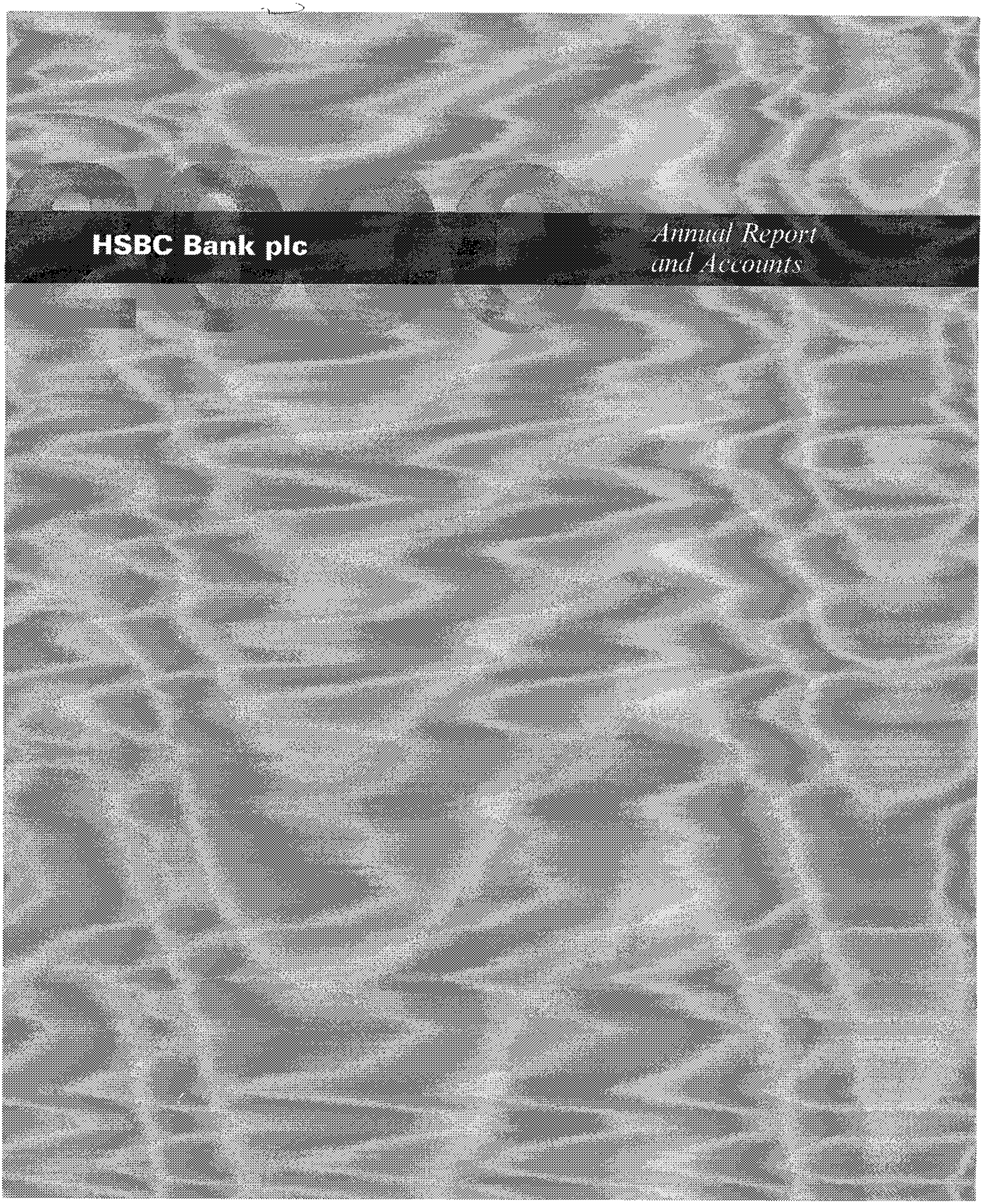
HSBC Bank plc

Report of the Directors and Financial Statements

31 December 2000

Registered No: 14259



HSBC Bank plc

Annual Report and Accounts

YOUR WORLD OF FINANCIAL SERVICES

HSBC

FORWARD-LOOKING STATEMENTS

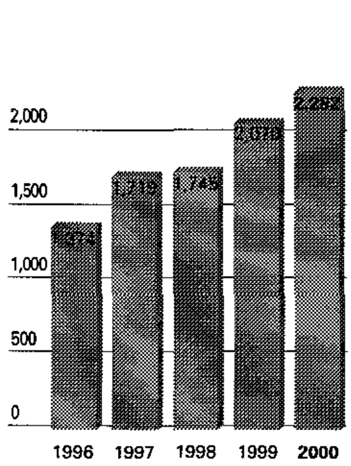
This document contains certain forward-looking statements with respect to the financial condition, results of operations and business of HSBC Bank plc (the 'bank') and its subsidiary undertakings, joint ventures and associates (together the 'group'). Among other sections, 'Business Description' and 'Financial Review' contain various forward-looking statements which represent the bank's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Certain statements, such as those that include the words 'potential', 'value at risk', 'estimation', 'hypothetical', and similar expressions or variations on such expressions may be considered 'forward-looking statements'. Other factors that could cause actual results, performance or events to differ materially from those expressed or implied in this document include, but are not limited to, general economic conditions, changes in competition, and fiscal and other government policies adopted in the UK and in other countries in which the group has significant business activity or investments.

Annual Report and Accounts 2000

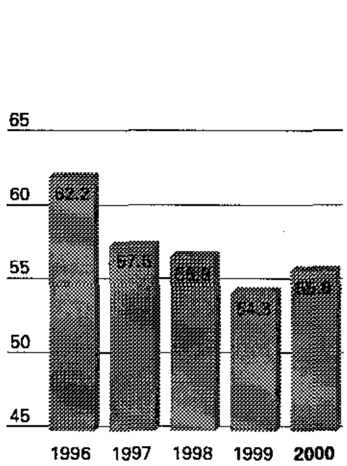
Financial Highlights

	2000	1999	1998	1997	1996
For the year (£m)					
Operating profit before provisions	**2,282**	2,070	1,745	1,719	1,374
Profit on ordinary activities before tax	**2,046**	1,724	1,522	1,625	1,272
Profit attributable	**1,345**	1,201	1,042	1,051	849
At year-end (£m)					
Shareholders' funds	**14,684**	4,868	4,780	4,435	3,960
Capital resources	**11,527**	8,121	7,918	7,600	7,332
Customer accounts and deposits by banks	**131,329**	77,874	72,181	70,169	66,318
Total assets	**185,203**	106,468	104,846	102,076	96,221
Ratios (%)					
Return on average shareholders' funds (equity)	**18.7**	25.9	23.4	26.0	24.5
Capital ratios					
— total capital	**10.7**	11.3	11.1	11.4	11.5
— tier 1 capital	**6.5**	6.8	6.8	6.7	6.7
Cost:income ratio (excluding the amortisation of goodwill)	**55.8**	54.3	56.8	57.5	62.2
Per ordinary share (pence)					
Earnings	**162.6**	144.8	125.3	126.3	101.9

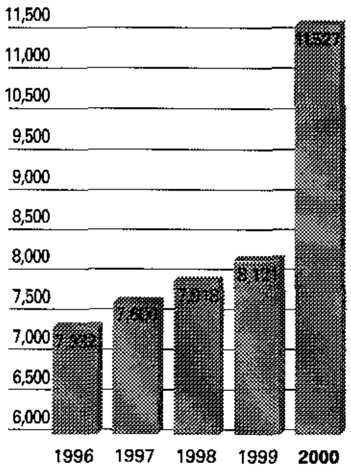
Operating profit before provisions (£m)



Cost:income ratio (%)



Capital resources (£m)



Contents

Presentation of Information

This document comprises the 2000 Annual Report and Accounts and the 2000 Annual Report on Form 20-F to the US Securities and Exchange Commission (the 'SEC') for HSBC Bank plc (the 'bank') and its subsidiary undertakings, joint ventures and associates (together the 'group'). It contains the Directors' Report and Accounts, together with the Auditors' Report thereon, as required by the UK Companies Act 1985.

The group's Accounts and Notes thereon, as set out on pages 74 to 144, are prepared in accordance with UK generally accepted accounting principles ('UK GAAP'), which differ in certain respects from US generally accepted accounting principles ('US GAAP') (see Note 44 of the Notes on the Accounts). UK GAAP, as applied to banks, include the Statements of Recommended Accounting Practice ('SORPs') issued by the British Bankers' Association and the Irish Bankers' Federation. In order to comply with US reporting requirements, three years' profit and loss information is presented.

Certain information relating to the group's activities is presented separately for domestic and international operations. For this purpose, domestic operations reflect the activities of UK Banking, excluding UK business with foreign correspondent banks, and the UK-based activities of Treasury and Capital Markets. International operations reflect the activities of International Banking, Crédit Commercial de France S.A. ('CCF'), HSBC Republic, Treasury and Capital Markets' overseas operations and UK business with foreign correspondent banks.

The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling respectively.

Exchange rates

In this *Annual Report and Accounts*, all amounts are expressed in pounds sterling unless otherwise specified. The following table sets forth, for the years and dates indicated, the US dollar exchange rate for pounds sterling based on the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the 'noon buying rate'). The average rate means the average of the exchange rates on the last business day of each month during the year.

US dollar:pound sterling noon buying rates	At year-end	Average	High	Low
2000	**1.494**	**1.516**	**1.652**	**1.400**
1999	1.612	1.618	1.676	1.553
1998	1.664	1.658	1.719	1.615
1997	1.643	1.640	1.711	1.578
1996	1.712	1.573	1.712	1.495

The noon buying rate on 7 March 2001 was US$1.461 = £1. No representation is made that pounds sterling amounts have been, could have been, or could be converted into US dollars at that rate.

The rate used in translating US dollar-denominated assets and liabilities at 31 December 2000 was US$1.492 = £1 (1999: US$1.616). The average rate used by the bank in translating US dollar-denominated results of overseas branches and subsidiary undertakings, joint ventures and associates for the year ended 31 December 2000 was US$1.515 = £1 (1999: US$1.618; 1998: US$1.657).

Business Description

Introduction

HSBC Bank plc and its subsidiaries form a UK-based financial services group providing a wide range of banking, treasury and financial services to personal, commercial and corporate customers in the United Kingdom and overseas, mainly in Europe.

HSBC Bank plc (formerly Midland Bank plc) was formed in England in 1836 and subsequently registered as a limited company in 1880. In 1923, the company adopted the name of Midland Bank Limited which it held up to 1982 when the name was changed to Midland Bank plc.

During the year ended 31 December 1992, Midland Bank plc became a wholly-owned subsidiary undertaking of HSBC Holdings plc ('HSBC Holdings'), which holds its principal executive office at 10 Lower Thames Street, London EC3R 6AE. HSBC Bank plc adopted its current name, changing from Midland Bank plc, in the year ending 31 December 1999.

HSBC Holdings, together with its subsidiary undertakings, joint ventures and associates is referred to as the 'HSBC Group'. The HSBC Group is one of the largest banking and financial services organisations in the world, with some 6,500 offices in 79 countries and territories. Its total assets at 31 December 2000 were £451 billion. The bank is the HSBC Group's principal operating subsidiary undertaking in Europe.

In 1999, the group adopted the HSBC Group's Managing for Value strategy, which focuses on the delivery of wealth management services to personal customers and growing the group's commercial business. In response to this, within the UK the bank created a unified personal banking operation and integrated the bank's commercial and corporate banking units.

As at 31 December 2000, the bank's principal subsidiary undertakings and their principal geographic areas of activity were:

Crédit Commercial de France S.A.	France
HSBC Asset Finance (UK) Limited	United Kingdom
HSBC Bank France S.A.	France
HSBC Bank International Limited	Jersey
HSBC Bank Malta p.l.c.	Malta
HSBC Invoice Finance (UK) Limited	United Kingdom
HSBC Life (UK) Limited	United Kingdom
HSBC Private Banking Holdings (Suisse) SA	Switzerland
HSBC Rail (UK) Limited	United Kingdom
HSBC Republic Bank (Guernsey) Limited	Guernsey
HSBC Republic Bank (Suisse) SA	Switzerland
HSBC Trust Company (UK) Limited	United Kingdom

Effective 1 January 2000, the group acquired 50.83 per cent of the issued share capital of HSBC Republic Holdings (Luxembourg) S.A. (formerly Safra Republic Holdings S.A.) from HSBC Holdings plc. As part of the HSBC Group's restructuring of its European private banking interests in December 2000, this interest was exchanged for a 97.45 per cent interest in HSBC Private Banking Holdings (Suisse) SA.

HSBC Private Banking Holdings (Suisse) SA, through its subsidiary undertakings, provides private banking and related services within Europe. These include deposit taking and funds transfer; asset and trust management; mutual funds; currency and securities transactions; lending, letters of credit, guarantees and other extensions of credits on a collateralised basis to existing depositors.

The group acquired 100 per cent of the issued share capital of Crédit Commercial de France S.A. (CCF) from HSBC Holdings on 31 October 2000. CCF provides personal, corporate, asset management and private banking services in Europe through a network of branches and nine regional banks.

The group divides its activities into the following business segments: UK Banking, International Banking, Treasury and Capital Markets, HSBC Republic and CCF.

UK Banking

The bank provides a wide range of banking and financial services to personal, commercial and corporate customers. The bank's strategy is to build long-term relationships and reward customers through value for money products and a high quality service. Customers benefit from multi-channel access to the bank through branches, the telephone, the internet, interactive TV, mobile phones and automated teller machines (ATMs).

HSBC Bank plc's personal banking services include personal current and savings accounts, loans and mortgages, wealth management services, card services and First Direct. Commercial banking includes current accounts, deposits, wealth management services, lending, invoice finance and leasing, trade services, equity finance, cross-border payments and cash management. Corporate and institutional clients are managed centrally through a number of specialist industry groups that work closely with other members of the HSBC Group to provide customers with comprehensive solutions tailored to their needs, including the treasury and investment banking services of other parts of the HSBC Group.

The bank remains committed to community banking and has a network of 1,663 branches, including 42 outlets in supermarkets. The bank has a policy of placing experienced managers in its local branches with sufficient authority to provide a quick, efficient and flexible service to both personal and business customers. Development of the branch network focuses on creating more time for branch staff to meet and serve customers by removing branch back office work to central processing sites. Telephone services, working in partnership with the branches, are increasingly popular with customers. The number of calls received in 2000 was 23 per cent up from 1999 and direct telephone sales continued to grow, with a 21 per cent increase year on year. The telephone service was further enhanced in 2000, including the benefit of an interactive voice messaging system.

The bank also provides an extensive network of cash, pay-in and statement machines. Customers have access to over 3,000 HSBC Bank plc UK ATM machines, 616 of which are at non-branch sites, over 30,000 cash machines through the UK LINK network and over 400,000 ATM machines worldwide, allowing customers convenient access to their cash when and where they need it. The bank's development of overall service levels encompasses aiming to increase the availability of cash machines and developing multi-media terminals.

Personal banking

The personal banking market has seen growth in the number of 'direct' (particularly internet) providers and aggressive pricing competition. The bank ensures it maintains its competitive position by continually improving customer service and re-pricing its products, thereby investing in long-term relationships and rewarding new and existing customers. During 2000, the bank re-priced a number of its products in support of the UK Government's CAT (Charges, Access, Terms) standard initiative, which sets out benchmarks for fair charges and practices.

Internet banking (www.hsbc.co.uk), which was successfully launched in August 2000, now has 340,000 HSBC Bank customers. The service allows customers to pay bills, make payments, transfer money, and view direct debits and standing orders. A number of innovative developments are planned for the future. The bank is also working across the HSBC Group to provide a seamless internet service for its customers wherever they are in the world. In partnership with BT Cellnet, the bank offers personal customers a mobile phone with a dedicated menu connected to the bank's telephone services. Further mobile phone services are currently being developed. In 1999, HSBC Bank plc launched the UK's first nationally available TV banking service via Sky Digital Satellite. By the end of 2000, over 126,000 customers had registered and were regularly using the TV Banking service for their banking needs.

Current accounts — the key element in the customer relationship remains the provision of current accounts. As at 31 December 2000, the bank had over six million personal current accounts, with a growth in current account balances of 8 per cent year on year. The bank is committed to making banking facilities as widely available as possible. In support of this, a new Basic Bank Account was launched in October 2000. It is available to customers who require straightforward banking, providing a self-service card, standing orders, bill payments and access to telephone, internet and TV banking.

Savings accounts — the bank offers an extensive range of term and call savings products. The bank's tax-free Individual Savings Account ('ISA') products are CAT standard, and TESSA and cash ISA customers receive the same terms. Savings balances overall grew by 20 per cent. In addition, the bank now has £3.2 billion equity-based ISA/PEP funds under management.

Loans and mortgages — the bank provides a wide range of loan products for its personal customers. In 2000, the bank took the initiative and radically changed its mortgage pricing. In July, the bank launched a CAT standard mortgage, guaranteeing that, in future, the HSBC Bank variable mortgage rate will be no more than 1 per cent over the Bank of England base rate. All

Business Description (continued)

existing customers have been transferred automatically from the bank's standard variable rate product to the new CAT standard mortgage. Also in July, the bank ceased charging up-front fees for loans in excess of 90 per cent of the market value of the property. The bank continues to charge interest daily and requires no extended tie-ins or compulsory purchase of its own insurance. This strategy has already resulted in increased sales and retention, with market share of net new mortgage business increasing from 2.1 per cent in the first half of 2000 to 4.3 per cent in the second half, and net balance growth being 50 per cent above that achieved in 1999. In 2000, a number of Best Value National Bank awards were again received from *What Mortgage* magazine. These prestigious awards are given to the lender providing best value for money to borrowers, while offering a national presence in the market place.

Wealth management — this includes life, pensions, investments, insurance, private client services and stockbroking. In recent years, the bank has significantly increased its focus on providing financial planning services and continues to develop its products for customers. In 2000, the bank's range of unit trusts was successfully converted to Open Ended Investment Companies (OEICs), a more flexible collective investment scheme providing greater choice for customers and 24 of its funds are now available for sale from third parties. The bank's private client services provide a tailored asset management and financial planning service to the bank's high net worth customers. To complement this, the bank launched HSBC *Premier* in 2000, its international premium banking service for personal customers and introduced a Portfolio Management Service allowing customers to invest in a range of independently sourced unit trusts and OEICs. Customers invested £80 million funds in this new service in the first six months, contributing to private clients' income growth of 18 per cent. From 1 July, the HSBC pension range has incorporated a stakeholder charging structure. HSBC Bank is the first high street bank to offer this type of pension and to commit to re-pricing pensions for existing customers to the new terms. The bank was one of the leading writers of income protection in the UK in 2000, with an 87 per cent increase in annualised premiums over 1999, and continued its success with term assurance and critical illness policies, with annualised premiums up 31 per cent on 1999. General insurance business also grew, with household insurance volumes increasing by over 60 per cent. Funds under management increased to £15.6 billion, including £2.5 billion of new funds. The bank's stockbroking services provide an execution-only share dealing service to personal customers through the branch network, directly by telephone and on-line. It also supports the share dealing requirements of external intermediaries.

Cards — the bank issues a comprehensive range of credit cards. It focuses on retaining, broadening and deepening high value customer relationships by providing more tailored, personal credit card solutions to customers, complementing the bank's wealth management strategy. Annual fee charging on the bank's credit card and gold Visa credit card was removed in 2000, benefiting 2.2 million customers. In addition, since 1 January 2001, the bank no longer charges its customers for withdrawing cash by debit cards from any UK ATM machine within the LINK network, nor are other banks' customers charged for using HSBC machines.

First Direct — the bank provides a full 24-hour banking service, 365 days a year through First Direct. First Direct continued to grow in the year in an increasingly competitive market, and won the *Your Money* award for 'Best Direct Bank'. Sales volumes were significantly ahead of 1999, especially in wealth management where life, pension and investment sales enjoyed substantial increases, as did those of home insurance. The year saw the launch of firstdirect.com, which offers customers a new internet banking service, and a range of internet products. 2000 also saw the continued development of First Direct's mobile phone banking service, which delivers account information to customers' mobile phones via a short messaging service. With 1,000 customers per week signing up to this service and with 270,000 customers using on-line services, more than one in three contacts with First Direct is now made electronically. By providing customers with the choice of how they access their bank, First Direct's multi-channel proposition has proved innovative and encouraged a shift away from internet-only access in the direct banking market. A further development in 2000 was the transformation of First Direct from 'tied agent' to 'independent financial adviser' (IFA) status. The move allowed First Direct to launch an integrated wealth management service to its customers in January 2001. Under the marketing umbrella 'capital', the service offers on-line and telephone access to investment and protection products selected using strict criteria including performance, financial strength and customer service. In addition, the service provides a telephone-based full IFA service offering customers the choice of the whole market and simply presented advice.

Commercial banking

The bank's commercial operation focuses on provision of a full range of banking products and services to many types of commercial organisations. With new entrants emerging all the time, the ability to be able to provide competitive pricing and a high standard of service is critical.

During 2000, the bank has made significant progress in bringing together its various product specialists serving the commercial market in order to improve the service available to customers. Asset finance activities have been more closely aligned with the network, the cards processing and Hexagon/BACS sales forces have been merged and business financial planning managers and relationship managers are working more closely in developing customer solutions. This process will continue during 2001 leading to the creation of a customer driven multi-disciplined sales team supporting the bank's aim to broaden and deepen customer relationships. The Forum of Private Business survey for 2000 reported the bank as again recording the highest satisfaction rating and in July *Datamonitor* ranked the bank as the best overall provider of current accounts to the small and medium-sized enterprise (SME) market.

To complement the emphasis on community banking, other delivery channels are also being opened up to provide commercial customers with greater flexibility in their bank dealings, while maintaining a consistent service level. Internet banking to business customers is currently being developed and will be launched later in 2001.

Business current and deposit accounts — the bank offers a full range of business current and deposit accounts with features and services, appropriate to all customers. Customers range from start-up businesses, for which the bank offers up to two years' free banking, to large multinationals with complex global requirements.

Lending — the bank offers a wide range of flexible loans and overdraft facilities reflecting features and services appropriate to all commercial customers. In 2000, a range of new and improved products and services has been offered in response to the needs of customers. These include invoice finance for smaller businesses and instalment finance for business equipment purchases, which are both available through the local branch network. The bank offers asset finance and related services to meet the needs of commercial customers through divisions specialising in equipment, invoice and vehicle finance. The bank has introduced a simple fixed-rate hire purchase product and internet Ledgerline, which provides enhanced functionality and speed of access to information, together with the full range of credit management, credit protection and sales-linked finance services for invoice finance customers. The readers of *Trade Finance* magazine voted the bank 'Best Factor' in their 2000 awards. Despite a difficult year in the motor market place, with no growth in new business registrations, vehicle finance was able to grow its sales by 3.5 per cent through provision of finance and value-added services.

Cards — the bank provides business, corporate and purchasing cards and is a leading processor in the UK for Switch, MasterCard and Visa transactions. Focusing on the recruitment and retention of quality business, it provides a card processing service that dovetails with cash and cheque processing to provide a seamless, integrated business banking service. The bank's customer service centre in Leicester has held the ISO9001 standard of excellence since 1994.

Trade services — the bank provides trade and international banking services, structuring trade finance and technology-based solutions to meet customer needs. The HSBC Group's international strength in trade services differentiates the bank from its competitors. The bank has been increasing its profile in the UK exporting community through the sponsorship of the Government backed export award for smaller businesses. Product enhancements include eForms, a PC-based programme for completion of the bank's trade documentation and Easy DC, a tailored documentary credit service for smaller and new importers. The bank now handles over 30 per cent of import documentary credits opened in the UK. Risk mitigation is particularly important for manufacturers and further support has been offered through the launch of pre-confirmed documentary credits, providing assurance of payment on shipment, and through the provision of marine insurance.

Business Description (continued)

Business wealth management — the bank offers a wide range of expertise to help business owners and directors manage their business and personal wealth efficiently through to retirement. Private client, actuarial and employee benefits services are also offered. The bank has been helping small businesses to meet new stakeholder pension requirements and an internet-based work site marketing proposition will be introduced in April 2001. Sales of pensions to small and medium-sized companies increased by 156 per cent in 2000.

Equity finance — through HSBC UK Enterprise Funds, the bank works closely with small businesses, offering advice and support, and providing equity finance in addition to its lending services. To date, funds have been invested in over 200 businesses. Together with the European Investment Bank, the bank has established the QTP fund for technology-based small firms. Investments have progressed well to date and the funds are expected to become fully invested in 2001. Equity funding for larger growth companies is available from HSBC Ventures (UK) Limited.

The markets for the provision of banking services to SMEs in the UK are currently being considered by the Competition Commission, whose final report is due to be presented to the Secretary of State for Trade and Industry in June 2001.

Corporate banking

Corporate and institutional clients are managed centrally through a number of specialist industry groups which work with all areas of the HSBC Group to provide a full range of banking products and services. Significant progress was made during the year to align further corporate and institutional banking with investment banking.

The HSBC Group's international reach offers a competitive advantage within the corporate and institutional market place. This extensive geographic coverage has enabled the bank to gain important cross-border business in support of the international operations of UK-based entities. The HSBC Group's expertise in Asia has led to it being seen as Asian bank of choice for many large corporates. Promotion of the HSBC brand, investment in European infrastructure and the acquisitions of CCF and HSBC Republic have opened new possibilities to supply core banking business, private banking and wealth management services. The HSBC Group in Europe won *The Banker* award for 'Best Bank in Western Europe' following the acquisition of CCF. The bank was ranked number two in the London loan syndication market in 2000.

The bank continues to direct its activity in this market towards fee-generating business to ensure balance sheet growth produces acceptable returns and has consciously reduced some credit exposures. The bank has increased its resources and focus upon the provision of risk mitigation systems for its key clients.

The rail and specialised asset finance divisions have been integrated within corporate banking during the year. A number of large value leasing transactions have been undertaken by each of these divisions.

Internet/e-commerce based products are being developed to enhance the service the bank offers. A new product, On-line Account Manager, was launched in 2000, providing market leading real-time internet reporting of balance and transaction information to financial institutions and major corporate clients. More new products and internet-based offerings are being developed to enhance the bank's service to customers. In 2001, a new service will be launched which reduces the inter-bank settlement risk associated with foreign exchange business. Operational process improvements are continually sought. A European service centre has been opened to provide centralised multi-lingual support and standard account opening documentation across Europe.

Payments and cash management — the HSBC Group is a world leader in providing payments, cash management and money transmission services. It provides domestic and international payments solutions throughout the world by offering a comprehensive range of traditional account and transaction services. These services are quickly and simply delivered via the HSBC Group's electronic banking service, Hexagon. During the second half of the year, HSBC launched Hexagon ABC, enhancing the transmission of bulk payment instructions and related information. The bank continues to be a leader in the provision of institutional banking services in London and approximately 50 per cent of the banks participating in the Clearing House Automated Payments System have registered the bank as their clearing bank. The bank also provides full payment and cash management facilities for corporate clients across Western Europe, which have been enhanced by the acquisition of CCF.

Global custody — Global Investor Services offers a worldwide, regional and UK sub-custodian service in over 60 markets worldwide. The bank remains the number one UK-based provider of custody services. It also acts as trustee to unit trusts and engages in agency stocklending of both fixed income and equity instruments. The business continues to grow strongly and, as the leading UK custodian, benefits from the strong growth in fixed income and equity investments. Assets under custody have grown by 12 per cent to £771 billion at 31 December 2000, notwithstanding the decline in the FTSE and other indices. Global Investor Services also plays a key role in the HSBC Group's wealth management strategy as custodian to both HSBC Asset Management and to the bank's private client business. Global Fund Services, which was introduced in 1999 offering investment administration and performance consultancy services, has continued to enhance the bank's services offering to institutional investors.

■ International Banking

International Banking provides a wide range of financial services, mainly across Europe, including wealth management services (personal and private banking, retail stockbroking and funds management), corporate and commercial banking services, trade finance, payments and cash management services, and treasury and capital markets activities.

At 31 December 2000, International Banking had offices based in 28 countries and territories, principally in Europe and Latin America, as listed below.

The bank had branches in Australia, Belgium, the Czech Republic, France, Greece, Guernsey, Ireland, the Isle of Man, Italy, Jersey, the Netherlands, Panama, Spain and Sweden.

International Banking had representative offices in Argentina, Brazil, Chile, Dubai, the Hong Kong Special Administrative Region, Mexico, Singapore, Taiwan, Venezuela and South Africa.

International Banking also operated through the following overseas subsidiary undertakings: in Armenia, HSBC Bank Armenia cjsc; in the Cayman Islands, HSBC Financial Services (Cayman) Limited; in Greece, HSBC Pantelakis Securities S.A. and HSBC (Hellas) AEDAK; in Jersey, Guernsey and the Isle of Man, HSBC Bank International Limited; in Ireland, HSBC Fund Administration (Ireland) Limited; in Malta, HSBC Bank Malta p.l.c.; and in Turkey, HSBC Bank A.S.

International Banking's wealth management team recently relocated to the Channel Islands to provide additional management resource and focus to support the planned growth in its core franchises in the bank's Offshore business, Greece and Turkey. Internet broking was introduced in Greece (www.investdirect.hsbc.gr) and is currently under development in Turkey.

HSBC Bank International Limited, based in the Channel Islands, is the HSBC Group's specialist provider worldwide of offshore financial services to international personal customers. It received 'Best Bank' awards in 2000 from *International Money Marketing* and from *International Wealth Management* for its offshore services. In particular, it broadened its distribution channels with the launch of an internet banking service (www.offshore.hsbc.com) and enhanced voice recognition technology in its 24-hour global call centre.

International Banking also manages the bank's residual long-term less developed country debt exposure and equity markets. Long-term debt exposures and debt:equity investments in Latin America continue to be reduced on a profitable basis, including the sale of Brady debt during 2000.

■ Treasury and Capital Markets

The European treasury and capital markets business serves the requirements of international corporations, institutional investors, private investors and central banks. These integrated dealing activities use the balance sheet strength of the bank to provide a high quality, tailored service in foreign exchange, fixed income trading, money markets, exchange-traded futures and options, precious metals and bank notes.

Foreign exchange — the HSBC Group is consistently ranked in international polls as a leading global foreign exchange market

Business Description (continued)

participant. Sophisticated 24-hour trading in the major currencies, combined with detailed knowledge and support of less liquid emerging market currencies, meets the execution and hedging needs of customers. The HSBC Group is a founder member of FXALL, a consortium of leading banks created to offer an electronic foreign exchange dealing platform.

Fixed income — the HSBC Group is a long established market maker and underwriter in the international bond markets. It underwrites and trades sovereign, supranational, agency, financial institution and corporate fixed and floating rate bonds, with particular strengths in sterling, the Hong Kong dollar, US dollar and euro. The HSBC Group also offers structured debt capital market finance for project and asset-based financing, and provides advisory services in the area of risk management to assist clients in protecting against interest rate and currency fluctuation through the use of derivative products.

The global money market business is a conduit for personal and corporate deposits in all major currencies. The bank participates in the professional money markets, taking institutional deposits and managing the HSBC Group's retail bank clearing operations.

Exchange-traded futures and options — Treasury and Capital Markets offers a global execution, research and clearing service for key currency, interest rate, and bond and equity futures and options markets with innovative and flexible account structures and a sophisticated on-line interface.

■ HSBC Republic

Effective 1 January 2000, a subsidiary of HSBC Bank plc acquired a 50.83 per cent interest in HSBC Republic Holdings (Luxembourg) S.A., the holding company of private banks in Switzerland, France, Luxembourg, Guernsey and Monaco. In December 2000, as part of the strategic restructuring of the HSBC Group's private banking operations, a new holding company, HSBC Private Banking Holdings (Suisse) SA, was formed in Switzerland and HSBC Bank plc's indirect ownership in this holding company was increased to 97.45 per cent. Also in December 2000, HSBC Republic Bank (France) S.A. was merged with HSBC Bank France S.A.

The Swiss holding company's subsidiary banks are located in Switzerland, Monaco, Guernsey and Luxembourg and together represent some 50 per cent of the global HSBC Republic business. HSBC Republic is the international private banking division of the HSBC Group, with operations in 33 locations in the Americas, Asia, Europe and the Middle East and client assets under management exceeding US$135 billion at 31 December 2000.

Client services include deposits and funds transfer; asset and trust management; mutual funds; currency and securities transactions; lending; letters of credit; guarantees and other extensions of credit on a collateralised basis to existing depositors.

The creation of HSBC Republic to bring together the former Safra Republic Holdings businesses and the HSBC Group's existing international private banking operations was a principal focus of activity during 2000. The integration proceeded successfully without loss of clients, assets or personnel in the face of intense market competition for both clients and employees.

As the business integration came to a natural close towards the end of 2000, HSBC Republic instituted a global strategy with strategic imperatives closely echoing the HSBC Group's client-focused approach. HSBC Republic's client base requires a highly differentiated service, provided through a combination of geographical support and specialised bankers, with expertise in areas such as sports and the media, diamonds and jewellery, technology and entrepreneurial activity. In support of front line private bankers, substantial investment is being made in the development of a global investment advisory capability, benefiting from the recognised product development expertise available within the HSBC Group. HSBC Republic's investment in IT infrastructure, which began in the second half of 2000, will end with the worldwide roll-out of an enhanced private banking system, supported from a global data centre located in Geneva.

■ Crédit Commercial de France

CCF, the seventh largest bank in France, is the HSBC Group's main flagship in continental Europe, with businesses in personal, corporate and investment banking, asset management and private banking. Headquartered in Paris, CCF serves over one million individual customers and important corporate and institutional business clients, and has a significant presence in other European markets. CCF has a network of 682 branches in France, 32 higher than in 1999. At 31 December 2000, CCF's total assets were £45.0 billion, total customer deposits were £15.6 billion and total net customer loans were £17.6 billion under French GAAP.

CCF's strategy is to focus on the most dynamic and profitable market segments. CCF is a leading bank in 'mass affluent' personal retail banking in France, with more than 80 per cent of CCF's clients concentrated in middle and upper income brackets and 90 per cent of its branches in France concentrated in the four regions with the highest growth potential for banking activity: Paris, Rhône-Alpes, Provence-Alpes-Côte d'Azur and Languedoc Roussillon. In corporate banking, CCF concentrates in the most profitable high added-value segments of the market. In asset management and private banking, CCF has specific subsidiaries dedicated to serving the most profitable client categories in the highest added-value sectors.

CCF's retail and commercial banking operations comprise the parent company CCF, with 208 branches, and a network of nine regional banks, with a total of 476 branches. Each regional bank operates in a specific geographic area, under its own brand name, with very strong local positions.

CCF offers the full range of retail products and services through a number of complementary distribution channels, including on-line, telephone and mobile phone banking. CCF's on-line brokerage service was launched in 1999, providing CCF customers and non-customers alike with trading opportunities on the Paris Bourse and financial information including stock quotes, French and international newswires and research. CCF's on-line credit company, Netvalor, offers credit for large household purchases directly to consumers through its dedicated consumer credit site, 123credit.com. CCF's WAP access joint venture with France Telecom began operating in 2000.

CCF networks also offer a full range of high quality products and services to medium-sized French corporates and, in the regional subsidiaries, to entrepreneurs. CCF offers its customers a number of innovative on-line account management products and services, including trade account management, business intelligence, centralised corporate treasury management, electronic payments systems and the judicial recovery of unpaid receivables, all branded under its 'Elys' product line. In addition, CCF provides secure payment facilities that permit merchants to manage order and inventory functions and conduct bank transactions simultaneously.

CCF provides equipment and finance leasing through Loxxia, which was merged with Slibail, the specialised subsidiary of Crédit Lyonnais, which has approximately 10 per cent of the French leasing market.

Through its Corporate Banking division, CCF offers account management, credit, cash management and stock custody services to the 50 largest French institutional and corporate groups and to international clients. The Corporate Banking Branch is very active in providing trade financing, export credit facilities and financing backed by public and private sector credit support.

CCF provides equity and corporate finance services, previously through two national bases, one in Paris and one in London. CCF advises on transactions involving French, British and international clients across a wide range of industries including retailing, chemicals, pharmaceuticals, utilities, steel, aerospace, automobiles, banking, finance and insurance, electronics and entertainment. CCF is one of the most active French banks advising on privatisations in France and in emerging markets in Africa and Eastern Europe, where it has built a strong reputation. CCF is actively involved in significant debt and equity offerings, including initial public offerings on the Paris Bourse. CCF also actively provides asset financing, particularly in the marine and aviation sectors, as well as structured financing for well-known corporates. Through a specialised subsidiary, CCF provides investment advice and third-party fund management in connection with commercial and residential real estate investment. This subsidiary is involved in the UK Government's public private partnership programme, with specific mandates ranging from hospital to communications services.

CCF provides asset management services primarily through four full-service fund management firms which serve institutional

Business Description (continued)

clients, as well as retail networks, with proprietary or non-proprietary products. CCF is particularly strong in providing equity and diversified products and in corporate savings plans (ranking third on the French market). CCF formed CCF SEI, a joint venture with the US fund manager SEI, in 2000 to develop a 'manager of fund managers' approach. Another project, Be.Partner, will provide customers with a central purchasing co-operative offering an array of integrated services for in-house and third-party distribution channels.

CCF offers a wide range of insurance products, including comprehensive health insurance, personal property casualty insurance and, through Erisa, its partnership with Swiss Life, homeowners' insurance.

CCF has grown its private banking business both organically and through the selective acquisition of a number of specialist institutions, including Banque du Louvre and Banque Eurofin in Paris and Banque Dewaay in Brussels.

At the end of 2000, CCF's funds under management were £52 billion, and were greater than its total assets of £45 billion.

On 22 February 2001, the French Finance Ministry announced the sale of Banque Hervet to CCF for a consideration of FRF3,471 million.

Competition

United Kingdom

The effects of mergers and acquisitions among the established industry players, particularly in the retail sector and the de-mutualisation of life insurers and building societies, are resulting in more aggressive competition and cost economies. Bank and building society networks have reduced significantly over the last decade, with some large banks continuing to reduce their network size.

As telecommunications and internet capabilities advance, it becomes easier to gain access to large numbers of customers without incurring the costs of a physical distribution infrastructure. This has assisted a number of new entrants in establishing UK financial services businesses, in competition with the bank. Several established UK banks have also launched separately branded internet banks in addition to their existing services.

Nevertheless, HSBC Bank is well placed to take advantage of the changes which are taking place. It has a relatively stable branch network with managers at local level with authority to take decisions and provide a quick and efficient service. This is supplemented by a range of TV, internet and telephone banking services.

Competition is also intense in the wholesale markets, where the group is competing with the largest international banking groups and investment houses. However, the HSBC Group provides considerable strengths, with access to research and advice, and treasury and capital markets capabilities worldwide.

France

Favourable economic conditions in France and CCF's competitive position allowed it to increase transaction volumes without modifying its selective risk criteria. The lending market remains highly competitive and margins continue to be squeezed although there are signs that the market is stabilising.

European Economic and Monetary Union

The conversion work required as a result of adoption of the euro by Greece on 1 January 2001 was completed successfully. Costs incurred on the conversion were not significant. Detailed plans have been drawn up for the demise of the 12 legacy currencies at the end of 2001.

Planning work continues for possible UK entry to EMU. During 2000, the group worked with the Bank of England on the way in which the different wholesale sterling financial markets might change over if the UK joins EMU. The group participates in further discussions, led by HM Treasury, on the likely possible demand for euro services through a transition period. In addition, work is being undertaken to identify the interdependencies between wholesale and retail financial services in preparing for possible UK entry.

Financial Review

Summary of Financial Performance

	2000 group excluding acquisitions £m	2000 acquisitions £m	2000 group £m	1999 group £m	1998 group £m
Net interest income	2,488	228	2,716	2,391	2,237
Other operating income	2,404	301	2,705	2,146	1,805
Operating income	4,892	529	5,421	4,537	4,042
Depreciation	(339)	(25)	(364)	(313)	(291)
Amortisation of goodwill	(5)	(111)	(116)	(3)	—
Administrative expenses	(2,332)	(327)	(2,659)	(2,151)	(2,006)
Operating profit before provisions	2,216	66	2,282	2,070	1,745
Provisions					
— provisions for bad and doubtful debts	(252)	8	(244)	(281)	(196)
— provisions for contingent liabilities and commitments	(20)	—	(20)	(50)	(59)
Amounts written off fixed asset investments	—	(2)	(2)	(3)	(1)
Operating profit	1,944	72	2,016	1,736	1,489
Share of operating loss in joint ventures and associates			(47)	(34)	(1)
Gains on disposal of					
— investments			75	21	28
— tangible fixed assets			2	1	6
Profit on ordinary activities before tax			2,046	1,724	1,522
Tax on profit on ordinary activities			(603)	(518)	(479)
Profit on ordinary activities after tax			1,443	1,206	1,043
Minority interests					
— equity			(83)	(5)	(1)
— non-equity			(15)	—	—
Profit attributable to shareholders			1,345	1,201	1,042

In 2000, operating profit before provisions was £2,282 million, an increase of 10 per cent over 1999. Excluding the results of HSBC Republic and Crédit Commercial de France, this represented an increase of 7 per cent over 1999. Net interest income increased by £325 million to £2,716 million, or by £97 million if the results of the acquired businesses are excluded, principally as a result of growth in personal and commercial current accounts, personal savings and personal and commercial lending in UK Banking.

Other operating income increased by £559 million to £2,705 million, or by £258 million, or 12 per cent, excluding the acquired businesses. This reflected growth in wealth management income, strong growth in global safe custody fees, higher current account and overdraft fees and increased corporate banking fees. Dealing profits benefited from strong growth in foreign exchange income reflecting higher volumes, particularly in respect of customer activities.

Operating expenses increased by £672 million to £3,139 million, including an increase in the amortisation of goodwill of £113 million. Excluding the results of the acquired businesses, operating expenses increased by £209 million, or 8 per cent. The increase was mainly in staff costs, resulting from an increase in headcount to support business development and growth in business volumes, in addition to the effect of annual pay increases and incentive costs. The cost:income ratio (excluding the amortisation of goodwill) was 55.8 per cent, slightly up from 54.3 per cent in 1999.

The charge for bad and doubtful debts was £37 million lower than in 1999, or £29 million lower excluding the results of acquired businesses, due to £91 million lower specific provisions, partially offset by a reduction of £34 million in releases and recoveries and an increase of £20 million in general provisions.

Financial Review (continued)

Provisions for contingent liabilities and commitments were £30 million lower than 1999, mainly due to a lower charge made for the amount of redress potentially payable to customers who may have been disadvantaged when transferring from, or opting out of, occupational pension schemes.

The increased share of operating loss in associates and joint ventures reflects a lower contribution following the sale of British Arab Commercial Bank to another HSBC Group company, which generated a gain on disposal of investments of £24 million. There was also a larger loss from the bank's 20 per cent shareholding in British Interactive Broadcasting ('BiB') and the associated investment in building its interactive television services, Open.... . In July, the bank agreed to sell its investment in BiB to BSkyB, subject to regulatory approval from the Office of Fair Trading, which is under review currently.

Acquisitions incorporate the full-year results of HSBC Republic, which was acquired with effect from 1 January 2000, and the results of CCF for the two months since its acquisition on 31 October 2000.

In 1999, operating profit before provisions was £2,070 million, an increase of 19 per cent over 1998. Net interest income was £154 million, or 7 per cent higher than in 1998, principally as a result of growth in personal and business current accounts and savings balances and increased lending to customers in UK Banking.

Other operating income increased by £341 million, or 19 per cent, in 1999 compared with 1998. Strong income growth from wealth management products contributed significantly to this increase. Higher fee and other operating income was generated from cards, overdrafts, operating leases and private clients and by First Direct and Global Investor Services. Dealing profits benefited from improved interest rate derivative and bond trading income following difficult trading conditions in 1998.

Improvements in the cost:income ratio (excluding the amortisation of goodwill) continued to be achieved with a reduction from 56.8 per cent in 1998 to 54.3 per cent in 1999, although operating expenses were £170 million or 7 per cent higher in 1999 than 1998. Staff costs increased by £100 million and other costs increased by £45 million.

The charge for bad and doubtful debts was £85 million higher in 1999 compared with 1998. The specific provisions charge increased by £99 million while the general provision was £14 million lower than 1998. Significant growth in personal lending contributed to increased new provisions and there were higher provisions against corporate lending.

Provisions for contingent liabilities and commitments were £9 million lower in 1999 compared with 1998. Further charges of £45 million, compared with £60 million in 1998, were made for the amount of redress potentially payable to customers transferring from, or opting out of, occupational pensions schemes, as a result of changes to the Financial Services Authority's ('FSA') guidance.

In 1999, the increased share of operating loss in associates and joint ventures reflected the bank's 20 per cent shareholding in British Interactive Broadcasting ('BiB') and the costs of promoting the new digital interactive television service and connecting subscribers.

The group's financial performance is analysed in accordance with UK GAAP. A reconciliation between attributable profit and shareholders' funds under UK GAAP and net income and shareholders' equity under US GAAP is disclosed in Note 44 'Differences between UK and US GAAP'.

Net interest income

In 2000, net interest income increased by £325 million to £2,716 million, HSBC Republic and Crédit Commercial de France contributed £228 million of the increase. Excluding the results of HSBC Republic and CCF, net interest income increased by £97 million. Average interest-earning assets increased by £24.4 billion, or by £4.4 billion excluding those related to the acquired businesses, reflecting growth in customer lending.

	2000 group excluding acquisitions £m	2000 acquisitions £m	2000 group £m	1999 group £m	1998 group £m
Net interest income	**2,488**	**228**	**2,716**	2,391	2,237
Average interest-earning assets	**92,355**	**19,991**	**112,346**	87,912	88,434

The increase in net interest income primarily reflected income growth in UK Banking, generated by balance growth in personal and commercial current accounts, personal savings and personal and commercial lending. The bank's reduction in its variable mortgage rate contributed to growth in mortgage balances.

There was a reduction in interest spread of 30 basis points to 1.9 per cent, mainly reflecting the lower spread in the acquired businesses. In addition, there was a reduction in earnings in Treasury, mainly due to a reduction in earnings on money market business caused by a flattening of the yield curve and higher costs of short-term funding, together with the maturity of high yielding assets. The bank's repricing of variable rate mortgages contributed to mortgage growth of £1.1 billion, with a decline in mortgage spread. Spread was also reduced on savings products reflecting competitive pricing. Excluding the effect of acquisitions, interest margin was stable, at 2.7 per cent, with lower interest spreads being compensated by an increase in the value of free funds.

In 1999, net interest income increased by £154 million, to £2,391 million, while average interest-earning assets decreased by £0.5 billion. The increase in net interest income reflected continued growth in personal and business current account and savings balances in UK Banking, where the competitiveness of the bank's product range and pricing was a contributory factor. This provided additional retail funding and reduced dependence on wholesale funding. The change in funding combined with growth in customer lending, offset by reductions in lower yielding treasury assets, contributed to higher spreads. Higher income was also earned from strong performance in Turkey and the acquisition of HSBC Bank Malta.

Prevailing average interest rates, interest yields, interest spreads and interest margins

	2000 %	1999 %	1998 %
HSBC Bank plc UK base lending rate	**6.0**	5.3	7.2
London interbank offered rate ('LIBOR')			
Three months pounds sterling	**6.2**	5.5	7.3
Six months eurodollar	**6.2**	5.5	5.5
US prime rate	**9.2**	8.0	8.4
Interest yield (i)			
Domestic	**7.0**	6.4	7.3
International	**6.7**	5.9	7.2
Total	**7.0**	6.4	7.3
Interest spread (ii)			
Domestic	**2.2**	2.3	1.9
International	**1.0**	1.8	1.3
Total	**1.9**	2.2	1.9
Interest margin (iii)			
Domestic	**2.7**	2.7	2.5
International	**1.6**	2.3	1.9
Total	**2.4**	2.7	2.5

(i) *Interest yield is the average interest rate earned on average interest-earning assets.*

(ii) *Interest spread is the difference between the average interest rate earned on average interest-earning assets and the average interest rate paid on average interest-bearing funds.*

(iii) *Interest margin is net interest income as a percentage of average interest-earning assets.*

Domestic yields, spreads and margins

In 2000, domestic yield increased from 6.4 per cent to 7.0 per cent, mainly reflecting an increase in average sterling interest rates compared with 1999. Interest spread declined slightly to 2.2 per cent compared with 2.3 per cent in 1999, partially due to lower earnings on money market business caused by a flattening of the yield curve and higher costs of short-term funding, together with the maturity of high yielding assets. Spreads on mortgage and savings products also reduced, reflecting the bank's competitive pricing. The decline in spread was partially offset by an increase in contribution from free funds, mainly due to higher interest rates, with domestic margin remaining at 2.7 per cent.

Financial Review (continued)

In 1999, domestic yield decreased from 7.3 per cent to 6.4 per cent, principally reflecting the decrease in average sterling interest rates, compared to 1998. Interest spread benefited from the change in liability mix where increases in interest-bearing current accounts and savings and deposits accounts have reduced dependence on wholesale funding requirements. The increase in spread was partially offset by a reduction in contribution from net free funds, mainly due to lower interest rates, leading to a smaller overall increase in margin.

International yields, spreads and margins

In 2000, international yield increased from 5.9 per cent to 6.7 per cent largely due to an increase in interest rates in Turkey. Spread decreased from 1.8 per cent to 1.0 per cent reflecting the effect of lower spreads within HSBC Republic.

In 1999, international yield decreased from 7.2 per cent to 5.9 per cent due to lower worldwide interest rates while spread increased from 1.3 per cent to 1.8 per cent, mainly in Latin America and Turkey.

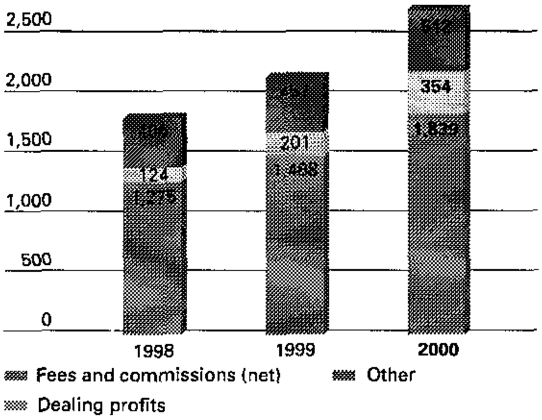
Other operating income

	2000 group excluding acquisitions £m	2000 acquisitions £m	2000 group £m	1999 group £m	1998 group £m
Dividend income	3	3	6	2	2
Fees and commissions receivable	1,987	255	2,242	1,851	1,632
Fees and commissions payable	(364)	(39)	(403)	(363)	(357)
Foreign exchange	234	24	258	162	173
Interest rate derivatives	25	(2)	23	11	4
Debt securities	42	9	51	57	17
Equities and other trading	11	11	22	(29)	(70)
Dealing profits	312	42	354	201	124
Operating lease income	316	—	316	314	300
Increase in the value of long-term assurance business attributable to shareholders	115	—	115	99	73
Other	35	40	75	42	31
Total other operating income	2,404	301	2,705	2,146	1,805

In 2000, other operating income increased by £559 million to £2,705 million, by £258 million, or 12 per cent excluding the results of the acquired businesses, with a good performance in wealth management activities, higher card fees, increased volumes of corporate banking fee income and growth in global safe custody fees. The growth in wealth management income in UK Banking was primarily driven by an increase of 16 per cent in life, pensions and investment income, an increase of 7 per cent in general insurance income and of 18 per cent in private client income. Wealth management activities of the bank's international operations included fees arising from the successful launches of funds products from the offshore islands. Higher income was also earned in UK Banking from personal current account and overdraft balances and card fees. Global Investor Services benefited from high transaction volumes in 2000, acquisition of new customers and growth in assets under custody, resulting in a 36 per cent increase in global safe custody fees. Corporate Banking fee income increased, mainly reflecting the bank's involvement in an active mergers and acquisitions market.

In 1999, other operating income increased by £341 million to £2,146 million. Fees and commissions receivable grew by £219 million to £1,851 million reflecting a strong performance in wealth management activities. During 1999, the bank gained an increased share of the life, pensions and investment market with income increasing by 27 per cent compared to 1998. Income from sales of HSBC unit trusts and life investment bonds were boosted by a strong performance in sales of ISAs and offshore products. Additionally, the drive to develop wealth management business was particularly successful in the Channel Islands and the Isle of Man, and in Greece. Commission income on general insurance sales increased. Higher mortgage sales led to increased cross-sales of health-care and other

Other operating income (£m)



insurance products. Higher fees were earned from cards, private clients, an increased number of overdrafts and a higher customer base in First Direct. Global Investor Services, the bank's specialist global custody division, benefited from a number of competitors leaving the market or changing control. Its other operating income rose by 35 per cent and assets under custody exceeded £686 billion. Operating lease income was also higher than in 1998, as were fees in Treasury and Capital Markets, which benefited from the management of primary issues of Eurobonds.

Dealing profits

The table below shows the total of dealing profits, which exclude the cost of associated staff and other administrative expenses, and dividend and net interest income attributable to dealing activities. The net interest income on securities trading arises on mark-to-market debt securities and treasury bills.

Securities held for dealing purposes include British Government securities, other government securities and securities issued by banks and corporates.

In 2000, dealing profits increased by £153 million, or by £111 million excluding the results of acquired businesses. The increase was primarily due to higher foreign exchange income, reflecting increased volumes of business and improved trading results in interest rate derivatives and other trading in Treasury and Capital Markets.

In 1999, dealing profits increased by £77 million to £201 million, primarily reflecting improved interest rate derivative and bond trading income in Treasury and Capital Markets.

	2000			1999			1998		
	Dealing profits £m	**Dividend and net interest income £m**	**Total £m**	Dealing profits £m	Dividend and net interest income £m	Total £m	Dealing profits £m	Dividend and net interest income £m	Total £m
Foreign exchange	**258**	**(1)**	**257**	162	4	166	173	2	175
Interest rate derivatives	**23**	**1**	**24**	11	10	21	4	33	37
Debt securities	**51**	**13**	**64**	57	(9)	48	17	3	20
Equities and other trading	**22**	**6**	**28**	(29)	9	(20)	(70)	18	(52)
	354	**19**	**373**	201	14	215	124	56	180

Financial Review (continued)

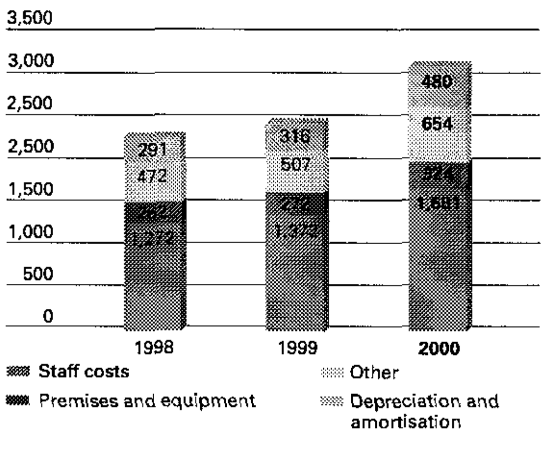
Operating expenses

	2000 group excluding acquisitions £m	2000 acquisitions £m	2000 group £m	1999 group £m	1998 group £m
Staff costs	**1,475**	**206**	**1,681**	1,372	1,272
Premises and equipment (excluding depreciation)	**283**	**41**	**324**	272	262
Other administrative expenses (excluding amortisation)	**574**	**80**	**654**	507	472
Administrative expenses	**2,332**	**327**	**2,659**	2,151	2,006
Depreciation	**339**	**25**	**364**	313	291
Amortisation of goodwill	**5**	**111**	**116**	3	—
Operating expenses	**2,676**	**463**	**3,139**	2,467	2,297
	%	**%**	**%**	%	%
Cost:income ratio (excluding the amortisation of goodwill)	**54.6**	**66.5**	**55.8**	54.3	56.8
Full-time equivalent staff numbers at 31 December	**47,267**	**14,656**	**61,923**	45,742	42,929

In 2000, operating expenses increased by £672 million to £3,139 million. Excluding the results of acquired businesses, there was an increase of £209 million, or 8 per cent. Staff costs, excluding those of acquired businesses, increased by 8 per cent, reflecting growth in staff numbers in order to support growth in the wealth management business and increased business volumes, in addition to the effect of annual pay increases and incentive costs. Additional IT staff have supported development projects integral to the continued improvement in customer service, particularly in relation to new delivery channels. International Banking costs also increased due to a full year of HSBC Bank Malta expenses. Other costs, excluding those of the acquired businesses, were 10 per cent higher, mainly reflecting costs to support business development, including internet banking initiatives and continued branch services improvement. Increased business volumes also contributed to higher expenditure, including IT processing capacity. Increased marketing costs included higher card loyalty scheme costs. The group's cost:income ratio, excluding the acquired businesses and the amortisation of goodwill, increased slightly to 54.6 per cent. The growth in full-time equivalent staff primarily reflects the effect of the acquisitions of HSBC Republic and Crédit Commercial de France, in addition to staff to support growth in wealth management activities, increased business volumes and development projects.

In 1999, the cost:income ratio, excluding the amortisation of goodwill, improved from 56.8 per cent to 54.3 per cent, although operating expenses increased by £170 million to £2,467 million, with HSBC Bank Malta representing £25 million of this increase. Staff costs increased by £100 million, or 8 per cent. This reflected annual pay awards and recruitment of employees principally to support increased wealth management activities and business volumes and as a result of replacement of temporary IT staff with permanent IT staff. Other operating expenses were £70 million higher, mainly reflecting higher volumes of communications and stationery, various marketing initiatives, higher IT equipment-related costs and higher depreciation costs arising from increased operating leased assets. The growth in full-time equivalent staff primarily reflected the acquisition of HSBC Bank Malta, which had 1,832 full-time equivalent staff at 31 December 1999, as well as additional staff to support wealth management activities and higher business volumes.

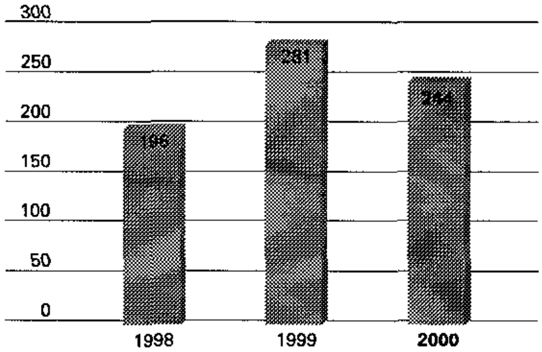
Operating expenses (£m)



Provisions for bad and doubtful debts

	2000 £m	1999 £m	1998 £m
UK Banking	**262**	310	194
International Banking	**(6)**	(25)	(8)
Treasury and Capital Markets	**(4)**	(4)	10
HSBC Republic	**(7)**	—	—
Crédit Commercial de France	**(1)**	—	—
Total bad and doubtful debts charge	**244**	281	196
Analysis of total charge			
— Charge for specific provisions	**217**	274	175
— Charge for general provisions	**27**	7	21
	244	281	196

Bad and doubtful debts (£m)



In 2000, the charge for bad and doubtful debts was £37 million lower than in 1999, or £29 million lower excluding the acquired businesses. UK Banking was £48 million lower, mainly due to lower new specific provisions against corporate lending, largely due to a small number of large provisions in 1999, as well as lower provisions against card balances and in First Direct. Net recoveries of £6 million in International Banking were £19 million lower than in 1999. General provisions increased by £20 million, reflecting balance sheet growth.

In 1999, the charge for bad and doubtful debts was £85 million higher than 1998, primarily due to new specific provisions in UK Banking. In UK Banking, new specific provisions increased by £109 million, reflecting the growth in personal lending and provisions raised against a small number of corporate lending exposures. In UK Banking, releases and recoveries decreased by £20 million while the general provision charge was £13 million lower than 1998. The bad debt charge was also reduced by recoveries of provisions against Latin American debt in International Banking.

Taxation

A reconciliation of the charge for taxation in the profit and loss account with the amount computed by applying the statutory rate of corporation tax to profit on ordinary activities before taxation is given in the table below.

In 2000, the effective tax rate reduced to 29.5 per cent compared with 30.0 per cent in 1999, due primarily to overseas profits taxed at lower rates, partially offset by higher goodwill amortisation and general bad debt provisions which are not allowable for tax purposes.

In 1999, the effective tax rate was 30.0 per cent, compared with 31.5 per cent in 1998, due primarily to a larger prior year adjustment and a lower standard rate of corporation tax.

	2000		1999		1998	
	£m	%	£m	%	£m	%
Taxation at UK corporation tax rate of 30% (1999: 30.25%, 1998: 31%)	**614**	**30.0**	522	30.3	472	31.0
General bad debt charge	**12**	**0.6**	3	0.2	6	0.4
Other non-deductible items including unrelieved losses	**15**	**0.7**	13	0.8	23	1.5
Tax-free gains	**(9)**	**(0.4)**	(2)	(0.1)	(3)	(0.2)
Impact of differently taxed overseas profits in principal locations	**(51)**	**(2.5)**	—	—	(5)	(0.3)
Amortisation of goodwill	**38**	**1.9**	—	—	—	—
Prior year adjustments	**(16)**	**(0.8)**	(20)	(1.3)	(9)	(0.6)
Other items	**—**	**—**	2	0.1	(5)	(0.3)
Overall tax charge	**603**	**29.5**	518	30.0	479	31.5

Financial Review (continued)

Results of Principal Business Segments

Detailed segmental information by class of business is shown in the Financial Review and in Note 42b of the Notes on the Accounts; Geographical analyses are shown in Note 42a.

Profit on ordinary activities before tax for each of the years in the three-year period ended 31 December 2000 is summarised in the table below.

	2000 £m	1999 £m	1998 £m
UK Banking	**1,502**	1,350	1,301
International Banking	**254**	238	150
Treasury and Capital Markets	**188**	148	38
HSBC Republic	**85**	—	—
Crédit Commercial de France	**(13)**	—	—
Operating profit	**2,016**	1,736	1,489
Share of operating loss in joint ventures and associates	**(47)**	(34)	(1)
Gains on disposal of investments and tangible fixed assets	**77**	22	34
Profit on ordinary activities before tax	**2,046**	1,724	1,522

UK Banking

	2000 £m	1999 £m	1998 £m
Net interest income	**2,127**	2,013	1,928
Other operating income	**1,981**	1,842	1,644
Operating income	**4,108**	3,855	3,572
Depreciation and amortisation	**(322)**	(300)	(280)
Other operating expenses	**(1,995)**	(1,847)	(1,736)
Operating profit before provisions	**1,791**	1,708	1,556
Provisions for bad and doubtful debts	**(262)**	(310)	(194)
Provisions for contingent liabilities and commitments	**(27)**	(45)	(60)
Amounts written off fixed asset investments	**—**	(3)	(1)
Operating profit	**1,502**	1,350	1,301
Share of operating (loss) in joint ventures and associates	**(50)**	(44)	(10)
Gains on disposal of investments and tangible fixed assets	**3**	6	12
Profit on ordinary activities before tax	**1,455**	1,312	1,303

In 2000, UK Banking's operating profit grew by 11 per cent to £1,502 million.

Net interest income was £2,127 million, 6 per cent higher than 1999, generated by balance growth in personal and commercial current accounts, personal savings and personal and commercial lending. The bank's repricing of variable rate mortgages contributed to mortgage growth of £1.1 billion, with a decline in mortgage spread. Spread was also reduced on savings products, reflecting competitive pricing. The effect on margin of the reduction in spread was partly mitigated by a greater benefit from free funds.

Other operating income was £1,981 million, 8 per cent higher than 1999, primarily reflecting growth in wealth management income and higher card, corporate banking and global safe custody fees.

Wealth management income showed a significant increase on 1999, up 14 per cent, from £444 million to £504 million. Within this, general insurance income increased by 7 per cent and private client income by 18 per cent. Life, pension and investment income increased by £37 million or 16 per cent, of which £10 million was the benefit of a reduction in the discount rate, used to calculate the net present value of future earnings inherent in policies in force, from 12.5 per cent to 11.5 per cent.

Global safe custody fees increased by 36 per cent compared with 1999, from £47 million to £64 million, benefiting from high transaction volumes in 2000, the acquisition of new customers and growth in assets under custody. Higher fee and other income was also generated by growth in personal current account and overdraft fees, increased card income and higher corporate banking fee income, mainly due to the bank's involvement in an active mergers and acquisitions market.

Operating expenses were £2,317 million, 8 per cent higher than 1999, with a cost:income ratio of 56.4 per cent. Staff costs increased by £84 million, or 7 per cent to £1,277 million, reflecting growth in staff numbers in order to support growth in the wealth management business and increased business volumes, in addition to the effect of annual pay increases and incentive costs. Additional IT staff have supported development projects integral to the continual improvement of customer service, particularly in relation to new delivery channels. As a result of business growth, 3 per cent more staff were employed on average during 2000. Non-staff costs increased by £86 million or 9 per cent, incurred primarily to support business development, including internet banking initiatives and continued branch services improvement. Increased business volumes also contributed to higher expenditure, including IT processing capacity. A rise in marketing costs included higher card loyalty scheme costs.

The charge for bad and doubtful debts was £262 million, 15 per cent lower than 1999. There was a reduction of £85 million in new provisions with lower provisioning against corporate lending, mainly due to a small number of large provisions in 1999. Provisions were also lower against card balances and in First Direct. General provisions increased by £28 million reflecting balance sheet growth. The credit environment remains satisfactory, but some business and personal customers continue to face difficulties from market pressures and unforeseen changes in financial circumstances.

Provisions for contingent liabilities were £18 million lower than 1999, mainly due to a lower charge for the amount of redress potentially payable to customers who may have been disadvantaged when transferring from, or opting out of, occupational pensions schemes.

UK Banking's share of the results of joint ventures and associates was a loss of £50 million compared with a loss of £44 million in 1999. The losses reflect the bank's 20 per cent shareholding in British Interactive Broadcasting ('BiB') and the associated investment in building its digital interactive television services, Open..... In July, the bank agreed to sell its investment in BiB to BSkyB, subject to regulatory approval from the Office of Fair Trading, which is under review currently.

In 1999, UK Banking's operating profit grew by 4 per cent to £1,350 million. The group continued to focus on the delivery of wealth management services to personal customers, expanding the group's commercial business and fee-based business and on making its product range competitive and transparent to customers.

Net interest income grew by 4 per cent in 1999 compared with 1998, principally as a result of growth in personal and business current account and savings balances. Increased deposits from customers reduced dependence on wholesale funding, thereby improving spreads.

Other operating income grew by 12 per cent to £1,842 million in 1999, due to progress in the development of income from wealth management products. Market share of life, pensions and investments increased with income up 27 per cent compared with 1998. Notable growth was achieved from sales of HSBC unit trusts and life investment bonds, commission on general insurance sales and increased cross-sales of health-care products and other insurance. Higher fee income was earned from cards, overdrafts and specialist global custody services, due to expansion of the customer base and higher volumes of business. In addition, a larger customer base in First Direct contributed to increased fee income.

Operating expenses increased by 6 per cent to £2,147 million in 1999. However, the cost:income ratio reduced from 56.4 per cent in 1998 to 55.7 per cent in 1999. Increases in staff costs were due to annual pay awards and higher numbers of employees, principally to support strengthening wealth management activities and business volumes. Other cost increases principally reflect higher volumes in communications and stationery, various marketing initiatives, higher IT equipment related costs and higher depreciation costs from increased operating lease assets.

Financial Review (continued)

The higher provision for bad and doubtful debts in 1999 reflected the substantial growth in personal lending and higher provisions against a small number of corporate lending exposures. This was combined with lower releases and recoveries of provisions against commercial lending. Provisions for contingent liabilities and commitments were £15 million lower than 1998. Further charges of £45 million, compared with £60 million in 1998, were made for the amount of redress potentially payable to customers transferring from or opting out of occupational pensions schemes, as a result of changes to the FSA's guidance.

UK Banking's share of the results of joint ventures and associates in 1999 was an operating loss of £44 million compared with a loss of £10 million in 1998. This reflected the bank's 20 per cent shareholding in BiB and the costs of promoting the new digital interactive television service and connecting subscribers.

International Banking

	2000 £m	1999 £m	1998 £m
Net interest income	264	216	158
Other operating income	168	146	79
Operating income	432	362	237
Depreciation and amortisation	(14)	(8)	(4)
Other operating expenses	(177)	(136)	(92)
Operating profit before provisions	241	218	141
Provisions for bad and doubtful debts	6	25	8
Provisions for contingent liabilities and commitments	7	(5)	1
Operating profit	254	238	150
Share of operating profit in associates and joint ventures	—	10	9
Gains on disposal of investments and tangible fixed assets	27	—	1
Profit on ordinary activities before tax	281	248	160

In 2000, International Banking reported an operating profit of £254 million, an increase of £16 million or 7 per cent compared with 1999. The Offshore financial services business produced an operating profit of £86 million reflecting the significant focus on expatriate wealth management. Turkey produced an operating profit of £53 million, in spite of major volatility in the local markets. HSBC Bank Malta reported an operating profit of £18 million. Net interest income was £264 million, 22 per cent higher than 1999, including a full year of income from HSBC Bank Malta, and increases from Offshore, reflecting increased deposits, and from Turkey, due to treasury activity. Other operating income was 15 per cent higher, including gains due to the successful launches of funds products globally from the Offshore Islands and a full year of income from HSBC Bank Malta. Operating expenses were 33 per cent higher, due to a full year of HSBC Bank Malta expenses and higher staff costs in Offshore, reflecting business expansion. Net recoveries for bad and doubtful debts of £6 million were £19 million lower than 1999 mainly due to a lower level of recoveries from the disposal of Latin American debt. The gain on disposal of investments and tangible fixed assets was £27 million mainly due to the sale of British Arab Commercial Bank to another HSBC Group company, which generated a gain on disposal of £24 million.

In 1999, International Banking reported an operating profit of £238 million, an increase of £88 million compared with 1998, with particularly good results in Turkey, Greece and the global expatriate business in the Channel Islands and the Isle of Man. The release of bad debt provisions against Latin American debt contributed to higher profits. In June 1999, a 70.03 per cent interest was acquired in HSBC Bank Malta, the largest commercial bank in Malta.

Treasury and Capital Markets

	2000 £m	1999 £m	1998 £m
Net interest income	**97**	162	151
Net fees and commissions payable	**(20)**	(13)	(30)
Dealing profits	**275**	171	112
Other operating income	**255**	158	82
Operating income	**352**	320	233
Depreciation and amortisation	**(8)**	(8)	(7)
Other operating expenses	**(160)**	(168)	(178)
Operating profit before provisions	**184**	144	48
Provisions for bad and doubtful debts	**4**	4	(10)
Operating profit	**188**	148	38
Gains on disposal of investments and tangible fixed assets	**13**	16	21
Profit on ordinary activities before tax	**201**	164	59

In 2000, Treasury and Capital Markets reported an operating profit of £188 million, 27 per cent higher than 1999. There was good all-round performance from foreign exchange, money market and fixed income activities primarily customer-driven business through the HSBC Group's corporate and institutional client relationships. Net interest income was 40 per cent lower than 1999. There was a decrease in spread, mainly due to a reduction in earnings on money market business caused by a flattening of the yield curve and higher costs of short-term funding, together with the maturity of high yielding assets. Other operating income was 61 per cent higher than 1999. Foreign exchange income increased by 45 per cent, reflecting higher volumes, particularly in respect of customer activities. Much of this was realised from an increase in business in the regional treasury centres, where income increased by 40 per cent.

In 1999, Treasury and Capital Markets reported an operating profit of £148 million, an increase of £110 million compared with 1998. This reflected improved interest rate derivative and bond trading income following difficult trading conditions in 1998. Net interest income benefited from reduced short-term funding costs following cuts in the UK base rate in the first half of 1999.

Financial Review (continued)

HSBC Republic

	2000 £m
Net interest income	150
Net fees and commissions receivable	134
Dealing profits	19
Other operating income	153
Operating income	303
Depreciation	(11)
Amortisation of goodwill	(62)
Other operating expenses	(149)
Operating profit before provisions	81
Provisions for bad and doubtful debts	7
Amounts written off fixed asset investments	(3)
Operating profit	85
Gains on disposal of investments and tangible fixed assets	30
Profit on ordinary activities before tax	115

The operations of HSBC Republic, acquired effective 1 January 2000, represent some 50 per cent of the HSBC Group's global HSBC Republic businesses. The acquired businesses provide private banking and trustee services for high net worth individuals with banks located in Switzerland, France, Luxembourg, Guernsey and Monaco.

The creation of HSBC Republic to bring together the former Safra Republic Holdings businesses and the HSBC Group's existing international private banking operations, was a principal focus of activity during 2000. The integration proceeded successfully without loss of clients, assets or personnel in the face of intense market competition for both clients and employees.

Operating profit before amortisation of goodwill was £147 million, after charging £36 million for the cost of funding the acquisition.

Net interest income was £150 million. Customer deposits remained stable throughout the year, while challenging market conditions saw a slight fall in demand for leveraged investment facilities. Less interest rate risk was taken during 2000 and there was some reduction in margins, mainly due to a change in funding policies but also in response to aggressive competitor strategies.

Other operating income was £153 million for the period. Significantly higher volumes of client securities transactions early in the year contributed to commissions growth of £16 million. Foreign exchange trading was also strong, while gains on sales of securities were less than in 1999. Other operating income included a one-off gain on the purchase and early cancellation of subordinated debt.

Operating expenses were £222 million. Cost savings were made on the consolidation of operations in Switzerland. There was substantial investment in IT infrastructure.

Crédit Commercial de France

	2000 £m
Net interest income	78
Net fees and commissions receivable	125
Dealing profits	23
Other operating income	148
Operating income	226
Depreciation	(14)
Amortisation of goodwill	(49)
Other operating expenses	(178)
Operating loss before provisions	(15)
Provisions for bad and doubtful debts	1
Amounts written off fixed asset investments	1
Operating loss	(13)
Share of operating profit in joint ventures and associates	3
Gains on disposal of investments and tangible fixed assets	4
Loss on ordinary activities before tax	(6)

The integration of CCF has proceeded smoothly since its acquisition on 31 October 2000. Benefits have already been realised in terms of increased revenues and favourable customer reaction.

CCF's business and corporate objectives are closely aligned to those of the HSBC Group. It has 682 branches and provides personal banking services to over one million predominantly mass-affluent customers. During 2000, a further 21 branches were opened and the acquisition of Banque Pelletier was completed. In addition to this strong focus on personal banking, CCF also provides value-added services to large corporates and has a well-regarded wealth management capability. On a UK GAAP basis, CCF's operating profit, excluding the amortisation of goodwill, was £36 million for the two months since 31 October 2000 after charging £6 million for funding the acquisition. The following commentary on underlying 2000 performance is based on CCF's French GAAP results adjusted to be on a comparable basis to the 1999 results.

CCF's operating income increased 10 per cent and its pre-tax profit rose by 20 per cent compared with 1999. All major business lines contributed to this performance.

In retail and commercial banking, operating income grew by 10 per cent and operating profit by 29 per cent reflecting higher volumes in CCF's domestic network. This was primarily driven by 13 per cent growth in average retail banking sight balances and 16 per cent growth in average retail banking customer loans. Wealth management income also grew strongly. Fee and commission income grew by 15 per cent which represented 44 per cent of operating income.

Operating income in corporate and investment banking grew by 14 per cent reflecting both strong demand for financing from large corporates and improved margins. The integration with the HSBC Group has already had a favourable impact in the development of activities with major corporates, with a significant rise in the number of euro-denominated bond issues managed.

Asset management and private banking operating income increased by 26 per cent. Growth was particularly robust in asset management where operating income was 36 per cent higher. Funds under management by CCF grew by 8 per cent to £52 billion despite the negative impact of market trends towards the end of the year.

Financial Review (continued)

Future Accounting Developments

United Kingdom

Financial Reporting Standard ('FRS') 17 'Retirement Benefits'

FRS 17 was issued in November 2000 and is fully effective for the group's 2003 financial statements. The FRS when applied in full will replace SSAP 24 'Accounting for pension costs', UITF Abstract 6 'Accounting for post-retirement benefits other than pensions' and UITF Abstract 18 'Pension costs following the 1997 tax changes in respect of dividend income'. There are also amendments to other accounting standards and UITF Abstracts.

The FRS prescribes the following:

- financial statements reflect at fair value the assets and liabilities arising from an employer's retirement benefit obligations and any related funding;
- the operating costs of providing retirement benefits to employees are recognised in the accounting period(s) in which the benefits are earned by the employees, and the related finance costs and any other changes in value of the assets and liabilities are recognised in the accounting periods in which they arise; and
- the financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities.

The FRS will require additional disclosures in the group's 2001 and 2002 financial statements, with the primary statement impact being recorded in 2003.

Management are currently assessing the impact of the FRS and the effect on the group's financial statements is not yet known.

FRS 18 'Accounting Policies'

FRS 18 was issued in December 2000 and is fully effective for the group's 2001 financial statements. The FRS replaces SSAP 2 'Disclosure of accounting policies', UITF Abstract 7 'True and fair view override disclosures' and UITF Abstract 14 'Disclosure of changes in accounting policy'. There are also amendments to other accounting standards and UITF Abstracts.

The objective of the FRS is to ensure that for all material items an entity adopts appropriate accounting policies, that they are regularly reviewed and that they are explained in sufficient detail.

Adoption of FRS 18 is not expected to have a material impact on the group's financial statements.

FRS 19 'Deferred Tax'

FRS 19 was issued in December 2000 and is fully effective for the group's 2002 financial statements. The FRS replaces SSAP 15 'Accounting for deferred tax' and there are some amendments to other accounting standards.

The objective of the FRS is to ensure that future tax consequences of past transactions and events are recognised as liabilities or assets in the financial statements and that the financial statements disclose any other special circumstances that may have an effect on future tax charges.

In practice, deferred tax will be provided in the accounts for all timing differences, where currently deferred tax assets and liabilities are recognised to the extent they are expected to crystallise.

Management are currently assessing the impact of the FRS and the effect on the group's financial statements is not yet known.

United States

Statement of Financial Accounting Standards ('SFAS') No. 133 'Accounting for Derivative Instruments and for Hedging Activities'

SFAS No. 133 was issued in June 1998 and amended in June 2000 by SFAS No. 138. It is effective for the group from 1 January 2001.

SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives be recognised as either assets or liabilities in the balance sheet and that those instruments be measured at fair value. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation as described below:

- For a derivative designated as hedging, the exposures to changes in the fair value of a recognised asset or liability or a firm commitment, the gain or loss is recognised in earnings in the period of change together with the associated loss or gain on the hedged item attributable to the risk being hedged.
- For a derivative designated as hedging, the exposure to variable cash flows of a recognised asset or liability, or of a forecasted transaction, the derivatives gain or loss associated with the effective portion of the hedge is initially reported as a component of the reconciliation of movements in shareholders' equity and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion is reported in earnings immediately.
- For net investment hedges, in which derivatives hedge the foreign currency exposure of a net investment in a foreign operation, the change in fair value of the derivative associated with the effective portion of the hedge is included as a component of the reconciliation of movements in shareholders' equity together with the associated loss or gain on the hedged item. The ineffective portion is reported in earnings immediately.
- For a derivative not designated as a hedging instrument, the gain or loss is recognised in earnings in the period of change in fair value.

At the date of initial application, all derivatives will be recognised on the balance sheet at fair value and all hedging relationships will be designated anew. Gains or losses on any hedged items attributable to the risk being hedged will also be recognised. Transition adjustments resulting from adopting this Statement shall be reported in US GAAP net income or reconciliation of movements in shareholders' equity, as appropriate based on the hedging relationship, if any, that had existed for that derivative. The group does not believe that any significant adjustment to either net income or shareholders' equity will result from this process.

The group will continue to mitigate economic risks in its non-trading portfolio with derivatives. This process will be managed to meet UK GAAP, rather than US GAAP requirements for hedge accounting. There may, therefore, be increased volatility in the group's earnings reported under US GAAP in future periods.

SFAS No. 140 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities'

SFAS No. 140, issued in September 2000, replaces SFAS No. 125, 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities'. It revises the standards for accounting for securitisations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of SFAS No. 125's provisions without change.

SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities of the group occurring after 31 March 2001. However, the provisions of SFAS No. 140 concerning the recognition and reclassification of collateral and disclosures relating to securitisation transactions and collateral are effective for the group's US GAAP reporting for the year ended 31 December 2000 and have been reflected in this Annual Report. SFAS No. 140 is to be applied prospectively with certain exceptions. Adoption is not expected to have a material impact on the group's US GAAP financial statements.

Financial Review (continued)

Average Consolidated Balance Sheet and Net Interest Income

	2000			1999			1998		
	Average balance £m	Interest £m	Average rate %	Average balance £m	Interest £m	Average rate %	Average balance £m	Interest £m	Average rate %
Assets									
Treasury bills and other eligible bills									
Domestic	2,976	140	4.7	3,904	170	4.4	2,737	167	6.1
International	609	58	9.5	211	23	10.9	289	48	16.6
	3,585	198	5.5	4,115	193	4.7	3,026	215	7.1
Loans and advances to banks (i)									
Domestic	14,001	837	6.0	11,093	509	4.6	11,786	679	5.8
International	8,976	529	5.9	2,583	142	5.5	2,721	233	8.6
	22,977	1,366	5.9	13,676	651	4.8	14,507	912	6.3
Loans and advances to customers (i)									
Domestic	53,156	4,080	7.7	48,343	3,564	7.4	48,270	3,980	8.2
International	10,086	733	7.3	4,678	314	6.7	3,772	245	6.5
	63,242	4,813	7.6	53,021	3,878	7.3	52,042	4,225	8.1
Debt securities									
Domestic	14,643	889	6.1	15,034	845	5.6	16,692	1,009	6.0
International	7,899	533	6.7	2,066	86	4.2	2,167	120	5.5
	22,542	1,422	6.3	17,100	931	5.4	18,859	1,129	6.0
Total average interest-earning assets	112,346	7,799	7.0	87,912	5,653	6.4	88,434	6,481	7.3
Provisions for bad and doubtful debts									
Domestic	(1,084)			(986)			(942)		
International	(250)			(124)			(120)		
	(1,334)			(1,110)			(1,062)		
Non-interest-earning assets	27,185			21,329			20,918		
Total average assets and interest income	138,197	7,799	5.6	108,131	5,653	5.2	108,290	6,481	6.0
Percentage of total average assets applicable to international operations	23.7%			9.7%			9.4%		

(i) *'Loans accounted for on a non-accrual basis' and 'Loans on which interest has been accrued but suspended' have been included in 'Loans and advances to banks' or 'Loans and advances to customers'. Interest income on such loans has been included in the consolidated profit and loss account to the extent that it has been received.*

	2000			1999			1998		
	Average balance £m	**Interest £m**	**Average rate %**	Average balance £m	Interest £m	Average rate %	Average balance £m	Interest £m	Average rate %
Liabilities and shareholders' funds									
Interest-bearing demand deposits									
Domestic	**25,455**	**807**	**3.2**	22,704	588	2.6	21,614	795	3.7
International	**2,301**	**95**	**4.1**	1,660	52	3.1	1,107	55	5.0
	27,756	**902**	**3.2**	24,364	640	2.6	22,721	850	3.7
Money market demand deposits									
Domestic	**6,394**	**325**	**5.1**	5,743	236	4.1	3,781	266	7.0
International	**1,920**	**106**	**5.5**	287	13	4.5	227	21	9.3
	8,314	**431**	**5.2**	6,030	249	4.1	4,008	287	7.2
Savings deposits									
Domestic	**7,636**	**405**	**5.3**	6,877	325	4.7	5,988	364	6.1
International	**1,726**	**112**	**6.5**	990	47	4.7	413	20	4.8
	9,362	**517**	**5.5**	7,867	372	4.7	6,401	384	6.0
Other time deposits									
Domestic	**29,895**	**1,678**	**5.6**	27,708	1,310	4.7	31,964	1,806	5.7
International	**16,624**	**988**	**5.9**	3,418	147	4.3	4,240	273	6.4
	46,519	**2,666**	**5.7**	31,126	1,457	4.7	36,204	2,079	5.7
Debt securities in issue									
Domestic	**3,471**	**220**	**6.3**	5,115	297	5.8	5,348	365	6.8
International	**1,108**	**67**	**6.0**	191	9	4.7	269	25	9.3
	4,579	**287**	**6.3**	5,306	306	5.8	5,617	390	6.9
Subordinated liabilities[(ii)]									
Domestic	**3,515**	**267**	**7.6**	3,354	237	7.1	3,360	254	7.6
International	**312**	**13**	**4.2**	18	1	5.6	—	—	—
	3,827	**280**	**7.3**	3,372	238	7.1	3,360	254	7.6
Total average interest-bearing liabilities	**100,357**	**5,083**	**5.1**	78,065	3,262	4.2	78,311	4,244	5.4
Non-interest-bearing customer accounts									
Domestic	**7,374**			6,814			6,365		
International	**940**			82			72		
	8,314			6,896			6,437		
Shareholders' funds and other non-interest-earning liabilities	**29,526**			23,170			23,542		
Total average liabilities and shareholders' funds and interest expense	**138,197**	**5,083**	**3.7**	108,131	3,262	3.0	108,290	4,244	3.9
Percentage of total average liabilities and shareholders' funds applicable to international operations	**23.3%**			7.8%			7.8%		
Net interest income		**2,716**			2,391			2,237	
Interest income as a percentage of average interest-earning assets			**7.0**			6.4			7.3
Interest expense as a percentage of average interest-bearing liabilities			**5.1**			4.2			5.4
Interest spread			**1.9**			2.2			1.9
Net interest margin			**2.4**			2.7			2.5

(ii) *Subordinated liabilities are fully subordinated to depositors and all other creditors.*

(a) *Balances and transactions between domestic and international operations are excluded. The average balance due from international to domestic for 2000 was £778 million (1999: £1,928 million; 1998: £1,763 million) and net interest paid by international to domestic for 2000 was £44 million (1999: £81 million; 1998: £82 million).*

(b) *Average balances are based upon daily averages for certain areas of the group's banking activities with monthly or less frequent averages used elsewhere.*

Financial Review (continued)

Changes in net interest income

The following table allocates changes in net interest income between changes in volume and changes in rates for the last three years. Volume changes are caused by differences in the level of interest-earning assets and of interest-bearing deposits and borrowings. Rate changes result from differences in yields earned on assets and rates paid on liabilities. Changes attributable to a combination of both volume and rate have been allocated to rate.

	2000 and 1999			1999 and 1998		
	Increase/(decrease) due to changes in			Increase/(decrease) due to changes in		
	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m
Interest income						
Treasury and other eligible bills						
Domestic	(40)	10	(30)	71	(68)	3
International	43	(8)	35	(13)	(12)	(25)
Loans and advances to banks						
Domestic	133	195	328	(40)	(130)	(170)
International	351	36	387	(12)	(79)	(91)
Loans and advances to customers						
Domestic	355	161	516	6	(422)	(416)
International	363	56	419	59	10	69
Debt securities						
Domestic	(22)	66	44	(99)	(65)	(164)
International	243	204	447	(6)	(28)	(34)
	1,426	720	2,146	(34)	(794)	(828)
Interest expense						
Interest-bearing demand deposits						
Domestic	71	148	219	40	(247)	(207)
International	20	23	43	28	(31)	(3)
Money market demand deposits						
Domestic	27	62	89	137	(167)	(30)
International	74	19	93	6	(14)	(8)
Savings deposits						
Domestic	36	44	80	54	(93)	(39)
International	35	30	65	28	(1)	27
Other time deposits						
Domestic	103	265	368	(243)	(253)	(496)
International	568	273	841	(53)	(73)	(126)
Debt securities in issue						
Domestic	(95)	18	(77)	(16)	(52)	(68)
International	43	15	58	(7)	(9)	(16)
Subordinated liabilities						
Domestic	11	19	30	—	(17)	(17)
International	16	(4)	12	—	1	1
	909	912	1,821	(26)	(956)	(982)
Net interest income						
Domestic	273	(124)	149	(34)	144	110
International	244	(68)	176	26	18	44
	517	(192)	325	(8)	162	154

■ Assets and Liabilities

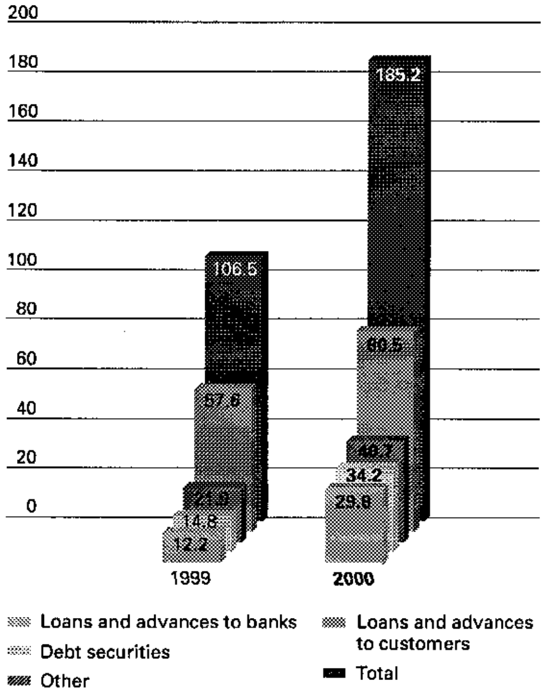
The following table analyses total assets by business segment:

	2000 £m	1999 £m
UK Banking	**72,752**	60,650
International Banking	**11,562**	10,018
Treasury and Capital Markets	**38,465**	35,800
HSBC Republic	**16,399**	—
Crédit Commercial de France	**46,025**	—
Total assets	**185,203**	106,468

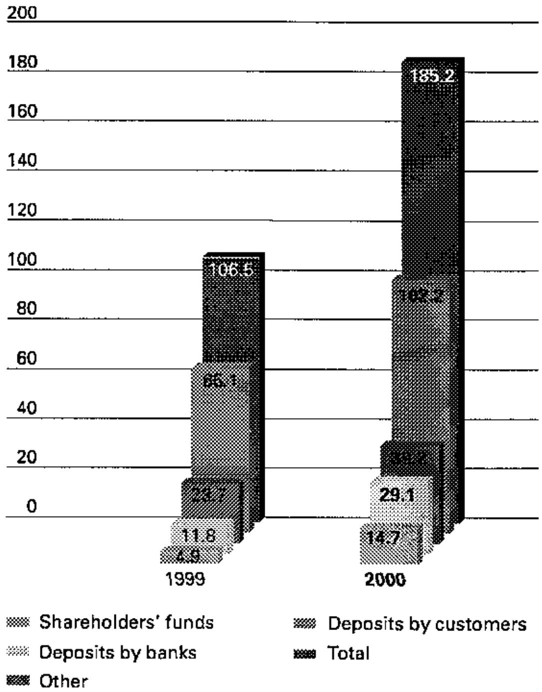
The above figures represent third-party assets only; intra-group balances are excluded.

Total assets were £78.7 billion, or 74 per cent, higher than at 31 December 1999, reflecting the acquisition of HSBC Republic and Crédit Commercial de France. In UK Banking, there was growth in mortgages, other personal loans and corporate lending. In Treasury and Capital Markets, assets were higher mainly as a result of increased holdings of debt securities. International Banking experienced growth across most regions. Within liabilities, there was growth in personal and business current and savings accounts, mainly within UK Banking.

Assets (£bn)



Liabilities (£bn)



■ Capital Management

Capital measurement and allocation

The Financial Services Authority ('FSA') is the supervisor of the bank and the group and, in this capacity, receives information on capital adequacy and sets capital requirements. Individual banking subsidiaries are directly regulated by the appropriate local banking supervisors, which set and monitor capital adequacy requirements for them. Similarly, non-banking subsidiaries are subject to supervision and capital requirements of relevant local regulatory authorities. Since 1988, when the governors of the Group of Ten central banks, who form the Basel Committee on Banking Supervision, agreed to guidelines for the international convergence of capital measurement and standards, the banking supervisors of the group have exercised capital adequacy supervision within a broadly similar framework.

Financial Review (continued)

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

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

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

The group's capital is divided into two tiers: tier 1, comprising shareholders' funds excluding revaluation reserves and minority interests; and tier 2, comprising general loan loss provisions, property revaluation reserves and qualifying subordinated loan capital. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital, and term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of general provisions that may be included in tier 2 capital. Deductions in respect of goodwill and intangible assets, and unconsolidated investments and investments in the capital of banks and other financial institutions are made from tier 1 capital and total capital, respectively. In the case of the solo and consolidated tier 1 ratios, these must exceed 6 per cent (excluding eligible capital in the form of non-cumulative preference shares issued by a subsidiary undertaking).

Under CAD2, banking operations are categorised as either trading book (broadly, marked-to-market activities) or banking book (all other activities) and risk-weighted assets are determined accordingly. Banking book risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book off-balance-sheet items giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market-related risks, such as foreign exchange, interest rate and equity position risks, as well as counterparty risk.

Capital analysis

The table on page 33 is an analysis of the group's regulatory capital position and risk-weighted assets at 31 December 2000 and 1999.

Tier 1 capital increased by £2,141 million in 2000 due to a capital injection from HSBC Holdings less goodwill (£1,183 million) relating to the purchase of CCF and HSBC Republic, and the issue of further eligible capital by a subsidiary undertaking (innovative tier 1 securities) amounting to £561 million. In addition, exchange rate and other movements contributed £239 million, profit retention £145 million and minority interests £70 million.

Total risk-weighted assets increased by £36 billion. Banking book risk-weighted assets increased due to growth in customer lending within the bank, and the acquisition of CCF and HSBC Republic, while risk-weighted assets in the trading book increased following these acquisitions.

In the case of tier 2 capital, undated subordinated loan capital increased by £175 million as a result of eligible loan capital issues from CCF (£116 million) and exchange rate movements.

Qualifying dated subordinated loan capital increased by £1,220 million due to subordinated loan issues by the bank (£870 million) and HSBC Republic (£201 million), the inclusion of eligible loan capital issues by CCF (£152 million) and also exchange rate movements (£100 million). This was offset by increased amortisation amounting to £103 million. Unconsolidated investments, and investments in other banks and other financial institutions increased by £176 million and £141 million respectively, largely due to the acquisition of CCF.

	2000 £m	1999 £m
Composition of capital		
Tier 1:		
Shareholders' funds	**14,684**	4,868
Minority interests	**217**	139
Innovative tier 1 securities	**561**	—
Less: property revaluation reserves	**(104)**	(77)
goodwill capitalised and intangible assets	**(8,342)**	(55)
Total qualifying tier 1 capital	**7,016**	4,875
Tier 2:		
Fixed asset revaluation reserve	**104**	77
General provisions	**531**	366
Undated subordinated loan capital	**1,455**	1,280
Qualifying dated subordinated loan capital	**3,154**	1,934
Total qualifying tier 2 capital	**5,244**	3,657
Unconsolidated investments	**(545)**	(369)
Investments in other banks and other financial institutions	**(177)**	(36)
Other deductions	**(11)**	(6)
Total capital	**11,527**	8,121
Total risk-weighted assets	**107,282**	71,557
	%	%
Total capital: risk-weighted assets	**10.7**	11.3
Tier 1 capital: risk-weighted assets	**6.5**	6.8

Market Risk Management

Market risk

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

The group makes markets in interest rate, exchange rate and equity derivative instruments, as well as in debt, equities and other securities. Trading risks arise either from customer-related business or from position taking.

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

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

VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. The group's VAR, predominantly calculated on a variance/covariance basis, uses historical movements in market rates and prices, a 99 per cent confidence level, a 10-day holding period and generally takes account of correlations between different markets and rates, and is calculated daily. The movement in market prices is calculated by reference to market data from the last two years. Aggregation of VAR from different risk types is based upon the assumption of independence between risk types.

The group VAR should be viewed in the context of the limitations of the methodology used. These include:

- The model assumes that changes in risk factors follow a normal distribution. This may not be the case in reality and may lead to an underestimation of the probability of extreme market movements.
- The use of a 10-day holding period assumes that all positions can be liquidated or hedged in 10 days. This does not fully capture the market risk arising from times of severe illiquidity, when a 10-day period may be insufficient to fully liquidate or hedge all positions.
- The use of a 99 per cent confidence level does not take account of any losses that might occur beyond this level of confidence.
- The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature.
- The assumption of independence between risk types may not always hold and therefore result in VAR not fully capturing market risk where correlation between variables is exhibited.
- VAR is calculated at the close of business with intra-day exposures not being subject to intra-day VAR calculations on a group basis.
- VAR does not necessarily capture all of the higher order market risks and as such VAR may be underestimated.

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

Trading VAR for 2000 is set out in the table below:

	At 31 December	Minimum during the year	Maximum during the year	Average for the year
	£m	**£m**	**£m**	**£m**
Trading activities	**13.7**	**6.9**	**20.1**	**12.2**
Foreign exchange trading positions	**4.1**	**1.9**	**10.3**	**5.2**
Interest rate trading positions	**12.9**	**5.9**	**19.6**	**10.8**
Equities trading positions	**0.5**	**0.5**	**10.3**	**2.2**

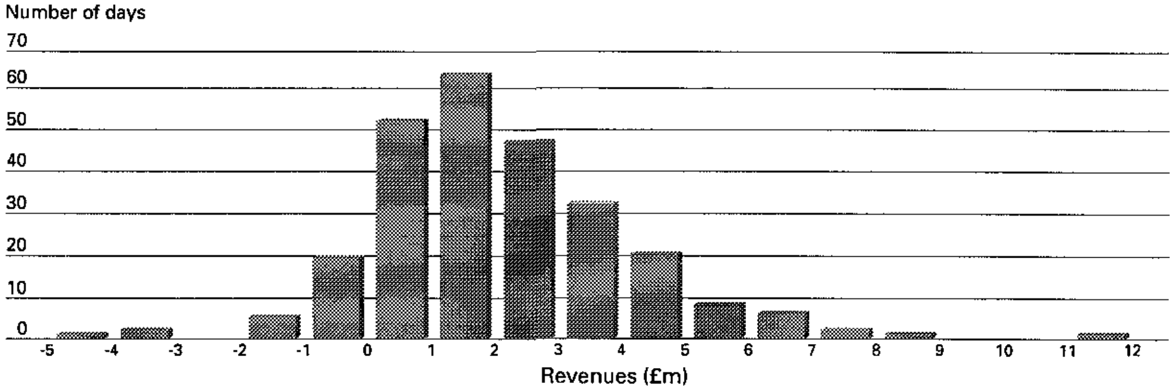
Trading VAR for CCF is included in the above table from the date of acquisition.

Trading VAR for 1999 is set out in the table below.

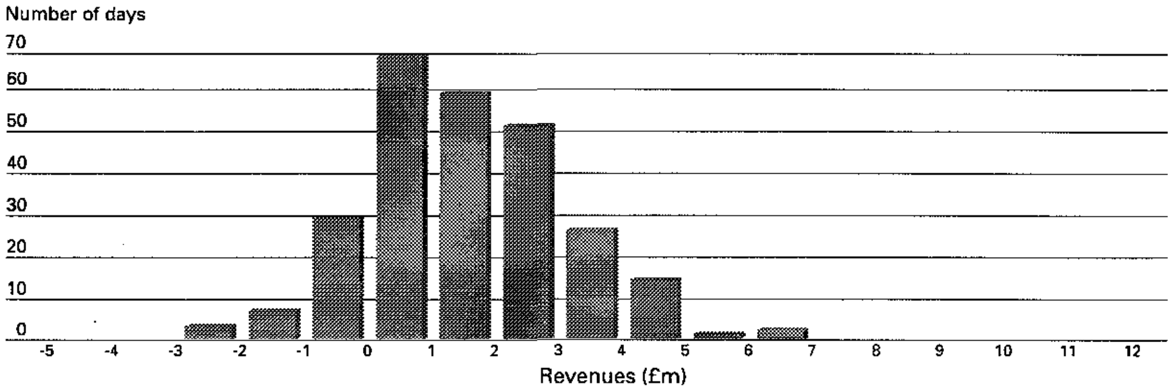
	At 31 December	Minimum during the year	Maximum during the year	Average for the year
	£m	£m	£m	£m
Trading activities	6.4	6.3	30.7	15.4
Foreign exchange trading positions	2.1	2.0	23.1	8.2
Interest rate trading positions	6.0	4.6	39.3	12.9
Equities trading positions	0.5	0.3	8.2	3.3

In 2000, the basis of computing equities VAR included a refinement in respect of non-linear risk. Non-linear risk was not a significant component of equities VAR in 1999 and it is not practicable retrospectively to amend the comparative figures for this refinement.

Daily distribution of market risk revenues 2000



Daily distribution of market risk revenues 1999



Daily distribution of market risk revenues

The average daily revenue earned from market-risk-related treasury activities in 2000, including accrual book net interest income and funding related to dealing positions, was £1.9 million, compared with £1.5 million in 1999. The standard deviation of this daily revenue was £1.9 million (£1.6 million in 1999). An analysis of the frequency distribution of daily revenues shows that negative revenues were reported on only 27 days during 2000. The most frequent result was a daily revenue of between £1 million and £2 million, with 63 occurrences. The highest daily revenue was £11.1 million.

Foreign exchange exposure

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

Trading value at risk

The foreign exchange exposure comprises those that arise from foreign exchange dealing within the group's treasury centres and currency exposures originated by the group's banking businesses. The latter are transferred to local treasury units where they are managed together with exposures which result from dealing with approved limits. VAR on foreign exchange trading positions is shown in the table on page 34.

Structural currency exposure

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

The group's structural foreign currency exposures are managed with the primary objective of ensuring, where practical, that the group's and individual banking subsidiaries' tier 1 capital ratios

Financial Review (continued)

are protected from the effect of changes in exchange rates. This is usually achieved by denominating tier 1 capital broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets at a subsidiary bank level. The group considers hedging structural foreign currency exposures only in limited circumstances, including protecting the tier 1 capital ratio or the value of capital invested.

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

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

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

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

Details of the group's structural foreign exchange exposure can be found in Note 37 'Market risk management' in the Notes on the Accounts.

Interest rate exposure

The group's interest rate exposures comprise those originating in its treasury trading activities and structural interest rate exposures; both are managed under limits described above. Interest rate risk arises on both trading positions and accrual books. The interest rate risk on interest rate trading positions is set out in the trading VAR table on page 34.

Structural interest rate risk

Structural interest rate risk arises from the differing repricing characteristics of commercial banking assets and liabilities, including non-interest-bearing liabilities such as shareholders' funds and some current accounts. The bank and each major subsidiary undertaking assesses the structural interest rate risks which arise in their businesses and either transfer such risks to their local treasury unit for management or transfer the risks to separate books managed by their local asset and liability committee ('ALCO'). ALCOs regularly monitor all such interest rate risk positions, subject to interest rate risk limits agreed with HSBC Holdings. In the course of managing interest rate risk, quantitative techniques and simulation models are used where appropriate to identify the potential net interest income and market value effects of these interest rate positions in different interest scenarios. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income. An immediate hypothetical 100 basis point parallel rise in all yield curves worldwide on 1 January 2001 would decrease planned net interest income for the 12 months to 31 December 2001 by £63 million, while a hypothetical 100 basis points parallel fall in all yield curves would increase planned income by £47 million, assuming no management action in response to these interest rate movements.

Rather than assuming that all interest rates move together, the group's interest rate exposures can be grouped into blocks whose interest rates are considered more likely to move together. The sensitivity of net interest income can then be described as follows.

The projections assume that rates of all maturities move by the same amount and, therefore, do not reflect the potential impact on net interest income of some rates changing while others remain unchanged. The projections also make other simplifying assumptions, including an assumption that all positions run to maturity. In practice, these exposures are actively managed.

Equities exposure

The group's equities exposure arises from equities and equity derivatives transactions. Value at risk relating to equity trading positions is set out in the trading VAR table on page 34.

Change in projected net interest income

	Sterling £m	US dollars £m	Other currencies £m	Total 2001 £m	Total 2000 £m
+100 basis points shift in yield curves	(45)	(8)	(10)	(63)	(66)
-100 basis points shift in yield curves	36	1	10	47	52

Liquidity Management

Liquidity is managed primarily through Treasury and Capital Markets in London to ensure that the group's cash flows are appropriately balanced, avoiding any concentration of maturity or source that might impede its ability to fund its assets or to meet its liability obligations. Where cash flow imbalances arise, the group's policy is for such imbalances to be covered by holdings of defined quality liquid assets in accordance with the HSBC Group's established ratios of liquid assets to customer deposits. The group's structural liquidity profile is also actively managed in line with strategic objectives, covering both the distribution of sources and maturities of capital, term funding and deposits, and the product types and maturities of lending to customers.

Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of the group's overall funding. Considerable importance is attached to this core deposit base which, over the years, has been stable and predictable. The HSBC Group prefers to grow its balance sheet through increasing core retail deposits where possible. Professional market funds are accessed for the purpose of providing additional funding, maintaining a presence in money markets and optimising asset and liability maturities. Of the bank's non-sterling asset base, approximately one third is denominated in US dollars and is partially funded through US dollar-denominated capital issues and loan stock, supplemented by time deposits taken from the eurocurrency interbank market, principally from central banks, other banks, corporate customers and other commercial institutions.

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

The group has for some years operated a liquidity management policy based on consolidated net cash flows that conforms to the FSA's arrangements for the supervision of major UK banks' sterling liquidity. Central to these arrangements is the requirement for banks to be able to survive five working days without the renewal of any maturing net wholesale liabilities, and after the leakage of 5 per cent of the gross retail deposit base, for which purpose a minimum coverage ratio of specified liquid assets must be maintained.

This ratio is computed daily with the position being managed so as to exceed the minimum ratio. In addition to complying with these FSA requirements on sterling liquidity, the group also adopts the same consolidated cash flow methodology for managing its all-currency 0-5 working day liquidity exposures. In addition, the group also maintains high-quality liquid assets at least equal to 0-30 days' cumulative refinancing exposures on an all-currency basis for HSBC Group liquidity management purposes.

Overseas units maintain sufficient liquidity to meet their day-to-day needs and local regulatory requirements unless specific arrangements are made for Treasury and Capital Markets in London to provide the necessary support.

Operational Risk Management

Operational risk is the risk of economic loss arising through fraud, unauthorised activities, error, omission or inefficiency. It is inherent to every entity and covers a wide spectrum of issues. The group manages this risk through a controls-based environment in which processes are documented, authorisation is independent and where transactions are reconciled and monitored. This is supported by an independent programme of periodic reviews undertaken by internal audit. The group also maintains contingency facilities to support operations in the event of disasters.

Credit Risk Management

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

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

Within the overall framework of HSBC Group policy, the bank has an established risk management process encompassing credit approvals, the control of exposures (including those to borrowers in financial difficulty), credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio

Financial Review (continued)

basis. Local management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products.

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

Loans and Advances

Analysis of loans and advances to banks and loans and advances to customers by geographic area and by type of customer

The following tables analyse loans by domicile of the lending office and by type of customer.

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Loans and advances to banks					
Domestic	**9,167**	9,847	8,503	11,159	10,100
International					
United Kingdom	**3,895**	997	1,880	990	769
Continental Europe	**15,953**	1,173	739	485	2,627
United States	**—**	—	—	24	192
Rest of the world	**825**	216	401	740	1,287
Total international	**20,673**	2,386	3,020	2,239	4,875
	29,840	12,233	11,523	13,398	14,975
Specific bad and doubtful debt provisions	**(19)**	(7)	(7)	(19)	(31)
Loans and advances to banks	**29,821**	12,226	11,516	13,379	14,944
Loans and advances to customers					
Domestic					
Customers domiciled in the United Kingdom					
Local and national government and government-owned utilities	**304**	555	464	592	27
Agriculture, forestry and fishing	**1,233**	1,212	1,256	1,257	1,055
Manufacturing and other production	**5,228**	4,650	5,430	5,724	5,055
Construction	**1,101**	798	974	928	842
Non-bank financial and services	**17,781**	16,035	14,223	14,710	12,189
Property companies	**3,869**	2,845	2,745	2,148	1,802
Individuals					
— mortgages	**14,190**	12,963	12,066	11,046	9,596
— other	**8,081**	7,566	6,254	5,407	5,100
	51,787	46,624	43,412	41,812	35,666
Overseas residents	**4,945**	5,125	3,968	3,896	3,470
Lease financing	**1,646**	1,613	1,682	1,979	1,724
Total domestic	**58,378**	53,362	49,062	47,687	40,860
International					
United Kingdom	**1,246**	1,317	1,635	1,402	1,490
Continental Europe	**21,968**	3,401	1,879	1,464	3,345
Rest of the world	**869**	666	810	681	904
Total international	**24,083**	5,384	4,324	3,547	5,739
	82,461	58,746	53,386	51,234	46,599
General and specific bad and doubtful debt provisions	**(1,940)**	(1,154)	(1,015)	(1,091)	(1,247)
Loans and advances to customers	**80,521**	57,592	52,371	50,143	45,352

Analysis of loans and advances to banks and loans and advances to customers by maturity and by interest sensitivity

The following tables analyse gross loans and advances to banks and to customers at 31 December 2000, by residual maturity and by interest sensitivity.

Loans and advances to banks

	Domestic £m	International United Kingdom £m	International Continental Europe £m	International Rest of the world £m
Maturity				
1 year or less	8,599	3,862	15,044	798
5 years or less but over 1 year	226	33	809	27
Over 5 years	342	—	100	—
	568	33	909	27
	9,167	3,895	15,953	825
Interest sensitivity (over 1 year)				
Fixed rate	8	1	332	27
Variable rate	560	32	577	—
	568	33	909	27

Loans and advances to customers

	Domestic £m	International United Kingdom £m	International Continental Europe £m	International Rest of the world £m
Maturity				
1 year or less	23,842	1,085	14,187	637
5 years or less but over 1 year	16,226	145	4,366	195
Over 5 years	18,310	16	3,415	37
	34,536	161	7,781	232
	58,378	1,246	21,968	869
Interest sensitivity (over 1 year)				
Fixed rate	1,315	21	2,909	134
Variable rate	33,221	140	4,872	98
	34,536	161	7,781	232

The above table includes domestic loans and advances to construction and property companies at 31 December 2000 which are due in one year or less, £2,372 million; in five years or less but over one year, £1,780 million; and over five years, £817 million.

Foreign outstandings

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

The table below shows the geographic distribution of total outstandings, amounting to £179 billion, £103 billion and £102 billion at 31 December 2000, 1999 and 1998 respectively, comprising loans, accrued interest, acceptances, interest-bearing deposits placed with other banks, other interest-earning investments and all other monetary assets. The breakdown is based on the country of domicile of the borrower or guarantor of ultimate risk.

	2000 %	1999 %	1998 %
United Kingdom	54	75	77
Continental Europe	34	15	12
United States	5	4	4
Rest of the world	7	6	7
	100	100	100

Financial Review (continued)

As shown in the table on page 39, the group's business is predominantly with countries and regions with developed economies. Outstandings to Latin America accounted for 2 per cent (1 per cent in 1999 and 2 per cent in 1998) of total outstandings. Outstandings to Indonesia, South Korea and Thailand, the three Asian countries that have negotiated arrangements with the International Monetary Fund, accounted for less than 1 per cent (less than 1 per cent in 1999 and 1998) of total outstandings.

Cross-border outstandings to borrowers in countries that individually represented in excess of 0.75 per cent of total assets, including acceptances, at 31 December 2000, with comparatives for 31 December 1999 and 1998, were as shown in the table below.

	2000		1999		1998	
	Total out-standings £bn	Percentage of total assets %	Total out-standings £bn	Percentage of total assets %	Total out-standings £bn	Percentage of total assets %
France	**5.6**	**3.0**	3.2	3.0	2.6	2.5
Germany	**5.9**	**3.2**	3.6	3.3	2.9	2.7
Italy	**5.3**	**2.8**	1.4	1.3	1.5	1.4
Japan	**1.4**	**0.8**	—	—	1.2	1.2
Mexico	—	—	—	—	0.8	0.8
Netherlands	**2.3**	**1.2**	1.2	1.1	—	—
Switzerland	**1.9**	**1.0**	1.0	1.0	—	—
United States	**8.2**	**4.4**	3.9	3.6	3.7	3.5

The following tables analyse cross-border outstandings by type of borrower in countries that individually represented in excess of 1 per cent of total assets, including acceptances, at 31 December 2000, 1999 and 1998.

	Government and official institutions £m	Banks and other financial institutions £m	Commercial, industrial and other £m	Total £m
2000				
France	**1,257**	**2,767**	**1,591**	**5,615**
Germany	**763**	**4,967**	**214**	**5,944**
Italy	**2,526**	**2,401**	**343**	**5,270**
Netherlands	**75**	**1,253**	**930**	**2,258**
Switzerland	**15**	**1,471**	**413**	**1,899**
United States	**3,432**	**2,697**	**2,113**	**8,242**
1999				
France	1,402	1,299	502	3,203
Germany	330	2,693	555	3,578
Italy	168	1,065	124	1,357
Netherlands	4	870	310	1,184
United States	364	2,625	909	3,898
1998				
France	989	1,215	444	2,648
Germany	593	2,275	39	2,907
Italy	232	1,278	15	1,525
Japan	70	1,085	80	1,235
United States	101	2,794	805	3,700

Loan concentrations

Information relating to industry concentrations, gross of specific provisions, is given within Note 16 'Concentrations of exposure' in the Notes on the Accounts.

Concentrations of credit risk

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

(a) the bank's position as one of the principal UK clearing banks means that the majority of the group's exposure to credit risk is concentrated in the United Kingdom. Within the United Kingdom, the group's credit risk is diversified over a wide range of industrial and economic groupings; and

(b) the group's position as part of a major international banking group means that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2000 and 31 December 1999 was concentrated in Europe (including the United Kingdom). Concentrations of credit risk arising from off-balance-sheet transactions are discussed on pages 48 and 49.

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

Bad and doubtful debts

The group's policy on bad and doubtful debts is discussed in Note 2b 'Principal accounting policies' in the Notes on the Accounts.

Movements in provisions for bad and doubtful debts analysed between domestic and international operations were as shown in the table below.

	2000 **£m**	1999 £m	1998 £m	1997 £m	1996 £m
Domestic					
At 1 January	**1,043**	912	972	924	942
Amounts written off	**(222)**	(208)	(320)	(203)	(248)
Recoveries of amounts written off in previous years	**25**	34	40	28	29
Charge to the profit and loss account	**259**	306	200	219	206
Exchange and other movements	**7**	(1)	20	4	(5)
At 31 December	**1,112**	1,043	912	972	924
Comprising:					
Specific provisions	**730**	698	574	650	646
General provisions	**382**	345	338	322	278
	1,112	1,043	912	972	924
International					
At 1 January	**118**	110	138	354	488
Amounts written off	**(33)**	(5)	(21)	(5)	(68)
Recoveries of amounts written off in previous years	**3**	8	1	8	22
Release for the year	**(15)**	(25)	(4)	(90)	(34)
Acquisition/(disposal) of subsidiary undertakings	**769**	30	—	(128)	—
Exchange and other movements	**5**	—	(4)	(1)	(54)
At 31 December	**847**	118	110	138	354
Comprising:					
Specific provisions	**701**	105	110	138	345
General provisions	**146**	13	—	—	9
	847	118	110	138	354
Total					
Comprising:					
Specific provisions	**1,431**	803	684	788	991
General provisions	**528**	358	338	322	287
	1,959	1,161	1,022	1,110	1,278

Financial Review (continued)

	2000 %	1999 %	1998 %	1997 %	1996 %
Total customer provisions as a percentage of gross loans and advances to customers	**2.4**	2.0	1.9	2.1	2.7
General provisions as a percentage of net loans and advances to customers	**0.7**	0.6	0.6	0.6	0.6
As a percentage of average gross loans and advances to banks and customers for the year:					
Charge for specific provisions	**0.3**	0.4	0.3	0.2	0.3
Total provisions charged	**0.3**	0.4	0.3	0.2	0.3
Amounts written off net of recoveries	**0.3**	0.3	0.5	0.3	0.5

Specific provisions increased by £628 million of which £627 million was due to acquisitions. The net specific charge in 2000 was £57 million (21 per cent) lower than in 1999. Excluding acquisitions, there was a £92 million (20 per cent) reduction in new provisions and a £34 million (19 per cent) fall in recoveries/releases. The domestic charge was £47 million lower than in 1999, with reductions in the specific charge for both personal and business customers being partially offset by a £29 million increase in the charge for general provisions. International businesses recorded a net release of provisions for the fifth successive year, partly as a result of the further sale of Latin American debt.

The £170 million increase in general provisions in 2000 comprised £134 million due to acquisitions made during the year, plus a £35 million net charge, taken primarily to ensure that coverage ratios were maintained at acceptable levels.

Total provisions increased by £798 million in 2000 and non-performing loans (NPLs) increased by £695 million of which £702 million was due to acquisitions. The coverage of provisions to NPLs increased from 76 per cent to 88 per cent primarily reflecting the acquisition of CCF. As a proportion of total advances, NPLs reduced from 2.2 per cent to 2.0 per cent in 2000.

Specific provisions increased by £119 million in 1999, influenced by the higher charge and a lower level of write-offs than in the previous year. The domestic charge in 1999 was £106 million (or 53 per cent) higher than 1998, including increased provisions on unsecured personal lending, but international businesses recorded a net release of provisions for the fourth successive year, following the further sale of Latin American debt. Despite this increase, the ratio of provisions to non-performing loans reduced to 76 per cent at the end of 1999, from 82 per cent at the end of 1998, since the non-performing debt portfolio had also grown during the period.

The following table analyses the amounts written off for each of the years in the five-year period ended 31 December 2000 by type of customer.

	2000		1999		1998		1997		1996	
	£m	%	£m	%	£m	%	£m	%	£m	%
Agriculture, forestry and fishing	**2**	**1**	2	1	1	—	1	—	1	—
Manufacturing, construction, property and other production	**117**	**38**	41	19	97	28	93	45	82	26
Financial and services	**67**	**22**	31	15	110	33	28	14	77	24
Individuals	**122**	**39**	134	63	112	33	84	40	91	29
Overseas customers	—	—	5	2	21	6	2	1	65	21
	308	**100**	213	100	341	100	208	100	316	100

The following table analyses the allocation of the provisions for bad and doubtful debts for each of the years in the five-year period ended 31 December 2000 by type of customer.

	2000		1999		1998		1997		1996	
	£m	**%**	£m	%	£m	%	£m	%	£m	%
Specific provisions										
Domestic										
Agriculture, forestry and fishing	**16**	**1**	15	1	8	1	10	1	6	—
Manufacturing, construction, property and other production	**142**	**7**	197	17	189	18	168	15	148	12
Financial and services	**178**	**9**	159	14	128	13	278	25	329	26
Individuals	**394**	**20**	327	28	249	24	194	18	162	13
Other	**—**	**—**	—	—	—	—	—	—	1	—
Total domestic	**730**	**37**	698	60	574	56	650	59	646	51
International	**701**	**36**	105	9	110	11	138	12	345	27
Specific provisions	**1,431**	**73**	803	69	684	67	788	71	991	78
General provisions	**528**	**27**	358	31	338	33	322	29	287	22
Total provisions	**1,959**	**100**	1,161	100	1,022	100	1,110	100	1,278	100

In 2000, domestic specific provisions increased by £32 million, including a £67 million rise in provisions held against individuals (primarily related to unsecured lending to customers of the branch network), which was partially offset by reductions in respect of business lending, notably in the manufacturing sector, where write-offs increased sharply. International provisions increased as a result of acquisitions in the year.

In 1999, domestic specific provisions increased by £124 million, mainly due to a £78 million increase in outstanding specific provisions against individuals in 1999, which reflects a higher charge on the unsecured loan book. Other domestic sectors were affected by the reduced level of write-offs in 1999. International provisions reduced by £5 million compared with 1998, mainly due to the sale of Latin American debt.

Credit risk elements

The SEC defines credit risk elements as (i) loans accounted for on a non-accrual basis, (ii) accruing loans that are contractually past due 90 days or more as to principal or interest payments and (iii) loans not included in (i) and (ii) that are 'troubled debt restructurings' as defined in Statement of Financial Accounting Standards ('SFAS') No. 15, 'Accounting by Debtors and Creditors for Troubled Debt Restructurings'. Credit risk elements also cover potential problem loans that are not included in the above three classifications. Such loans are discussed below.

However, the US accounting practice of classifying loans in accordance with the guidelines of the SEC is not, in normal circumstances, followed by UK banks. As a result, the group's credit risk elements are classified, as shown in the table below, as either 'Loans accounted for on a non-accrual

Non-performing loans	**2000 £m**	1999 £m	1998 £m	1997 £m	1996 £m
Loans accounted for on a non-accrual basis					
Domestic	**693**	614	533	520	591
International	**596**	16	22	36	243
	1,289	630	555	556	834
Loans on which interest has been accrued but suspended					
Domestic	**627**	777	624	759	824
International	**314**	128	67	106	136
	941	905	691	865	960

Financial Review (continued)

basis' or 'Loans on which interest has been accrued but suspended' (as defined on page 81). Both of these classifications are designated as non-performing loans and reflect situations where management has serious doubts as to the ability of the customer to comply with the loan repayment terms, with provisions having been raised as required.

There are no loans that are contractually past due 90 days or more or any loans classified as troubled debt restructurings that are not included in the table on page 43.

Total non-performing loans increased by £695 million in 2000, but this was more than accounted for by the acquisitions made during the year and is reflected in the rise in international figures shown in the table on page 43. Domestic non-performing loans decreased by £71 million, with a £150 million reduction in loans on which interest is suspended being partially offset by a £79 million increase in non-accrual loans, the latter largely reflecting a rise in relatively low value loans which have been referred for debt collection.

Interest income included in the consolidated profit and loss account for the year ended 31 December 2000, applicable to non-performing loans was £18 million (1999: £22 million; 1998: £25 million). Interest income that would have been included under the original terms of such loans was £82 million (1999: £66 million; 1998: £83 million).

Potential problem loans
At 31 December 2000, there were no significant potential problem loans, other than the amounts shown in the table on page 43. Problem loans are ones where known information about possible credit problems causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Impaired loans
Under SFAS No. 114, 'Accounting by Creditors for Impairment of a Loan', as amended by SFAS No. 118, 'Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosure', addresses accounting by creditors for impairment of a loan by specifying how allowances for credit losses for certain loans should be determined.

A loan is impaired when it is probable that a creditor will be unable to collect all amounts in accordance with the contractual terms of the loan agreement. Impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective rate or, as an expedient, at the fair value of the loan's collateral. Leases, smaller-balance homogeneous loans and debt securities are excluded from the scope of SFAS No. 114.

At 31 December 2000, the group estimated that the difference between the carrying value of its loan portfolio on the basis of SFAS No. 114 and its value in the group's UK GAAP financial statements was such that no adjustment to net income or shareholders' equity was required.

Impaired loans represent those reported as non-performing in the table on page 43; the value of such loans at 31 December 2000 was £2,230 million (1999: £1,535 million). Of this total, loans that were included within the scope of SFAS No. 114 and for which a provision has been established amounted to £1,781 million (1999: £1,183 million). The impairment reserve in respect of these loans estimated in accordance with the provisions of SFAS No. 114 is not significantly different from the UK GAAP provision of £1,018 million (1999: £454 million) held for such loans.

During the year ended 31 December 2000, impaired loans, including those excluded from SFAS No. 114, averaged £1,614 million (1999: £1,374 million).

Investment Securities

The book value of investment securities, analysed by type of borrower, is shown in the table below.

The group had no securities classified as held-to-maturity at 31 December 2000 and 1999.

	Debt securities £m	Treasury and other eligible bills £m	Total £m
2000			
US Government	3,339	98	**3,437**
UK Government	2,190	1,821	**4,011**
Other governments	2,253	1,581	**3,834**
Corporate and other	11,656	782	**12,438**
Total	**19,438**	**4,282**	**23,720**
Equity shares			**1,524**
Total investment securities			**25,244**
1999			
US Government	620	152	772
UK Government	4,463	819	5,282
Other governments	665	1,519	2,184
Corporate and other	5,649	1,373	7,022
Total	11,397	3,863	15,260
Equity shares			20
Total investment securities			15,280

The data required to complete a full analysis of investment securities is not available prior to 1999.

Treasury and other eligible bills

The following table analyses the weighted average yields of treasury bills and other eligible bills that meet the definition of securities available for sale under SFAS No. 115 at 31 December 2000. These are mainly short-term in maturity with a book value not materially different from market value.

For 1999, book value was not materially different from market value.

	Within one year		After one but within five years		After five but within 10 years		
	Balance £m	Yield %	Balance £m	Yield %	Balance £m	Yield %	Total £m
US Treasury and Government agencies	98	6.2	—	—	—	—	98
UK Government	1,752	5.0	69	7.0	—	—	1,821
Other governments	1,521	6.5	54	4.8	6	5.2	1,581
Corporate debt and other securities	780	5.9	2	6.8	—	—	782
Book value	4,151		125		6		4,282
Market value	4,123		125		6		4,254

The gross unrealised gains and losses on treasury and other eligible bills available for sale at 31 December 2000 are analysed in the table below.

	Book value £m	Gross unrealised holding gains £m	Gross unrealised holding losses £m	Market value £m
US Treasury and Government agencies	98	—	—	98
UK Government	1,821	11	(22)	1,810
Other government	1,581	26	(28)	1,579
Corporate debt and other securities	782	9	(24)	767
	4,282	46	(74)	4,254

Debt Securities

	Within one year		After one but within five years		After five but within 10 years		After 10 years		
	Balance £m	Yield %	Balance £m	Yield %	Balance £m	Yield %	Balance £m	Yield %	Total £m
US Treasury and Government agencies	76	4.3	564	4.6	74	6.6	2,625	7.2	3,339
UK Government	1,868	4.2	322	4.6	—	—	—	—	2,190
Other governments	1,231	2.7	536	4.9	315	7.8	171	9.2	2,253
Corporate debt and other securities	6,794	5.9	2,796	5.5	755	5.3	1,311	5.9	11,656
Book value	9,969		4,218		1,144		4,107		19,438
Market value	9,995		4,220		1,155		4,174		19,544

The table above analyses the maturities and weighted average yields of debt securities that meet the definition of securities available for sale under SFAS No. 115 at 31 December 2000.

The weighted average yield for each range of maturities in the above table is calculated by dividing the annualised interest income in relation to securities held as at 31 December 2000 by the amortised cost of securities at that date. The yields do not include the effect of related derivatives.

At 31 December 2000, the group held debt securities available for sale that exceeded 10 per cent of shareholders' funds as shown in the following table.

	2000	
	Amortised cost £m	Market value £m
Issued by UK Government	2,190	2,195
Issued by US Treasury and Government agencies	3,339	3,393

Financial Review (continued)

The gross unrealised gains and losses on securities available for sale at 31 December 2000 and 1999 are analysed in the table below.

	2000			
	Book value £m	Gross unrealised holding gains £m	Gross unrealised holding losses £m	Market value £m
US Treasury and Government agencies	**3,339**	**59**	**(5)**	**3,393**
UK Government	**2,190**	**5**	**—**	**2,195**
Other governments	**2,253**	**33**	**(8)**	**2,278**
Corporate debt and other debt securities	**11,656**	**70**	**(48)**	**11,678**
Total debt securities	**19,438**	**167**	**(61)**	**19,544**

	1999			
	Book value £m	Gross unrealised holding gains £m	Gross unrealised holding losses £m	Market value £m
US Treasury and Government agencies	620	—	(15)	605
UK Government	4,463	1	(21)	4,443
Other governments	665	19	(3)	681
Corporate debt and other debt securities	5,649	7	(5)	5,651
Total debt securities	11,397	27	(44)	11,380

Equity shares

The following table analyses the gross unrealised gains and losses arising on those equity shares which meet the definitions of securities available for sale under SFAS No. 115 at 31 December 2000.

	Book value £m	Gross unrealised holding gains £m	Gross unrealised holding losses £m	Market value £m
2000	**1,524**	**116**	**(18)**	**1,622**
1999	20	9	—	29

Securities available for sale

The proceeds on disposal and amounts received on maturity of securities available for sale during the year ended 31 December 2000 were £39,592 million (1999: £24,554 million; 1998: £12,317 million), on which gross realised gains of £45 million (1999: £45 million; 1998: £26 million) and gross realised losses of £18 million (1999: £25 million; 1998: £ nil) arose.

The amount received on maturity of securities available for sale during the year ended 31 December 2000 was £32,790 million (1999: £19,291 million; 1998: £8,886 million). The proceeds on disposal of securities available for sale during the year ended 31 December 2000 were £6,802 million (1999: £5,263 million; 1998: £3,431 million).

The cost of securities available for sale purchased during the year ended 31 December 2000 was £40,752 million (1999: £27,825 million; 1998: £13,078 million).

■ Deposits

Year-end non-interest-bearing and interest-bearing deposits, analysed between domestic and international, were as shown in the table below.

	2000 £m	1999 £m
Domestic		
Non-interest-bearing	**10,090**	9,399
Interest-bearing	**66,787**	61,302
	76,877	70,701
International		
Non-interest-bearing	**8,406**	102
Interest-bearing	**46,046**	7,071
	54,452	7,173

The above analysis includes short-term borrowings, which are analysed further on page 47.

At 31 December 2000, the aggregate amount of deposits by foreign depositors in domestic offices was £20,337 million (1999: £18,873 million; 1998: £16,506 million).

Interest rates on deposits are varied from time to time, being set and published by the bank.

An analysis of the average amount of, and the average rate paid on, domestic and international deposits by banks and customer accounts by type is shown on page 29.

At 31 December 2000, the maturity of certificates of deposit and other time deposits was:

	2000			
	Certificates of deposit £m	%	Other time deposits £m	%
Domestic				
3 months or less	463	78	17,063	83
6 months or less but over 3 months	60	10	897	4
12 months or less but over 6 months	17	3	609	3
Over 12 months	52	9	1,951	10
	592	100	20,520	100
International				
3 months or less	2,412	93	22,536	95
6 months or less but over 3 months	166	6	530	2
12 months or less but over 6 months	12	1	520	2
Over 12 months	—	—	191	1
	2,590	100	23,777	100

Certificates of deposit and other time deposits, most of which were in denominations of US$100,000 or more, have fixed maturity dates and bear interest at rates that reflect money market rates.

Further analyses of deposits by banks and customer accounts at 31 December 2000 and 1999 are shown in Notes 25 'Deposits by banks' and 26 'Customer accounts' respectively in the Notes on the Accounts.

Short-term borrowings

Short-term borrowings are not shown separately on the balance sheet but are included in deposits. Short-term borrowings include securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

The group had liabilities relating to securities sold under agreements to repurchase as shown in the table below.

Other than securities sold under agreements to repurchase, the group had no significant short-term borrowings.

	2000		1999		1998	
	Balance £m	Weighted average rate %	Balance £m	Weighted average rate %	Balance £m	Weighted average rate %
At 31 December	4,865	6.2	1,715	4.9	3,457	5.2
Average during the year	3,651	6.1	2,784	4.3	4,182	5.9
Maximum outstanding at any month-end	6,791		4,328		5,742	

Derivatives

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

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

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

Financial Review (continued)

Type of instruments

Exchange rate contracts include spot and forward foreign exchange contracts, cross currency swaps, currency futures, currency options and similar instruments.

Forward foreign exchange contracts are agreements to buy or sell fixed amounts of currency at agreed rates of exchange on a specified future date.

Cross currency swaps are agreements to exchange, and on termination of the swap re-exchange, principal amounts denominated in different currencies. Cross currency swaps may involve the exchange of interest payments in one specified currency for interest payments in another specified currency for a specified period.

Currency futures are agreements to buy or sell standard amounts of a specified currency at an agreed exchange rate on a standard future date.

Currency options give the buyer the right, but not the obligation, to buy or sell specified amounts of currency at agreed rates of exchange on or before a specified date.

Interest rate contracts include interest rate swaps, interest rate futures, forward rate agreements ('FRAs') and interest rate options, caps and floors.

Interest rate swaps involve the exchange of interest rate obligations with a counterparty for a specified period without exchanging the underlying (or notional) principal. The group may enter a swap transaction either as an intermediary (i.e. guaranteeing one or both counterparties) or as a direct counterparty.

Interest rate futures are agreements to buy or sell a standard amount of a specified fixed income security or time deposit at an agreed interest rate on a standard future date.

FRAs give the buyer the ability to determine the underlying rate of interest for a specified period commencing on a specified future date (the 'settlement date'). There is no exchange of principal and settlement is effected on the settlement date. The settlement amount is calculated by reference to the difference between the contract rate and the market rate prevailing on the settlement date.

Interest rate options give the buyer the right, but not the obligation, to fix the rate of interest on a future deposit or security (e.g. gilt options) for a specified period and commencing on a specified future date.

Interest rate caps and floors give the buyer the ability to fix the maximum or minimum rate of interest. There is no facility to deposit or draw down funds, instead the writer pays to the buyer the amount by which the market rate exceeds or is less than the cap rate or floor rate respectively. A combination of a bought (or sold) interest rate cap and a bought (or sold) floor is known as an interest rate collar.

Risks associated with derivatives

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

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than required in cash markets. Recognising this, only certain offices with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. The management of market risk arising from derivatives business is monitored daily by the market risk control unit in each office and on a regular basis by Group Market Risk, in combination with market risks arising from on-balance-sheet instruments (Note 37 'Market risk management' in the Notes on the Accounts).

Unlike assets recorded on the balance sheet, where the credit risk is typically the full amount of the principal value, together with any unrealised interest accrued or mark-to-market gain (Note 12 'Credit risk management' in the Notes on the Accounts), the credit risk relative to a derivative is principally the replacement cost of any contract with a positive mark-to-market gain and an estimate for the potential future change in value, reflecting the volatilities affecting the contract. Credit risk on contracts having a negative mark-to-market value is restricted to the potential future change in value. Credit risk on derivatives is, therefore, small in relation to a comparable balance sheet risk. In addition, credit exposure with individual counterparties can be reduced by close-out netting agreements, which allow for positive and negative mark-to-market values on different transactions to be offset and settled by a single payment in the event of default by either party. Such agreements are enforceable in the jurisdictions of the major market makers and the group has executed close-out netting agreements with the majority of these counterparties, notwithstanding the fact that the group deals only with the most creditworthy counterparties.

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

The following table analyses the replacement cost of all third-party exchange rate, interest rate and equities contracts with positive mark-to-market gains, after netting where possible, by maturity and by category of counterparty at 31 December 2000 and 31 December 1999. The table shows that the replacement cost of derivatives is predominantly with banks and under five years.

Replacement cost

	Residual maturity					
	Less than 1 year £m	1-5 years £m	Over 5 years £m	Netting £m	Total 2000 £m	Total 1999 £m
Government	2	8	70	—	**80**	86
Banks	3,859	3,516	1,339	(3,709)	**5,005**	3,586
Non-bank financial institutions						
Exchanges*	10	3	—	—	**13**	25
Other	837	569	251	(311)	**1,346**	942
Other sectors	725	211	70	(127)	**879**	432
Netting	(1,430)	(1,757)	(960)	4,147	—	
Total 2000	**4,003**	**2,550**	**770**	**—**	**7,323**	
Total 1999	2,544	1,994	533			5,071

** Exchanges with margining requirements*

A maturity profile of the contract amounts of third-party derivative contracts outstanding at 31 December 2000 and 31 December 1999 shows that the majority of contracts are executed over the counter and mature within one year (see table below).

Contract amount

	Residual maturity				
	Less than 1 year £m	1-5 years £m	Over 5 years £m	Total 2000 £m	Total 1999 £m
Exchanges and interest rate contracts					
Exchanges with margining requirements	43,793	18,656	9	**62,458**	65,841
Other	440,678	246,072	72,244	**758,994**	537,976
Total 2000	**484,471**	**264,728**	**72,253**	**821,452**	
Total 1999	412,601	154,778	36,438		603,817

Further information on derivatives can be found in Note 35 'Financial instruments' in the Notes on the Accounts.

Derivatives used for trading purposes

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

The average mark-to-market values for the years ended 31 December 2000 and 31 December 1999 are analysed below. Positive amounts represent replacement cost values, while negative amounts represent losses on contracts where the current mark-to-market value is less than the value contracted.

	2000 £m	1999 £m
Average mark-to-market value		
Exchange rate contracts		
Assets	**2,748**	2,711
Liabilities	**(3,428)**	(3,001)
Interest rate contracts		
Assets	**1,458**	2,174
Liabilities	**(1,538)**	(1,929)
Equities contracts		
Assets	**982**	1,452
Liabilities	**(1,156)**	(1,479)

Financial Review (continued)

Mark-to-market values are determined by reference to market rates prevailing on the date of valuation or by discounting future cash flows.

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

Assets, including gains, resulting from derivatives that are marked to market, are included within 'Other assets' in the consolidated Balance Sheet (on page 75). Liabilities, including losses, resulting from such contracts, are included in 'Other liabilities'.

Dealing revenues arising from derivative instruments are analysed on page 17.

The contract amount, replacement cost and mark-to-market values of third-party and internal trading derivatives by product type is on page 116, in Note 35 'Financial instruments' in the Notes on the Accounts.

Derivatives used for non-trading purposes

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

For the year ended 31 December 2000, gross interest income on non-trading derivative activities was £240 million (1999: £174 million; 1998: £84 million) and gross interest payable was £119 million (1999: £60 million; 1998: £85 million). Other operating income, relating to terminated contracts, was £ nil (1999: £ nil; 1998: £3 million).

The table below summarises, by contract amount, the activity in non-trading derivatives.

	2000 £m	1999 £m	1998 £m
At 1 January	**26,459**	32,855	32,632
New contracts	**22,559**	9,683	15,933
Matured and amortised contracts	**(9,643)**	(13,196)	(15,824)
Terminated contracts	**(1,560)**	(3,147)	(234)
Effect of foreign exchange rate and other movements	**4,559**	264	348
Acquisition of subsidiary undertakings	**50,255**	—	—
At 31 December	**92,629**	26,459	32,855

Of the above non-trading derivatives, £46,694 million related to contracts maturing in 2001, £37,613 million to contracts maturing in 2002 to 2005 and £8,322 million to contracts maturing in 2006 and thereafter.

The contract amounts at 31 December 2000 and 31 December 1999 of each type of non-trading exchange rate contract, excluding cross currency interest rate swaps that are included in interest rate swaps detailed above, are analysed by currency in the table below.

	2000 £m	1999 £m
US dollars	**3,238**	2,763
Japanese yen	**341**	564
Euros	**498**	199
Sterling	**1,888**	734
Other	**2,307**	1,483
Total	**8,272**	5,743

Of the above non-trading exchange rate contracts, £8,236 million related to contracts maturing in 2001 and £36 million to contracts maturing in 2002 to 2005.

At 31 December 2000, the group had no significant derivative instruments held or issued that were accounted for as hedges of anticipated transactions.

Further disclosures of derivatives used for non-trading purposes are in Note 35 'Financial instruments' in the Notes on the Accounts.

Fair Value of Financial Instruments

SFAS No. 107 'Disclosures about Fair Value of Financial Instruments' requires disclosure of the estimated fair values of certain financial instruments, both on-balance-sheet and off-balance-sheet, where it is practicable to do so.

Where possible, fair values have been estimated using market prices for the financial instruments. Where market prices are not available, fair values have been estimated using quoted prices for financial instruments with similar characteristics, or otherwise using a suitable valuation technique where practicable to do so. The fair value information presented represents the group's best estimate of those values and may be subject to certain assumptions and limitations.

The fair values presented in the table on page 52 are at a specific date and may be significantly different from the amounts that will actually be paid or received on the maturity or settlement date. In many cases, the estimated fair values could not be realised immediately and accordingly do not represent the value of these instruments to the group as a going concern.

The group has excluded the fair value of intangible assets, such as values placed on its portfolio of core deposits, credit card relationships and customer goodwill, as these are not considered to constitute financial instruments for the purposes of SFAS No. 107. The group believes such items to be significant and essential to the overall evaluation of the group's worth.

In view of the above, comparisons of fair values between financial institutions may not be meaningful and users are advised to exercise caution when using this data.

Financial instruments for which fair value is equal to carrying value

The following table lists those financial instruments, within the scope of SFAS No. 107, where carrying value is an approximation of fair value because they are either (i) carried at market value or (ii) short term in nature or reprice frequently. By definition, the fair value of trading account assets and liabilities, including derivative instruments, equals carrying value. Carrying values of these instruments are presented on the balance sheets and related notes on pages 75 and 117.

Assets	Liabilities
Cash and balances at central banks	Deposits by banks repayable on demand or that mature/reprice within six months
Items in the course of collection	Customer accounts repayable on demand or that mature/reprice within six months
Trading treasury bills and other eligible bills, debt securities and equity shares	Trading debt securities in issue
	Short positions in treasury bills, debt securities and equity shares
	Items in the course of transmission
Other assets	Other liabilities
Prepayments and accrued income	Accruals and deferred income
Off-balance-sheet trading instruments	Off-balance-sheet trading instruments

Financial Review (continued)

Other financial instruments

The fair value of other financial instruments within the scope of SFAS No. 107 is set out in the table below. The valuation technique adopted for each major category is discussed below.

Loans and advances to banks and customers

For personal and commercial loans and advances which mature or reprice after six months, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates).

Performing loans are grouped, to the extent possible, into homogeneous pools segregated by maturity and the coupon rates of the loan within each pool. In general, cash flows are discounted using current market rates for instruments with similar maturity, repricing and credit risk characteristics.

For non-performing uncollateralised commercial loans, an estimate is made of the time period to realise these cash flows and the fair value is estimated by discounting these cash flows at a risk-free rate of interest. For non-performing commercial loans where collateral exists, the fair value is the lesser of the carrying value of the loans, net of specific provisions, or the fair value of the collateral, discounted where appropriate. General provisions are deducted from the fair values of these non-performing loans.

Treasury and other eligible bills, debt securities and equity shares held for investment purposes, and other participating interests

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

Deposits by banks and customer accounts

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

Debt securities in issue and subordinated liabilities

Fair value is estimated using quoted market prices at the balance sheet date.

The following table presents the carrying value and fair value for those financial instruments whose fair value is derived using these various estimation techniques.

The carrying and fair values of non-trading derivative financial instruments are disclosed on page 118 in Note 35 'Financial instruments' in the Notes on the Accounts.

	2000		1999	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Assets				
Treasury and other eligible bills — non-trading	**4,282**	**4,254**	3,863	3,863
Loans and advances to banks and customers	**110,342**	**110,357**	69,818	69,788
Debt securities — non-trading	**19,438**	**19,544**	11,397	11,380
Equity shares — non-trading	**1,524**	**1,622**	20	29
Liabilities				
Deposits by banks and customer accounts	**131,329**	**131,338**	77,874	77,881
Debt securities in issue — non-trading	**9,191**	**9,201**	3,917	3,923
Subordinated liabilities	**5,212**	**5,113**	3,373	3,257

Other information

Supervision and Regulation

The Financial Services Authority ('FSA') is responsible for authorising and supervising UK institutions in accordance with the UK Banking Act 1987. Within the group, the bank and HSBC Trust Company (UK) Limited are the main authorised institutions supervised by the FSA, whilst Crédit Commercial de France S.A. is the principal overseas banking subsidiary which is regulated by the FSA and in turn, local regulators in France.

UK supervision and regulation

The UK Banking Act sets out the requirements for banks to report, and in certain cases obtain consent for, large individual exposures and large exposures to related borrowers, and the minimum criteria for authorisation. The UK Banking Act permits the FSA to obtain independent reports from the reporting accountants for authorised institutions, usually their auditors, as to the adequacy of systems of internal control and accounting and internal records. The FSA also has statutory powers to object, on prudential grounds, to persons who are, or intend to become, controllers of 10 per cent or more of the voting power of an authorised institution. The FSA may also object to directors and managers who are not, in its view, fit and proper persons. A deposit protection scheme, originally established under the UK Banking Act 1979 and continued under the UK Banking Act 1987, was amended during 1995 to be consistent with the Deposit Guarantee Directive under the terms of the EU single market. The scheme is administered by a statutory body and provides a measure of protection for deposits denominated in euros or European Economic Area ('EEA') member country currencies made with the EEA offices of authorised institutions in the event of their insolvency. The scheme is funded by contributions made by authorised institutions. Depositors with an insolvent institution are entitled to receive 90 per cent of their protected deposits, subject to a maximum payment to any one depositor of £18,000 (or €20,000 if greater).

The FSA regulates UK banks and banking groups by monitoring their performance through interviews and regular prudential reporting which, under the UK Banking Act, may be subject to review by reporting accountants, at their request. The group's senior executives attend regular meetings with the FSA and these meetings are used by the FSA to ensure that authorised institutions are conducting their business in a prudent manner and with due regard for the prudential guidelines that it has issued. Fundamental matters relating to the group's business, such as strategic and operating plans, risk control, loan portfolio composition and organisational changes, are regularly discussed.

The group's securities and investment businesses in the United Kingdom, including the sale of personal financial services in the investment field through the bank's branches, are regulated under the Financial Services Act 1986 ('FS Act'). The FS Act established a framework for strengthening investor protection by the regulation of investment businesses and securities markets. Every investment firm is required to join one or more Self-Regulating Organisations ('SROs') or be directly authorised by the FSA. The bank is subject to regulation both by the FSA under the powers of the Banking Act and by the relevant SROs under the FS Act. In recognition of the industry's desire to avoid duplication, agreement was reached between the FSA and the relevant SROs that the FSA would act as 'lead regulator' in monitoring compliance with the capital requirements for the securities and investment businesses undertaken by banks. Additionally, the FSA provides the staff under contract to the SROs for the regulation of investment business.

The Personal Investment Authority ('PIA') is responsible for the regulation of the majority of the bank's investment business for retail investors. The bank is also regulated by the Investment Management Regulatory Organisation ('IMRO') for its collective investment scheme trusteeship activity. The Securities and Futures Authority ('SFA') regulates the bank's custody services and its branch share dealing.

In due course, the SROs, to which have been delegated certain powers by the FSA under the FS Act, will have their powers re-assigned to the FSA when the Financial Services and Markets Act 2000 comes into effect. The exact timing of this change is unknown at present but it is expected to be during the course of the year.

Other information (continued)

French supervision and regulation

French banking law sets out the conditions under which banks may operate in France and vests related supervisory and regulatory powers in certain administrative authorities as follows:

- The National Credit and Securities Council, is a consultative organisation that studies the operation of the banking and financial service industries and participates in the formulation of national credit and monetary policy.
- The Banking and Finance Regulatory Committee, establishes general rules for the conditions under which banks operate, including management standards, financial ratios and credit policy and determination of capital requirements.
- The Credit Institutions and Investment Firms Committee, which is chaired by the Governor of the Bank of France, grants banking and investment firms licences and makes other specific decisions and grants specific exemptions as provided in applicable banking regulations.
- The Banking Commission, which is chaired by the Governor of the Bank of France, is responsible for the supervision of credit institutions and certain investment firms and enforcement of laws and regulations applicable to them. Banks are required to submit periodic (either monthly or quarterly) accounting reports to the Banking Commission concerning the principal areas of their activity. The Banking Commission may also carry out on-site inspections.

In addition, the Banking Commission has the power to appoint a temporary administrator to manage provisionally a bank which it deems to be mismanaged.

The principal regulations applicable to deposit banks such as Crédit Commercial de France are minimum capital ratio requirements, equity and permanent resources (certain long-term assets denominated in French francs) ratios, risk diversification and liquidity, as well as monetary policy, restrictions on equity investments and reporting requirements.

French regulations permit only licensed credit institutions to engage in banking activities on a regular basis.

All credit institutions operating in France are required by law to operate a deposit guarantee mechanism for customers of commercial banks, except branches of European Economic Area banks which are covered by their home country's guarantee system. The contribution of each credit institution is calculated on the basis of the aggregate deposits and one-third of the gross customer loans held by such credit institution and of the risk exposure of such credit institution.

French credit institutions are required to establish appropriate internal control systems and prepare an annual report for review by the institution's board of directors and the Banking Commission.

■ Monetary Policy

Low and stable inflation remains the cornerstone of UK monetary policy. The Government sets an inflation target which is reviewed in each Budget Statement. The Government's current target is to achieve underlying inflation as measured by the retail price index, excluding mortgage interest payments, of 2.5 per cent. Operational responsibility for setting short-term interest rates to achieve that target is in the hands of the Bank of England and a Monetary Policy Committee that meets monthly, normally on the Wednesday afternoon and Thursday morning after the first Monday of the month, to decide on the appropriate level. Decisions are announced at noon following the Thursday meeting. Monetary policy is assumed to influence inflation with a lag so that base rates are set on a judgement of inflation prospects up to two years ahead. Should the underlying rate move outside a band of one percentage point above or below the 2.5 per cent target, the Governor of the Bank of England has to write to the Chancellor setting out the reasons for the divergence.

Since the introduction of inflation targets, inflation in the UK has recorded its best performance for nearly 50 years and, since 1993, the underlying measure has ranged between 1.9 and 3.5 per cent. In 2000, underlying inflation in the UK averaged 2.1 per cent, compared with 2.3 per cent in 1999 and 2.6 per cent in 1998, and had no significant impact on the results of the group's UK operations.

UK growth is expected to slow to around trend this year, partly in response to the earlier increases in interest rates, partly as a result of moderating world growth. The slowing in activity should ensure inflation remains benign, allowing base rates to fall as the year progresses.

Description of Premises

The group has a substantial network of premises, including an extensive branch network in the United Kingdom and, following the acquisition of CCF, a significant network in France. The group has about 2,700 premises, principally in the United Kingdom, of which approximately 900 are either freehold or long leasehold premises in the United Kingdom and approximately 700 are in France. The bank's head office is at Poultry, London, England.

Further details are included in Note 23 of the Notes on the Accounts.

In 1998, HSBC Holdings announced its intention to develop a new Headquarters building at London's Canary Wharf, bringing together some 8,500 staff from HSBC Holdings and its subsidiaries including the bank. The bank's head office departments will relocate to the new building on completion in 2002. The building will be held on a 999-year lease by the bank.

Employees

As at 31 December 2000, the group had approximately 68,400 employees (of whom approximately 51,000 work in the United Kingdom and 11,900 in France), compared with approximately 50,000 at 31 December 1999 and 49,000 at 31 December 1998. Most of the group's labour force in the UK and France is unionised. Management believes that the current relationship between the group and its employees is harmonious, as it has been in the past. The group has not experienced any material strikes or work stoppages within the prior five years.

Legal Proceedings

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

Board of Directors

Directors

Sir John Bond, *Chairman*
Age 59. A Director since 1993 and Chairman from 1998. Group Chairman of HSBC Holdings plc. Joined HSBC in 1961. Chairman of HSBC USA Inc., HSBC Bank USA and HSBC Bank Middle East. A Director of The Hongkong and Shanghai Banking Corporation Limited. Chairman of the Institute of International Finance and a Director of Ford Motor Company.

K R Whitson, *Deputy Chairman*
Age 57. A Director since 1992, Deputy Chief Executive from 1992 to 1994, Chief Executive from 1994 to 1998 and Deputy Chairman since 1998. Joined HSBC in 1961. Group Chief Executive of HSBC Holdings plc. Chairman of Merrill Lynch HSBC Limited and Deputy Chairman of the Supervisory Board of HSBC Trinkaus & Burkhardt KGaA. A Director of The Hongkong and Shanghai Banking Corporation Limited, HSBC USA Inc., HSBC Bank Canada and HSBC Argentina Holdings S.A. A non-executive Director of the Financial Services Authority.

W R P Dalton, *Chief Executive*
Age 57. A Director and Chief Executive since 1998. An executive Director of HSBC Holdings plc. Joined HSBC in 1980. President and Chief Executive Officer, HSBC Bank Canada from 1992 to 1997. Deputy Chairman of Merrill Lynch HSBC Limited and a Director of Crédit Commercial de France S.A., HSBC Investment Bank Holdings plc, HSBC Private Banking Holdings (Suisse) SA and HSBC Bank Malta p.l.c. President of The Chartered Institute of Bankers. A non-executive Director of MasterCard International Inc. and a non-executive Director and Chairman of Young Enterprise Limited.

D W Baker, *Chief Operating Officer*
Age 58. A Director since 1996 and Chief Operating Officer since 1998. Joined HSBC in 1962. Chairman, HSBC Bank Pension Trust (UK) Limited and a Director of HSBC Bank Malta p.l.c. and The Cyprus Popular Bank Limited. A non-executive Director of Market Harborough Building Society, VISA European Union, Industry in Education and a member of the CBI Council.

C F W de Croisset
Age 57. A Director since September 2000. Chairman and Chief Executive of Crédit Commercial de France S.A. An executive Director of HSBC Holdings plc. Joined Crédit Commercial de France S.A. in 1980.

* **R Emerson**
Age 51. A Director since 1996. Senior Vice President Tax & Treasury at GlaxoSmithKline plc. Formerly a partner of Coopers & Lybrand.

C-H Filippi
Age 48. A Director since September 2000. Administrateur Directeur Général of Crédit Commercial de France S.A., President of HSBC CCF Investment Bank (France) and a Director of HSBC Investment Bank Holdings plc. Joined Crédit Commercial de France S.A. in 1987.

S K Green
Age 52. A Director since 1995. Executive Director Investment Banking and Markets. Joined HSBC in 1982. An executive Director of HSBC Holdings plc. Group Treasurer, HSBC Holdings plc from 1992 to 1998. Chairman of HSBC Investment Bank Holdings plc and a Director of Crédit Commercial de France S.A., HSBC Guyerzeller Bank AG, HSBC USA Inc., HSBC Bank USA, HSBC Private Banking Holdings (Suisse) SA and HSBC Trinkaus & Burkhardt KGaA.

* **A J Hales**
Age 52. A Director since 1994. Formerly Chief Executive of Allied Domecq PLC. A non-executive Director of Aston Villa plc and Reliance Security Group plc.

R M J Orgill
Age 62. A Director since 1994. Deputy Chief Executive from 1994 to 1998. Global Head of Corporate and Institutional Banking for the HSBC Group. Joined HSBC in 1958. A Director of HSBC Investment Bank Holdings plc and The Hongkong and Shanghai Banking Corporation Limited. A non-executive Director of Euroclear Clearance System S.C. and British Trade International.

*** A C Reed (Mrs)**
Age 44. A Director since 1996. Finance Director, UK Retail, at Marks & Spencer plc.

*** H A Rose**
Age 60. A Director since 1997. Formerly Deputy Chairman of The Rover Group Limited.

*** J Singh**
Age 49. Appointed a Director on 25 January 2001. Chairman and Chief Executive Officer of Edwardian Group Limited.

**Independent non-executive Director*

Secretary

I B Marshall
Age 51. Joined HSBC in 1995.

Registered Office: Poultry, London EC2P 2BX

Senior Executives

A J Ashford
Age 51. General Manager, Personal Financial Services. Joined HSBC in 1985.

G P S Calvert, OBE
Age 48. General Manager, Northern, Scotland and Northern Ireland Division. Joined HSBC in 1974.

R L Carlson
Age 56. Head of Information Technology. Joined HSBC in 1982.

S A Donohoe
Age 59. General Manager, Service and Sales. Joined HSBC in 1960.

I M Dorner
Age 46. Head of Human Resources. Joined HSBC in 1986.

R J Duke
Age 50. General Manager, Southern Division. Joined HSBC in 1971.

R P Hennessy
Age 47. Chief Financial Officer. Joined HSBC in 1982.

A R F Hughes
Age 49. Chief Executive, First Direct. Joined HSBC in 1969.

A M Keir
Age 42. General Manager, Midlands Division. Joined HSBC in 1981.

D J Mills
Age 57. General Manager, Personal Banking. Joined HSBC in 1962.

R J Moseley
Age 43. General Manager, Card Services. Joined HSBC in 1976.

I D F Ogilvie
Age 41. General Manager, Marketing. Joined HSBC in 1987.

G E Picken
Age 51. General Manager, Commercial and Corporate Banking. Joined HSBC in 1971.

A F Rademeyer
Age 42. Treasurer, Treasury and Capital Markets. Joined HSBC in 1982.

W E Roberts
Age 54. General Manager, Western and Wales Division. Joined HSBC in 1962.

T Robson
Age 56. Chief Executive Officer, HSBC Bank Malta p.l.c. Joined HSBC in 1962.

C S Smith
Age 54. Head of Credit and Risk. Joined HSBC in 1964.

R G Spence
Age 41. General Manager, Operations. Joined HSBC in 1978.

C S O'N Wallis
Age 45. Head of International. Joined HSBC in 1978.

Report of the Directors

Results for 2000

The consolidated profit for the year attributable to the shareholders of the bank was £1,345 million.

Interim dividends of £550 million have been paid on the ordinary share capital during the year and the Directors have resolved to pay a further interim dividend for 2000 of £600 million.

Further information about the results is given in the consolidated profit and loss account on page 74.

Principal Activities and Business Review

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

The bank has approximately 1,700 branches in the United Kingdom. Outside the United Kingdom it has branches in Australia, Belgium, the Czech Republic, France, Greece, Guernsey, the Hong Kong Special Administrative Region, Ireland, the Isle of Man, Italy, Jersey, the Netherlands, Spain and Sweden; it has representative offices in Argentina, Bahrain, Brazil, Chile, Mexico, Singapore, South Africa, Taiwan and Venezuela. Through its subsidiary undertakings, joint ventures and associates, the bank provides a comprehensive range of banking and related financial services through an international network in some 35 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

The bank acquired 50.83 per cent (subsequently increased to 51.45 per cent) of HSBC Republic Holdings (Luxembourg) S.A. from HSBC Holdings plc on 4 January 2000. As part of an HSBC Group restructuring of its European private banking interests in December 2000, this interest was exchanged for a 97.45 per cent interest in HSBC Private Banking Holdings (Suisse) SA.

The bank acquired Crédit Commercial de France S.A. from HSBC Holdings plc on 31 October 2000.

A review of the development of the business of the group during the year and an indication of likely future developments are given in the Business Description and Financial Review on pages 4 to 52.

Share Capital

In January 2000, HSBC Holdings plc subscribed £987,052,325 for three additional ordinary shares of £1 each, credited as fully paid, in the ordinary share capital of the bank. The proceeds were used to fund, in part, the transfer to the bank of 50.83 per cent of HSBC Republic Holdings (Luxembourg) S.A., formerly Safra Republic Holdings S.A.

In October 2000, HSBC Holdings plc subscribed £6,718,619,902 for one additional ordinary share of £1 each, credited as fully paid, in the ordinary share capital of the bank. The proceeds were used to fund, in part, the transfer to the bank of Crédit Commercial de France S.A.

In December 2000, HSBC Holdings plc subscribed the equivalent of £1,327,526,970 for one additional ordinary share of £1 each, credited as fully paid, in the ordinary share capital of the bank. The share was issued as part of the restructuring of the HSBC Group's European private banking interests referred to above.

Subsequent Event

On 22 February 2001, the French Finance Ministry announced the sale of Banque Hervet to Crédit Commercial de France S.A., a subsidiary of the bank, for a consideration of FRF3,471 million.

Valuation of Freehold and Leasehold Land and Buildings

Freehold and long leasehold properties were revalued by professionally qualified valuers in November 2000 in accordance with the bank's policy of annual valuation. As a result of this revaluation, the net book value of land and buildings has increased by £28 million. Further details are included in Note 23c 'Tangible fixed assets — Valuations' in the Notes on the Accounts.

Board of Directors

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

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

The names of Directors serving at the date of this report and brief biographical particulars for each Director are set out on pages 56 and 57.

C F W de Croisset and C-H Filippi were appointed Directors on 1 September 2000. J Singh was appointed a Director on 25 January 2001. Having been appointed since the Annual General Meeting in 2000, they will retire at the forthcoming Annual General Meeting and offer themselves for election. Mr J F Devaney retired as a Director on 24 May 2000.

W R P Dalton, A J Hales and H A Rose will retire by rotation at the Annual General Meeting. With the exception of A J Hales, who will not seek re-election, they offer themselves for re-election.

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

Board Committees

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

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board. The members of the Executive Committee are W R P Dalton (Chairman), D W Baker, both of whom are executive Directors, and R P Hennessy, D J Mills, G E Picken, A F Rademeyer and C S Smith, all of whom are senior executives.

Audit Committee

The Audit Committee meets regularly with the bank's senior financial, internal audit and compliance management and the external auditor to consider the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee are H A Rose (Chairman), R Emerson and Mrs A C Reed, each of whom is an independent non-executive Director.

Property Committee

The Property Committee meets regularly to supervise and control the development of the new Headquarters building at London's Canary Wharf. The members of the Committee are Sir Wilfrid Newton (Chairman), a former independent non-executive Director, W R P Dalton, D J Flint (Finance Director of HSBC Holdings plc), S K Green and K R Whitson.

Corporate Governance

The HSBC Group is committed to high standards of corporate governance. The bank has complied throughout the year with the relevant best practice provisions of the Combined Code on corporate governance appended to the Listing Rules of the UK Listing Authority.

Report of the Directors (continued)

Internal Control

The Directors are responsible for internal control in the group and for reviewing its effectiveness. Procedures have been designed for safeguarding assets against unauthorised use or disposition, for maintaining proper accounting records, and for the reliability of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material errors, losses or fraud.

The key procedures that the Directors have established are designed to provide effective internal control within the HSBC Group and accord with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales. Such procedures have been in place throughout the year and up to 26 February 2001, the date of approval of the annual report and accounts. In the case of companies acquired during the year, including Crédit Commercial de France S.A., the internal controls in place have been reviewed against the HSBC Group's benchmarks since they were acquired and they are being integrated into the HSBC Group's systems. The HSBC Group's key internal control procedures include the following:

- Authority to operate the bank is delegated to the Chief Executive within limits set by the Board of Directors of the Company. The appointment of executives to the most senior positions within the group requires the approval of the Board of Directors of the Company. Functional, operating and financial reporting standards are established by HSBC Holdings' management for application across the whole HSBC Group. These are supplemented by operating standards set by the bank's management, as required.
- Systems and procedures are in place in the bank to identify, control and to report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error and fraud. Exposure to these risks is monitored by the Executive Committee and the Asset and Liability Management Committee.
- Comprehensive annual financial plans are prepared, reviewed and approved by the Board of Directors. Results are monitored regularly and reports on progress compared with plan are prepared monthly. Financial accounting and reporting and certain management reporting standards have been established. Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in the bank and aggregated for review of risk concentrations on an HSBC Group-wide basis.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in HSBC Holdings has been given responsibility to set policies, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain global product lines.
- The internal audit function, which is centrally controlled, monitors compliance with policies and standards and the effectiveness of internal control structures across the HSBC Group. The work of the internal audit function is focused on areas of greatest risk as determined by a risk management approach. The head of this function reports to the Group Chairman and the Group Audit Committee.

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

The Directors, through the Group Audit Committee, have conducted an annual review of the effectiveness of the bank's system of internal control covering all controls, including financial, operational and compliance controls and risk management.

Remuneration

The functions of the Remuneration Committee are fulfilled by the Remuneration Committee of the Board of the bank's parent company, HSBC Holdings plc. Its members are Sir Peter Walters (Chairman), W K L Fung and Lord Marshall, each of whom is an independent non-executive Director of HSBC Holdings plc.

Policy

The Remuneration Committee is responsible for determining the remuneration policy of the HSBC Group, including the terms of bonus plans, share option plans and other long-term incentive plans, and for agreeing the individual remuneration packages of the bank's executive Directors and other senior employees. No Directors are involved in deciding their own remuneration. During 2000, seven meetings of the Remuneration Committee were held.

The Remuneration Committee strives to ensure that total remuneration is fair and attractive to potential employees, whilst motivating and retaining existing high-calibre staff. The remuneration packages are structured to take due account of levels and composition of pay and the market positioning in the many countries and businesses in which the HSBC Group operates. In appropriate circumstances, performance-related payments and share awards are provided with the objective of rewarding achievement and aligning the interests of the individual with those of the HSBC Group's shareholders. The vesting of share awards is subject to the attainment of certain total shareholder return targets. The Remuneration Committee seeks to respond to the variety of environments and circumstances which are faced by different businesses in different markets at different times.

In determining the terms of annual bonus and incentive plans, individual remuneration awards, retirement benefit arrangements, notice periods and severance terms, the Remuneration Committee considers the practices and levels of remuneration in appropriate comparator companies that operate in similar industry sectors and territories to those in which an HSBC Group company operates and by which the executive Director or employee is employed. Due regard is paid to advice rendered by independent external professional consultants.

Share options are awarded to employees under the Group Share Option Plan (previously under the Executive Share Option Scheme) and Savings-Related Share Option Plan in order to align the interests of staff with those of the HSBC Group's shareholders.

During 2000, an independent survey of remuneration in respect of HSBC Group executive Directors and senior executives identified a need to review base salaries, cash bonuses and long-term incentives. The survey's recommendations, which took into account the fact that the remuneration of the HSBC Group's key Directors and executives was significantly behind the international market, were endorsed by the Remuneration Committee in January 2001 and have been implemented.

Basic salary and benefits

Salaries are reviewed annually in the context of individual and business performance, market practice, internal relativities and competitive market pressures. Allowances and benefits are largely determined by local market practice.

Annual performance-related payments

The level of performance-related payment depends upon the performance of the bank and the individual concerned. Key measures of success include achievement of financial goals, concerning both revenue generation and expense control; customer relationships; full utilisation of professional skills; and adherence to the HSBC Group's ethical standards. The HSBC Group has a long history of paying close attention to its customers in order to provide value for its shareholders. This has been achieved by ensuring that the interests of the HSBC Group and its staff are aligned with those of its shareholders, and that the HSBC Group's approach to risk management serves the interests of all. Closer alignment with the interests of shareholders is being achieved by extending employee participation in the existing share plans and the bank's 'Let's Reward Success' initiative, which seeks to incentivise all staff to deliver higher levels of customer-driven service.

Report of the Directors (continued)

Long-term share awards

The HSBC Holdings Restricted Share Plan 2000, and previously the Restricted Share Plan, are intended to align the interests of executives with those of shareholders by linking executive rewards to the creation of superior shareholder value. This is achieved by focusing on predetermined total shareholder return targets. The shares awarded are normally held under restrictions for five years and are transferred to the individuals only after the attainment of a performance condition which demonstrates the sustained and above average financial performance of the HSBC Group.

HSBC Holdings' executive Directors and Group General Managers have been eligible to receive conditional awards of Performance Shares under the Restricted Share Plan since 1997. The award of Performance Shares under the Restricted Share Plan was extended to other senior executives from 1999.

In appropriate circumstances, employees may receive awards under the Restricted Share Plan 2000 and the HSBC Group Share Option Plan. Participants in these Plans are also eligible to participate in the Savings-Related Share Option Plan on the same terms as other eligible employees.

As part of the HSBC Group's strategy, the use of the existing share plans has been extended so that more employees participate in the success they help to create.

Service contracts and terms of appointment

Neither executive Director has a service contract with the bank or any of its subsidiaries with a notice period in excess of one year or with provisions for predetermined compensation on termination which exceeds one year's salary and benefits in kind.

W R P Dalton, who is to stand for re-election at the forthcoming Annual General Meeting, is employed on a contract that requires 12 months' notice to be given by either party. C F W de Croisset and C-H Filippi, who will stand for election at the forthcoming Annual General Meeting, have contracts of employment that were in force before they joined the board of Crédit Commercial de France S.A. In accordance with French legal requirements and practice, these contracts are suspended while they serve as executive Directors of Crédit Commercial de France S.A.

However, on 7 July 2000 HSBC Holdings undertook with them that, in the event of the termination of their employment (except for serious cause) with Crédit Commercial de France S.A. during 2000 or 2001, it will procure that they receive an aggregate termination sum equal to (a) twice their total annual compensation for the preceding calendar year and (b) such termination indemnity (but not to exceed twice such total annual compensation) as would have been payable had they been salaried employees during the entire length of their careers with Crédit Commercial de France S.A. HSBC Holdings also undertook to procure that their total annual compensation from Crédit Commercial de France S.A., both base and variable, in respect of 2000 and 2001 would be no less than their total annual compensation in respect of 1999.

Senior executives are employed on service contracts which generally provide for a term of service expiring at the end of a period of up to two years, or the individual's sixtieth birthday, whichever is earlier.

Non-executive Directors are appointed for fixed terms not exceeding three years, subject to their re-election by shareholders at the intervening Annual General Meetings. Independent non-executive Directors terms of appointment will expire in: 2002 — Mrs A C Reed; 2003 — R Emerson; and 2004 — H A Rose and J Singh. A J Hales will retire at the forthcoming Annual General Meeting.

Directors' emoluments

The emoluments of the Directors of the Company for 2000 were as follows:

	Fees	*Salary and other remuneration*	*Benefits in kind*	*Discretionary bonuses* [1]	*Total 2000*	*Total 1999*
	£000	£000	£000	£000	£000	£000
Executive Directors						
D W Baker	25	285	1	137	448	370
W R P Dalton	—	488	23	—[2]	511	416
Non-executive Directors						
C F W de Croisset[3]	—	41	—	67	108	—
J F Devaney[4]	15	—	—	—	15	35
R Emerson	33	—	—	—	33	33
C-H Filippi[3]	6	36	—	133	175	—
A J Hales	25	—	—	—	25	25
R M J Orgill	25	—	—	—	25	25
A C Reed	33	—	—	—	33	33
H A Rose	34	—	—	—	34	33
Total	196	850	24	337	1,407	970

1 *These discretionary bonuses are in respect of 2000 and will be paid in 2001.*
2 *In return for the prior waiver of bonus, the employer contribution into the pension scheme has been increased by the amount (£300,000) which would otherwise have been paid.*
3 *Executive Directors of Crédit Commercial de France S.A., appointed on 1 September 2000.*
4 *Retired on 24 May 2000.*

A fee of £25,000 was paid to Sir Wilfrid Newton, a former Director of the bank, in respect of his role as Chairman of the Property Committee.

Sir John Bond, S K Green and K R Whitson received no emoluments from the bank or from its subsidiary undertakings.

The aggregate remuneration of Directors and senior executives of the bank for the year ended 31 December 2000 was to £6,406,000.

2001 conditional awards under the Restricted Share Plan 2000

The Remuneration Committee has proposed to the Trustee of the Restricted Share Plan 2000 that conditional awards of Performance Shares under the Plan should be made in 2001. The Trustee to the Plan will be provided with funds to acquire ordinary shares of US$0.50 each between 26 February and 9 March 2001. The 2001 awards proposed for HSBC Holdings executive Directors and Group General Managers in respect of 2000 would have an aggregate value at the date of award of £8.275 million including awards to the following values to Directors of the bank:

	£000
D W Baker	200
Sir John Bond	700
W R P Dalton	400
S K Green	700
R M J Orgill	150
K R Whitson	550
Total	2,700

No share options will be granted to those executives under the HSBC Group Share Option Plan in respect of 2000.

No award under the Restricted Share Plan 2000 has been made to C F W de Croisset or C-H Filippi in respect of 2000. They will instead receive options to acquire 206,000 and 202,000 ordinary shares of US$0.50 each respectively under the HSBC Group Share Option Plan.

Report of the Directors (continued)

Purpose

The Restricted Share Plan 2000 is intended to reward the delivery of sustained financial growth of the HSBC Group. So as to align the interests of Directors and senior employees more closely with those of shareholders, the Restricted Share Plan 2000 links the vesting of 2001 awards to the attainment of predetermined total shareholder return ('TSR') targets.

TSR is defined as the growth in share value and declared dividend income during the relevant period. In calculating TSR, dividend income is assumed to be reinvested in the underlying shares.

The vesting of awards made in 1997 and 1998 is linked to growth in earnings per share, details of which are set out in the 1996 and 1997 Annual Report and Accounts. From 1999, the vesting of awards was linked to the attainment of predetermined TSR targets. Particulars of the terms applicable in 2001 are set out below.

Vesting schedule

Having regard to the HSBC Group's size and status within the financial sector, a benchmark has been established which takes account of:

1. a peer group of nine banks;
2. the five largest banks from each of the United States, the United Kingdom, continental Europe and the Asia-Pacific region, other than any within 1 above; and
3. the banking sector of the Morgan Stanley Capital International World Index, excluding any within 1 and 2 above.

By combining the above three elements and weighting the average so that 50 per cent is applied to 1, 25 per cent is applied to 2 and 25 per cent is applied to 3, an appropriate market comparator is determined.

The extent to which awards will vest will be determined by reference to the HSBC Group's TSR measured against the mean of the benchmark. The calculation of the share price component within the HSBC Group's TSR will be the average market price over the 20 trading days commencing on the day when the annual results are announced, which in 2001 is 26 February. The starting point will be, therefore, the average over the period 26 February to 23 March inclusive. TSR for the benchmark banks will be based on the published share price for 23 March 2001.

If the HSBC Group's TSR over the performance period exceeds the mean of the comparator group, awards with a value at the date of grant of up to 100 per cent of an employee's earnings or less will vest. For higher value awards, the greater of 50 per cent of the award or the number of shares equating at the date of grant to 100 per cent of the employee's earnings will vest at this level of performance. If the HSBC Group's TSR over the performance period places it within the upper quartile in the ranked list, these higher value awards will vest in full. For performance between the mean and upper quartile, vesting will be on a straightline basis. The level of awards will continue to be determined by the Remuneration Committee. It is the Committee's current intention that the annual value of awards to UK-based executive Directors and senior executives will not as a general rule exceed 100 per cent of earnings.

The initial performance period will be three years. If the upper quartile performance target is achieved at the third anniversary of the date of grant, but not if it is achieved later, an additional award equal to 20 per cent of the initial performance share award will be made and will vest at the same time as the original award to which it relates. However, regardless of whether the upper quartile target is achieved at the third anniversary or the benchmark mean is achieved on the third, fourth or fifth anniversary, full vesting and transfer of shares will not generally occur until the fifth anniversary.

As a secondary condition, options and awards will only vest if the Remuneration Committee is satisfied that HSBC Holdings' financial performance has shown a sustained improvement in the period since the date of grant.

Awards will vest immediately in cases of death or if the business is no longer part of the HSBC Group. The Remuneration Committee retains discretion to allow early release of share awards in the event of termination of employment due to retirement, injury, illness, disability or redundancy. Awards will normally be forfeited if the participant is dismissed or resigns from the HSBC Group.

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

Pensions

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

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

C F W de Croisset and C-H Filippi are eligible for pension benefits which are supplementary to those accrued under the French State and compulsory arrangements. The amount of these additional pensions, payable from age 60, currently accrue at the rate of FRF40,000 and FRF30,000 per annum respectively for each year of service (maximum 18 years) as executive Directors of Crédit Commercial de France S.A. The whole cost of these benefits is met by Crédit Commercial de France S.A.

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

	Accrued annual pension at 31 December 2000	*Increase in accrued pension during 2000, excluding any increase for inflation*	*Transfer value relating to increase in accrued pension*[1]
	£000	£000	£000
Executive Director			
D W Baker	146	25	440
Non-executive Directors			
C F W de Croisset	46	2	23
C-H Filippi	13	2	11

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

The pension arrangements for W R P Dalton, an executive Director, to contractual retirement age of 60 are provided under the HSBC Holdings Overseas (No.1) Pension Plan on a defined contribution basis, with an employer contribution during 2000, including a bonus waiver of £300,000, of £454,511 (1999: £249,000).

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

Pension payments totalling £377,000 (1999: £359,000) were made to seven former Directors of the Company.

The aggregate pension benefits of Directors and senior executives listed on pages 56 to 57 for the year ended 31 December 2000 was £736,000.

Report of the Directors (continued)

Directors' Interests

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

	At 1 January 2000	*At 31 December 2000*
Ordinary shares of US$0.50		
D W Baker[1]	26,426	63,524
Sir John Bond[1]	58,317	265,767
C F W de Croisset[2]	32,500	32,847
W R P Dalton[1]	3,798	12,534
R Emerson	—	1,419
C-H Filippi[2]	418,236	359,870
S K Green[1]	13,030	13,414
A J Hales	3,524	3,628
R M J Orgill[1]	4,476	16,177
K R Whitson[1]	5,598	15,413
11.69 per cent subordinated bonds 2002 of £1		
Sir John Bond	500,000	500,000
R M J Orgill	250,000	250,000

1 *Details of additional interests in ordinary shares of US$0.50 each under the Share Option Plans and Restricted Share Plan are set out below.*
2 *Interest as at date of appointment, 1 September 2000.*

At 31 December 2000, Directors and senior executives held, in aggregate, beneficial interests in 2,055,616 ordinary shares of US$0.50 each.

Share options

At 31 December 2000, the undernamed Directors held options to acquire the number of HSBC Holdings ordinary shares of US$0.50 each set against their respective names. The options were awarded for nil consideration at exercise prices equivalent to the market value at the date of award except that options awarded under the HSBC Holdings Savings-Related Share Option Plan are exercisable at a 15 per cent discount to the market value at the date of award. There are no remaining performance criteria conditional upon which the outstanding options are exercisable. The market value of the ordinary shares of US$0.50 each at 31 December 2000 was £9.85. The highest and lowest market values of the ordinary shares during the year were £10.50 and £6.815. Market value is the mid-market price derived from the London Stock Exchange Daily Official List on the relevant date.

	Options held at 1 January 2000	*Options awarded during year*	*Options exercised during year*	*Options held at 31 December 2000*	*Exercise price in £*	*Date of award*	*Exercisable from*[1]	*Exercisable until*
Executive Directors								
D W Baker	18,750	—	18,750[3]	—	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	2,139[2]	—	2,139[4]	—	1.8060	10 Apr 1995	1 Aug 2000	31 Jan 2001
	19,500	—	19,500[5]	—	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	21,000	—	—	21,000	5.0160	24 Mar 1997	24 Mar 2000	24 Mar 2007
	669[2]	—	—	669	4.5206	9 Apr 1997	1 Aug 2002	31 Jan 2003
	24,000	—	—	24,000	6.2767	16 Mar 1998	16 Mar 2001	16 Mar 2008
	1,875[2]	—	—	1,875	5.3980	1 Apr 1999	1 Apr 2004	31 Jan 2005
W R P Dalton	22,704	—	—	22,704	2.4062	12 Oct 1993	12 Oct 1996	12 Oct 2003
	30,273	—	—	30,273	2.8376	8 Mar 1994	8 Mar 1997	8 Mar 2004
	36,000	—	—	36,000	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	8,625[2]	—	8,625[4]	—	1.8060	10 Apr 1995	1 Aug 2000	31 Jan 2001
	36,000	—	—	36,000[6]	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	—	2,798[2]	—	2,798	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006
Non-executive Directors								
Sir John Bond	60,543	—	60,543[7]	—	2.4062	12 Oct 1993	12 Oct 1996	12 Oct 2003
	60,543	—	60,543[7]	—	2.8376	8 Mar 1994	8 Mar 1997	8 Mar 2004
	75,000	—	75,000[7]	—	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	9,549[2]	—	9,549[4]	—	1.8060	10 Apr 1995	1 Aug 2000	31 Jan 2001
	75,000	—	—	75,000[6]	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	—	2,798[2]	—	2,798	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006
C F W de Croisset[8]		See below						
C-H Filippi[8]		See below						
S K Green	24,216	—	—	24,216	2.4062	12 Oct 1993	12 Oct 1996	12 Oct 2003
	36,324	—	—	36,324	2.8376	8 Mar 1994	8 Mar 1997	8 Mar 2004
	45,000	—	—	45,000	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	45,000	—	—	45,000[6]	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	5,637[2]	—	—	5,637	3.0590	3 Apr 1996	1 Aug 2001	31 Jan 2002
R M J Orgill	30,000	—	—	30,000	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,819[2]	—	3,819[4]	—	1.8060	10 Apr 1995	1 Aug 2000	31 Jan 2001
	30,000	—	—	30,000[6]	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	1,875[2]	—	—	1,875	5.3980	1 Apr 1999	1 Aug 2004	31 Jan 2005
K R Whitson	37,839	—	—	37,839	2.8376	8 Mar 1994	8 Mar 1997	8 Mar 2004
	60,000	—	—	60,000	2.1727	7 Mar 1995	7 Mar 1998	7 Mar 2005
	9,549[2]	—	9,549[4]	—	1.8060	10 Apr 1995	1 Aug 2000	31 Jan 2001
	60,000	—	—	60,000[6]	3.3334	1 Apr 1996	1 Apr 1999	1 Apr 2006
	—	2,798[2]	—	2,798	6.0299	10 Apr 2000	1 Aug 2005	31 Jan 2006

1 *May be advanced to an earlier date in certain circumstances, e.g. retirement.*
2 *Options awarded under the Savings-Related Share Option Plan.*
3 *As at the date of exercise, 27 April 2000, the market value per share was £7.045.*
4 *As at the date of exercise, 1 August 2000, the market value per share was £8.93.*
5 *As at the date of exercise, 7 June 2000, the market value per share was £7.73.*
6 *The exercise of these options was conditional upon the growth in earnings per share over a three-year period being equal to or greater than a composite rate of inflation (comprising 50 per cent of the Hong Kong Composite Consumer Price Index, 35 per cent of the UK Retail Price Index and 15 per cent of the USA All Urban Consumer Price Index) plus 2 per cent per annum. This condition has been satisfied.*
7 *As at the date of exercise, 18 December 2000, the market value per share was £9.72.*
8 *Details of options over Crédit Commercial de France S.A. shares, which are convertible automatically on exercise to HSBC Holdings ordinary shares of US$0.50 each, are set out below.*

Report of the Directors (continued)

Following the acquisition of Crédit Commercial de France S.A. by the HSBC Group, 40,000,000 HSBC Holdings plc ordinary shares of US$0.50 each have been purchased to satisfy the exercise of Crédit Commercial de France S.A. employee share options. These shares are held through the HSBC Holdings General Employee Benefit Trust. C F W de Croisset and C-H Filippi each have a technical interest in all of the shares held by the Trust. At 31 December 2000, the Trust held 39,838,800 HSBC Holdings plc ordinary shares of US$0.50 each.

At 31 December 2000, C F W de Croisset and C-H Filippi held the following options to acquire Crédit Commercial de France S.A. shares of €5 each. On exercise of these options, each Crédit Commercial de France S.A. share will be exchanged for 13 HSBC Holdings plc ordinary shares of US$0.50 each. The options were granted by Crédit Commercial de France S.A. for nil consideration at a 5 per cent discount to the market value at the date of award. Except where indicated, there are no performance criteria conditional upon which the outstanding options are exercisable.

Crédit Commercial de France S.A. shares of €5 each

Options held at 1 September 2000[1]	Exercise price per share	Options exercised during period	Options held at 31 December 2000	Equivalent HSBC Holdings plc ordinary shares of US$0.50 each as at 31 December 2000	Date of award	Exercisable until
C F W de Croisset						
20,000	FRF215 (€32.78)	10,000[2]	10,000	130,000	23 Jun 1994	23 Jun 2004
30,000	FRF223 (€34.00)	—	30,000	390,000	22 Jun 1995	22 Jun 2005
30,000	FRF233 (€35.52)	—	30,000	390,000	9 May 1996	9 May 2006
30,000	FRF243 (€37.05)	—	30,000	390,000	7 May 1997	7 May 2007
30,000	FRF482 (€73.50)	—	30,000	390,000	29 Apr 1998	29 Apr 2008
28,000	€81.71	—	28,000	364,000	7 Apr 1999	7 Apr 2009
28,000	€142	—	28,000	364,000[3]	12 Apr 2000	12 Apr 2010
C-H Filippi						
10,000	FRF223 (€34.00)	—	10,000	130,000	22 Jun 1995	22 Jun 2005
18,000	FRF233 (€35.52)	—	18,000	234,000	9 May 1996	9 May 2006
20,000	FRF482 (€73.50)	—	20,000	260,000	29 Apr 1998	29 Apr 2008
23,000	€81.71	—	23,000	299,000	7 Apr 1999	7 Apr 2009
23,000	€142	—	23,000	299,000[3]	12 Apr 2000	12 Apr 2010

1 *Date of appointment.*
2 *On exercise of this option, the 10,000 Crédit Commercial de France S.A. shares were exchanged for HSBC Holdings plc ordinary shares of US$0.50 each in the same ratio as for the acquisition of Crédit Commercial de France S.A. (13 HSBC Holdings shares for one Crédit Commercial de France S.A. share.) As at the date of exercise, 25 October 2000, the market value per HSBC Holdings share was £9.83.*
3 *The exercise of this option is conditional upon continued employment with Crédit Commercial de France S.A. until 1 January 2002.*

Restricted Share Plan

	Ordinary shares of US$0.50 each					
	Awards held at 1 January 2000	*Awards made during year*	*Monetary value of awards made during year*	*Awards vested during year*[1]	*Awards held at 31 December 2000*[1]	*Year in which awards may vest*
			£000			
D W Baker	17,230	—	—	—	17,737	2004
	—	24,301	175	—	25,017	2005
Sir John Bond	25,179	—	—	—	25,921	2001[2]
	26,614	—	—	—	27,397	2002 or 2003
	51,688	—	—	—	53,210	2004
	—	76,375	550	—	78,624	2005
W R P Dalton	31,938	—	—	32,877[3]	—	—
	15,747	—	—	—	16,211	2001[2]
	17,745	—	—	—	18,267	2002 or 2003
	30,152	—	—	—	31,039	2004
	—	34,716	250	—	35,739	2005
S K Green	18,897	—	—	—	19,453	2001[2]
	21,290	—	—	—	21,917	2002 or 2003
	30,152	—	—	—	31,039	2004
	—	34,716	250	—	35,739	2005
R M J Orgill	4,712	—	—	4,798[4]	—	—
	25,844	—	—	—	26,605	2004
	—	20,829	150	—	21,443	2005
K R Whitson	18,897	—	—	—	19,453	2001[2]
	21,290	—	—	—	21,917	2002 or 2003
	43,074	—	—	—	44,342	2004
	—	48,602	350	—	50,034	2005

Unless otherwise indicated, vesting of these shares is subject to the performance tests described in the 'Report of the Directors' in the 1996, 1997, 1998 and 1999 Annual Report and Accounts being satisfied.

1 *Includes additional shares arising from scrip dividends.*

2 *Based on performance over the four-year period to 31 December 2000, 50 per cent of share awards will vest in 2001 and 50 per cent will be forfeited.*

3 *Award not subject to performance conditions. Vested on 29 December 2000.*

4 *Award vested on 2 October 2000.*

Sir John Bond has a personal interest in £290,000 of HSBC Capital Funding (Sterling 1) L.P. 8.208 per cent Non-cumulative Step-up Perpetual Preferred Securities, which he acquired during the year.

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

As Directors of Crédit Commercial de France S.A., C F W de Croisset and C-H Filippi, with effect from 20 December 2000, and W R P Dalton and S K Green, with effect from 14 February 2001, each acquired a personal interest in 10 shares of €5 each in that Company but have waived their rights to receive dividends. On cessation of this directorship, the Directors have undertaken to transfer these shares to the bank.

Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings or any of its subsidiary undertakings at the beginning or at the end of the year and none of the Directors, or members of their immediate families, were awarded or exercised any right to subscribe for any shares or debentures during the year. No option held by Directors lapsed during the year.

There have been no other changes in Directors' interests from 31 December 2000 to the date of this report.

Report of the Directors (continued)

Other Directorships

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

Employee Communication and Involvement

The bank continues to regard communication with its employees as a key aspect of its policies and uses a wide variety of methods to encourage and maintain effective two-way communication with its employees on key issues including financial and economic factors which affect performance. Consultation arrangements include consultative forums for managers, agreed procedures with the recognised union and the bank's participation in an HSBC European Council. Every employee is encouraged to contribute to the success of the business through the performance management process and innovation, improvement and creativity are encouraged and rewarded through 'Make a difference', the employee suggestion scheme. The involvement of employees in the performance of the bank is further encouraged through participation in bonus and share option plans as appropriate.

There are some 30,000 bank employees now participating in one or more of the HSBC Group's employee share plans.

Employment of Disabled Persons

The bank is committed to providing equal opportunities in all employment. The employment of disabled people is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual. This is reinforced by the bank's adoption of the 'two tick' disability symbol. The bank's continued employment policy means that it will make every effort, if existing employees become disabled, to retain them within the workforce. The bank is a board member of the Employers' Forum on Disability.

The bank believes that good employment policies provide a firm foundation for the delivery of its services to the disabled community. In furtherance of these it has progressed the five-year programme, commenced in 1998, to survey and modify its branch network and, during 2000, a further 5 per cent of the network was made accessible to wheelchair users.

Community Involvement and Donations

During the year, the bank spent £4.1 million within the community, made gifts in kind and agreed staff secondments in support of community activities in the United Kingdom. Many staff also gave their time. Within this amount, charitable donations totalling £2.1 million were made.

The bank continued to build its support for the communities in which it operates through activities focused on its commitment to education, particularly for under-privileged primary and secondary school students, and the environment. This commitment to education is now led by Dame Mary Richardson. Dame Mary joined the HSBC Group after a distinguished career in education and sits on a number of authoritative education committees. Her primary role with the HSBC Group is as Chief Executive of the HSBC Education Trust in the United Kingdom.

The Trust will consider charitable payments relating to education. Among the initiatives the Trust will support are increased funding for language colleges and primary and secondary school programmes for children in economically deprived areas.

The bank commissioned a ground-breaking anti-racism play, 'My England', which was performed in secondary schools throughout the United Kingdom in 2000, and continued its leading role in the Race for Opportunity programme, reinforcing its commitment to cultural diversity.

The bank's staff and customers made contributions through a number of events and raised more than £540,000 for BBC Children in Need and was named the largest corporate fundraiser for Children in Need for the sixth year running. Staff raised a further £198,000 for the mobility charity Whizz Kidz with sponsored walks.

In addition, the HSBC Group continued its policy of making donations to charities instead of sending Christmas cards. In 2000, this totalled £150,000, the beneficiaries being: Befrienders International, the international Samaritan organisation; Centrepoint, helping the homeless; Future Hope, operating in India helping street children; the Princess Royal Trust for Carers, providing facilities for carers and their relatives; Perpetual Hope, working with former street children in Brazil; and Richard House Trust, a children's hospice in Tower Hamlets, London.

No political donations were made during the year.

■ Supplier Payment Policy

The bank subscribes to the Better Payment Practice Code for all suppliers, the four principles of which are: to agree payment terms at the outset and stick to them; to explain payment procedures to suppliers; to pay bills in accordance with any contract agreed with the supplier or as required by law; and to tell suppliers without delay when an invoice is contested and settle disputes quickly. Copies of, and information about, the Code are available from: The Department of Trade and Industry, No. 1 Victoria Street, London SW1 0ET.

The amount due to the bank's trade creditors at 31 December 2000 represented 25 days' average daily purchases of goods and services received from those creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

■ Auditor

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

On behalf of the Board
I B Marshall, *Secretary*

26 February 2001

Statement of Directors' Responsibilities in Relation to Financial Statements

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

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

The Directors consider that, in preparing the financial statements (on pages 74 to 144), the bank has used appropriate accounting policies, consistently applied save as disclosed in the 'Notes on the Accounts' and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

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

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

On behalf of the Board
I B Marshall, *Secretary*

26 February 2001

Report of the Auditors to the Members of HSBC Bank plc

We have audited the financial statements on pages 74 to 144.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report and Annual Report on Form 20F. As described on page 72 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards; the Directors have also presented additional information under US requirements. Our responsibilities, as independent auditors, are established by statute in the United Kingdom, Auditing Standards generally accepted in the United Kingdom and the United States, the Listing Rules of the UK Financial Services Authority, the United States Securities and Exchange Commission and by our profession's ethical guidance.

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

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with auditing standards generally accepted in the United Kingdom and the United States. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to HSBC Bank plc's circumstances, consistently applied and adequately disclosed.

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

United Kingdom opinion

In our opinion the financial statements give a true and a fair view of the state of affairs of the bank and the group as at 31 December 2000 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

United States opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the group as at 31 December 2000 and 1999, and the consolidated results of its operations and cash flows for each of the years in the three-year period ended 31 December 2000, in conformity with generally accepted accounting principles in the United Kingdom.

Generally accepted accounting principles in the United Kingdom vary in certain significant respects from generally accepted accounting principles in the United States. Application of generally accepted accounting principles in the United States would have affected the results of operations for each of the years in the three-year period ended 31 December 2000 and shareholders' equity as of 31 December 2000 and 1999 to the extent summarised in Note 44 of 'Notes on the Accounts'.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

26 February 2001

Consolidated Profit and Loss Account for the Year Ended 31 December 2000

	Note	*group excluding acquisitions* 2000 £m	*acquisitions* 2000 £m	*group* 2000 £m	*group* 1999 £m	*group* 1998 £m
Interest receivable						
— interest receivable and similar income arising from debt securities		**968**	**464**	**1,432**	936	1,081
— other interest receivable and similar income		**5,472**	**895**	**6,367**	4,717	5,400
Interest payable		**(3,952)**	**(1,131)**	**(5,083)**	(3,262)	(4,244)
Net interest income		**2,488**	**228**	**2,716**	2,391	2,237
Dividend income	3	**3**	**3**	**6**	2	2
Fees and commissions receivable		**1,987**	**255**	**2,242**	1,851	1,632
Fees and commissions payable		**(364)**	**(39)**	**(403)**	(363)	(357)
Dealing profits	4	**312**	**42**	**354**	201	124
Other operating income		**466**	**40**	**506**	455	404
Other income		**2,404**	**301**	**2,705**	2,146	1,805
Operating income		**4,892**	**529**	**5,421**	4,537	4,042
Administrative expenses	5	**(2,332)**	**(327)**	**(2,659)**	(2,151)	(2,006)
Depreciation and amortisation						
— tangible fixed assets	23	**(339)**	**(25)**	**(364)**	(313)	(291)
— goodwill	22	**(5)**	**(111)**	**(116)**	(3)	—
Operating expenses		**(2,676)**	**(463)**	**(3,139)**	(2,467)	(2,297)
Operating profit before provisions		**2,216**	**66**	**2,282**	2,070	1,745
Provisions						
— provisions for bad and doubtful debts	15	**(252)**	**8**	**(244)**	(281)	(196)
— provisions for contingent liabilities and commitments	29	**(20)**	—	**(20)**	(50)	(59)
Amounts written off fixed asset investments		—	**(2)**	**(2)**	(3)	(1)
Operating profit		**1,944**	**72**	**2,016**	1,736	1,489
Share of operating (loss)/profit in joint ventures and associates		**(50)**	**3**	**(47)**	(34)	(1)
Gains on disposal of						
— investments		**42**	**33**	**75**	21	28
— tangible fixed assets		**1**	**1**	**2**	1	6
Profit on ordinary activities before tax	6	**1,937**	**109**	**2,046**	1,724	1,522
Tax on profit on ordinary activities	7			**(603)**	(518)	(479)
Profit on ordinary activities after tax				**1,443**	1,206	1,043
Minority interests						
— equity				**(83)**	(5)	(1)
— non-equity				**(15)**	—	—
Profit for the financial year attributable to shareholders				**1,345**	1,201	1,042
Dividends (including amounts attributable to non-equity shareholders)	9			**(1,200)**	(1,147)	(693)
Retained profit for the year				**145**	54	349
				pence	pence	pence
Earnings per ordinary share (basic and diluted)	10			**162.6**	144.8	125.3

Movements in reserves are set out in Note 33 'Reserves'. All of the above represents continuing operations.

Consolidated Balance Sheet at 31 December 2000

	Note	2000 £m	1999 £m
Assets			
Cash and balances at central banks		**1,626**	1,306
Items in the course of collection from other banks		**2,430**	1,776
Treasury bills and other eligible bills	*11*	**5,699**	4,026
Loans and advances to banks	*13*	**29,821**	12,226
Loans and advances to customers	*14*	**80,521**	57,592
Debt securities	*17*	**34,185**	14,836
Equity shares	*18*	**1,968**	99
Interests in joint ventures			
— gross assets		**1,392**	—
— gross liabilities		**(1,221)**	—
	19	**171**	—
Interests in associates	*20*	**119**	87
Intangible fixed assets	*22*	**8,211**	55
Tangible fixed assets	*23*	**4,359**	3,331
Other assets	*24*	**13,698**	9,903
Prepayments and accrued income		**2,395**	1,231
Total assets	*37*	**185,203**	106,468
Liabilities			
Deposits by banks	*25*	**29,141**	11,780
Customer accounts	*26*	**102,188**	66,094
Items in the course of transmission to other banks		**1,431**	1,139
Debt securities in issue	*27*	**9,307**	3,945
Other liabilities	*28*	**18,404**	13,179
Accruals and deferred income		**2,776**	1,051
Provisions for liabilities and charges	*29*		
— deferred taxation		**621**	509
— other provisions for liabilities and charges		**717**	489
Subordinated liabilities	*30*		
— undated loan capital		**1,485**	1,259
— dated loan capital		**3,727**	2,114
Minority interests			
— equity		**161**	41
— non-equity	*31*	**561**	—
Called up share capital	*32*	**797**	797
Share premium account	*33*	**11,063**	1,986
Revaluation reserve	*33*	**104**	77
Profit and loss account	*33*	**2,720**	2,008
Shareholders' funds (including non-equity interests)		**14,684**	4,868
Total liabilities	*37*	**185,203**	106,468
Memorandum items			
Contingent liabilities	*36*		
— acceptances and endorsements		**1,378**	1,169
— guarantees and assets pledged as collateral security		**11,362**	8,061
		12,740	9,230
Commitments	*36*	**43,988**	37,455

Sir John Bond, *Chairman*
W R P Dalton, *Chief Executive and Director*
D W Baker, *Chief Operating Officer and Director*
I B Marshall, *Secretary*

Balance Sheet of HSBC Bank plc at 31 December 2000

	Note	2000 £m	1999 £m
Assets			
Cash and balances at central banks		**687**	1,274
Items in the course of collection from other banks		**1,690**	1,769
Treasury bills and other eligible bills	*11*	**3,916**	3,913
Loans and advances to banks	*13*	**12,339**	14,809
Loans and advances to customers	*14*	**61,401**	52,654
Debt securities	*17*	**16,967**	13,952
Equity shares	*18*	**190**	60
Interests in associates	*20*	**6**	81
Investments in subsidiary undertakings	*21*	**12,935**	1,566
Intangible fixed assets	*22*	**33**	4
Tangible fixed assets	*23*	**1,556**	1,480
Other assets	*24*	**6,879**	6,005
Prepayments and accrued income		**1,766**	1,347
Total assets	*37*	**120,365**	98,914
Liabilities			
Deposits by banks	*25*	**17,540**	15,508
Customer accounts	*26*	**65,944**	59,947
Items in the course of transmission to other banks		**926**	1,130
Debt securities in issue	*27*	**3,815**	3,609
Other liabilities	*28*	**10,993**	9,182
Accruals and deferred income		**1,206**	994
Provisions for liabilities and charges	*29*		
— other provisions for liabilities and charges		**303**	333
Subordinated liabilities	*30*		
— undated loan capital		**1,339**	1,259
— dated loan capital		**3,615**	2,084
Called up share capital	*32*	**797**	797
Share premium account	*33*	**11,063**	1,986
Revaluation reserves	*33*	**996**	267
Profit and loss account	*33*	**1,828**	1,818
Shareholders' funds (including non-equity interests)		**14,684**	4,868
Total liabilities	*37*	**120,365**	98,914
Memorandum items			
Contingent liabilities	*36*		
— acceptances and endorsements		**788**	1,166
— guarantees and assets pledged as collateral security		**8,745**	10,050
		9,533	11,216
Commitments	*36*	**39,742**	36,788

Sir John Bond, *Chairman*
W R P Dalton, *Chief Executive and Director*
D W Baker, *Chief Operating Officer and Director*
I B Marshall, *Secretary*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 2000

	2000 £m	1999 £m	1998 £m
Profit for the financial year attributable to shareholders	**1,345**	1,201	1,042
Impairment of land and buildings	—	—	(14)
Unrealised surplus on revaluation of land and buildings	**28**	29	6
Exchange and other movements	**608**	5	3
Total recognised gains and losses for the year	**1,981**	1,235	1,037

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 2000

	2000 £m	1999 £m	1998 £m
Profit for the financial year attributable to shareholders	**1,345**	1,201	1,042
Dividends	**(1,200)**	(1,147)	(693)
	145	54	349
Other recognised gains and losses relating to the year	**636**	34	(5)
New share capital subscribed	**9,033**	—	—
Goodwill written back on disposals	**2**	—	1
Net addition to shareholders' funds	**9,816**	88	345
Shareholders' funds at 1 January	**4,868**	4,780	4,435
Shareholders' funds at 31 December	**14,684**	4,868	4,780
Shareholders' funds are analysed as follows:			
Equity interests	**14,101**	4,330	4,258
Non-equity interests	**583**	538	522
	14,684	4,868	4,780

Non-equity interests in shareholders' funds comprise proceeds of the issue of US$ non-cumulative preference shares and the £ preferred ordinary share (Note 32), including share premium and after deducting unamortised issue costs.

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

Statement of Consolidated Cash Flows for the Year Ended 31 December 2000

	Note	2000 £m	1999 £m	1998 £m
Net cash inflow from operating activities	*38*	**2,687**	7,297	1,520
Dividends received from associates		**2**	6	6
Returns on investments and servicing of finance:				
Interest paid on finance leases and similar hire purchase contracts		**(11)**	(12)	(14)
Interest paid on subordinated loan capital		**(268)**	(214)	(256)
Dividends paid to minority interests		**(11)**	(1)	—
Preference dividends paid		**(49)**	(44)	(39)
Net cash (outflow) from returns on investments and servicing of finance		**(339)**	(271)	(309)
Taxation paid		**(562)**	(506)	(525)
Capital expenditure and financial investment:				
Purchase of investment securities		**(40,752)**	(27,825)	(13,078)
Proceeds from sale of investment securities and amounts repaid		**39,592**	24,554	12,317
Purchase of tangible fixed assets	*23*	**(665)**	(419)	(892)
Proceeds from sale of tangible fixed assets		**78**	80	102
Net cash (outflow) from capital expenditure and financial investments		**(1,747)**	(3,610)	(1,551)
Acquisitions and disposals:				
Net cash outflow from acquisition of interest in subsidiary undertakings		**(8,027)**	(74)	—
Purchase of interest in associates and other participating interests		**(23)**	(41)	(19)
Proceeds from disposal of associates and other participating interests		**88**	4	2
Proceeds from disposal of subsidiary undertakings		**21**	—	3
Net cash (outflow) from acquisitions and disposals		**(7,941)**	(111)	(14)
Equity dividends paid		**(850)**	(1,150)	(650)
Net cash (outflow)/inflow before financing		**(8,750)**	1,655	(1,523)
Financing:				
Issue of ordinary share capital		**9,033**	—	—
Subordinated loan capital issued		**1,077**	238	197
Subordinated loan capital issued to minority interest		**524**	—	—
Subordinated loan capital repaid		**(149)**	(295)	(121)
Net cash inflow/(outflow) from financing	*38*	**10,485**	(57)	76
Increase/(decrease) in cash	*38*	**1,735**	1,598	(1,447)

Notes on the Accounts

1 Basis of preparation

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

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

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

The bank is a wholly owned subsidiary undertaking of HSBC Holdings plc ('HSBC Holdings') which, together with its subsidiary undertakings, joint ventures and associates is referred to as the 'HSBC Group'.

In accordance with Financial Reporting Standard ('FRS') 8 'Related Party Disclosures', no disclosure is presented of transactions with entities that are part of the HSBC Group as all voting rights are controlled by HSBC Holdings, which publishes its own publicly available accounts.

The group has adopted the provisions of Financial Reporting Standards ('FRSs'): FRS 15, 'Tangible Fixed Assets' and FRS 16, 'Current Taxation'.

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

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

All significant intra-group transactions are eliminated on consolidation.

d The group's financial statements are prepared in accordance with UK generally accepted accounting principles ('UK GAAP'), which differ in certain respects from US generally accepted accounting principles ('US GAAP'). For a discussion of significant differences between UK GAAP and US GAAP and a reconciliation to US GAAP of certain amounts see Note 44 'Differences between UK and US GAAP'. In addition, certain disclosures in the Notes on the Accounts have been made to comply with US reporting requirements.

2 Principal accounting policies

a *Income recognition*

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

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

The group's residential mortgage origination activities are supported by a range of incentive arrangements, principally discounted rates, and, to a lesser extent, cashbacks and reimbursement of professional fees. The costs of these incentives are charged to the profit and loss account as they arise.

b *Loans and advances and doubtful debts*

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

Notes on the Accounts (continued)

2 Principal accounting policies *(continued)*

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

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

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

— where cash collateral is held covering the total of principal and interest due and the right to set-off is legally sound; or

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

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

Specific provisions

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

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

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

— the realisable value of any security for the loan;

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

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

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

General provisions

General provisions augment specific provisions and provide cover for loans that are impaired at the balance sheet date but which will not be identified as such until some time in the future. The HSBC Group requires operating companies to maintain a general provision equivalent to a minimum percentage of customer lending as set from time to time, currently 0.6 per cent. This level has been determined as appropriate, taking into account the structure and risk characteristics of the group's loan portfolio and an evaluation of historic levels of latent risk, and its continuing appropriateness is regularly reviewed. Where entities operate in a significantly higher risk environment, an increased level of general provisioning will apply, taking into account local market conditions and economic and political factors. General provisions are deducted from loans and advances to customers in the balance sheet.

2 Principal accounting policies *(continued)*

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

Loans on which interest is being suspended

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

Non-accrual loans

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

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

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

c *Treasury bills, debt securities and equity shares*

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

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

Debt securities held for the purpose of hedging are valued on the same basis as the liabilities that are being hedged.

Other treasury bills, debt securities, equity shares and short positions in securities are included in the balance sheet at market value. Changes in the market value of such assets and liabilities are recognised in the profit and loss account as 'Dealing profits' as they arise.

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

d *Subsidiary undertakings, joint ventures and associates*

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

Notes on the Accounts (continued)

2 Principal accounting policies *(continued)*

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

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

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

Goodwill arises on the acquisition of subsidiary undertakings, joint ventures and associates when the cost of acquisition exceeds the fair value of the group's share of separable net assets acquired. For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets', in respect of subsidiary undertakings, in 'Interests in joint ventures', in respect of joint ventures and in 'Interests in associates', in respect of associates. Capitalised goodwill is amortised over its estimated life on a straight-line basis. For acquisitions prior to 1 January 1998, goodwill was charged against reserves in the year of acquisition.

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

e *Tangible fixed assets*

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

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

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

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

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

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

f *Finance and operating leases*

Assets leased to customers under agreements that transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the group is a lessor under finance leases, the amounts due under the lease, and under hire purchase contracts that are in the nature of finance leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers'. Finance charges receivable are recognised over the periods of the leases in proportion to the funds invested, after taking into account the effects of taxation.

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

All other leases are classified as operating leases and, where the group is the lessor, are included in 'Tangible fixed assets'. Rentals payable and receivable under operating leases are accounted for on the straight-line basis over the periods of the leases and are included in 'Administrative expenses' and 'Other operating income' respectively.

g *Long-term assurance business*

The value placed on the group's interest in long-term assurance business includes a prudent valuation of the future earnings expected to emerge from business currently in force, together with the surplus retained in the long-term assurance funds. These are determined annually in consultation with independent actuaries and are included in 'Other assets'.

2 Principal accounting policies *(continued)*

g *Long-term assurance business (continued)*

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

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

h *Deferred taxation*

Deferred taxation is provided on timing differences, using the liability method, between the accounting and taxation treatment of income and expenditure. Provision is made for deferred tax only to the extent that it is probable that an actual liability will crystallise. Deferred tax assets are recognised when recovery is anticipated in the near future without replacement by equivalent assets.

i *Pension and other post-retirement benefits*

The group operates a number of pension and other post-retirement benefit schemes throughout the world and the majority of staff are members of defined benefit schemes.

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

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

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

j *Foreign currencies*

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

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

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

k *Off-balance-sheet financial instruments*

Off-balance-sheet financial instruments arise from futures, forward, swap and option transactions undertaken by the group in the foreign exchange, interest rate and equity markets. Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with allowable netting shown separately. Previously, mark-to-market assets and liabilities were presented net, without allowable netting being shown separately.

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

Trading transactions

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

Notes on the Accounts (continued)

2 Principal accounting policies *(continued)*

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

Transactions undertaken for trading purposes are marked to market value and the net present value of any gain or loss arising is recognised in the profit and loss account as 'Dealing profits', after appropriate deferrals for unearned credit margin and future servicing costs.

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

Non-trading transactions

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

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

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

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

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

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

3 Dividend income

	2000	1999	1998
	£m	£m	£m
Income from equity shares	**6**	2	2

4 Dealing profits

	2000	1999	1998
	£m	£m	£m
Foreign exchange	**258**	162	173
Interest rate derivatives	**23**	11	4
Debt securities	**51**	57	17
Equities and other trading	**22**	(29)	(70)
	354	201	124

5 Administrative expenses

a

Staff costs	2000 £m	1999 £m	1998 £m
— wages and salaries	**1,419**	1,159	1,066
— social security costs	**125**	90	83
— other pension costs (Note 5b below)	**137**	123	123
	1,681	1,372	1,272
Premises and equipment (excluding depreciation)	**324**	272	262
Other administrative expenses	**654**	507	472
	978	779	734
	2,659	2,151	2,006

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

	2000	1999	1998
UK Banking	**48,193**	46,913	45,291
International Banking	**3,982**	2,997	1,795
Treasury and Capital Markets	**985**	1,146	1,320
HSBC Republic	**964**	—	—
Crédit Commercial de France	**2,285**	—	—
	56,409	51,056	48,406

b *Retirement benefits*

Within the group, the HSBC Bank (UK) Pension Scheme, assets of which are held in a separate trust fund, covers 96 per cent of UK employees. The HSBC Bank (UK) Pension Scheme comprises a funded defined benefit scheme ('the Principal Scheme') and a defined contribution scheme which was established on 1 July 1996 for new employees.

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

The latest valuation of the Principal Scheme was made at 31 December 1999 by C G Singer, Fellow of the Institute of Actuaries, of Watson Wyatt Partners. At that date, the market value of the Principal Scheme's assets was £7,265 million. The actuarial value of the assets represented 104 per cent of the benefits accrued to members, after allowing for expected future increases in earnings, and the resulting surplus amounted to £232 million. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 6.85 per cent per annum, salary increases of 4.0 per cent per annum, equity dividend increases and rental growth of 3.5 per cent per annum, and post-retirement pension increases of 2.5 per cent per annum.

In consultation with the actuaries, the bank has decided to increase contributions to 16.9 per cent of pensionable salaries from 1 January 2001 until the next actuarial valuation. The next actuarial valuation is due as at 31 December 2002.

The total pension cost for the year ended 31 December 2000 was £126 million (1999: £112 million; 1998: £112 million), which includes £98 million (1999: £94 million; 1998: £97 million) in respect of the Principal Scheme.

For CCF, retirement provision for employees in France is provided via both State and compulsory supplementary pension funds founded (via Government decree) on agreements between Employer Organisations and Unions. These 'compulsory supplementary' arrangements cover some 13,250 employees.

Notes on the Accounts (continued)

5 Administrative expenses *(continued)*

b *Retirement benefits (continued)*

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

The charge relating to post-retirement health-care benefits was £11 million (1999: £11 million; 1998: £11 million).

The latest actuarial assessment, which was made at 31 December 2000, estimated the present value of the post-retirement benefit obligation to be £145 million for the group and £135 million for the bank, of which £91 million (1999: £84 million) has been provided for the group and £85 million (1999: £79 million) has been provided for the bank. The main financial assumptions used at 31 December 2000 were price inflation of 2.5 per cent per annum, health-care claims costs escalation of 7.5 per cent per annum, and a discount rate of 6 per cent per annum. The next actuarial assessment will be performed as at 31 December 2003.

c *Directors' emoluments*

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

	2000 £000	1999 £000
Fees	**196**	217
Salaries and other emoluments	**874**	676
Discretionary bonuses	**337**	85
	1,407	978
Gains on exercise of share options	**2,916**	54

In addition, there are annual commitments under retirement benefit agreements with former Directors of £482,952 (1999: £479,197).

Retirement benefits accrue to one Director under a defined benefit scheme and to one Director under a money purchase scheme.

During the year, aggregate contributions to money purchase pension schemes were £454,000 (1999: £249,000).

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

Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 63.

d *Auditors' remuneration*

Auditors' remuneration amounted to £3.2 million (1999: £1.9 million; 1998: £1.8 million) including £1.1 million (1999: £1.1 million; 1998: £1.0 million) which relates to the bank. £1.7 million (1999: £1.1 million; 1998: £0.9 million) was paid to the bank's Auditors and their associates for non-audit work as analysed below:

	2000 £000	1999 £000	1998 £000
Regulatory work	**641**	697	545
Tax services	**176**	72	117
Consultancy	**220**	60	7
Acquisition services	**—**	21	—
Other	**671**	266	193
	1,708	1,116	862

5 Administrative expenses *(continued)*

d *Auditors' remuneration (continued)*

Of fees paid to the Auditors for non-audit work, £0.2 million (1999: £ nil; 1998: £ nil) was capitalised as part of the cost of acquisitions made during the year.

6 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after:

a *Income*	**2000 £m**	1999 £m	1998 £m
Aggregate rentals receivable, including capital repayments, under			
— finance leases	**336**	557	527
— hire purchase contracts	**499**	604	727
— operating leases	**316**	314	300
Increase in the value of long-term assurance business	**115**	99	73
Profits less losses on debt securities and equities dealing	**56**	58	17
Gain on disposal of investment securities	**29**	20	26

b *Charges*	**2000 £m**	1999 £m	1998 £m
Charges incurred with respect to subordinated liabilities	**287**	238	254
Finance charges in respect of finance leases and similar hire purchase contracts	**11**	12	14
Rentals payable on premises held under operating leases	**95**	74	69
Residential mortgage incentives	**33**	32	36

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

Gains on disposal of investments and tangible fixed assets attracted a tax charge of £6 million (1999: £6 million; 1998: £9 million).

7 Tax on profit on ordinary activities

The charge for taxation comprises:

	2000 £m	1999 £m	1998 £m
United Kingdom corporation tax charge	**547**	395	423
Relief for overseas taxation	**(8)**	(8)	(8)
	539	387	415
United Kingdom corporation tax — prior year	**(16)**	(26)	(11)
	523	361	404
Overseas taxation	**85**	52	18
Deferred taxation (Note 29)	**6**	116	57
	614	529	479
Joint ventures and associates	**(11)**	(11)	—
	603	518	479

Notes on the Accounts (continued)

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

During the year, the group provided for UK corporation tax at 30 per cent (1999: 30.25 per cent; 1998: 31 per cent).

The tax charge includes £25 million (1999: £29 million; 1998: £22 million) in respect of the tax attributable to the increase in the value of long-term assurance business attributable to shareholders.

8 Profit of the bank

The profit of the bank for the year attributable to shareholders was £1,198 million (1999: £1,103 million; 1998: £984 million).

9 Dividends

	2000 £m	1999 £m	1998 £m
Equity			
Ordinary dividends			
— paid	**550**	800	300
— proposed	**600**	300	350
	1,150	1,100	650
Non-equity			
Preference dividends	**48**	44	39
Other finance costs	**2**	3	4
	50	47	43
	1,200	1,147	693

Non-cumulative dividends of US$1.42 and US$0.577 per share per annum are payable on the Series A1 and the Series A2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.64 and US$0.666 per share per annum are payable on the Series B1 and the Series B2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.46 and US$0.593 per share per annum are payable on the Series C1 and the Series C2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.528 and US$0.621 per share per annum are payable on the Series D1 and the Series D2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.344 and US$0.546 per share per annum are payable on the Series 1 and Series 2 US$ Second preference shares respectively in quarterly instalments.

10 Earnings per ordinary share

Basic and diluted earnings per ordinary share are calculated by dividing the profit for the financial year attributable to equity shareholders, after deducting preference dividends and finance costs, of £1,295 million (1999: £1,154 million; 1998: £999 million) by the weighted average number of ordinary shares in issue in 2000 of 797 million (1999: 797 million; 1998: 797 million).

11 Treasury bills and other eligible bills

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Treasury bills and similar securities	**3,534**	2,622	**3,135**	2,509
Other eligible bills	**2,165**	1,404	**781**	1,404
	5,699	4,026	**3,916**	3,913

Investment securities:

	Cost and book value
group	**£m**
At 1 January 2000	**3,863**
Additions	**13,407**
Acquisition of subsidiaries	**129**
Disposals and amounts repaid	**(13,205)**
Amortisation of discounts and premiums	**120**
Exchange and other movements	**(32)**
At 31 December 2000	**4,282**

	Cost and book value
bank	**£m**
At 1 January 2000	**3,816**
Additions	**13,033**
Disposals and amounts repaid	**(13,061)**
Amortisation of discounts and premiums	**119**
Exchange and other movements	**(20)**
At 31 December 2000	**3,887**

Of the total treasury and other eligible bills, £4,282 million (1999: £3,863 million) for the group and £3,887 million (1999: £3,816 million) for the bank are non-trading book items.

The maturities of investment treasury bills and other eligible bills at 31 December 2000 are analysed as follows:

	group		*bank*	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	£m	**£m**	£m
1 year or less	**4,151**	4,123	**3,885**	3,843
Greater than 1 year	**131**	131	**2**	2
	4,282	4,254	**3,887**	3,845

At 31 December 1999, the book value was not materially different from market value.

Notes on the Accounts (continued)

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

The net unamortised discounts on investment securities were:

	group	bank
	2000	**2000**
	£m	**£m**
	37	**38**

12 Credit risk management

The group's credit risk management process is discussed in the 'Financial Review' section in the paragraph headed 'Credit risk management' on pages 37 and 38.

13 Loans and advances to banks

	group		bank	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Remaining maturity				
— repayable on demand	**5,004**	3,523	**2,978**	3,159
— 3 months or less but not repayable on demand	**19,523**	6,800	**7,041**	8,254
— 1 year or less but over 3 months	**3,776**	1,009	**1,729**	1,384
— 5 years or less but over 1 year	**1,095**	587	**261**	1,506
— over 5 years	**442**	314	**337**	513
Specific bad and doubtful debt provisions (Note 15)	**(19)**	(7)	**(7)**	(7)
	29,821	12,226	**12,339**	14,809
Amounts include:				
Subordinated	**40**	—	**2**	246
Due from subsidiary undertakings				
— subordinated			**—**	246
— unsubordinated			**1,418**	3,645
			1,418	3,891
Due from fellow subsidiary undertakings				
— subordinated	**7**	—	**2**	—
— unsubordinated	**2,018**	2,151	**1,706**	2,093
	2,025	2,151	**1,708**	2,093

14 Loans and advances to customers

	group		bank	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Remaining maturity				
— repayable on demand or at short notice	**14,807**	10,345	**11,070**	9,810
— 3 months or less but not repayable on demand or at short notice	**15,255**	5,972	**10,441**	5,400
— 1 year or less but over 3 months	**9,689**	7,022	**6,476**	6,302
— 5 years or less but over 1 year	**20,932**	16,533	**17,098**	14,943
— over 5 years	**21,778**	18,874	**17,418**	17,265
General and specific bad and doubtful debt provisions (Note 15)	**(1,940)**	(1,154)	**(1,102)**	(1,066)
	80,521	57,592	**61,401**	52,654
Amounts include:				
Subordinated	**73**	—		
Amounts include:				
Due from subsidiary undertakings				
— subordinated			**155**	—
— unsubordinated			**4,774**	1,056
			4,929	1,056
Due from fellow subsidiary undertakings				
— unsubordinated	**371**	271	**279**	271
Due from parent undertaking				
— unsubordinated	**70**	82	**70**	82
Due from joint ventures and associates				
— unsubordinated	**110**	4	**110**	4

Notes on the Accounts (continued)

15 Provisions for bad and doubtful debts

a *Movements on provisions for bad and doubtful debts*

	Specific	*General*	*Total*	*Specific*	*General*	*Total*
	2000	**2000**	**2000**	1999	1999	1999
group	**£m**	**£m**	**£m**	£m	£m	£m
At 1 January	**803**	**358**	**1,161**	684	338	1,022
Amounts written off	**(255)**	—	**(255)**	(213)	—	(213)
Recoveries of amounts written off in previous years	**28**	—	**28**	42	—	42
Charge to the profit and loss account	**217**	**27**	**244**	274	7	281
Acquisition of subsidiary undertakings	**626**	**143**	**769**	16	14	30
Exchange and other movements	**12**	—	**12**	—	(1)	(1)
At 31 December	**1,431**	**528**	**1,959**	803	358	1,161
bank						
At 1 January	**752**	**321**	**1,073**	678	311	989
Amounts written off	**(242)**	—	**(242)**	(223)	—	(223)
Recoveries of amounts written off in previous years	**25**	—	**25**	39	—	39
Charge to the profit and loss account	**203**	**40**	**243**	258	10	268
Exchange and other movements	**10**	—	**10**	—	—	—
At 31 December	**748**	**361**	**1,109**	752	321	1,073

	group		*bank*	
	2000	1999	**2000**	1999
Included in:	**£m**	£m	**£m**	£m
Loans and advances to banks (Note 13)	**19**	7	**7**	7
Loans and advances to customers (Note 14)	**1,940**	1,154	**1,102**	1,066
	1,959	1,161	**1,109**	1,073

b *Movements on suspended interest account*

	group			*bank*		
	2000	1999	1998	**2000**	1999	1998
	£m	£m	£m	**£m**	£m	£m
At 1 January	**68**	48	95	**42**	47	94
Amounts written off	**(25)**	(13)	(45)	**(19)**	(13)	(45)
Interest suspended during the year	**37**	25	33	**20**	22	33
Suspended interest recovered	**(25)**	(14)	(17)	**(15)**	(14)	(17)
Acquisition of subsidiary undertakings	**15**	23	—	—	—	—
Exchange and other movements	**(1)**	(1)	(18)	**1**	—	(18)
At 31 December	**69**	68	48	**29**	42	47

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

c *Non-performing loans*

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Loans on which interest has been suspended				
(net of suspended interest)	**941**	905	**655**	806
Provisions	**(455)**	(432)	**(290)**	(387)
	486	473	**365**	419
Other non-performing loans	**1,289**	630	**700**	619
Provisions	**(976)**	(371)	**(458)**	(365)
	313	259	**242**	254
Total non-performing loans (net of provisions)	**799**	732	**607**	673

16 Concentrations of exposure

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

	2000	1999
	£m	£m
Total gross advances to customers:		
Residential mortgages	**16,452**	13,486
Other personal	**12,307**	7,749
Commercial, industrial and international trade	**24,514**	15,838
Commercial real estate	**6,056**	3,472
Other property related	**2,022**	1,188
Government	**1,219**	1,477
Non-bank financial institutions	**7,012**	4,668
Other commercial*	**12,944**	10,935
	82,526	58,813

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

The analysis of concentration of exposure is based on the categories used by the group to manage the associated risks. Of total loans and advances to customers gross of provisions, £59,303 million (1999: £54,685 million) was advanced by operations located in the United Kingdom.

Notes on the Accounts (continued)

17 Debt securities

	group				bank			
	Book value	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*
	2000	**2000**	1999	1999	**2000**	**2000**	1999	1999
Issued by public bodies	**£m**	**£m**	£m	£m	**£m**	**£m**	£m	£m
Investment securities								
— government securities and US government agencies	**7,782**	**7,866**	5,748	5,729	**3,994**	**4,016**	5,173	5,138
— other public sector securities	**531**	**542**	—	—	—	—	—	—
	8,313	**8,408**	5,748	5,729	**3,994**	**4,016**	5,173	5,138
Other debt securities								
— government securities and US government agencies	**5,638**		1,515		**2,056**		1,469	
— other public sector securities	**8**		25		**6**		25	
	5,646		1,540		**2,062**		1,494	
Issued by other bodies								
Investment securities								
— bank and building society certificates of deposit	**5,875**	**5,876**	5,260	5,264	**5,789**	**5,789**	5,260	5,264
— other securities	**5,250**	**5,260**	389	387	**1,061**	**1,081**	156	156
	11,125	**11,136**	5,649	5,651	**6,850**	**6,870**	5,416	5,420
Other debt securities								
— bank and building society certificates of deposit	**76**		28		**1**		—	
— other securities	**9,025**		1,871		**4,060**		1,869	
	9,101		1,899		**4,061**		1,869	
	34,185		14,836		**16,967**		13,952	
Due within 1 year	**13,801**		10,466		**9,714**		10,294	
Due 1 year and over	**20,384**		4,370		**7,253**		3,658	
	34,185		14,836		**16,967**		13,952	
Amounts include:								
Subordinated debt securities	**84**		31		**83**		30	
Unamortised net (discounts)/premiums on investment securities	**(153)**		98		**38**		98	
Investment securities								
— listed	**11,474**	**11,590**	5,341	5,335	**4,258**	**4,297**	4,869	4,847
— unlisted	**7,964**	**7,954**	6,056	6,045	**6,586**	**6,589**	5,720	5,711
	19,438	**19,544**	11,397	11,380	**10,844**	**10,886**	10,589	10,558
Other debt securities								
— listed	**10,071**		2,577		**4,744**		2,529	
— unlisted	**4,676**		862		**1,379**		834	
	14,747		3,439		**6,123**		3,363	
	34,185		14,836		**16,967**		13,952	

17 Debt securities *(continued)*

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

The above market valuations do not take account of transactions entered into to hedge the value of the group's investment securities. If these transactions were included, the market valuation of investment securities would be £19,533 million for the group (1999: £11,379 million) and £10,886 million (1999: £10,557 million) for the bank.

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
group			
At 1 January 2000	**11,398**	**(1)**	**11,397**
Acquisition of subsidiary undertakings	**7,175**	**(14)**	**7,161**
Additions	**27,240**	—	**27,240**
Disposals and amounts repaid	**(26,350)**	—	**(26,350)**
Amortisation of discounts and premiums	**(94)**	—	**(94)**
Exchange and other movements	**84**	—	**84**
At 31 December 2000	**19,453**	**(15)**	**19,438**
bank			
At 1 January 2000	**10,589**	—	**10,589**
Additions	**24,416**	—	**24,416**
Disposals and amounts repaid	**(24,131)**	—	**(24,131)**
Amortisation of discounts and premiums	**(110)**	—	**(110)**
Exchange and other movements	**80**	—	**80**
At 31 December 2000	**10,844**	—	**10,844**

18 Equity shares

	group				*bank*			
	Book value	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*	*Book value*	*Market valuation*
	2000	**2000**	1999	1999	**2000**	**2000**	1999	1999
	£m	**£m**	£m	£m	**£m**	**£m**	£m	£m
Investment securities								
— listed	**504**	**542**	1	5	**3**	**5**	1	5
— unlisted	**1,020**	**1,080**	19	24	**97**	**102**	7	12
	1,524	**1,622**	20	29	**100**	**107**	8	17
Other securities								
— listed	**377**		76		**88**		52	
— unlisted	**67**		3		**2**		—	
	444		79		**90**		52	
	1,968		99		**190**		60	

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

Notes on the Accounts (continued)

18 Equity shares *(continued)*

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
group			
At 1 January 2000	**23**	**(3)**	**20**
Acquisition of subsidiary undertakings	**1,504**	**(119)**	**1,385**
Additions	**105**	—	**105**
Disposals	**(10)**	—	**(10)**
Provisions made	—	**(2)**	**(2)**
Exchange and other movements	**26**	—	**26**
At 31 December 2000	**1,648**	**(124)**	**1,524**
bank			
At 1 January 2000	**11**	**(3)**	**8**
Additions	**94**	—	**94**
Disposals	**(2)**	—	**(2)**
At 31 December 2000	**103**	**(3)**	**100**

Included in investment securities is £2 million, after amortisation, of HSBC Holdings' own shares (1999: £1 million) held in trust for the purposes of conditional awards under the Restricted Share Plan, details of which are provided in the 'Report of the Directors' on pages 63 to 65 and 69. At 31 December 2000, the trust held 484,114 shares of nominal value US$0.50 with a market value at that date of £4.8 million (1999: 276,968 shares with a market value of £2 million) in respect of these conditional awards.

19 Interests in joint ventures

a *Movements in joint ventures*

	group
	£m
At 1 January 2000	—
Acquisition of subsidiary undertakings	**164**
Retained profits and losses	**2**
Exchange and other movements	**5**
At 31 December 2000	**171**

None of the joint ventures are listed or are banks.

b *The principal joint ventures of the group as at 31 December 2000 were:*

	Country of incorporation	*Principal activity*	*Interest in equity capital*
Framlington Group Limited	UK	Asset management	51%
Loxxia Slibail	France	Leasing	50%

All of the above make their financial statements up to 31 December.

The principal countries of operation are the same as the countries of incorporation.

The group's share of total operating income in joint ventures is £18 million.

The group's share of contingent liabilities in joint ventures is £25 million. The group's share of commitments by joint ventures is £65 million.

19 Interests in joint ventures *(continued)*

c *Goodwill*

Included within the group's share of gross assets of joint ventures is goodwill as follows:

	group
	£m
Cost	
At 1 January 2000	—
Acquisition of subsidiary undertakings	**121**
Exchange movements	**5**
At 31 December 2000	**126**

	group
Accumulated amortisation	£m
At 1 January 2000	—
Charge to the profit and loss account	1
At 31 December 2000	**1**
Net book value at 31 December 2000	**125**

Additions represent goodwill arising on the acquisition of Framlington Group Limited and Loxxia Slibail as part of the acquisition of CCF (Note 21(c)). The goodwill is being amortised over 20 years, reflecting its expected useful life.

20 Interests in associates

a *Movements in associates*

	group	*bank*
	£m	**£m**
At 1 January 2000	**87**	**81**
Acquisition of subsidiary undertakings	**105**	—
Additions	**23**	**23**
Disposals	**(63)**	**(63)**
Write-down to net asset value	—	**(36)**
Retained losses	**(38)**	—
Exchange and other movements	**5**	**1**
At 31 December 2000	**119**	**6**

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Shares in banks	**67**	61	—	61
Other	**52**	26	**6**	20
	119	87	**6**	81

None of the associates are listed.

Notes on the Accounts (continued)

20 Interests in associates *(continued)*

a *Movements in associates (continued)*

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

	2000 **£m**	1999 £m
Cost	**94**	136
Provisions	**(9)**	(9)
	85	127

b *Principal associates as at 31 December 2000*

	Country of incorporation	*Principal activity*	*Interest in equity capital*
British Interactive Broadcasting Holdings Limited*	England	Digital interactive services	20%
Erisa	France	Insurance	49.9%
Mondex Holdings Limited	England	Electronic cash	
£1 ordinary A shares			50%†
£1 ordinary B shares			47.5%†
£1 ordinary C shares			50%†
£1 ordinary D shares			50%†

Effective 1 January 2000, the group transferred its holding in British Arab Commercial Bank to HSBC Holdings BV, a fellow subsidiary undertaking of HSBC Holdings plc.

* *The group has agreed to sell its interest in British Interactive Broadcasting Holdings Limited. The sale is subject to regulatory approval.*

† *The rights attaching to the classes of share vary. The principal rights are the voting rights in Mondex Holdings Limited, which are carried by the A shares, and the beneficial ownership of the Mondex franchise operation in the United Kingdom, which is carried by the B shares.*

21 Investments in subsidiary undertakings

a *Movements in the bank's interests in shares in subsidiary undertakings*

	£m
At 1 January 2000	1,566
Additions	11,619
Disposals	(543)
Write-up to net asset value including attributable goodwill	745
Exchange and other movements	(452)
At 31 December 2000	**12,935**

The above amount represents the direct interests of the bank in its subsidiary undertakings. None of these interests is listed. Interests in subsidiary undertakings include £8,370 million (1999: £16 million) representing interests in banks.

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

	2000 **£m**	1999 £m
Cost	**11,986**	1,363
Provisions	**(36)**	(37)
	11,950	1,326

21 Investments in subsidiary undertakings *(continued)*

b *Principal subsidiary undertakings of the bank as at 31 December 2000*

	Country of incorporation
Crédit Commercial de France S.A. (99.98% owned)	France
HSBC Asset Finance (UK) Limited	England
HSBC Bank France S.A. (97.45% owned)	France
HSBC Bank International Limited	Jersey
HSBC Bank Malta p.l.c. (70% owned)	Malta
HSBC Invoice Finance (UK) Limited	England
HSBC Life (UK) Limited	England
HSBC Private Banking Holdings (Suisse) SA (97.45% owned)	Switzerland
HSBC Rail (UK) Limited	England
HSBC Republic Bank (Guernsey) Limited (97.45% owned)	Guernsey
HSBC Republic Bank (Suisse) SA (97.45% owned)	Switzerland
HSBC Trust Company (UK) Limited	England

Except where indicated otherwise, the issued equity capital of the above undertakings is wholly owned by the group and, except for HSBC Trust Company (UK) Limited and HSBC Bank International Limited, is held by subsidiaries of the bank.

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

c *Acquisitions*

The group acquired a 50.8 per cent interest in HSBC Republic Holdings (Luxembourg) S.A. effective 1 January 2000. The consideration paid comprised cash of £1,584 million, and goodwill of £1,063 million arose.

The group acquired a 100 per cent interest in Crédit Commercial de France S.A. (CCF) from HSBC Holdings on 31 October 2000. The consideration paid comprised cash of £7,828 million, and goodwill of £5,742 arose. The fair values of the assets and liabilities have been determined only on a provisional basis at 31 December 2000 pending completion of the fair value appraisal process. At 31 December 2000, following the exercise of CCF share options in respect of shares which have not yet been exchanged for HSBC Holdings ordinary shares, the effective holding was 99.98 per cent.

Notes on the Accounts (continued)

21 Investments in subsidiary undertakings *(continued)*

c *Acquisitions (continued)*

The assets and liabilities at the dates of acquisition and the total consideration paid are set out in the following table. There were no differences between book value and fair value as all assets and liabilities had been restated to fair value upon acquisition by HSBC Holdings.

At the date of acquisition:	*HSBC Republic Holdings (Luxembourg) S.A.* £m	*Crédit Commercial de France S.A.* £m
Cash and balances at central banks	**17**	**1,610**
Treasury bills and other eligible bills	**112**	**1,384**
Loans and advances to banks	**5,136**	**10,824**
Loans and advances to customers	**1,923**	**15,822**
Debt securities	**4,981**	**10,503**
Equity shares	**95**	**1,661**
Interests in joint ventures	—	**164**
Interests in associates	—	**105**
Tangible fixed assets	**88**	**647**
Other asset categories	**370**	**3,267**
Deposits by banks	**(2,668)**	**(17,179)**
Customer accounts	**(8,352)**	**(15,753)**
Debt securities in issue	—	**(5,422)**
Subordinated capital		
— dated loan capital	**(134)**	**(140)**
— undated loan capital	—	**(440)**
Other liability categories	**(543)**	**(4,967)**
Total	**1,025**	**2,086**
Less: minority interests	**(504)**	—
Net assets acquired	**521**	**2,086**
Goodwill attributable		
— subsidiary undertakings (Note 22)	**1,063**	**5,621**
— joint ventures (Note 19(c))	—	**121**
	1,063	**5,742**
Total consideration including cost of acquisition	**1,584**	**7,828**

Operating income, operating profit, profit on ordinary activities before tax, tax charge and profit attributable to shareholders for the period from 1 January 2000 to 31 October 2000 for CCF were £1,297 million, £494 million, £356 million, £122 million and £250 million respectively. Profit attributable to shareholders for the year ended 31 December 1999 was £286 million. These were determined under French generally accepted accounting principles. Profit attributable to shareholders for HSBC Republic for the year ended 31 December 1999 was £172 million, determined under US generally accepted accounting principles.

Pursuant to an HSBC Group reorganisation, effective 15 December 2000, the group acquired a 97.45 per cent interest in HSBC Private Banking Holdings (Suisse) SA and the other subsidiary undertakings of HSBC Republic Holdings (Luxembourg) S.A., and transferred its interest in HSBC Republic Holdings (Luxembourg) S.A. to HSBC Investments Bahamas Inc., a fellow subsidiary undertaking of HSBC Holdings. The consideration for the overall reorganisation comprised net cash paid of £1,315 million and goodwill of £1,160 million arose. There were no significant changes to the fair value of the net assets shown above other than the profit for the period.

21 Investments in subsidiary undertakings *(continued)*

c *Acquisitions (continued)*

Other acquisitions

On 25 February 2000, the group acquired 100 per cent of the issued share capital of HSBC Investment Funds Administration Limited, HSBC Unit Trust Management Limited and HSBC Investment Services Limited for an aggregate cash consideration of £8 million.

On 31 March 2000, the group acquired 100 per cent of the issued share capital of South Yorkshire Light Rail Limited for a cash consideration of £13 million.

On 15 December 2000, a 97.45 per cent owned subsidiary undertaking acquired a 100 per cent interest in the issued share capital of HSBC Bank France S.A. for a cash consideration of £114 million. Gross assets acquired totalled £351 million and goodwill of £6 million arose.

There were no fair value adjustments. The pre-acquisition, prior year and post-acquisition results of these acquisitions were not material in the context of the group's 2000 results.

All acquisitions have been accounted for on an acquisitions basis.

22 Intangible fixed assets

Goodwill	*group*	*bank*
	2000	**2000**
	£m	**£m**
Cost		
At 1 January 2000	**58**	**4**
Additions	**7,883**	**31**
Exchange movements	**394**	**—**
At 31 December 2000	**8,335**	**35**
Accumulated amortisation		
At 1 January 2000	**3**	**—**
Charge to the profit and loss account	**116**	**2**
Exchange and other movements	**5**	**—**
At 31 December 2000	**124**	**2**
Net book value at 31 December 2000	**8,211**	**33**
Net book value at 31 December 1999	55	4

Additions represent goodwill arising on the acquisition of and increased holdings in subsidiaries during 2000. Goodwill on these items is being amortised over periods of up to 20 years, reflecting their expected useful lives.

Notes on the Accounts (continued)

23 Tangible fixed assets

a *Movements on tangible fixed assets*

	Freehold land and buildings	Long leasehold land and buildings	Short leasehold land and buildings	Equipment, fixtures and fittings	Equipment on operating leases	Total
	£m	£m	£m	£m	£m	£m
group						
Cost or valuation						
At 1 January 2000	594	510	213	1,078	2,220	4,615
Additions	36	53	15	252	309	665
Disposals	(23)	(1)	(1)	(101)	(158)	(284)
Acquisition of subsidiary undertakings	459	64	100	505	10	1,138
Transfer of accumulated depreciation arising on revaluation	(17)	(4)	—	—	—	(21)
Surplus on revaluation	21	7	—	—	—	28
Exchange and other movements	7	(4)	4	4	—	11
At 31 December 2000	1,077	625	331	1,738	2,381	6,152
Accumulated depreciation						
At 1 January 2000	(7)	(1)	(146)	(613)	(517)	(1,284)
Disposals	—	—	—	87	121	208
Acquisition of subsidiary undertakings	—	—	(1)	(368)	(1)	(370)
Transfer of accumulated depreciation arising on revaluation	17	4	—	—	—	21
Charge to the profit and loss account	(19)	(4)	(13)	(167)	(161)	(364)
Exchange and other movements	(3)	1	(1)	(1)	—	(4)
At 31 December 2000	(12)	—	(161)	(1,062)	(558)	(1,793)
Net book value						
At 31 December 2000	1,065	625	170	676	1,823	4,359
At 31 December 1999	587	509	67	465	1,703	3,331
bank						
Cost or valuation						
At 1 January 2000	478	497	195	1,006	—	2,176
Additions	7	46	7	185	—	245
Disposals	(11)	—	(1)	(56)	—	(68)
Transfer of accumulated depreciation arising on revaluation	(10)	(4)	—	—	—	(14)
Surplus on revaluation	12	5	—	—	—	17
Exchange and other movements	1	(2)	—	—	—	(1)
At 31 December 2000	477	542	201	1,135	—	2,355
Accumulated depreciation						
At 1 January 2000	(7)	(1)	(123)	(565)	—	(696)
Disposals	—	—	—	49	—	49
Transfer of accumulated depreciation arising on revaluation	10	4	—	—	—	14
Charge to the profit and loss account	(15)	(4)	(7)	(138)	—	(164)
Exchange and other movements	—	1	—	(3)	—	(2)
At 31 December 2000	(12)	—	(130)	(657)	—	(799)
Net book value						
At 31 December 2000	465	542	71	478	—	1,556
At 31 December 1999	471	496	72	441	—	1,480

23 Tangible fixed assets *(continued)*

b *Assets held under finance leases*

The net book amount of equipment, fixtures and fittings included assets held under finance leases of £27 million (1999: £5 million) for the group and £10 million (1999: £22 million) for the bank, on which the depreciation charge was £2 million (1999: £3 million) for the group and £12 million (1999: £17 million) for the bank. The net book amount of equipment on operating leases included assets held under finance leases of £121 million (1999: £132 million) for the group on which the depreciation charge was £11 million (1999: £ nil).

c *Valuations*

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Cost or valuation of freehold and long leasehold land and buildings:				
At valuation	**1,205**	652	**522**	523
At cost	**497**	452	**497**	452
	1,702	1,104	**1,019**	975
On the historical cost basis, freehold and long leasehold land and buildings would have been included as follows:				
Cost	**1,695**	1,106	**930**	883
Accumulated depreciation	**(250)**	(227)	**(151)**	(132)
Net book value	**1,445**	879	**779**	751

The group values its freehold and long leasehold properties on an annual basis. In November 2000, the group's freehold and long leasehold properties were revalued on an existing use basis or open market value as appropriate or, in the case of a few specialised properties, at depreciated replacement cost. The properties were revalued either by professional external valuers or by professionally qualified staff.

As a result of the revaluation, there was a surplus above the net book value of land and buildings of £28 million (bank £17 million) which has been included in the revaluation reserve at 31 December 2000.

d *Land and buildings occupied for own activities*

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Net book value	**1,293**	669	**548**	573

Land and buildings with a net book value of £36 million (1999: £34 million) are occupied by HSBC Holdings plc and its subsidiaries other than the group.

e *Payment on account*

Included in the cost and net book value of long leasehold land and buildings is a payment on account in respect of a long leasehold interest of £497 million (1999: £452 million).

Notes on the Accounts (continued)

24 Other assets

	group 2000 £m	group 1999 £m	bank 2000 £m	bank 1999 £m
Bullion	**12**	179	**2**	179
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	**7,197**	5,062	**5,985**	5,054
Deferred taxation (Note 29)	**—**	—	**38**	55
Long term assurance assets attributable to policyholders (Note 28)	**3,117**	3,132	**—**	—
Other	**3,372**	1,530	**854**	717
	13,698	9,903	**6,879**	6,005
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market include unsubordinated amounts due from:				
Subsidiary undertakings			**177**	14
Fellow subsidiary undertakings	**808**	607	**785**	605

Included within 'Other' in the above table is £3 million (1999: £4 million) for the group and £3 million (1999: £4 million) for the bank in respect of other participating interests.

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

	2000 £m	1999 £m
Net tangible assets of HSBC Life (UK) Limited and HSBC Life (Europe) Limited	**24**	23
Surplus retained in long-term assurance funds and net present value of policies in force	**381**	292
Total long-term assurance business attributable to shareholders	**405**	315

The increase in the value of long-term assurance business attributable to shareholders which is included in the consolidated profit and loss account amounts to £115 million (1999: £99 million; 1998: £73 million) before tax and £90 million (1999: £70 million; 1998: £51 million) after tax.

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

	2000	1999
Risk discount rate (net of tax)	**11.5%**	12.5%
Economic assumptions (gross of tax)		
Investment return on unit-linked funds	**7.1%**	7.1%
Investment return on non-linked funds	**5.0%**	5.0%
Expense inflation	**3.7%**	3.7%

24 Other assets *(continued)*

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

	2000 £m	1999 £m
Loans and advances to banks	**192**	133
Debt securities	**660**	586
Equity shares	**1,351**	1,332
Other assets	**974**	1,127
Prepayments and accrued income	**17**	18
Other liabilities	**(77)**	(64)
Long-term assurance net assets attributable to policyholders	**3,117**	3,132

25 Deposits by banks

	group		*bank*	
	2000 £m	1999 £m	**2000 £m**	1999 £m
Repayable on demand	**6,371**	3,943	**4,136**	4,053
With agreed maturity dates or periods of notice by remaining maturity				
— 3 months or less but not repayable on demand	**19,365**	6,910	**11,924**	10,075
— 1 year or less but over 3 months	**2,538**	690	**1,095**	987
— 5 years or less but over 1 year	**556**	183	**358**	340
— over 5 years	**311**	54	**27**	53
	29,141	11,780	**17,540**	15,508
Amounts include:				
Due to subsidiary undertakings			**6,613**	4,018
Due to fellow subsidiary undertakings	**2,242**	1,196	**1,067**	1,191

26 Customer accounts

	group		*bank*	
	2000 £m	1999 £m	**2000 £m**	1999 £m
Repayable on demand	**57,286**	40,669	**43,409**	35,864
With agreed maturity dates or periods of notice by remaining maturity				
— 3 months or less but not repayable on demand	**38,974**	20,610	**18,740**	20,046
— 1 year or less but over 3 months	**3,075**	1,984	**1,606**	1,413
— 5 years or less but over 1 year	**2,418**	2,455	**1,858**	2,256
— over 5 years	**435**	376	**331**	368
	102,188	66,094	**65,944**	59,947
Amounts include:				
Due to joint ventures and associates	**3**	2	**3**	2
Due to subsidiary undertakings			**539**	188
Due to fellow subsidiary undertakings	**599**	358	**481**	283
Due to parent undertaking	**2,118**	727	**2,117**	726

Notes on the Accounts (continued)

27 Debt securities in issue

	group		bank	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Bonds and medium-term notes, by remaining maturity				
— within 1 year	**899**	506	**419**	478
— between 1 and 2 years	**1,072**	411	**679**	387
— between 2 and 5 years	**2,760**	1,302	**1,871**	1,302
— over 5 years	**199**	115	**57**	71
	4,930	2,334	**3,026**	2,238
Other debt securities in issue, by remaining maturity				
— 3 months or less	**3,123**	1,358	**656**	1,118
— 1 year or less but over 3 months	**350**	246	**73**	246
— 5 years or less but over 1 year	**769**	7	**60**	7
— over 5 years	**135**	—	—	—
	4,377	1,611	**789**	1,371
	9,307	3,945	**3,815**	3,609

28 Other liabilities

	group		bank	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Short positions in debt securities				
— government securities	**2,975**	1,892	**2,563**	1,892
— other debt securities	**917**	82	**331**	82
	3,892	1,974	**2,894**	1,974
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked to market	**7,586**	5,418	**6,193**	5,415
Current taxation	**475**	350	**281**	302
Obligations under finance leases	**177**	146	**10**	22
Dividend payable	**600**	300	**600**	300
Long-term assurance liabilities attributable to policyholders (Note 24)	**3,117**	3,132	—	—
Other liabilities	**2,557**	1,859	**1,015**	1,169
	18,404	13,179	**10,993**	9,182
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts that are marked-to-market include amounts due to:				
Subsidiary undertakings			**113**	26
Fellow subsidiary undertakings	**734**	575	**717**	575
Obligations under finance leases fall due as follows:				
— within 1 year	**2**	2	**12**	17
— between 1 to 5 years	**2**	4	**7**	23
— over 5 years	**418**	352	—	—
	422	358	**19**	40
— less future finance charges	**(245)**	(212)	**(9)**	(18)
	177	146	**10**	22

29 Provisions for liabilities and charges

a *Deferred taxation*

	group	*bank*
	£m	**£m**
At 1 January 2000	**509**	**(55)**
Charge to the profit and loss account (Note 7)	**6**	**18**
Acquisition of subsidiary undertakings	**144**	**—**
Exchange and other movements	**(38)**	**(1)**
At 31 December 2000	**621**	**(38)**

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Included in 'Provisions for liabilities and charges'	**621**	509	**—**	—
Included in 'Other assets' (Note 24)	**—**	—	**(38)**	(55)
	621	509	**(38)**	(55)

	Unprovided deferred tax/(relief)	*Provided in accounts*	*Unprovided deferred tax/(relief)*	*Provided in accounts*
	2000	**2000**	1999	1999
	£m	**£m**	£m	£m
group				
Short-term timing differences	**(6)**	**105**	(7)	(7)
Accelerated capital allowances	**(16)**	**(1)**	(10)	(1)
Leasing transactions	**14**	**537**	14	561
Provisions for bad and doubtful debts	**(26)**	**2**	(20)	(15)
Relief for tax losses	**(14)**	**(15)**	—	—
Other items	**(13)**	**(7)**	(18)	(29)
	(61)	**621**	(41)	509
bank				
Short-term timing differences	**(6)**	**(19)**	(7)	(18)
Accelerated capital allowances	**(15)**	**—**	(10)	—
Provisions for bad and doubtful debts	**(18)**	**2**	(12)	(6)
Other items	**(10)**	**(21)**	(10)	(31)
	(49)	**(38)**	(39)	(55)

There is no material deferred taxation liability not provided for.

At 31 December 2000, in addition to the unprovided deferred tax asset of £61 million, there were other potential future tax benefits of approximately £134 million (1999: £141 million) in respect of capital losses that have not been recognised because recoverability of the potential benefits is not considered certain.

No provision has been made for taxation on capital gains that might arise on the disposal of subsidiary undertakings, joint ventures or associates at their balance sheet amounts, or for taxation on capital gains that might arise on the disposal of premises, as it is anticipated that any liability will be covered by capital losses or other reliefs. No provision has been made for any liability to UK taxation on overseas earnings that are not expected to be remitted.

Notes on the Accounts (continued)

29 Provisions for liabilities and charges *(continued)*

b *Other provisions for liabilities and charges*

	Provisions for pensions and other post-retirement obligations	*Provisions for contingent liabilities and commitments*	*Premises-related provisions*	*Insurance and other provisions*	*Total*
	£m	**£m**	**£m**	**£m**	**£m**
group					
At 1 January 2000	**91**	**107**	**133**	**158**	**489**
Additional provisions/increase in provisions	**16**	**30**	**10**	**59**	**115**
Provisions released	—	**(10)**	**(21)**	—	**(31)**
Acquisition of subsidiary undertakings	**128**	**65**	**1**	**51**	**245**
Provisions utilised	**(8)**	**(24)**	**(9)**	**(61)**	**(102)**
Exchange and other movements	**1**	—	—	—	**1**
At 31 December 2000	**228**	**168**	**114**	**207**	**717**
bank					
At 1 January 2000	**85**	**105**	**128**	**15**	**333**
Additional provisions/increase in provisions	**11**	**30**	**10**	—	**51**
Provisions released	—	**(10)**	**(20)**	—	**(30)**
Provisions utilised	**(4)**	**(24)**	**(8)**	**(15)**	**(51)**
At 31 December 2000	**92**	**101**	**110**	—	**303**

Included within 'Provisions for contingent liabilities and commitments' are provisions for the costs of possible redress relating to the sales of certain personal pension plans of £79 million (1999: £92 million). This is the result of an actuarial calculation extrapolated from a sample of cases and the timing of the expenditure depends on settlement of the individual claims.

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

30 Subordinated liabilities

	2000 £m	1999 £m
Undated subordinated loan capital		
— bank	**1,339**	1,259
— subsidiary undertakings	**146**	—
	1,485	1,259
Dated subordinated loan capital		
— bank	**3,054**	2,084
— subsidiary undertakings	**673**	30
	3,727	2,114
Total subordinated liabilities		
— bank	**4,393**	3,343
— subsidiary undertakings	**819**	30
	5,212	3,373
Dated subordinated loan capital is repayable:		
— within 1 year	**359**	1
— between 1 to 2 years	**62**	250
— between 2 to 5 years	**660**	246
— over 5 years	**2,646**	1,617
	3,727	2,114

Undated subordinated loan capital

		2000 £m	1999 £m
bank			
US$750 million	Undated Floating Rate Primary Capital Notes	**503**	464
US$500 million	Undated Floating Rate Primary Capital Notes	**335**	309
US$300 million	Undated Floating Rate Primary Capital Notes (Series 3)	**201**	186
£150 million	9.25% Step-up Undated Subordinated Notes	**150**	150
£150 million	8.625% Step-up Undated Subordinated Notes	**150**	150
		1,339	1,259
subsidiary undertakings			
¥10,000 million	Undated Subordinated Loan Notes	**59**	—
	Other Subordinated Liabilities less than £50 million	**87**	—
		146	—

Notes on the Accounts (continued)

30 Subordinated liabilities *(continued)*

Dated subordinated loan capital

		2000	1999
		£m	£m
bank			
£250 million	Subordinated Floating Rate Notes 2001	**250**	250
US$400 million	8.625% Subordinated Notes 2004	**267**	246
£200 million	9% Subordinated Notes 2005	**200**	200
US$500 million	7.625% Subordinated Notes 2006	**335**	309
£100 million	14% Subordinated Unsecured Loan Stock 2002/2007	**100**	100
US$50 million	Subordinated Step-up Coupon Callable Floating Rate Notes 2007	**33**	31
£150 million	Subordinated Step-up Coupon Floating Rate Notes 2007	**150**	150
US$375 million	Subordinated Step-up Coupon Floating Rate Notes 2009	**250**	230
US$300 million	6.95% Subordinated Notes 2011	**201**	186
£300 million	6.5% Subordinated Notes 2023	**298**	197
US$300 million	7.65% Subordinated Notes 2025	**200**	185
£150 million	6.25% Subordinated Notes 2041*	**147**	—
		2,431	2,084
Amounts owed to fellow subsidiary undertaking			
€1,000 million	Subordinated Loan 2012*	**623**	—
		3,054	2,084
Amounts owed to subsidiary undertaking			
€900 million	7.75% Non-cumulative Subordinated Notes 2040*	**561**	—
		3,615	2,084
subsidiary undertakings			
CHF147 million	7.25% Subordinated Loan 2001	**60**	—
US$81 million	Floating Rate Subordinated Notes 2005	**54**	—
FRF1,000 million	Subordinated Collared Floating Rate Notes 2004	**95**	—
Other subordinated liabilities less than £50 million		**263**	30
		472	30
Amounts owed to parent undertaking			
US$300 million	Term Subordinated Debt 2010*	**201**	—
		673	30

* *The issue of new subordinated loan capital was in respect of the acquisition of CCF and the increased holding in HSBC Private Banking Holdings (Suisse) SA.*

Interest rates on the floating rate subordinated loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 14 per cent.

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

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

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

31 Minority interests — non equity

At 31 December 2000, the following innovative tier 1 capital issue was outstanding:

		2000 £m	1999 £m
€900 million	Capital contribution	**561**	—

HSBC Capital Funding 1 (UK) Limited Partnership was established by a subsidiary undertaking of the bank as General Partner, and a fellow subsidiary undertaking of HSBC Holdings, as Limited Partner. The Limited Partner's capital contribution of €900 million qualifies as innovative tier 1 capital for both the bank and the group on a consolidated basis.

The proceeds of the capital contribution were on-lent by HSBC Capital Funding 1 (UK) Limited Partnership to the bank's Paris branch by issue of 7.75% Non-Cumulative Subordinated Notes, due 2040. The Subordinated Notes may be redeemed at the option of the issuer on the interest payment date in 2010, or any interest payment date thereafter.

The Limited Partner's profits share for each distribution period is calculated as the lower of a) €69,750,000 and b) the profit of the Limited Partnership available for that distribution period. There are limitations on the payment of the Limited Partner's profit share if the bank is prohibited under UK banking regulations or other requirements from paying distributions on its Parity Obligations, or if the bank has insufficient distributable reserves.

The Limited Partnership will only be dissolved upon the occurrence of i) the redemption of the Subordinated Notes, provided certain redemption conditions are satisfied, or ii) the passing of a resolution for the winding-up of the bank. The return of capital contribution to which the Limited Partner is entitled shall not exceed the amount per security that would have been paid as the liquidating distribution from the assets of the bank had the Limited Partner's interest in the Limited Partnership been substituted by the Substitute Securities (see below).

If i) the total capital ratio of the bank or the group, on a consolidated basis, has fallen below the regulatory minimum ratio required, or ii) in view of the bank's deteriorating financial condition, the bank's Board of Directors expect i) to occur in the near term, then fully paid ordinary shares issued by the bank ('Substitute Securities') shall be substituted for the Limited Partner's interest in the Limited Partnership.

32 Called up share capital

	Non-cumulative preference shares of £1 each	*Non-cumulative preference shares of US$0.01 each*	*Ordinary shares of £1 each*	*Total*
At 31 December 1998, 1999 and 2000	£m	£m	£m	£m
Authorised share capital	150	1	1,000	1,151
Issued, allotted and fully paid share capital	—	—	797	797

The issued, allotted and fully paid share capital of the bank comprises 796,903,208 ordinary shares of nominal value £1 each, 20,000,000 Series A, 14,000,000 Series B, 16,000,000 Series C, and 16,000,000 Series D US$ non-cumulative preference shares of nominal value US$0.01 each, 4,000,000 Second US$ non-cumulative preference shares of nominal value US$0.01 each and one preferred ordinary share of nominal value £1.

Notes on the Accounts (continued)

32 Called up share capital *(continued)*

The bank issued the following ordinary shares of nominal value £1 each to HSBC Holdings during the year:

	Ordinary shares of £1 each	*Share premium*
	£	£
2 January 2000	1	249,999,999
10 January 2000	1	299,999,999
10 January 2000	1	437,052,324
31 October 2000	1	6,718,619,901
20 December 2000	1	1,327,526,969

The issue of shares was in respect of the acquisition of HSBC Republic Holdings (Luxembourg) S.A., CCF and HSBC Private Banking Holdings (Suisse) SA.

In the event of a winding-up, US$ preference shareholders would receive, in priority to the ordinary shareholders of the bank, repayment of US$20 per share in the case of the Series A1, Series B1, Series C1 and Series D1 preference shares and Series 1 Second preference shares, and US$5 per share in the case of the Series A2, Series B2, Series C2 and Series D2 preference shares and Series 2 Second preference shares, plus an amount equal to any dividends declared but unpaid in respect of the previous dividend for the period and any accrued and unpaid dividends for the period to the date of the commencement of the winding-up. With the exception of the above, the preference shares do not carry any right to participate in any surplus of assets on a winding-up. The Second preference shares are subordinated, as regards payment of capital and dividends, to the other US$ preference shares.

Holders of the Series A1, Series A2, Series B1, Series B2, Series C1, Series C2, Series D1 and Series D2 preference shares and Series 1 and Series 2 Second preference shares are not entitled to vote at general meetings of the shareholders, except in certain limited circumstances, such as the variation of the rights attaching to those shares, or in the event of reduction of the preference share capital. In addition, the Series A1, Series B1, Series C1 and Series D1 preference shareholders and Series 1 Second preference shareholders are entitled to vote at general meetings of the shareholders if any resolution is proposed for a winding-up or sale of the whole business of the bank, or in the event of a failure to pay in full the dividend payable on the Series A1, Series B1, Series C1 or Series D1 preference shares or Series 1 Second preference shares for the most recent dividend period.

The Series A1 and A2 preference shares are redeemable at the option of the bank at a redemption price of US$20 per Series A1 and US$5 per Series A2 preference share. A special dividend is payable for redemptions of Series A2 preference shares up to 4 October 2003. The dividend amounts to US$0.666 per Series A2 preference share until 4 October 2001, and thereafter decreases for share redemptions made up to 4 October 2003.

The Series B1 and B2 preference shares are redeemable at the option of the bank at a redemption price of US$20 per Series B1 and US$5 per Series B2 preference share. A special dividend is payable for redemptions of Series B2 preference shares up to 23 February 2005 inclusive. The dividend amounts to US$1.281 per Series B2 preference share until 23 February 2002, and thereafter decreases for share redemptions up to 23 February 2005.

The Series C1 and C2 preference shares are redeemable at the option of the bank, at a redemption price of US$20 per Series C1 and US$5 per Series C2 preference share. A special dividend is payable for redemptions of Series C2 preference shares up to 26 October 2005 inclusive. The dividend amounts to US$1.141 per Series C2 preference share until 26 October 2001, and thereafter decreases for share redemptions up to 26 October 2005.

The Series D1 and D2 preference shares are redeemable at the option of the bank, on or after 25 July 2001, at a redemption price of US$20 per Series D1 and US$5 per Series D2 preference share.

The Series 1 and 2 Second preference shares are redeemable at the option of the bank, on or after 7 February 2002, at a redemption price of US$20 per Series 1 and US$5 per Series 2 Second preference share.

33 Reserves

	group			bank		joint ventures and associates	
	2000 £m	1999 £m	1998 £m	**2000 £m**	1999 £m	**2000 £m**	1999 £m
Share premium account							
At 1 January	**1,986**	1,973	1,976	**1,986**	1,973	—	—
New share capital subscribed	**9,033**	—	—	**9,033**	—	—	—
Exchange movements	**44**	13	(3)	**44**	13	—	—
At 31 December	**11,063**	1,986	1,973	**11,063**	1,986	—	—
Revaluation reserves							
At 1 January	**77**	51	65	**267**	153	—	—
Realisation on disposal of properties	**(1)**	(3)	(6)	—	(3)	—	—
Unrealised surplus/(deficit) on revaluation of freehold and long leasehold properties	**28**	29	(8)	**17**	24	—	—
Net increase in attributable net assets of subsidiary and associates	—	—	—	**709**	93	—	
Realisation on disposal of subsidiary and associates	—	—	—	**3**	—	—	—
At 31 December	**104**	77	51	**996**	267	—	—
Profit and loss account							
At 1 January	**2,008**	1,959	1,597	**1,818**	1,857	**(40)**	(11)
Retained profit/(loss) for the year	**145**	54	349	**(2)**	(44)	**(36)**	(29)
Goodwill written back on disposals	**2**	—	1	—	—	—	—
Realisation on disposal of properties	**1**	3	6	—	3	—	—
Realisation on disposal of subsidiary and associates	—	—	—	**(3)**	—	—	—
Exchange and other movements	**564**	(8)	6	**15**	2	**2**	—
At 31 December	**2,720**	2,008	1,959	**1,828**	1,818	**(74)**	(40)

Cumulative goodwill amounting to £84 million (1999: £86 million; 1998: £86 million) has been charged against reserves in respect of acquisitions prior to 1 January 1998.

The reserves of the bank include distributable reserves of £1,813 million (1999: £1,804 million; 1998: £1,845 million).

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

Advantage has been taken of the exemptions applicable to Inland Revenue approved SAYE share option schemes and equivalent overseas schemes under Urgent Issues Task Force Abstract 17 (revised 2000) 'Employee share schemes'.

34 Analysis of total assets and total liabilities

a *Assets subject to sale and repurchase transactions*

	group 2000 £m	group 1999 £m	bank 2000 £m	bank 1999 £m
Total assets subject to sale and repurchase transactions	**2,151**	1,360	**1,425**	1,346

b *Assets leased to customers*

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

	group 2000 £m	group 1999 £m
Finance leases		
— loans and advances to banks	**7**	7
— loans and advances to customers	**1,720**	1,614
Hire purchase agreements		
— loans and advances to customers	**769**	840
Tangible fixed assets		
— equipment on operating leases	**1,823**	1,703
	4,319	4,164

The cost of assets acquired during 2000 for letting under finance leases and hire purchase contracts by the group amounted to £291 million (1999: £312 million) and £413 million (1999: £386 million), respectively.

c *Assets charged as security for liabilities*

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

	group 2000 £m	group 1999 £m	bank 2000 £m	bank 1999 £m
Deposits by banks	**150**	112	**150**	112
Customer accounts	**118**	312	**98**	312
Debt securities in issue	**563**	43	**519**	—
	831	467	**767**	424

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

	group 2000 £m	group 1999 £m	bank 2000 £m	bank 1999 £m
Assets pledged to secure liabilities	**6,045**	3,372	**5,553**	3,059

The above amounts are mainly made up of items included in 'Debt securities' of £5,012 million (1999: £2,761 million) for the group and £4,661 million (1999: £2,506 million) for the bank.

35 Financial instruments

a *Derivatives*

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

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

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

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

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than required in cash markets. Recognising this, only certain branches and offices within major subsidiaries with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. The management of market risk arising from derivatives business is monitored by Traded Markets Development and Risk, in combination with market risks arising from on-balance-sheet instruments (Note 37).

Unlike assets recorded on the balance sheet, where the credit risk is typically the full amount of the principal value, together with any unrealised interest accrued or mark-to-market gain (Note 12), the credit risk relative to a derivative is principally the replacement cost of any contract with a positive mark-to-market gain and an estimate for the potential future change in value, reflecting the volatilities affecting the contract. Credit risk on contracts having a negative mark-to-market value is restricted to the potential future change in value. Credit risk on derivatives is, therefore, small in relation to a comparable balance sheet risk. In addition, credit exposure with individual counterparties can be reduced by close-out netting agreements that allow for positive and negative mark-to-market values on different transactions to be offset and settled by a single payment in the event of default by either party. Such agreements are enforceable in the jurisdictions of the major market makers and the group has executed close-out netting agreements with the majority of its counterparties, notwithstanding the fact that the group deals only with the most creditworthy counterparties.

i Derivatives used for trading purposes

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

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

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

Notes on the Accounts (continued)

35 Financial instruments *(continued)*

a *Derivatives (continued)*

Netting is applied where a legal right of set-off exists. Mark-to-market assets and liabilities are presented gross, with allowable netting shown separately. Previously, mark-to-market assets and liabilities were presented net, without allowable netting being shown separately. Comparative data have been restated accordingly.

	2000		1999	
	Contract amount	*Replacement cost**	*Contract amount*	*Replacement cost**
	£m	**£m**	£m	£m
Spot and forward foreign exchange	**219,974**	**4,126**	182,758	2,315
Currency swaps, futures and options purchased	**47,111**	**1,292**	35,881	890
Currency options written	**10,819**	**—**	13,018	—
Other contracts	**763**	**12**	1,100	65
Total exchange rate contracts	**278,667**	**5,430**	232,757	3,270
Interest rate swaps	**431,156**	**4,409**	219,144	2,353
Interest rate futures, forward rate agreements, collars and options purchased	**126,220**	**322**	126,831	280
Interest rate options written	**19,584**	**—**	27,914	—
Total interest rate contracts	**576,960**	**4,731**	373,889	2,633
Equities, futures and options purchased	**8,475**	**1,156**	5,934	1,349
Equities options written	**9,087**	**—**	8,551	—
Total equities contracts	**17,562**	**1,156**	14,485	1,349
Netting		**(4,147)**		(2,215)
Total	**873,189**	**7,170**	621,131	5,037

* *Third-party contracts only*

	2000	1999
	Mark-to-market values	*Mark-to-market values*
	£m	£m
Exchange rate		
— assets	**5,457**	3,295
— liabilities	**(5,661)**	(3,412)
Interest rate		
— assets	**4,731**	2,633
— liabilities	**(4,936)**	(2,902)
Equities		
— assets	**1,156**	1,349
— liabilities	**(1,136)**	(1,319)
Total		
— assets	**11,344**	7,277
— liabilities	**(11,733)**	(7,633)
Netting	**(4,147)**	(2,215)

35 **Financial instruments** *(continued)*

a *Derivatives (continued)*

ii Derivatives used for risk management purposes

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

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

	2000		1999	
	Contract amount	*Replacement cost**	*Contract amount*	*Replacement cost**
	£m	**£m**	£m	£m
Spot and forward foreign exchange	**8,159**	—	5,743	—
Currency swaps, futures and options purchased	**1,843**	**34**	346	2
Total exchange rate contracts	**10,002**	**34**	6,089	2
Interest rate swaps	**79,576**	**114**	19,109	32
Interest rate futures, forward rate agreement and options purchased	**3,051**	**5**	1,261	—
Total interest rate contracts	**82,627**	**119**	20,370	32

* *Third-party contracts only*

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

	2000		1999	
	Carrying value	*Mark-to-market values*	*Carrying value*	*Mark-to-market values*
	£m	**£m**	£m	£m
Exchange rate				
— assets	**57**	**76**	5	20
— liabilities	**(63)**	**(94)**	(26)	(43)
Interest rate				
— assets	**439**	**1,049**	199	356
— liabilities	**(294)**	**(789)**	(53)	(211)

Notes on the Accounts (continued)

35 Financial instruments *(continued)*

b *Other financial instruments*

i Financial instruments held for trading purposes

	2000	1999
	Mark-to-market values	*Mark-to-market values*
	£m	£m
Assets		
Treasury bills and other eligible bills	**1,417**	163
Loans and advances to banks and customers	**8,009**	5,029
Debt securities	**14,747**	3,439
Equity shares	**444**	79
	24,617	8,710
Liabilities		
Short positions in securities	**3,892**	1,974
Debt securities in issue	**116**	28
Deposits by banks and customer accounts	**6,154**	4,375
	10,162	6,377

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

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

	2000		1999	
	Carrying value	*Mark-to-market values*	*Carrying value*	*Mark-to-market values*
	£m	£m	£m	£m
Assets				
Treasury bills and other eligible bills	**4,282**	**4,254**	3,863	3,863
Debt securities	**19,438**	**19,544**	11,397	11,380
Equity shares	**1,524**	**1,622**	20	29
	25,244	**25,420**	15,280	15,272
Liabilities				
Debt securities in issue	**9,191**	**9,201**	3,917	3,923
Subordinated liabilities	**5,212**	**5,113**	3,373	3,257
Preference shares	**583**	**583**	538	502
	14,986	**14,897**	7,828	7,682

35 Financial instruments *(continued)*

b *Other financial instruments (continued)*

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

The valuation techniques used are:

— *Treasury bills and other eligible bills*

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

— *Loans and advances to banks and customers*

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

— *Debt securities and equity shares*

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

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

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

— *Deposits by banks and customer accounts*

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

c *Gains and losses on hedges*

Gains and losses on instruments used for hedging are recognised in line with the underlying items that are being hedged. The unrecognised gains on instruments used for hedging as at 31 December 2000 were £684 million (1999: £172 million) and the unrecognised losses were £581 million (1999: £175 million).

Unrecognised gains of £252 million and unrecognised losses of £226 million are expected to be recognised in 2001.

Of the gains and losses included in the profit and loss account in 2000, £53 million gains and £57 million losses were unrecognised at 1 January 2000.

d *Liquidity management*

The group's liquidity management process is described in the 'Financial Review' section on page 37.

Notes on the Accounts (continued)

36 Memorandum items and foreign exchange rate, interest rate and equities contracts

a *Contingent liabilities and commitments*

	2000			1999		
	Contract amount	*Credit equivalent amount*	*Risk-weighted amount*	*Contract amount*	*Credit equivalent amount*	*Risk-weighted amount*
	£m	**£m**	**£m**	£m	£m	£m
group						
Contingent liabilities						
Acceptances and endorsements	**1,378**	**916**	**895**	1,169	1,121	1,089
Guarantees and assets pledged as collateral security						
— guarantees and irrevocable letters of credit	**11,357**	**8,230**	**6,458**	8,061	6,489	4,473
— other	**5**	**5**	**4**	—	—	—
	12,740	**9,151**	**7,357**	9,230	7,610	5,562
Commitments						
Documentary credits and short-term trade-related transactions	**1,498**	**798**	**362**	1,109	605	242
Forward asset purchases and forward forward deposits placed	**167**	**167**	**153**	165	165	144
Undrawn note issuance and revolving underwriting facilities	**110**	**55**	**55**	—	—	—
Undrawn formal standby facilities, credit lines and other commitments to lend						
— over 1 year	**13,020**	**6,510**	**5,588**	9,668	4,834	4,300
— 1 year or less	**29,193**	—	—	26,513	—	—
	43,988	**7,530**	**6,158**	37,455	5,604	4,686

	2000	1999
	£m	£m
Incurred on behalf of parent and fellow subsidiary undertakings (contract amount)		
— contingent liabilities	**40**	82
— commitments	—	—

36 Memorandum items and foreign exchange rate, interest rate and equities contracts *(continued)*

a *Contingent liabilities and commitments (continued)*

	2000			1999		
	Contract amount	*Credit equivalent amount*	*Risk-weighted amount*	*Contract amount*	*Credit equivalent amount*	*Risk-weighted amount*
	£m	**£m**	**£m**	£m	£m	£m
bank						
Contingent liabilities						
Acceptances and endorsements	**788**	**755**	**754**	1,166	1,118	1,086
Guarantees and assets pledged as collateral security						
— guarantees and irrevocable letters of credit	**8,745**	**4,775**	**3,632**	10,050	6,412	4,455
	9,533	**5,530**	**4,386**	11,216	7,530	5,541
Commitments						
Documentary credits and short-term trade-related transactions	**1,340**	**712**	**279**	1,082	585	236
Forward asset purchases and forward forward deposits placed	**67**	**67**	**62**	17	17	14
Undrawn formal standby facilities, credit lines and other commitments to lend						
— over 1 year	**9,859**	**4,930**	**4,286**	9,621	4,811	4,275
— 1 year or less	**28,476**	**—**	**—**	26,068	—	—
	39,742	**5,709**	**4,627**	36,788	5,413	4,525

	2000	1999
	£m	£m
Incurred on behalf of subsidiary undertakings (contract amount)		
— contingent liabilities	**2,408**	2,033
Incurred on behalf of parent and fellow subsidiary undertakings *(contract amount)*		
— contingent liabilities	**40**	83
— commitments	**—**	—

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

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

Notes on the Accounts (continued)

36 Memorandum items and foreign exchange rate, interest rate and equities contracts *(continued)*

b *Concentrations of contingent liabilities and commitments*

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

	United Kingdom	*Continental Europe*	*Rest of the world*	*Total*
Contract amounts	**£m**	**£m**	**£m**	**£m**
Contingent liabilities				
2000	**6,181**	**6,342**	**217**	**12,740**
1999	7,980	1,038	212	9,230
Commitments				
2000	**37,866**	**5,513**	**609**	**43,988**
1999	35,407	1,675	373	37,455

37 Market risk management

The group's market risk management process is discussed in the 'Financial Review' on pages 33 to 34 from the paragraph under the heading 'Market risk' to the paragraph ended 'impact of extreme events on the market risk exposures of the group'.

a *Trading Value at Risk (VAR)*

VAR is a technique that estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence.

Trading VAR for 2000 is set out below:

	At 31 December	*Minimum during the year*	*Maximum during the year*	*Average for the year*
	£m	**£m**	**£m**	**£m**
Trading activities	**13.7**	**6.9**	**20.1**	**12.2**
Foreign exchange trading positions	**4.1**	**1.9**	**10.3**	**5.2**
Interest rate trading positions	**12.9**	**5.9**	**19.6**	**10.8**
Equities trading positions	**0.5**	**0.5**	**10.3**	**2.2**

Trading VAR for CCF is included in the above table from the date of acquisition.

Trading VAR for 1999 is set out below:

	At 31 December	*Minimum during the year*	*Maximum during the year*	*Average for the year*
	£m	£m	£m	£m
Trading activities	6.4	6.3	30.7	15.4
Foreign exchange trading positions	2.1	2.0	23.1	8.2
Interest rate trading positions	6.0	4.6	39.3	12.9
Equities trading positions	0.5	0.3	8.2	3.3

In 2000, the basis of computing equities VAR included a refinement in respect of non-linear risk. Non-linear risk was not a significant component of equities VAR in 1999 and it is not practicable retrospectively to amend the comparative figures for this refinement.

The VAR noted for foreign exchange positions excludes structural foreign currency exposures, since related gains or losses are taken through reserves.

37 Market risk management *(continued)*

b *Interest rate sensitivity gap table*

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

The presentation of the interest rate gap sensitivity table has been changed to disclose trading balances to facilitate reconciliation with the balance sheet.

2000	*Not more than three months* £m	*More than three months but not more than six months* £m	*More than six months but not more than one year* £m	*More than one year but not more than five years* £m	*More than five years* £m	*Non-interest-bearing* £m	*Trading book* £m	*Total* £m
Assets								
Treasury bills and other eligible bills	**2,869**	**802**	**512**	**93**	**6**	—	**1,417**	**5,699**
Loans and advances to banks	**20,649**	**1,246**	**818**	**283**	**65**	**1,824**	**4,936**	**29,821**
Loans and advances to customers	**51,913**	**4,934**	**4,194**	**10,302**	**2,288**	**3,817**	**3,073**	**80,521**
Debt securities and equity shares	**8,871**	**684**	**3,160**	**3,025**	**3,699**	**1,523**	**15,191**	**36,153**
Other assets	—	—	—	—	—	**25,525**	**7,484**	**33,009**
Internal funding of the trading book	**14,227**	—	—	—	—	—	**(14,227)**	—
Total assets	**98,529**	**7,666**	**8,684**	**13,703**	**6,058**	**32,689**	**17,874**	**185,203**
Liabilities								
Deposits by banks	**21,501**	**1,294**	**710**	**321**	**2**	**2,155**	**3,158**	**29,141**
Customer accounts	**79,394**	**1,389**	**943**	**769**	**356**	**16,341**	**2,996**	**102,188**
Debt securities in issue	**7,042**	**662**	**723**	**615**	**149**	—	**116**	**9,307**
Other liabilities	**27**	—	—	**107**	**69**	**12,142**	**11,604**	**23,949**
Loan capital and other subordinated liabilities	**1,384**	**965**	—	**749**	**2,114**	—	—	**5,212**
Minority interests and shareholders' funds	—	—	—	—	—	**15,406**	—	**15,406**
Total liabilities	**109,348**	**4,310**	**2,376**	**2,561**	**2,690**	**46,044**	**17,874**	**185,203**
Net on-balance sheet items	**(10,819)**	**3,356**	**6,308**	**11,142**	**3,368**	**(13,355)**	—	—
Off-balance sheet items	**(3,498)**	**(449)**	**482**	**3,162**	**303**	—	—	—
Interest rate sensitivity gap	**(14,317)**	**2,907**	**6,790**	**14,304**	**3,671**	**(13,355)**	—	—
Cumulative interest rate sensitivity gap	**(14,317)**	**(11,410)**	**(4,620)**	**9,684**	**13,355**	—	—	—

Notes on the Accounts (continued)

37 Market risk management *(continued)*

b *Interest rate sensitivity gap table (continued)*

1999	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non-interest-bearing £m	Trading book £m	Total £m
Assets								
Treasury bills and other eligible bills	2,956	656	251	—	—	—	163	4,026
Loans and advances to banks	7,165	1,191	157	303	6	951	2,453	12,226
Loans and advances to customers	40,148	2,958	2,727	8,267	722	194	2,576	57,592
Debt securities and equity shares	6,577	1,088	2,693	923	114	22	3,518	14,935
Other assets	—	—	—	—	—	12,650	5,039	17,689
Internal funding of the trading book	1,830	—	—	—	—	—	(1,830)	—
Total assets	58,676	5,893	5,828	9,493	842	13,817	11,919	106,468
Liabilities								
Deposits by banks	7,713	149	186	121	15	1,309	2,287	11,780
Customer accounts	53,051	1,186	589	519	295	8,266	2,188	66,094
Debt securities in issue	1,560	213	338	1,691	115	—	28	3,945
Other liabilities	5	—	—	110	31	8,805	7,416	16,367
Loan capital and other subordinated liabilities	971	650	—	346	1,406	—	—	3,373
Minority interests and shareholders' funds	—	—	—	—	—	4,909	—	4,909
Total liabilities	63,300	2,198	1,113	2,787	1,862	23,289	11,919	106,468
Net on-balance sheet items	(4,624)	3,695	4,715	6,706	(1,020)	(9,472)	—	—
Off-balance sheet items	(661)	(675)	553	1,531	(748)	—	—	—
Interest rate sensitivity gap	(5,285)	3,020	5,268	8,237	(1,768)	(9,472)	—	—
Cumulative interest rate sensitivity gap	(5,285)	(2,265)	3,003	11,240	9,472	—	—	—

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

37 Market risk management *(continued)*

c *Assets and liabilities denominated in foreign currency*

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Denominated in sterling	**79,382**	76,904	**81,210**	72,026
Denominated in currencies other than sterling	**105,821**	29,564	**39,155**	26,888
Total assets	**185,203**	106,468	**120,365**	98,914
Denominated in sterling	**81,166**	77,509	**81,147**	72,456
Denominated in currencies other than sterling	**104,037**	28,959	**39,218**	26,458
Total liabilities	**185,203**	106,468	**120,365**	98,914

d *Structural currency exposures*

The group's management of structural foreign currency exposures is disclosed in the 'Financial Review' on pages 35 to 36.

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

2000

Functional currency of the operation involved	*Net investments in operations*	*Borrowings taken out in the functional currencies of operations in order to hedge the net investments in such operations*	*Remaining structural currency exposures*
	£m	**£m**	**£m**
Euros	**9,293**	**1,184**	**8,109**
US dollars	**1,498**	**602**	**896**
Swiss francs	**510**	**89**	**421**
Maltese liri	**97**	**—**	**97**
Other	**211**	**7**	**204**
Total	**11,609**	**1,882**	**9,727**

1999

Functional currency of the operation involved	*Net investments in operations*	*Borrowings taken out in the functional currencies of operations in order to hedge the net investments in such operations*	*Remaining structural currency exposures*
	£m	£m	£m
US dollars	554	538	16
Maltese liri	84	—	84
Other	63	—	63
Total	701	538	163

Notes on the Accounts (continued)

38 Notes to the statement of consolidated cash flows

a *Reconciliation of operating profit to net cash flow from operating activities*

	2000 £m	1999 £m	1998 £m
Operating profit	**2,016**	1,736	1,489
Change in prepayments and accrued income	**(398)**	76	(437)
Change in accruals and deferred income	**363**	(89)	33
Interest on finance leases and similar hire-purchase contracts	**11**	12	14
Interest on subordinated loan capital	**287**	238	254
Depreciation and amortisation	**480**	316	291
Amortisation of discounts and premiums	**(25)**	118	78
Provisions for bad and doubtful debts	**244**	281	196
Loans written off net of recoveries	**(227)**	(171)	(300)
Provisions for liabilities and charges	**84**	136	202
Provisions utilised	**(102)**	(79)	(129)
Amounts written off fixed asset investments	**—**	3	1
Net cash inflow from trading activities	**2,733**	2,577	1,692
Change in items in the course of collection from other banks	**68**	267	9
Change in treasury bills and other eligible bills	**145**	(1,439)	412
Change in loans and advances to banks	**(2,091)**	255	494
Change in loans and advances to customers	**(4,932)**	(4,153)	(2,124)
Change in other securities	**(2,839)**	7,521	(231)
Change in other assets	**(449)**	2,556	(605)
Change in deposits by banks	**(2,051)**	(171)	(385)
Change in customer accounts	**11,906**	4,111	2,397
Change in items in the course of transmission to other banks	**(150)**	(77)	84
Change in debt securities in issue	**(68)**	(1,094)	277
Change in other liabilities	**405**	(3,008)	(52)
Elimination of exchange differences and other non-cash movements	**10**	(48)	(448)
Net cash inflow from operating activities	**2,687**	7,297	1,520

b *Changes in financing during the year*

	Share capital (including share premium)			*Subordinated loan capital*		
	2000 £m	1999 £m	1998 £m	**2000 £m**	1999 £m	1998 £m
Balance at 1 January	**2,783**	2,770	2,773	**3,373**	3,380	3,297
Issued during the year	**9,033**	—	—	**1,077**	238	197
Repaid during the year	**—**	—	—	**(149)**	(295)	(121)
Net cash inflow/(outflow) from financing	**9,033**	—	—	**928**	(57)	76
Acquisition of subsidiary undertakings	**—**	—	—	**714**	29	—
Exchange and other movements	**44**	13	(3)	**197**	21	7
Balance at 31 December	**11,860**	2,783	2,770	**5,212**	3,373	3,380

38 Notes to the statement of consolidated cash flows *(continued)*

c *Changes in cash during the year*

	2000 **£m**	1999 £m	1998 £m
Balance at 1 January	**4,829**	3,233	4,689
Net cash inflow/(outflow) before the effect of foreign exchange and other movements	**1,735**	1,598	(1,447)
Effect of foreign exchange movements	**66**	(2)	(9)
Balance at 31 December	**6,630**	4,829	3,233

d *Analysis of the balances of cash as classified in the consolidated balance sheet*

	2000 **£m**	1999 £m	1998 £m
Cash and balances at central banks	**1,626**	1,306	533
Loans and advances to banks	**5,004**	3,523	2,700
	6,630	4,829	3,233

39 Litigation

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

40 Capital commitments

	group		*bank*	
	2000 **£m**	1999 £m	**2000** **£m**	1999 £m
Expenditure contracted for	**339**	357	**128**	21

Notes on the Accounts (continued)

41 Lease commitments

At 31 December 2000, the group was committed to various non-cancellable operating leases, which require aggregate future rental payments as follows:

	Leasehold land and buildings
	£m
Payable within 1 year	**77**
1 to 2 years	**73**
2 to 3 years	**71**
3 to 4 years	**68**
4 to 5 years	**61**
Over 5 years	**517**
	867

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

	group		*bank*	
	2000	1999	**2000**	1999
	£m	£m	**£m**	£m
Leasehold land and buildings				
Operating leases which expire				
— within 1 year	**2**	3	**1**	2
— 1 to 5 years	**16**	16	**11**	14
— over 5 years	**59**	51	**66**	59
	77	70	**78**	75

42 Segmental analysis

As the group is not required to disclose turnover, no segmental analysis of turnover is included. Turnover of non-banking businesses is included in other operating income on page 129. The allocation of earnings reflects the benefit of shareholders' funds to the extent that these costs are actually allocated to businesses in the segment by way of intra-group capital and funding structures. Common costs are included in segments on the basis of the actual recharges made.

a *By geographical region*

In the analysis set out on page 129, net assets include an appropriate amount of shareholders' funds, based on the proportion of risk-weighted assets in each segment. Geographical information has been classified by the location of the principal operations of the subsidiary undertaking or, in the case of the bank, by the location of the branch responsible for reporting the results or for advancing the funds.

42 Segmental analysis *(continued)*

a *By geographical region (continued)*

		International			
	Domestic	*United Kingdom*	*Continental Europe*	*Rest of the world*	*Total*
2000	**£m**	**£m**	**£m**	**£m**	**£m**
Gross income					
Interest receivable	**5,838**	**405**	**1,437**	**119**	**7,799**
Dividend income	**1**	**—**	**4**	**1**	**6**
Fees and commissions receivable	**1,882**	**52**	**294**	**14**	**2,242**
Dealing profits	**273**	**1**	**61**	**19**	**354**
Other operating income	**452**	**3**	**50**	**1**	**506**
Total gross income	**8,446**	**461**	**1,846**	**154**	**10,907**
Profit on ordinary activities before tax	**1,693**	**82**	**254**	**17**	**2,046**
Attributable profit	**1,137**	**89**	**101**	**18**	**1,345**
Net assets	**5,048**	**803**	**8,550**	**283**	**14,684**
Total assets	**100,472**	**8,498**	**73,523**	**2,710**	**185,203**
1999	£m	£m	£m	£m	£m
Gross income					
Interest receivable	5,088	111	298	156	5,653
Dividend income	1	—	1	—	2
Fees and commissions receivable	1,735	28	78	10	1,851
Dealing profits	170	—	19	12	201
Other operating income	444	—	10	1	455
Total gross income	7,438	139	406	179	8,162
Profit on ordinary activities before tax	1,364	140	152	68	1,724
Attributable profit	901	121	112	67	1,201
Net assets	4,435	27	270	136	4,868
Total assets	96,978	1,881	5,642	1,967	106,468
1998	£m	£m	£m	£m	£m
Gross income					
Interest receivable	5,829	167	254	231	6,481
Dividend income	2	—	—	—	2
Fees and commissions receivable	1,558	35	30	9	1,632
Dealing profits	98	6	9	11	124
Other operating income	397	—	7	—	404
Total gross income	7,884	208	300	251	8,643
Profit on ordinary activities before tax	1,262	164	44	52	1,522
Attributable profit	807	162	28	45	1,042
Net assets	4,419	32	165	164	4,780
Total assets	94,139	3,195	3,082	4,430	104,846

Notes on the Accounts (continued)

42 Segmental analysis *(continued)*

b *By class of business*

	UK Banking	*International Banking*	*Treasury and Capital Markets*	*HSBC Republic*	*CCF*	*Total*
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
2000						
Profit on ordinary activities before tax	**1,455**	**281**	**201**	**115**	**(6)**	**2,046**
Net assets	**4,210**	**606**	**668**	**2,288**	**6,912**	**14,684**
Total assets	**72,752**	**11,562**	**38,465**	**16,399**	**46,025**	**185,203**
1999						
Profit on ordinary activities before tax	1,312	248	164	—	—	1,724
Net assets	3,729	530	609	—	—	4,868
Total assets	60,650	10,018	35,800	—	—	106,468
1998						
Profit on ordinary activities before tax	1,303	160	59	—	—	1,522
Net assets	3,467	439	874	—	—	4,780
Total assets	58,044	8,078	38,724	—	—	104,846

HSBC Republic and CCF are disclosed as classes of business as they are managed as separate banks.

Included within 1999 profit on ordinary activities before tax and total assets for International Banking are £2 million and £2,006 million, respectively, in relation to HSBC Bank Malta p.l.c., which was acquired during 1999.

43 Related party transactions

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

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

	2000		1999	
	Number	*£000*	*Number*	*£000*
Directors and connected persons and companies controlled by them:				
Loans and credit card transactions (including £44,000 in credit card transactions (1999: £63,000))	**13**	**6,621**	13	3,948
Officers:				
Loans and credit card transactions (including £79,000 in credit card transactions (1999: £92,000))	**26**	**2,881**	21	1,873

43 Related party transactions *(continued)*

b *Joint ventures and associates*

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

— Note 14: amounts due from joint ventures and associates
— Note 19: interests in joint ventures
— Note 20: interests in associates
— Note 26: amounts due to joint ventures and associates

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c *Transactions with other related parties of the group*

Pension funds

At 31 December 2000, the HSBC Bank (UK) Pension Scheme had deposits of £198 million with the bank.

Notes on the Accounts (continued)

44 Differences between UK and US GAAP

The consolidated financial statements of the group are prepared in accordance with UK generally accepted accounting principles ('GAAP'), which differ in certain significant respects from US GAAP. The following is a summary of the significant differences applicable to the group:

UK GAAP	US GAAP
Leasing	
Finance lease income is recognised so as to give a constant rate of return on the net cash investment in the lease, taking into account tax payments and receipts associated with the lease.	Unearned income on finance leases is taken to income at a rate calculated to give a constant rate of return on the investment in the lease, but no account is taken of the tax flows generated by the lease.
Leases are categorised as finance leases when the substance of the agreement is that of a financing transaction and the lessee assumes substantially all of the risks and benefits relating to the asset. All other leases are categorised as operating leases.	Leases are classified as capital leases when any of the criteria outlined under Statement of Financial Accounting Standards ('SFAS') No. 13 'Accounting for Leases' are met.
Operating lease assets are depreciated over their useful lives such that, for each asset, rentals less depreciation are recognised at a constant periodic rate of return on the net cash invested in that asset. Rentals receivable under operating leases are accounted for on a straight-line basis over the lease term.	Operating lease assets are depreciated such that in each period the depreciation charge is at least equal to that which would have arisen on a straight-line basis.
Debt swaps	
Assets acquired in exchange for other advances in order to achieve an orderly realisation are reported as advances. The assets acquired are recorded at the carrying value of the advances disposed of at the date of the exchange, with any provision having been duly updated. Any subsequent deterioration in their value will be recorded as an additional provision.	Under SFAS No. 15 'Accounting by Debtors and Creditors for Troubled Debt Restructurings', debt securities and equity shares acquired in exchange for advances in order to achieve an orderly realisation are required to be accounted for at their fair value, usually their secondary market value, at the date of exchange. Under SFAS No. 115 'Accounting for Certain Investments in Debt and Equity Securities', certain of these debt swaps qualify as securities and, accordingly, are classified as available for sale.
Shareholders' interest in the long-term assurance fund	
The shareholders' interest in the in-force life assurance and fund pensions policies of the long-term assurance fund is valued at the net present value of the profits inherent in such policies.	The net present value of these profits is not recognised. An adjustment is made to amortise acquisition costs and fees in accordance with SFAS No. 97 'Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments'.
Pension costs	
Pension costs, based on actuarial assumptions and methods, are charged so as to allocate the cost of providing benefits over the average remaining service lives of employees.	SFAS No. 87 'Employers' Accounting for Pensions' prescribes a similar method of actuarial valuation but requires assets to be assessed at fair value and the assessment of liabilities to be based on current settlement rates. Certain variations from regular cost are allocated in equal amounts over the average remaining service lives of current employees.

44 Differences between UK and US GAAP *(continued)*

Share compensation schemes

UK GAAP

For executive share option schemes, such options are granted at fair value and no compensation costs are recognised under the 'intrinsic value method'.

For Save-As-You-Earn schemes, employees are granted shares at a 15 per cent discount to fair value at the date of grant. No compensation cost is recognised for such awards.

For longer term and other restricted share award schemes, the fair value of the shares awarded is charged to compensation cost over the period in respect of which performance conditions apply. To the extent the award is adjusted by virtue of performance conditions being met or not, the compensation cost is adjusted in line with this.

US GAAP

SFAS No. 123 'Accounting for Stock Based Compensation', encourages a fair value based method of accounting for stock based compensation plans. Options granted prior to 1999 continue to be accounted for under Accounting Principles Board ('APB') opinion No. 25 'Accounting for Stock Issued to Employees' using the intrinsic value method where compensation cost is based on the difference between the market value of the stock and any contribution made by the employee.

Goodwill

UK GAAP

For acquisitions prior to 1 January 1998, goodwill arising on the acquisition of subsidiary, associates or joint ventures was charged against reserves in the year of acquisition. For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets' in respect of subsidiary undertakings, in 'Interests in associates' in respect of associates and 'Interests in joint ventures' in respect of joint ventures. Capitalised goodwill is amortised over its estimated life on a straight-line basis.

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

US GAAP

Goodwill is capitalised and amortised over its estimated useful life but not more than 25 years. Goodwill is written off when judged to have no recoverable value.

Costs of software developed for internal use

UK GAAP

The group generally expenses costs of software developed for internal use. If it can be demonstrated that conditions for capitalisation are met under FRS 10 'Goodwill and intangible assets' or FRS 15 'Tangible fixed assets', purchased software can be capitalised and amortised over its useful life.

US GAAP

The American Institute of Certified Public Accountants' ('AICPA') Statement of Position ('SOP') 98-1 'Accounting for costs of computer software developed or obtained for internal use', requires that all costs incurred in the preliminary project and post implementation stages of internal software development be expensed. Costs incurred in the application development stage must be capitalised and amortised over the estimated useful life.

Notes on the Accounts (continued)

44 Differences between UK and US GAAP *(continued)*

UK GAAP	US GAAP
Property	
The group values its properties on an annual basis and adjustments arising from such revaluations are taken to reserves.	US GAAP does not permit revaluations of property although it requires recognition of asset impairment. Any realised surplus or deficit is therefore reflected in income on disposal of the property.
The group depreciates its freehold and long leasehold buildings based on cost or the revalued amounts.	Depreciation is charged on all properties based on cost.
Investment securities	
Debt securities and equity shares intended to be held on a continuing basis are disclosed as investment securities and are included in the balance sheet at cost less provision for any permanent diminution in value. Other participating interests are accounted for on the same basis. Where dated investment securities have been purchased at a premium or discount, these premiums and discounts are amortised through the profit and loss account over the period from the date of purchase to the date of maturity and included in 'Interest receivable'. Any profit or loss on realisation of these securities is recognised in the profit and loss account as it arises and included in 'Gains on disposal of investments'. Other debt securities and equity shares held for trading purposes are included in the balance sheet at market value; changes in the market value of such assets are recognised in the profit and loss account as 'Dealing profits'.	Under SFAS No. 115 'Accounting for Certain Investments in Debt and Equity Securities', all debt securities and equity shares are classified and disclosed within one of the following three categories: held-to-maturity; available for sale; or trading. Held-to-maturity debt securities are measured at amortised cost. Available for sale securities are measured at fair value with unrealised holding gains and losses excluded from earnings and reported net of applicable taxes and minority interests in a separate component of shareholders' funds. Trading securities are measured at fair value with unrealised holding gains and losses included in earnings.
Dividends payable	
Dividends declared after the period end are recorded in the period to which they relate.	Dividends are recorded in the period in which they are declared.
Deferred taxation	
Deferred taxation is provided on timing differences using the liability method to the extent that it is probable that an actual liability or asset will crystallise.	As provided by SFAS No. 109 'Accounting for Income Taxes', deferred tax liabilities and assets are recognised in respect of all temporary differences. A valuation allowance is raised against any deferred tax asset where it is more likely than not that the asset, or part thereof, will not be realised.

44 Differences between UK and US GAAP *(continued)*

UK GAAP

Sales and repurchase transactions ('repos') and reverse repos

Repos and reverse repos are accounted for as if the collateral involved remains with the transferor. On the balance sheet, repos are included within 'Deposits by banks' and 'Customer accounts' and reverse repos are included within 'Loans and advances to banks' and 'Loans and advances to customers'.

Acceptances

Acceptances outstanding are not included in the consolidated balance sheet.

US GAAP

Sales and repurchase transactions ('repos') and reverse repos

In September 2000, SFAS No. 125 'Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities' was replaced by SFAS No. 140 'Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities'.

Under SFAS No. 140, repos and reverse repos transacted under agreements that give the transferee the right by contract or custom to sell or repledge the collateral, give rise to the following adjustments and disclosures. For repos, where the transferee has the right to sell or repledge the collateral, the transferor would report the securities separately in the Financial Statements from other securities not so encumbered. For reverse repos, where the transferee has the right to sell or repledge the collateral, the transferee should not recognise the pledged asset but should disclose the fair value of the collateral, and if the transferee sells collateral pledged to it, the proceeds from the sale and the transferee's obligation to return the collateral should be recognised.

Acceptances

Acceptances outstanding and the matching customer liabilities are included in the consolidated balance sheet.

Notes on the Accounts (continued)

44 Differences between UK and US GAAP *(continued)*

The following tables summarise the significant adjustments to net income and shareholders' equity which would result from the application of US GAAP.

Net income	*Note*		**2000 £m**		1999 £m		1998 £m
Attributable profit of the group (UK GAAP)			**1,345**		1,201		1,042
Estimated adjustments regarding:							
Lease financing		**(36)**		(44)		(64)	
Debt swaps		**64**		(27)		6	
Shareholders' interest in long-term assurance fund		**(76)**		(15)		(19)	
Pension costs	*a*	**(91)**		(173)		(29)	
Stock-based compensation		**(56)**		(45)		—	
Goodwill	*c*	**(5)**		(4)		(5)	
Internal software costs		**54**		50		—	
Revaluation of property		—		7		14	
Accruals accounted derivatives	*d*	**63**		—		—	
Taxation	*f*						
— US GAAP		**22**		(11)		(4)	
— on reconciling items		**5**		59		47	
			(56)		(203)		(54)
Estimated net income (US GAAP)			**1,289**		998		988
Of which:							
UK Banking			**891**		728		772
International Banking			**220**		158		178
Treasury and Capital Markets			**215**		112		38
HSBC Republic			**(11)**		—		—
CCF			**(26)**		—		—
Estimated net income (US GAAP)			**1,289**		998		988
Per ordinary share			**155.5p**		119.3p		118.6p

44 Differences between UK and US GAAP *(continued)*

Shareholders' equity

	Note		2000 £m		1999 £m
Shareholders' funds (UK GAAP)			**14,684**		4,868
Estimated adjustments regarding:					
Lease financing		**(179)**		(143)	
Debt swaps		**(3)**		(67)	
Shareholders' interest in long-term assurance fund		**(393)**		(317)	
Pension costs	*a*	**(421)**		(306)	
Goodwill	*c*	**10**		54	
Internal software costs		**104**		50	
Revaluation of property		**(304)**		(276)	
Accruals accounted derivatives	*d*	**63**		—	
Fair value adjustment for securities available for sale	*e*	**159**		75	
Dividend payable		**600**		300	
Taxation	*f*				
— US GAAP		**206**		146	
— on reconciling items		**201**		214	
			43		(270)
Minority interest in reconciling items			**(3)**		(2)
Estimated shareholders' equity (US GAAP)			**14,724**		4,596
Of which:					
UK Banking			**4,140**		3,449
International Banking			**622**		541
Treasury and Capital Markets			**740**		606
HSBC Republic			**2,303**		—
CCF			**6,919**		—
Estimated shareholders' equity (US GAAP)			**14,724**		4,596

Notes on the Accounts (continued)

44 Differences between UK GAAP and US GAAP *(continued)*

Reconciliation of movements in shareholders' equity adjusted to accord with US GAAP

	2000 £m	1999 £m	1998 £m
Estimated net income (US GAAP)	**1,289**	998	988
Dividends	**(900)**	(1,197)	(693)
	389	(199)	295
Other recognised gains and losses for the year	**592**	5	14
New share capital subscribed	**9,033**	—	—
Stock-based compensation capital contribution	**56**	45	—
Minimum pension liability adjustment	—	141	(141)
Change in fair value of securities available for sale	**58**	(17)	(24)
Net addition/(reduction) to shareholders' equity	**10,128**	(25)	144
Estimated shareholders' equity at 1 January	**4,596**	4,621	4,477
Estimated shareholders' equity at 31 December	**14,724**	4,596	4,621

a *Pension costs*

For the reconciliation below, the group has adopted the provisions of SFAS No. 87, as amended by SFAS No. 132 'Employers' Disclosures about Pensions and Other Postretirement Benefits', in respect of both the HSBC Bank (UK) Pension Scheme (a funded defined benefit plan) and the CCF Pension Scheme (an unfunded defined benefit plan). The estimated pension costs for these plans computed under SFAS No. 87 are as follows:

	2000 £m	1999 £m	1998 £m
Service cost	**176**	175	145
Interest cost	**359**	343	333
Expected return on plan assets	**(342)**	(280)	(349)
Net amortisation and deferral	**(3)**	29	(3)
Pension costs	**190**	267	126

The estimated funded status of the pension schemes under SFAS No. 87 was as follows:

	2000 £m	1999 £m
Projected benefit obligation		
Benefit at 1 January	**6,574**	6,357
Service cost	**176**	175
Interest cost	**359**	343
Benefits paid	**(220)**	(217)
Acquisition of subsidiary	**148**	—
Actuarial gain	**(59)**	(84)
Benefit at 31 December	**6,978**	6,574
Plan assets at fair value		
Assets at 1 January	**6,276**	5,147
Actual return	**512**	1,252
Employers' contribution	**99**	94
Benefits paid	**(220)**	(217)
Assets at 31 December	**6,667**	6,276

44 Differences between UK and US GAAP *(continued)*

a *Pension costs (continued)*

	2000 £m	1999 £m
Plan assets deficient to projected benefit obligation	**(311)**	(298)
Amounts available to be applied as an increase/(reduction) to future pension cost		
— balance of initial transition amount	**(10)**	(15)
— net unrecognised gain	**(238)**	(9)
— unrecognised prior service cost	**14**	16
Accrued benefit liability and pension cost	**(545)**	(306)
US GAAP adjustment:		
Accrued net pension cost under US GAAP	**(545)**	(306)
Pension liability recognised for these schemes under UK GAAP	**124**	—
	(421)	(306)

The valuations of plan assets were conducted as at 30 September 2000 and 1999 for the HSBC Bank (UK) Pension Scheme.

In 2000, plan assets with an accumulated benefit obligation of £141 million (1999: £ nil) and assets with a fair value of £ nil (1999: £ nil) had an accumulated benefit obligation in excess of plan assets.

Plan assets are invested primarily in equities and fixed interest securities.

Under SFAS No. 87, the excess of plan assets over the projected benefit obligation at the transition date (1 January 1988) is recognised as a reduction to pension expense on a prospective basis over 15 years.

The financial assumptions used to calculate the projected benefit obligation at 31 December 2000 and 1999 are as follows:

	HSBC Bank (UK) Pension Scheme		*CCF Pension Scheme*	
	2000 %	1999 %	2000 %	1999 %
Discount rate	**5.5**	5.5	**5.0**	—
Rate of pay escalation	**4.0**	4.5	**2.5**	—
Rate of pension increase	**2.5**	3.0	**1.5**	—
Rate of return on assets	**6.0**	5.5	**n/a**	—

The £190 million US GAAP pension cost (1999: £267 million; 1998: £126 million) compares with £99 million (£98 million relating to the HSBC Bank (UK) Pension Scheme), (1999: £94 million; 1998: £97 million) under UK GAAP. The difference, net of UK corporation tax at 30 per cent in 2000, 30.25 per cent in 1999 and 31 per cent in 1998, results in an additional charge to attributable profit of £64 million (1999: £121 million; 1998: £20 million) under US GAAP.

b *Post-retirement benefits other than pensions*

US GAAP requires the cost of post-retirement benefits other than pensions to be accrued over the service lives of employees from the date of full eligibility for all of the benefits expected to be received. The statement permits companies to account for the unfunded and previously unrecognised accumulated benefit obligation either by a full charge to income in the year of adoption, or by amortisation over the average remaining service period of active scheme participants, or 20 years, if greater.

The UK Urgent Issues Task Force issued Abstract 6 ('UITF 6') 'Accounting for post-retirement benefits other than pensions' in November 1992. Its requirements are similar to those of SFAS No. 106. The group adopted UITF 6 with effect from 1 January 1993.

Notes on the Accounts (continued)

44 Differences between UK and US GAAP *(continued)*

b *Post-retirement benefits other than pensions (continued)*

Approximately 4,000 (1999: 3,700) pensioners are covered by the group's post-retirement health-care scheme and approximately 900 (1999: 1,200) staff members may become eligible if they remain with the group until retirement.

The charge relating to post-retirement health-care benefits was made up as follows:

	2000	1999	1998
	£m	£m	£m
Interest cost	**8**	8	8
Amortisation of actuarial gain	**(3)**	(3)	(3)
Amortisation of transition obligation	**6**	6	6
	11	11	11

c *Goodwill*

Under US GAAP, goodwill on acquisition both pre and post 1 January 1998 would have been capitalised and amortised over its estimated useful life. At 31 December 2000, the cost of goodwill acquired both pre and post 1 January 1998 on a US GAAP basis was £8,403 million (1999: £165 million) and accumulated amortised goodwill was £182 million (1999: £56 million). Goodwill is being amortised over periods of up to 20 years.

d *Accruals accounted derivatives*

Under UK GAAP, internal derivatives used to hedge banking book transactions may be accruals accounted. Under US GAAP, any such derivatives entered into post 1 January 1999 must be marked-to-market unless there is a designated matching transaction entered into with a third party. In prior reporting periods, the difference between the book values and mark-to-market values of such derivatives was not significant and therefore, there was no adjustment to net income. However, following movements in market rates in the latter part of 2000, together with the acquisition of CCF which has a significant portfolio of internal accruals accounted derivatives, the mark-to-market of derivatives entered into post 1 January 1999 has become significant. Accordingly, an adjustment has been made to net income for the full year 2000.

e *Investment securities*

Under SFAS No. 115, the group's investment securities, other participating interests, and debt securities and equity shares with a readily determinable market value acquired in exchange for advances, are classified as available for sale securities. All other debt and equity shares are categorised as trading securities.

The book value and market value of these investment securities are analysed as follows:

	2000		1999	
	Book value	*Market value*	*Book value*	*Market value*
	£m	**£m**	£m	£m
Available for sale	**24,236**	**24,395**	15,533	15,551
Trading	**16,608**	**16,608**	3,602	3,602

Debt securities and equity shares categorised as available for sale under US GAAP give rise to an adjustment in the reconciliation of shareholders' funds under UK and US GAAP, as they are carried at amortised cost less any permanent diminution in value under UK GAAP, but are required to be measured at fair value under SFAS No. 115. The net unrealised holding gains as at 31 December 2000 amounted to £159 million before tax (1999: £75 million) and £108 million (1999: £50 million) after tax and minority interests.

44 Differences between UK and US GAAP *(continued)*

e *Investment securities (continued)*

In addition, under US GAAP, debt securities and equity shares acquired in exchange for advances in order to achieve an orderly realisation are required to be accounted for at their fair value at the date of exchange. Under SFAS No. 115, certain debt swaps qualify as securities and, accordingly, have been classified as available for sale. The adjustment to shareholders' funds to reflect the US GAAP treatment of debt swaps included write-downs of £ nil at 31 December 2000 (1999: £57 million; 1998: £30 million) which related to securities. The adjustments required under SFAS No. 115 have been calculated based on balances that already incorporate the adjustments made for debt swaps.

f *Deferred taxation*

Under SFAS No. 109, the group's total deferred tax assets were £317 million at 31 December 2000 (1999: £237 million). The group's deferred tax liabilities at 31 December 2000 amounted to £732 million (1999: £600 million).

Realisation of the total deferred tax assets of £317 million is considered more likely than not, as the temporary timing differences are expected to reverse in the foreseeable future.

g *Loan impairment*

SFAS No. 114 'Accounting by Creditors for Impairment of a Loan', as amended by SFAS No. 118 'Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures', addresses accounting by creditors for impairment of a loan by specifying how allowances for credit losses for certain loans should be determined. A loan is impaired when it is probable that the creditor will be unable to collect all amounts in accordance with the contractual terms of the loan agreement. Impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective rate or, as an expedient, at the fair value of the loan's collateral. Leases, smaller-balance homogeneous loans and debt securities are excluded from the scope of SFAS No. 114.

At 31 December 2000, the group estimated that the difference between the carrying value of its loan portfolio on the basis of SFAS No. 114 and its value in the group's UK GAAP financial statements was such that no adjustment to net income or shareholders' equity was required.

h *Repurchase agreements*

At 31 December 2000, substantially all of the collateral obtained from reverse repo transactions has been utilised by the group and sold or pledged in connection with repo transactions and securities sold, not yet purchased.

i *Stock lending and borrowing transactions*

The group entered into stock lending and borrowing transactions for which either cash or other securities may be received in exchange. Stock lending transactions where the securities lent are subject to sale or repledge amounted to £1,057 million (1999: £ nil). Stock borrowing transactions where the securities borrowed are subject to sale or repledge amounted to £1,991 million (1999: £ nil).

j *Statement of consolidated cash flows*

The group prepares its cash flow in accordance with FRS 1 (revised) 'Cash Flow Statements'. Its objectives and principles are similar to those set out in SFAS No. 95 'Statement of Cash Flows', as amended by SFAS No. 104 'Statement of Cash Flows – Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions'.

FRS 1 (revised) defines cash as cash and balances at central banks and advances to banks payable on demand. Under US GAAP, 'Cash equivalents' are defined as short-term highly liquid investments that are both:

44 Differences between UK and US GAAP *(continued)*

j *Statement of consolidated cash flows (continued)*

— convertible to known amounts of cash; and

— so near their maturity that they present insignificant risk of changes in value because of fluctuations in interest rates.

The other principal differences between UK GAAP and US GAAP are in respect of classification. Under UK GAAP, the group presents its cash flows for (a) Operating activities; (b) Dividends received from associated undertakings; (c) Returns on investments and servicing of finance; (d) Taxation; (e) Capital expenditure and financial investment; (f) Acquisitions and disposals; (g) Equity dividends paid; and (h) Financing. Under US GAAP, only three categories of cash flow activity are required. These are: (a) Operating; (b) Investing; and (c) Financing.

Cash flows arising from taxation and returns on investments and servicing of finance under UK GAAP would, with the exception of dividends paid, be included as operating activities under US GAAP; dividend payments would be included as a financing activity under US GAAP. Cash flows arising from capital expenditure and financial investments, as well as cash flows arising from transfers of subsidiaries and other associated interests under UK GAAP, would be classified as investing activities under US GAAP.

Net changes in loans and advances to customers, including lease financing receivables, would be reclassified from operating activities under UK GAAP to investing activities under US GAAP. Net changes in deposits and other short-term funding not included in cash, would be reclassified from operating activities to financing activities.

Under FRS 1 (revised), transactions designated as hedges are reported under the same heading as the related assets or liabilities.

Set out below is a summary combined statement of cash flows under US GAAP.

	2000	1999	1998
	£m	£m	£m
Cash flows from operating activities	**1,612**	1,230	(35)
Cash flows from investing activities	**(4,882)**	(7,796)	(3,985)
Cash flows from financing activities	**19,367**	8,002	1,848
Effect of exchange rate changes on cash and cash equivalents	**53**	(45)	50
Net movement in cash and cash equivalents under US GAAP	**16,150**	1,391	(2,122)
Cash and cash equivalents at the beginning of the year	**12,809**	11,418	13,540
Cash and cash equivalents at the end of the year	**28,959**	12,809	11,418

k *Profit and loss account presentation*

Provisions for contingent liabilities and commitments

Under US GAAP, 'Provisions for contingent liabilities and commitments' of £20 million, £50 million and £59 million for 2000, 1999 and 1998 respectively, would be classified as 'Operating expenses'.

Amounts written off fixed asset investments

Under US GAAP, 'Amounts written off fixed asset investments' of £2 million, £3 million and £1 million for 2000, 1999 and 1998 respectively, would be classified as 'Other operating income'.

Gains on disposal of investments and tangible fixed assets

Under US GAAP, 'Gains on disposal of investments and tangible fixed assets' of £77 million, £22 million and £34 million for 2000, 1999 and 1998 respectively, would be classified as 'Other operating income'.

44 Differences between UK and US GAAP *(continued)*

l *Acquisition and restructuring of HSBC Republic Holdings (Luxembourg) S.A.*

Note 21 in the Notes on the Accounts, prepared under UK GAAP, refers to the acquisition of HSBC Republic Holdings (Luxembourg) S.A. and the group reorganisation on 15 December 2000.

Under US GAAP, the acquisition of HSBC Republic Holdings (Luxembourg) S.A. and group reorganisation is accounted for on an 'as if' pooling basis. No significant adjustment to consolidated net income or shareholders' equity arises from the application of US GAAP to this transaction.

m *Future developments*

SFAS No. 133 'Accounting for Derivative Instruments and for Hedging Activities'

SFAS No. 133 'Accounting for Derivative Instruments and for Hedging Activities' was issued in June 1998 and amended in June 2000 by SFAS No. 138. It is effective for the group from 1 January 2001.

SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives be recognised as either assets or liabilities in the balance sheet and that those instruments be measured at fair value. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation as described below:

— For a derivative designated as hedging the exposures to changes in the fair value of a recognised asset or liability or a firm commitment, the gain or loss is recognised in earnings in the period of change together with the associated loss or gain on the hedged item attributable to the risk being hedged.

— For a derivative designated as hedging the exposure to variable cash flows of a recognised asset or liability, or of a forecasted transaction, the derivatives gain or loss associated with the effective portion of the hedge is initially reported as a component of the reconciliation of movements in shareholders' equity and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion is reported in earnings immediately.

— For net investment hedges, in which derivatives hedge the foreign currency exposure of a net investment in a foreign operation, the change in fair value of the derivative associated with the effective portion of the hedge is included as a component of the reconciliation of movements in shareholders' equity, together with the associated loss or gain on the hedged item. The ineffective portion is reported in earnings immediately.

— For a derivative not designated as a hedging instrument, the gain or loss is recognised in earnings in the period of change in fair value.

At the date of initial application, the group, in its US GAAP financial statements, will recognise all derivatives on the balance sheet at fair value and all hedging relationships will be designated anew. Certain of the derivative contracts that qualify for hedge accounting under UK GAAP will not meet the requirements of SFAS No. 133. These contracts will be carried at fair value, with changes in value included in earnings under US GAAP. Transition adjustments resulting from adopting this statement shall be reported in US GAAP net income or the reconciliation of movements in shareholders' equity as appropriate, based on the hedging relationship, if any, that had existed for that derivative.

SFAS No. 140 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities'

SFAS No. 140 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities', issued in September 2000, replaces SFAS No. 125 'Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities'. It revises the standards for accounting for securitisations and other transfers of financial assets and collateral, and requires certain disclosures, but it carries over most of SFAS No. 125's provisions without change.

Notes on the Accounts (continued)

44 Differences between UK and US GAAP *(continued)*

m *Future developments (continued)*

SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities of the group occurring after 31 March 2001. However, the provisions of SFAS No. 140 concerning the recognition and reclassification of collateral and disclosures relating to securitisation transactions and collateral are effective for the group's US GAAP reporting for the year ended 31 December 2000 and have been reflected in this Annual Report. SFAS No. 140 is to be applied prospectively, with certain exceptions. Adoption is not expected to have a material impact on the group's US GAAP financial statements.

45 Subsequent event

On 22 February 2001, the French Finance Ministry announced the sale of Banque Hervet to CCF for a consideration of FRF3,471 million.

46 Approval of the accounts

These accounts were approved by the Board of Directors on 26 February 2001.

47 Ultimate parent company

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

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

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

Copies of HSBC Holdings plc's *Annual Review 2000* and *Annual Report and Accounts 2000* can be obtained from its registered office at 10 Lower Thames Street, London EC3R 6AE, or on the HSBC Group's web site, www.hsbc.com.

Five-Year Summary

Summary Consolidated Profit and Loss Account

Amounts in accordance with UK GAAP

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Interest receivable	**7,799**	5,653	6,481	5,855	5,115
Interest payable	**(5,083)**	(3,262)	(4,244)	(3,652)	(3,064)
Net interest income	**2,716**	2,391	2,237	2,203	2,051
Other income	**2,705**	2,146	1,805	1,839	1,587
Operating income	**5,421**	4,537	4,042	4,042	3,638
Operating expenses	**(3,139)**	(2,467)	(2,297)	(2,323)	(2,264)
Operating profit before provisions	**2,282**	2,070	1,745	1,719	1,374
Provisions					
— provisions for bad and doubtful debts	**(244)**	(281)	(196)	(129)	(172)
— provisions for contingent liabilities and commitments	**(20)**	(50)	(59)	(3)	(3)
Amounts written off fixed asset investments	**(2)**	(3)	(1)	(4)	(40)
Operating profit	**2,016**	1,736	1,489	1,583	1,159
Share of operating (loss)/profit in joint ventures and associates	**(47)**	(34)	(1)	9	21
Gains on disposal of					
— investments	**75**	21	28	24	91
— tangible fixed assets	**2**	1	6	9	1
Profit on ordinary activities before tax	**2,046**	1,724	1,522	1,625	1,272
Tax on profit on ordinary activities	**(603)**	(518)	(479)	(559)	(408)
Profit on ordinary activities after tax	**1,443**	1,206	1,043	1,066	864
Minority interests	**(98)**	(5)	(1)	(15)	(15)
Profit for the financial year attributable to shareholders	**1,345**	1,201	1,042	1,051	849
Dividends (including amounts attributable to non-equity shareholders)	**(1,200)**	(1,147)	(693)	(644)	(537)
Retained profit for the year	**145**	54	349	407	312
Earnings per ordinary share (basic and diluted)	**162.6p**	144.8p	125.3p	126.3p	101.9p
Dividends per ordinary share	**144.3p**	138.0p	81.6p	75.3p	62.7p
Dividend payout ratio	**88.8%**	95.3%	65.1%	59.6%	61.6%
Ratio of earnings to combined fixed charges and preference share dividend[1]					
— excluding interest on deposits	**6.5**	6.2	5.4	5.7	4.5
— including interest on deposits	**1.4**	1.5	1.3	1.4	1.4

1 *For the purpose of calculating the ratios of earnings to combined fixed charges and preference share dividends, earnings consist of profit before tax and minority interests, less the unremitted income of joint ventures and associates plus fixed charges. Fixed charges consist of total net interest expense, including or excluding interest on deposits, as appropriate, and the proportion of rental expense deemed representative of the interest factor.*

Five-Year Summary (continued)

Summary Consolidated Balance Sheet

Amounts in accordance with UK GAAP

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Assets					
Treasury bills and other eligible bills	**5,699**	4,026	2,562	2,974	1,649
Loans and advances to banks	**29,821**	12,226	11,516	13,379	14,944
Loans and advances to customers	**80,521**	57,592	52,371	50,143	45,352
Debt securities	**34,185**	14,836	18,734	17,418	16,851
Other assets	**34,977**	17,788	19,663	18,162	17,425
Total assets	**185,203**	106,468	104,846	102,076	96,221
Liabilities					
Deposits by banks	**29,141**	11,780	11,882	12,267	12,401
Customer accounts	**102,188**	66,094	60,299	57,902	53,917
Debt securities in issue	**9,307**	3,945	5,014	4,737	3,065
Other liabilities	**23,949**	16,367	19,488	19,436	19,520
Subordinated liabilities					
— undated loan capital	**1,485**	1,259	1,235	1,241	1,061
— dated loan capital	**3,727**	2,114	2,145	2,056	2,142
Minority interests	**722**	41	3	2	155
Shareholders' funds (including non-equity interests)	**14,684**	4,868	4,780	4,435	3,960
Total liabilities	**185,203**	106,468	104,846	102,076	96,221
Attributable profit as a percentage of:					
Average shareholders' funds (equity)	**18.7%**	25.9%	23.4%	26.0%	24.5%
Average total assets	**1.0%**	1.1%	1.0%	1.0%	0.9%
Average capital:					
Undated and dated subordinated loan capital, minority interests and shareholders' funds (equity) as a percentage of average total assets	**8.8%**	7.8%	7.5%	7.6%	7.3%
Shareholders' funds (equity) as a percentage of average total assets	**5.0%**	4.1%	3.9%	3.7%	3.4%

Summary Financial Data

Amounts in accordance with US GAAP

	2000 £m	1999 £m	1998 £m	1997 £m	1996 £m
Profit for the financial year attributable to shareholders from continuing operations	**1,289**	998	988	1,071	812
Total assets[1]	**186,156**	107,109	105,634	102,900	96,669
Shareholders' funds (including non-equity interests)	**14,724**	4,596	4,621	4,477	4,025
Earnings per ordinary share	**155.5p**	119.3p	118.6p	129.0p	97.2p
Dividends per ordinary share	**106.6p**	144.3p	81.6p	69.0p	43.9p
Dividend payout ratio	**68.6%**	121.0%	68.8%	53.6%	45.2%
Attributable profit as a percentage of:					
Average shareholders' funds (equity)	**18.2%**	22.4%	22.4%	26.2%	23.2%
Average total assets[1]	**0.9%**	0.9%	0.9%	1.0%	0.8%
Average capital:					
Undated and dated subordinated loan capital, minority interests and shareholders' funds (equity) as a percentage of average total assets[1]	**8.6%**	7.5%	7.2%	7.7%	7.4%
Shareholders' funds (equity) as a percentage of average total assets[1]	**4.9%**	3.9%	3.7%	3.8%	3.5%
Ratio of earnings to combined fixed charges and preference share dividend[2]					
— excluding interest on deposits	**6.4**	5.4	5.1	5.7	4.3
— including interest on deposits	**1.4**	1.4	1.3	1.4	1.4

1 *The above comparatives have been restated to exclude the SFAS No. 125 adjustment to the balance sheet, which is not required under SFAS No. 140.*

2 *For the purpose of calculating the ratios of earnings to combined fixed charges and preference share dividends, earnings consist of profit before tax and minority interests, less the unremitted income of joint ventures and associates plus fixed charges. Fixed charges consist of total net interest expense, including or excluding interest on deposits, as appropriate, and the proportion of rental expense deemed representative of the interest factor.*

Shareholder Information

Control of Registrant

The whole of the ordinary share capital and the one preferred ordinary share of HSBC Bank plc are 100 per cent owned by HSBC Holdings plc.

None of the Directors or executive officers owned any ordinary shares in HSBC Bank plc at 31 December 2000.

Nature of Trading Market

The authorised and issued, allotted and fully paid share capital of the bank is as set out in Note 32 of the Notes on the Accounts.

In October 1993, the bank issued 20,000,000 non-cumulative dollar-denominated preference shares represented by 10,000,000 Series A American Depositary Share ('ADS') units, each consisting of one Series A1 ADS and one Series A2 ADS. The Series A ADS units are evidenced by units of Series A1 American Depositary Receipts ('ADR') and Series A2 ADRs. The Series A1 ADSs and Series A2 ADSs represent one non-cumulative dollar-denominated preference share, Series A1 ('Series A1 dollar preference share') and one non-cumulative dollar-denominated preference share, Series A2 ('Series A2 dollar preference share'), respectively.

In February 1995, the bank issued 14,000,000 non-cumulative dollar-denominated preference shares represented by 7,000,000 Series B ADS units, each consisting of one Series B1 ADS and one Series B2 ADS. The Series B ADS units are evidenced by units of Series B1 ADRs and Series B2 ADRs. The Series B1 ADSs and Series B2 ADSs represent one non-cumulative dollar-denominated preference share, Series B1 ('Series B1 dollar preference share') and one non-cumulative dollar-denominated preference share, Series B2 ('Series B2 dollar preference share'), respectively.

In October 1995, the bank issued 16,000,000 non-cumulative dollar-denominated preference shares represented by 8,000,000 Series C ADS units, each consisting of one Series C1 ADS and one Series C2 ADS. The Series C ADS units are evidenced by units of Series C1 ADRs and Series C2 ADRs. The Series C1 ADSs and Series C2 ADSs represent one non-cumulative dollar-denominated preference share, Series C1 ('Series C1 dollar preference share') and one non-cumulative dollar-denominated preference share, Series C2 ('Series C2 dollar preference share'), respectively.

In July 1996, the bank issued 16,000,000 non-cumulative dollar-denominated preference shares represented by 8,000,000 Series D ADS units, each consisting of one Series D1 ADS and one Series D2 ADS. The Series D ADS units are evidenced by units of Series D1 ADRs and Series D2 ADRs. The Series D1 ADSs and Series D2 ADSs represent one non-cumulative dollar-denominated preference share, Series D1 ('Series D1 dollar preference share') and one non-cumulative dollar-denominated preference share, Series D2 ('Series D2 dollar preference share'), respectively.

In February 1997, the bank issued 2,000,000 non-cumulative Second dollar-denominated preference share units, each consisting of one non-cumulative Second dollar-denominated preference share, Series 1 and one non-cumulative Second dollar-denominated preference share, Series 2. These securities have not been and will not be registered under the US Securities Act of 1933 and there is no established public trading market for these securities.

The ADR depositary is HSBC Bank USA and the ADSs are listed and traded on the New York Stock Exchange. The Series A and B dollar preference shares are listed on the London Stock Exchange, although no trading takes place. The Series A1, A2, B1, B2, C1, C2, D1 and D2 ADSs are not separately transferable. The Series A1, A2, B1, B2, C1, C2, D1 and D2 dollar preference shares can be transferred separately if they are withdrawn from deposit.

The following table shows the number of ADS record holders, the number of ADS record holders with US addresses and the number of units held by those with US addresses as at 31 December 2000.

	Number of record holders	*Number of record holders with US addresses*	*Those with US addresses hold the following number of units*
Series A	**533**	**528**	**9,996,400**
Series B	**405**	**404**	**6,999,000**
Series C	**274**	**267**	**7,990,800**
Series D	**204**	**201**	**7,995,900**

The following table shows the high and low sales prices for the Series A ADS units, the Series B ADS units, the Series C ADS units and the Series D ADS units during the periods indicated, as reported by the New York Stock Exchange.

	Series A ADS units		*Series B ADS units*		*Series C ADS units*		*Series D ADS units*	
	High US$	*Low US$*	*High US$*	*Low US$*	*High US$*	*Low US$*	*High US$*	*Low US$*
2000								
December	**24.87**	**23.62**	**26.25**	**25.39**	**25.12**	**24.37**	**25.37**	**24.81**
November	**24.62**	**23.50**	**26.31**	**25.37**	**25.00**	**24.37**	**25.60**	**24.75**
October	**24.25**	**23.43**	**26.50**	**25.87**	**24.75**	**24.06**	**25.18**	**24.87**
September	**24.52**	**23.81**	**26.37**	**25.56**	**24.75**	**24.06**	**25.12**	**24.75**
August	**24.62**	**23.62**	**26.87**	**25.12**	**24.87**	**23.87**	**25.50**	**24.37**
July	**24.42**	**23.25**	**26.37**	**25.62**	**24.87**	**23.37**	**25.37**	**24.31**
Fourth quarter	**24.87**	**23.43**	**26.50**	**25.37**	**25.12**	**24.06**	**25.60**	**24.75**
Third quarter	**24.62**	**23.25**	**26.87**	**25.12**	**24.87**	**23.37**	**25.50**	**24.31**
Second quarter	**23.62**	**22.37**	**26.56**	**24.52**	**24.06**	**22.25**	**25.06**	**23.08**
First quarter	**23.00**	**21.25**	**26.06**	**24.94**	**24.81**	**23.00**	**25.06**	**23.50**
1999								
Fourth quarter	24.88	20.25	26.88	25.00	25.56	23.50	25.75	22.00
Third quarter	25.63	23.88	27.50	26.44	27.38	24.38	25.88	25.00
Second quarter	26.13	25.13	27.31	26.50	27.00	25.75	26.75	25.38
First quarter	26.69	25.50	27.94	26.75	27.38	26.00	27.44	26.00

■ Exchange Controls and Other Limitations Affecting Security Holders

There are no UK exchange controls that would affect payments to holders of the bank's securities who are US citizens or residents.

Shareholder Information (continued)

Taxation

The following is a summary of certain US federal and UK tax considerations relevant to the acquisition, ownership and disposition of dollar-denominated preference shares, ADRs and debt securities (issued by the bank) by a holder that qualifies as a resident of the United States for the purposes of, and is fully entitled to benefits under, the income tax treaty between the United States and the United Kingdom (an 'Eligible US Holder'). Holders should consult their own advisers regarding their entitlement to treaty benefits and other matters relevant to their particular circumstances.

This summary deals only with original purchasers who hold dollar-denominated preference shares, ADRs or debt securities as capital assets, and does not address tax considerations applicable to investors who may be subject to special tax rules. The summary does not address the tax treatment for persons or entities who hold dollar-denominated preference shares, ADRs or debt securities in connection with the conduct of business in the United Kingdom. Special considerations applicable to certain classes of debt securities are discussed in the relevant prospectus supplement.

UK taxation

Dividends

Up to 5 April 1999, an Eligible US Holder generally was entitled to receive, in respect of a cash dividend from the bank, an additional payment (a 'treaty payment') equal to the associated UK tax credit to which an individual resident in the United Kingdom was entitled, reduced by a UK withholding tax not exceeding 15 per cent of the sum of the cash dividend and the associated UK tax credit. As a result, an Eligible US Holder receiving a dividend of US$80 from the bank was entitled to receive a treaty payment of US$5 (i.e. an associated UK tax credit of US$20, less UK withholding tax of US$15), for a total receipt after UK taxes but before US taxes of US$85.

From 6 April 1999, the amount of the tax credit has fallen from 20 per cent to 10 per cent of the aggregate of the dividend and the tax credit. So, for example, on a dividend of US$80, the tax credit is US$8.89 (i.e. 10 per cent of US$80 plus US$8.89). An effect of the changes has been to reduce the treaty payment to zero for dividends paid after 5 April 1999.

Under the terms of issue prospectus in respect of each dollar-denominated preference share, the bank has guaranteed a fixed tax credit inclusive return to the shareholders. Therefore, in the above example, for dividends paid after 5 April 1999 the tax credit inclusive return has been maintained by the bank increasing the cash dividend to US$90, i.e. US$100 inclusive as before.

Interest

Payments of interest on debt securities will be exempt from UK withholding tax so long as the Global Security (debt securities are issued as a Global Security in bearer form) remains in its current form and continues to be quoted on the New York or London Stock Exchange. A paying agent or collecting agent in the United Kingdom may be required to report details of the interest to the UK Inland Revenue. This information may be exchanged with the investor's own fiscal authority.

Disposal

An Eligible US Holder who is not resident (nor, in the case of an individual, ordinarily resident) in the United Kingdom normally will not be liable for UK taxation on any capital gain realised on the sale or redemption of a dollar preference share, ADR or debt security.

Stamp duty
No UK stamp duty will be payable on the transfer of, or agreement to transfer, an ADR, or beneficial ownership of an ADR, provided that the ADR and any separate instrument of transfer or written agreement to transfer is executed and remains at all times outside the United Kingdom. In the event that the dollar-denominated preference shares are not held as ADRs, UK stamp duty or stamp duty reserve tax normally will be payable on or in respect of transfers of dollar-denominated preference shares. Prospective purchasers of dollar-denominated preference shares should consult their own advisers regarding this issue. No UK stamp duty will be payable on the acquisition or transfer, or agreement to transfer, of a beneficial interest in the Global Security, provided that the Global Security remains in its current form and that any instrument of transfer or agreement to transfer is not executed in the United Kingdom and remains at all times outside the United Kingdom.

US taxation

Dividends
The gross amount of dividends received by an Eligible US Holder (including amounts in respect of the associated UK tax credit) will be treated as foreign source dividend income for US tax purposes, and will not be eligible for the dividends received deduction allowed to corporations. UK taxes withheld from dividend distributions (in effect 10 per cent after 5 April 1999) are eligible for credit against an Eligible US Holder's US federal income tax liability, subject to generally applicable limitations. If the bank declares and pays a special dividend in connection with the redemption of dollar-denominated preference shares of any series, that special dividend, although no authority directly addresses the issue, should be treated for US tax purposes in the same manner as any other dividend paid by the bank.

Interest
Payments of interest on a debt security should be included in an Eligible US Holder's income at the time that such payments accrue or are received, in accordance with the Eligible US Holder's method of tax accounting.

Disposal
Upon the sale, exchange or redemption of a dollar-denominated preference share or ADR, a US holder generally will recognise a gain or loss for US federal income tax purposes in an amount equal to the difference between the amount realised (including in the case of a redemption, any related associated UK tax credit, but excluding amounts treated as dividends for US tax purposes) and the holder's tax basis in the dollar-denominated preference share or ADR. Upon the sale, exchange or retirement of a debt security, a US holder generally will recognise a gain or loss equal to the difference between the amount realised on the sale, exchange or retirement (less any accrued interest, which will be taxable as such) and the holder's tax basis in the debt security.

■ Memorandum and Articles of Association

The following information is a summary of the material terms of the HSBC Bank Memorandum of Association (the 'Memorandum') and Articles of Association as in effect at 31 December 2000 (the 'Articles') and certain relevant provisions of the Companies Act 1985, as amended (the 'Companies Act'). The Memorandum and Articles are registered with the Registrar of Companies of England and Wales with registered number 14259. Holders of the Shares are encouraged to read the full HSBC Bank Memorandum and Articles.

Purpose and objects

HSBC Bank was established to act conducting banking business of all kinds in all parts of the world and transacting and doing all matters and things incidental thereto. The specific objects for which HSBC Holdings was established are set forth in paragraphs 4.1 through 4.30 of the Memorandum.

Shareholder Information (continued)

Authorised capital

The authorised share capital of HSBC Holdings is:

- £1,150,000,000, divided into 999,999,999 ordinary shares of nominal value £1 each (the 'Shares'), 1 preferred share of £1 each and 150,000,000 non-cumulative preferred shares of £1.00, and
- US$2,000,000 divided into 200,000,000 non-cumulative preference shares of $0.01 each.

All the ordinary shares and one preferred share of £1 is held by HSBC Holdings plc. There are no other sterling preference shares in issue.

The non-cumulative dollar preference shares are described in the bank's registration statement on Form F-3 (File No. 53-99468) and incorporated by reference.

Directors

Powers

The Board is empowered to exercise all powers of HSBC Holdings to borrow money and to mortgage all or any part of the undertaking, property and assets, both present and future, of HSBC Holdings. The Board, subject to the Companies Act, may issue debentures and other securities outright or for use as collateral for any debt, or other obligations, of HSBC Holdings or any third party.

Interested Directors

A Director may enter into contracts or other arrangements with HSBC Holdings or in which HSBC Holdings is otherwise interested so long as:

- the interested Director discloses his interests to the Board, and
- the interested Director does not vote on, and is not counted in the quorum in relation to, any contract or other arrangements to which HSBC Holdings is a party and in which he (or any related person as defined in the Companies Act) has an interest.

A Director may not vote on or be counted in the quorum for any resolution of the Board or any Board committee concerning his own appointment, including fixing or varying the terms of his appointment or termination. Any Director may vote on and be counted in the quorum for any resolution of the Board or a committee of the Board concerning the appointment of any other Director.

Retirement

In accordance with Section 293 of the Companies Act and the Articles, Directors must retire at the annual general meeting next following their seventieth birthday.

SEC Cross-Reference Sheet and Other Information

Cross-Reference Sheet

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* *Filed with the Securities and Exchange Commission.*

Glossary of Terms

Term Used	US Equivalent or Brief Description
Accounts	Financial statements
Advance Corporation Tax	Tax paid on company distributions offsettable against UK taxes due on income (repealed with effect 6 April 1999)
Allotted	Issued
Attributable profit	Net income
Balance sheet	Statement of financial position
Bills	Notes
Called-up share capital	Ordinary shares, issued and fully paid
Capital allowances	Tax depreciation allowances
Class of business	Industry segment
Creditors	Payables
Dealing	Trading
Debtors	Receivables
Deferred tax	Deferred income tax
Depreciation	Amortisation
Fees and commissions payable	Fees and commissions expense
Fees and commissions receivable	Fees and commissions income
Finance lease	Capital lease
Financial Review	Management's Discussion and Analysis
Freehold	Ownership with absolute rights in perpetuity
Interest payable	Interest expense
Interest receivable	Interest income
Loans and advances	Lendings
Loan capital	Long-term debt
Net asset value	Book value
Nominal value	Par value
Ordinary shares	Common stock
Overdraft	A line of credit, contractually repayable on demand unless a fixed term has been agreed, established through a customer's current account

SEC Cross-Reference Sheet and Other Information (continued)

Term Used	US Equivalent or Brief Description
Preference shares	Preferred stock
Premises	Real estate
Profit and loss account	Income statement
Profit and loss account reserve	Retained earnings
Provisions	Allowances
Revaluation reserve	Increase or temporary decrease in the valuation of certain assets as compared with historical cost
Share capital	Ordinary shares or common stock issued and fully paid
Shareholders' funds	Stockholders' equity
Share premium account	Additional paid-in capital
Shares in issue	Shares outstanding
Tangible fixed assets	Property and equipment
Write-offs	Charge-offs

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