	1,294	1,439	(10)
Currency translation adjustment[1]		(6)			(11)	
Acquisitions, disposals and dilutions	**(4)**	(13)		(7)	(14)	
Underlying	**1,142**	1,275	(10)	1,287	1,414	(9)
Other operating income						
Reported	**(239)**	151		151	30	403
Currency translation adjustment[1]		(13)			(1)	
Acquisitions, disposals and dilutions	**(1)**	(56)		(56)		
Underlying	**(240)**	82		95	29	228
Revenue[4]						
Reported	**2,439**	3,172	(23)	3,172	3,292	(4)
Currency translation adjustment[1]		(19)			(35)	
Acquisitions, disposals and dilutions	**(5)**	(72)		(65)	(28)	
Underlying	**2,434**	3,081	(21)	3,107	3,229	(4)
LICs[42]						
Reported	**(31)**	(27)	(15)	(27)	(86)	69
Currency translation adjustment[1]		1			1	
Acquisitions, disposals and dilutions						
Underlying	**(31)**	(26)	(19)	(27)	(85)	68
Operating expenses						
Reported	**(2,229)**	(2,143)	(4)	(2,143)	(2,266)	5
Currency translation adjustment[1]		2			26	
Acquisitions, disposals and dilutions	**4**	15		10	37	
Underlying	**(2,225)**	(2,126)	(5)	(2,133)	(2,203)	3
Underlying cost efficiency ratio	**91.4%**	69.0%		68.7%	68.2%	
Profit before tax						
Reported	**193**	1,009	(81)	1,009	944	7
Currency translation adjustment[1]		(16)			(8)	
Acquisitions, disposals and dilutions	**(1)**	(57)		(55)	9	
Underlying	**192**	936	(79)	954	945	1

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Other

2013 compared with 2012

	2012 as reported	Currency translation adjustment[1]	2012 at 2013 exchange rates	2013 as reported	Reported change[2]	Constant currency change[2]
	US$m	US$m	US$m	US$m	%	%
Net interest income	(730)	(4)	(734)	**(737)**	**(1)**	
Net fee income	194		194	**64**	**(67)**	**(67)**
Net trading income	(537)	(1)	(538)	**6**		
Own credit spread[3]	(5,215)	12	(5,203)	**(1,246)**	**76**	**76**
Other expense from financial instruments designated at fair value	(248)	7	(241)	**(558)**	**(125)**	**(132)**
Net expense from financial instruments designated at fair value	(5,463)	19	(5,444)	**(1,804)**	**67**	**67**
Gains on disposal of US branch network, US cards business and Ping An	3,012		3,012		**(100)**	**(100)**
Gains less losses from financial investments	344		344	**1,212**	**252**	**252**
Other operating income (including dividend income)	5,512	(210)	5,302	**6,910**	**25**	**30**
Total operating income	2,332	(196)	2,136	**5,651**	**142**	**165**
Net insurance claims incurred and movement in liabilities to policyholders						
Net operating income[4]	2,332	(196)	2,136	**5,651**	**142**	**165**
LICs[42]						
Net operating income	2,332	(196)	2,136	**5,651**	**142**	**165**
Operating expenses	(9,369)	81	(9,288)	**(7,796)**	**17**	**16**
Operating loss	(7,037)	(115)	(7,152)	**(2,145)**	**70**	**70**
Income from associates[43]	47		47	**(14)**		
Loss before tax	(6,990)	(115)	(7,105)	**(2,159)**	**69**	**70**

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2012 compared with 2011

2011 as	Currency	2011	2012 as	Reported	Constant

	reported US$m	translation adjustment[1] US$m	at 2012 exchange rates US$m	reported US$m	change[2] %	currency change[2] %
Net interest income	(911)	35	(876)	(730)	20	17
Net fee income	34	(6)	28	194	471	593
Own credit spread[3]	3,933	(35)	3,898	(5,215)		
Gains on disposal of Ping An				3,012		
Other income[7]	6,089	(119)	5,970	5,071	(17)	(15)
Net operating income[4]	9,145	(125)	9,020	2,332	(74)	(74)
LICs[42]						
Net operating income	9,145	(125)	9,020	2,332	(74)	(74)
Operating expenses	(7,492)	122	(7,370)	(9,369)	(25)	(27)
Operating profit/(loss)	1,653	(3)	1,650	(7,037)		
Income from associates[43]	9	(1)	8	47	422	488
Profit/(loss) before tax	1,662	(4)	1,658	(6,990)		

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and underlying items

	Year ended 31 December					
	2013 US$m	2012 US$m	Change[2] %	2012 US$m	2011 US$m	Change[2] %
Revenue[4]						
Reported	**5,651**	2,332	142	2,332	9,145	(74)
Currency translation adjustment[1]		(209)			(90)	
Own credit spread[3]	**1,246**	5,215		5,215	(3,933)	
Acquisitions, disposals and dilutions	**(1,044)**	(3,107)		(3,107)	(208)	
Underlying	**5,853**	4,231	38	4,440	4,914	(10)
Operating expenses						
Reported	**(7,796)**	(9,369)	17	(9,369)	(7,492)	(25)
Currency translation adjustment[1]		81			122	
Acquisitions, disposals and dilutions	**29**	1			4	
Underlying	**(7,767)**	(9,287)	16	(9,369)	(7,366)	(27)
Underlying cost efficiency ratio	**132.7%**	219.5%		211.0%	149.9%	
Profit/(loss) before tax						
Reported	**(2,159)**	(6,990)	69	(6,990)	1,662	
Currency translation adjustment[1]		(127)			31	
Own credit spread[3]	**1,246**	5,215		5,215	(3,933)	
Acquisitions, disposals and dilutions	**(1,015)**	(3,106)		(3,107)	(141)	
Underlying	**(1,928)**	(5,008)	62	(4,882)	(2,381)	(105)

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Analysis by global business

HSBC profit/(loss) before tax and balance sheet data

	2013						
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other[39]	Inter segment elimination[49]	Total
	US$m	US$m	US$m	US$m	US$m	US$m	US$m
Profit/(loss) before tax							
Net interest income/(expense)	18,339	10,200	6,766	1,146	(737)	(175)	35,539
Net fee income	7,021	4,717	3,482	1,150	64		16,434
Trading income/(expense) excluding net interest income	689	649	4,953	390	(38)		6,643
Net interest income/(expense) on trading activities	(3)		1,827	4	44	175	2,047
Net trading income[44]	686	649	6,780	394	6	175	8,690
Changes in fair value of long- term debt issued and related derivatives					(1,228)		(1,228)
Net income/(expense) from other financial instruments designated at fair value	1,638	332	599	4	(576)	(1)	1,996
Net income/(expense) from financial instruments designated at fair value	1,638	332	599	4	(1,804)	(1)	768
Gains less losses from financial investments	55	1	747	(3)	1,212		2,012
Dividend income	21	15	129	8	149		322
Net earned insurance premiums	10,543	1,375	6	16			11,940
Other operating income/ (expense)	544	621	670	(239)	6,761	(5,725)	2,632
Total operating income	38,847	17,910	19,179	2,476	5,651	(5,726)	78,337
Net insurance claims[50]	(12,107)	(1,545)	(3)	(37)			(13,692)
Net operating income[4]	26,740	16,365	19,176	2,439	5,651	(5,726)	64,645
Loan impairment charges and other credit risk provisions	(3,227)	(2,384)	(207)	(31)			(5,849)
Net operating income	23,513	13,981	18,969	2,408	5,651	(5,726)	58,796
Employee expenses[51]	(5,219)	(2,327)	(3,549)	(776)	(7,325)		(19,196)

Other operating expenses	**(12,029)**	**(4,722)**	**(6,411)**	**(1,453)**	**(471)**	**5,726**	**(19,360)**
Total operating expenses	**(17,248)**	**(7,049)**	**(9,960)**	**(2,229)**	**(7,796)**	**5,726**	**(38,556)**
Operating profit/(loss)	**6,265**	**6,932**	**9,009**	**179**	**(2,145)**		