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Midland Bank plc

Annual Report and Accounts 1997

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COMPANIES HOUSE 23/05/98

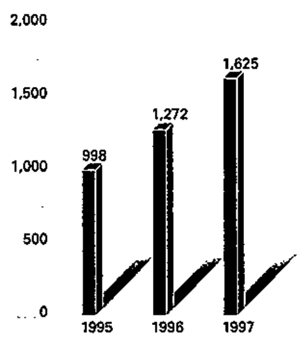
Member HSBC *Group*


Midland

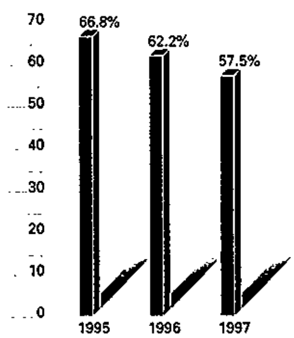
Financial Highlights

For the year	1997 £m	1996 £m
Profit on ordinary activities before tax	**1,625**	1,272
Profit attributable	**1,051**	849
At year-end		
Shareholders' funds	**4,435**	3,960
Capital resources	**7,600**	7,332
Customer accounts and deposits by banks	**70,169**	66,318
Total assets	**102,076**	96,221
Ratios	**%**	**%**
Return on average shareholders' funds (equity)	**26.0**	24.5
Capital ratios		
- total capital	**11.4**	11.5
- tier 1 capital	**6.7**	6.7
Cost:income ratio	**57.5**	62.2
Per ordinary share	**Pence**	**Pence**
Earnings	**126.3**	101.9

Pre-tax profit £m



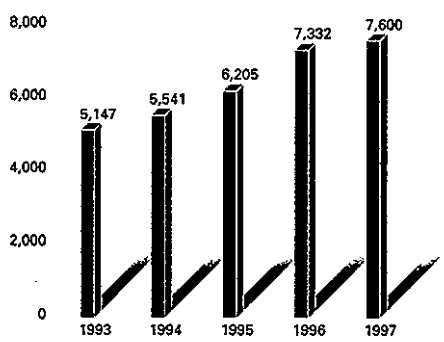
Cost:income ratio %



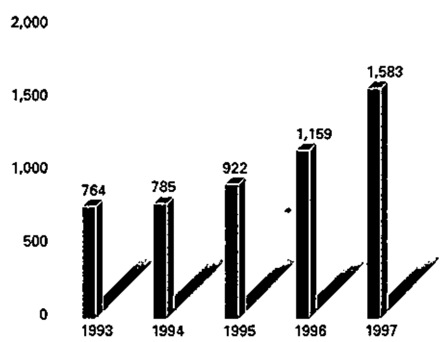
Five Year Comparison

At year-end (£m)	1993	1994	1995	1996	1997
Shareholders' funds (including non-equity interests)	2,670	2,858	3,239	3,960	**4,435**
Capital resources	5,147	5,541	6,205	7,332	**7,600**
Customer accounts	40,498	44,557	49,617	53,917	**57,902**
Loans and advances to customers	37,526	37,780	42,548	45,352	**50,143**
Total assets	76,473	80,375	93,627	96,221	**102,076**
For the year (£m)					
Operating profit before provisions	1,469	925	1,121	1,374	**1,719**
Provisions for bad and doubtful debts	(679)	(98)	(198)	(172)	**(129)**
Operating profit	764	785	922	1,159	**1,583**
Pre-tax profit	844	905	998	1,272	**1,625**
Profit attributable to shareholders	646	595	610	849	**1,051**
Dividends (including amounts attributable to non-equity shareholders)	403	413	472	537	**644**
Per ordinary share (pence)					
Earnings	80.7	73.1	73.8	101.9	**126.3**
Dividends	50.2	50.2	56.5	62.7	**75.3**

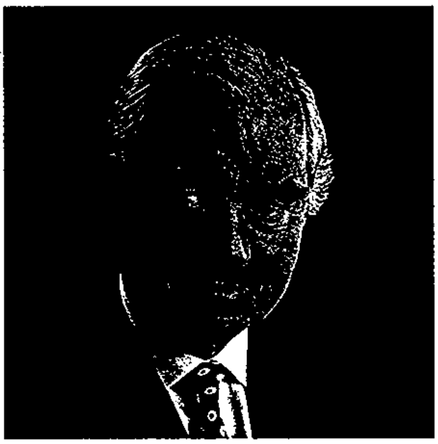
Capital resources £m



Operating profit £m



Chairman's Statement



J R H Bond, Chairman

Midland produced record results in 1997, generating strong revenue growth while continuing to manage its expenses efficiently. Profit attributable to shareholders grew by £202 million to £1,051 million, an increase of 24 per cent on 1996.

Midland's market share in personal, business and wholesale banking grew steadily in 1997, despite extreme competition across the industry. Our philosophy is simply stated: to know our customers and to deliver first class service, complemented by straightforward, competitive products. This commitment, coupled with the financial strength and international reach afforded through membership of the HSBC Group, sets Midland apart from its UK competitors.

The continued improvement in performance could not have been achieved without the strong efforts of my Midland colleagues in the UK and overseas, and I should like to thank them for their hard work.

There have been a number of changes to the Board in the last year. Following the retirement of Sir William Purves as Chairman on 31 December 1997, I was delighted to become Midland's Chairman on 1 January 1998. Sir William has also announced that he will retire as a Director in May 1998 after 10 years on the Board. We are indebted to him for his invaluable contribution to Midland's success during his time both as a Director and as Chairman.

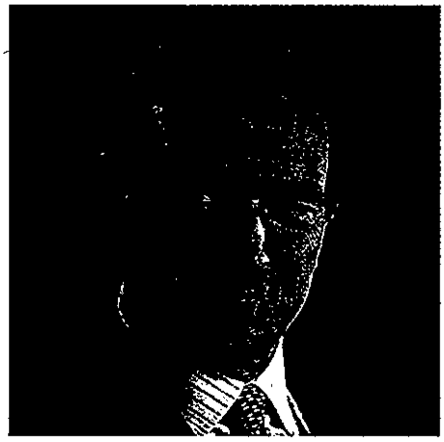
Our thanks go also to Bernard Asher, a Director since 1991, who retired from the Board in February 1998; to Sir Archibald Forster, our longest-serving Director, who has offered support and advice to the Board since 1986, who will retire in May 1998; and to Herbert Jacobi, the senior partner of Trinkaus & Burkhardt, the HSBC Group's German subsidiary, who has been a Director since 1995, and who also will retire in May.

Tony Rose, Finance and Strategy Director at The Rover Group Limited, was appointed a non-executive Director in May 1997.

Keith Whitson, Midland's Chief Executive since 1994, became Deputy Chairman of Midland on 1 January 1998. William Dalton will succeed him as a Director and Chief Executive on 1 April 1998, when Keith becomes Group Chief Executive-Designate of HSBC Holdings. He will become HSBC's Group Chief Executive on 29 May.

J R H Bond, Chairman
25 March 1998

Chief Executive's Statement



K R Whitson, Chief Executive

Midland made good progress in all its principal business areas in 1997, achieving record results through a combination of increased revenues and continued cost containment.

Pre-tax profits increased by 28 per cent to £1,625 million. Operating profits before provisions rose £345 million (25 per cent) to £1,719 million.

Operating profit in UK Banking increased by £270 million or 37 per cent, to £1,000 million. Improved net interest income arose from strong customer recruitment and higher balances, with higher fee income earned on a range of personal finance products.

We achieved significant growth in our business, while keeping cost increases to below three per cent. This enabled us to achieve a substantial improvement in our cost:income ratio, which fell to a new low of 57.5 per cent, from 62.2 per cent in 1996.

Provisions for bad and doubtful debts were lower than in 1996 following increased recoveries.

A financial review appears later in this report.

Strong growth in business volumes and revenues has been achieved despite fierce competition in many of the markets in which we operate. A major factor in this has been our commitment to providing all our customers, individual or corporate, with the highest standards of service. Maintaining and continuously improving our customer service will remain at the core of Midland's business philosophy.

Allied to this, we have taken a number of steps to rationalise our product range to ensure that we provide straightforward, fairly priced products which meet our customers' needs and expectations.

We began the year by introducing the Midland Bank Account, the cornerstone of our relationship with personal customers, offering a simplified and enhanced current account. We subsequently improved our savings rates, in preparation for the overhaul of our entire savings range in 1998.

In addition to streamlining our products, we continue to refine our service delivery. With this aim we completed major centralisation programmes in the course of the year.

Through the bank's telephone customer service centres, all of our personal customers now have the convenience of seven-day access to their accounts. With customer enquiries totalling over 19 million in 1997, the facility has been a popular addition to our customer service. A fourth call centre was opened in September to meet customer demand, and we extended both the opening hours and the range of services available.

We also completed our programme to remove routine paperwork from branches into regional processing centres, which has improved our efficiency and given us better control over service performance.

Both initiatives have enabled our branch staff to spend more time dealing with customers face to face. This has helped us strengthen relationships and complements our community banking philosophy, with experienced managers in our branches who have the authority to make decisions locally.

We recognise, however, that today's consumers enjoy increasing choice in the way in which they conduct their banking business. While large numbers of customers continue to visit our branches, and we remain committed to maintaining our extensive branch presence, we are also testing new ways to deliver banking services. In March 1997, Midland entered an alliance with Wm Morrison Supermarkets plc, opening the first ever full-service bank branches within a supermarket in the UK. Outlets were opened in nine superstores and more are planned in 1998.

In another innovation, we successfully piloted a PC banking service through First Direct, the country's leading telephone bank, and a national roll-out is planned this year. Television banking is also being developed through Midland's joint venture with BSkyB, BT and Matsushita. The new company, British Interactive Broadcasting, will develop interactive television after the launch of digital TV broadcasting in 1998 and will, subject to European Commission approval, begin services in 1999. We expect that familiarity with television technology will encourage early and widespread use of home banking and other interactive services.

Increasingly, our customers operate in a global marketplace and our decision early in 1997 to adopt the HSBC Group's identity signalled Midland's desire to play to the full strengths and international reach of the Group. The roll-out of our new signage has progressed well and is scheduled for completion by the end of June 1998. Our new identity is a visual reminder of the tangible benefits that Group membership can bring to our customers, and has strengthened awareness of our global capabilities among our business and corporate clients.

As trading barriers decline, the HSBC Group's international reach can open doors for businesses as they explore new markets. One of 1998's key challenges will be to help our customers exploit these opportunities more fully.

There are many other challenges in the year ahead, as we and our customers prepare for the opportunities presented by the likely introduction of a single European currency in 1999, and for the threat to systems posed by the Year 2000.

We have been working on a Year 2000 programme to upgrade our systems since 1993, and we are scheduled to complete, and have tested, all major system changes by the end of 1998. We are also seeking assurances from our suppliers that their systems pass the 'Millennium test'. This is an equally critical issue for our business customers and we are taking steps to alert customers to the risks and to prompt them to action to achieve Year 2000 compliance.

Preparations for the introduction of the euro are well advanced. Midland is already able to open euro-based accounts and will be ready to process transactions and support business customers with a full range of products and services from January 1999. Our aim is to become a leading institution in euro trading, offering euro solutions worldwide.

In 1998, growth in the UK economy is likely to be slower than in recent years, and competitive pressures will escalate.

A world of opportunity
Since 1992, when Midland became a member of the HSBC Group, our customers have had access to an unrivalled network of 5,500 offices in 79 countries and territories worldwide, and the use of over 330,000 cash machines globally.

Our decision in 1997 to adopt the HSBC identity further underlines Midland's international capabilities. We can now offer our personal and business customers worldwide solutions to their banking needs, from opening a current account overseas to transacting international trade.

The roll-out of Midland's new identity will be completed by the end of June 1998.

Chief Executive's Review of Operations

Convenient access
Delivering first class customer service is fundamental to our success and we made further investments here in 1997.

We extended the opening hours at our telephone customer service centres to 90 hours a week, responding to over 19 million customer enquiries in 1997. Over three million calls were answered outside traditional banking hours.

Midland customers also have round the clock access to their account balances, through a 24-hour automated voice response service.

Achieving further business growth will be demanding but we will continue to focus on our core principle of delivering excellent customer service, while maintaining the cost discipline that is essential to enable us to invest in quality products and services.

Personal Banking
In the personal sector, increased competition has extended customer choice and created a more discerning consumer. In this challenging environment, it is reassuring that significantly more customers are choosing Midland to serve their financial needs.

Growing our current account and personal deposit bases remain key strategic aims, and we continue to improve the competitiveness of our products with this in mind.

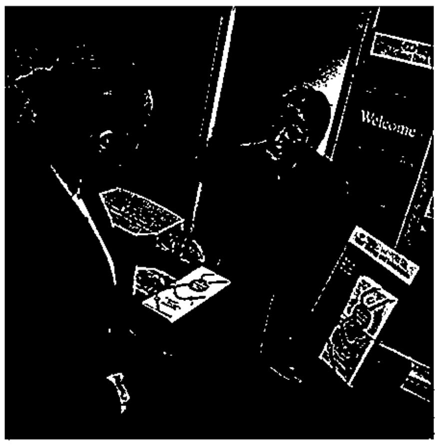
We re-launched our current account, abolishing fees on arranged overdrafts and introducing a free £50 overdraft 'buffer' zone. The move has proved popular, and contributed to more than a 30 per cent increase in new accounts. In July, we increased interest rates for two million savers, doubling rates on instant access accounts, a forerunner to a comprehensive restructuring of our savings products in January 1998.

In the youth sector, we maintained our position as the first choice for young people. Almost one third of new students chose us as their main bank, and we now have an overall market share of 25 per cent of all accounts of young people aged between 16 and 20.

Midland Personal Financial Services (MPFS), our regulated life, pensions, investments and general insurance division, celebrated its 10th anniversary in 1997, and grew total funds under management by one third, to over £8 billion. Now, almost three quarters of a million people hold an investment product, have taken out a pension, or are covered by insurance from Midland. Our general insurance business experienced significant growth, and Midland Direct, MPFS's telephone delivery operation, tripled sales. We are already among the top 10 PEP providers in the UK and the level of investment remained strong, in spite of the many new entrants in this market. Our wealth management arm, Midland Private Banking, also experienced good growth, attracting new investments of over £400 million through its portfolio management service.

Midland's mortgage business continued to enjoy healthy growth, expanding almost three times faster than the market average. Lending increased by 15 per cent and the total value of our mortgage portfolio, which provides a stable source of assets and long-term customer commitment, passed £11 billion.

Midland Card Services also made good progress, attracting more customers and improving service levels. The popularity of cards continues to increase and the range of services is changing rapidly. In July, we were one of the the first banks to launch Solo, extending debit card facilities to over 600,000 customers previously restricted to a cash machine card. Midland's card



acquiring business now offers Solo and Electron debit facilities to retailers, and increased the customer base to 37,000 in the course of the year.

We continued to develop new card products, adding a fourth affinity card to our range, in support of Shelter, the charity for homeless people. The National Trust Card, Artscard and Carecard, have already raised over £2.5 million for charitable causes.

We also tested smart card technology for credit and debit cards, participating in an industry trial aimed at continuing to improve security. Development of the Mondex electronic cash smart card continued with launches at Sheffield Hallam and Aston universities.

New technology is also enhancing our service. New terminals have been installed on branch counters to help improve the quality and speed of information we offer customers. This allows counter staff to check customer records and respond to queries more effectively.

We further improved service by extending the hours of our telephone customer service centres, which are now open until 10pm six days a week, and from 10am to 4pm on Sundays. In addition, we extended the services available at the 300 branches that open on Saturdays, to offer a full cashiering facility.

First Direct
First Direct, the UK's first 24-hour telephone banking service launched by Midland in 1989, continued to expand its business. Over 150,000 new customers opened accounts in 1997, almost one third of whom followed personal recommendation, and First Direct continues to lead the market with over 800,000 accounts. To meet increasing demand, we expanded our existing call centres to accommodate 1,200 new staff and acquired a new site, in Scotland, which will open in 1998.

A PC banking service was also piloted, giving 5,000 customers their first experience of this innovation. The service will be made available to all First Direct customers, free of charge, in 1998.

In January 1997, First Direct Business to Business began operations. Offering personal credit facilities through third party retailers, First Direct Business to Business granted 190,000 loans totalling almost £400 million during the year.

Business Banking
Business confidence remained high in 1997 and this contributed to a rise in the number of new business start-ups, as entrepreneurs moved to exploit fresh opportunities.

With more than half of the UK labour force employed in smaller firms, we continue to recognise the importance of supporting small and medium-sized enterprises. We helped to set up almost one in every six new firms, with our market share of business start-ups rising to 17.4 per cent, a 10-year high.

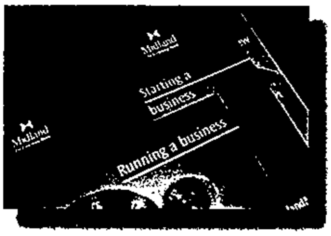
Small companies also appreciate price stability and, for the eighth successive year, there has been no increase to our small business tariff.

Overall, we opened 30 per cent more start-up business accounts than in 1996, evidence that our community banking strategy continues to work well. Business customers welcome the support that a local manager can provide, and prefer to know that decisions are based on a sound understanding of local trading conditions.

First Direct
Since it was established less than 10 years ago, the UK's leading 24-hour telephone bank has gained a 60 per cent market share of customers who bank exclusively by telephone.

In 1997, First Direct continued to attract over 10,000 new cheque account customers every month and now has over 800,000 customers.

Customer satisfaction remains very high, with 87 per cent of First Direct customers recommending the service.



Supporting small business
In 1997, Midland's community-based branch and business banking managers helped establish almost one in six of the UK's new firms.

For our existing customers, we also froze our business tariff for the eighth consecutive year, equivalent to a 35% decrease in the costs of running a business account in real terms.

Midland also established six teams to deal with the special requirements of the UK's South Asian business sector.

Our approach to community banking also recognises that different business communities have different needs and, in 1997, we established six new units to offer a dedicated service for South Asian business customers. Midland South Asian Banking teams now operate from the City of London, Harrow, Southall, Birmingham, Leicester and Manchester. Four more units were established early in 1998.

Similarly, our long established teams of agricultural banking managers offer a dedicated service to the farming community. Our market share of agricultural lending increased for the sixth consecutive year and, in spite of the difficult trading conditions farmers faced with the strength of the Green Pound and food scares, the long-term outlook for the industry remains sound.

Forward Trust Group
Midland's asset finance and leasing business, Forward Trust, experienced a year of steady growth in its existing businesses and considerable strategic change.

Eversholt Leasing, now renamed Forward Trust Rail, a railway rolling-stock leasing company which owns one-third of all UK passenger trains, was acquired in February 1997. The business complements the existing asset finance operation, and is well placed to participate in the redevelopment of Britain's railways.

Changes in taxation have reduced profits in the finance leasing market and, as a result, Forward Trust will be concentrating on sectors less dependent on tax benefits and withdrawing from others altogether.

In the commercial vehicles market, Forward Trust overcame subdued conditions to achieve an impressive 12 per

cent increase in the number of vehicles financed. The commercial vehicles division was also voted 'Best Finance Company' by the Institute of Transport Managers.

In the same period, Swan National, the car contract hire business, grew its fleet by 13 per cent to 52,000 vehicles. The business relocated to new premises in Birmingham, where a modern customer service centre now addresses the needs of fleet and personal customers.

In the factoring market, Griffin Credit Services enjoyed its 14th successive year of profit growth and recorded a 30 per cent increase in the number of clients introducing business. Despite a growing number of companies moving into the factoring and invoice discounting market, Griffin acquired a record 1,000 new clients in the year.

Corporate Banking
Midland Corporate Banking had a strong year and we continued to expand our franchise in the corporate and correspondent banking markets. Among other significant deals, we acted as a lead arranger for the year's two largest UK syndicated debt transactions, for ICI and BAT.

Corporate customers increasingly recognise the benefits of dealing with a bank with the geographic spread, and the range of services, that our membership of the HSBC Group confers. To ensure that we offer our customers a seamless range of services, we established client relationship teams which include HSBC Investment Bank and HSBC MIDLAND, our treasury and capital markets arm, in 1997.

The single European currency will have a significant impact on many of our corporate and institutional customers, and we have invested heavily to ensure that we offer a complete euro service from 1 January 1999. Our corporate banking managers have been trained in the implications of monetary union and we have established a programme of customer seminars to encourage awareness among our clients. We are also investing in developing further our European payment and cash management capabilities.

Our custody business, Midland Securities Services, continued to strengthen our position as the top UK provider of custodial services and as a leading global player. Total assets under custody rose by a third to over £400 billion.

HSBC MIDLAND

The HSBC Group's treasury and capital markets activities in London, New York, Tokyo, Paris, Madrid, Milan and Stockholm achieved strong growth in its core foreign exchange businesses and continued to develop its new issues and derivatives businesses.

HSBC MIDLAND has a significant share of the foreign exchange market in London and was named the capital's best foreign exchange bank by *Euromoney* magazine. HSBC MIDLAND is also a prominent participant in the Asian, Middle Eastern and East European currency markets.

In the new issues market, HSBC MIDLAND was a leading underwriter for sterling Eurobonds, and floating rate notes were completed for several sovereign issuers. The presence in the Yankee market was also increased introducing several British and Hong Kong corporate borrowers.

HSBC MIDLAND's derivatives business performed satisfactorily and increased its range of risk management products offered to UK and foreign corporates.

Trade Services

The strength of sterling combined with currency instability in Asia made 1997 a difficult year for importers and exporters, and had an impact on the overall performance of HSBC Trade Services in the UK. However, demand for specialist trade and international banking services was steady.

In April, we opened our office in Belfast, a city which is experiencing its fastest growth for many years. This has brought our network of international trade branches to 13 in all, offering customers access to trade and international banking services through regional offices across the UK.

Offering innovative business solutions to our customers' trade needs is fundamental to our business. In 1997, we developed a sophisticated EDI-related product, Electronic Direct Sends, designed to smooth the documentation handling for exporters who use Documentary Collections.

The introduction of the single European currency in 1999, and uncertainty over Asia, will make 1998 another difficult year for British importers and exporters.

Deal makers

We grew our relationships with our major corporate customers during the year.

Midland was a lead arranger and underwriter for two of the UK's largest syndicated loan financings of 1997.

In May, the bank co-arranged a US$8.5 billion facility for ICI, to fund the chemical giant's acquisition of specialty chemicals businesses.

In October, Midland jointly arranged BAT Industries' five-year US$8 billion financing.

Euro solutions worldwide
The single European currency is set to become a primary reserve currency in addition to the dollar and the yen.

Approximately 60 per cent of the UK's trade is with countries likely to join the first wave of EMU, and many corporate, institutional and business customers will be affected by monetary union.

To ease the transition, Midland business customers may open an ECU account at any time before the start of monetary union. These will automatically be converted to the euro, free of charge, on 1 January 1999.

However, in an unpredictable market, our understanding of international trade, and ability to provide structured trade finance, will help set us apart and grow market share.

International

Internationally, Midland concentrates primarily on providing corporate banking, trade finance, treasury business and private banking services. In 1997, our overseas offices were located in 30 countries and territories, principally in continental Europe, with a number of offices in Latin America.

In 1997, we saw significant improvements in our operations in France, the Channel Islands and Turkey and, with increased bad debt recoveries, overall performance in Midland's international business was strong. Our Armenian subsidiary, in which Midland has a 70 per cent stake, returned a profit in its second year of operation.

We continued to pursue opportunities to establish or increase our presence in developing markets as they open up to international business and overseas investment. An office was opened in Prague, in the Czech Republic, in April 1997. In Spain, business development centres were opened in Bilbao and Valencia, in addition to our existing offices in Madrid and Barcelona.

In France, we joined the new clearing system, in support of our strategy to join local clearing systems in major European centres in advance of EMU. Our French operations have also created a small team with technical expertise in Export Finance, successfully completing transactions totalling US$200 million, and referring deals totalling US$280 million to other members of the HSBC Group.

In Turkey, we remain the only UK bank with a commercial banking operation and successfully extended our business to provide a private investment service, including equity investment and portfolio management.

Our Latin American businesses performed well in largely stable economies. Our 29.9 per cent holding in Banco Roberts in Argentina was transferred to a fellow subsidiary of the HSBC Group and our representative offices in Argentina and Brazil relocated to HSBC Banco Roberts and Banco HSBC Bamerindus. In Panama, we have opened a new branch.

There were several changes in subsidiary shareholding structures. Our subsidiaries, Trinkaus & Burkhardt in Germany and Guyerzeller Bank in Switzerland were transferred to other member companies of the HSBC Group during the year. Although the results of these businesses were included within Midland's 1997 results, their year-end balance sheets have been transferred.

Our staff and Midland in the community

There can be no doubt that our future depends on the relationships we develop with our customers and our ability to serve their needs. The bank's 48,000 staff in the UK and overseas are the ambassadors who have the responsibility for establishing and maintaining these customer relationships.

In order to equip our staff with the skills required for the future, we continue to invest heavily in training. In 1997, we launched the second phase of our customer service training programme, The Winning Team. Like the first phase, all employees will attend, whatever their seniority. A total of 21,000 employees participated in 1997, and the remainder will take part in 1998.

We have also extended the number of our multi-media Learning Centres, where employees learn by modern, technology-based methods. One hundred centres are now located around the country, putting the facilities within easy reach of the majority of our staff.

Midland staff also contribute to local volunteer and charitable activities in areas where they live and work, helping enhance our reputation as a community bank. Around 900 staff work as Young Enterprise advisers, helping school students experience first-hand the challenges and rewards of establishing and running a business. Thousands more employees hold positions of responsibility in their community, such as school governors or treasurers of local clubs and societies.

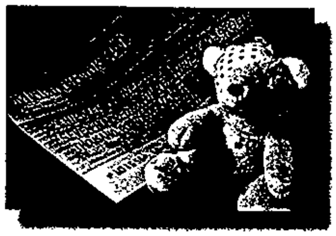
Others devote their spare time to raising money for local and national charities. In addition to the £6.4 million Midland donated to community activities in 1997, our staff raised a further one million pounds. Their efforts made Midland the largest corporate fundraiser for the BBC Children in Need appeal. Staff in our branches and departments put tremendous energy into many inventive projects to contribute £439,000, with a further £300,000 being donated by customers through our credit card loyalty programme. Hundreds of staff also took part in Midland's annual Sponsored Walk, raising over £80,000 for Whizz-Kidz, a charity which supports disabled children. In addition, staff raised over £500,000 for charities of their choice.

These activities underline our links with local people and businesses. We are proud of our heritage and longstanding involvement in the community, which in many cases dates back for over a century. Sixty-two Midland branches celebrated their centenary in 1997 and 500 branches have been open for over 100 years.

This is my last report as Midland's Chief Executive, before I hand over to Bill Dalton, who joins from our sister company, Hongkong Bank of Canada. I will continue to take an active interest in the bank's progress, both in my new role as HSBC Group Chief Executive and also as Midland's Deputy Chairman. I am confident that we are well prepared to meet the challenges that lie ahead.

In the last few years, the bank has recorded strong growth and record profitability and I would like to thank all our staff for their contribution to Midland's success. Their continued commitment to the highest standards of customer service will ensure Midland's progress towards becoming the UK's most respected and successful bank.

K R Whitson, Chief Executive
25 March 1998



Midland in the community
Through a £6.4 million programme of corporate sponsorship and donations, Midland helped support thousands of charitable and community activities in the UK.

Our staff also continue to support Midland's community commitment in impressive numbers.

With the help of our customers, Midland supported the BBC Children in Need appeal, breaking national records in 1997 with a total donation of £739,000.

Acting as school governors or treasurers for clubs and raising funds for local charities, Midland staff also support a host of day-to-day community activities.

Board of Directors

J R H Bond Chairman (56)
Chairman from 1 January 1998 and a Director since 1993. Group Chief Executive and Group Chairman (designate) of HSBC Holdings plc. Chairman of HSBC Americas, Inc., Marine Midland Bank and The British Bank of the Middle East. A Director of The Hongkong and Shanghai Banking Corporation Limited and The Saudi British Bank and a non-executive Director of the London Stock Exchange and Orange plc.

K R Whitson Deputy Chairman and Chief Executive (55)
Deputy Chairman from 1 January 1998; appointed a Director and Deputy Chief Executive in 1992; and Chief Executive 1994 to 31 March 1998. An executive Director and Group Chief Executive (designate) of HSBC Holdings plc and Deputy Chairman of the Supervisory Board of Trinkaus & Burkhardt KGaA. A Director of HSBC Investment Bank Holdings plc, Hongkong Bank of Canada and HSBC Roberts S.A. de Inversiones. A non-executive Director and Chairman of Young Enterprise Limited.

W R P Dalton Chief Executive (designate) (54)
Chief Executive, an executive Director of HSBC Holdings plc and Chairman of Forward Trust Group Limited from 1 April 1998. President and Chief Executive Officer of Hongkong Bank of Canada from 1992 to December 1997.

R M J Orgill Deputy Chief Executive (59)
A Director and Deputy Chief Executive since 1994. Chairman of Midland Life Limited and the Association for Payment Clearing Services (APACS) in the UK and a non-executive Director of The Thomas Cook Group Limited, Euroclear Clearance System S.C. and Visa EU.

D W Baker (55)
A Director since 1996. General Manager, Midlands Division, Midland Bank plc. Chairman, Midland Bank Pension Trust Limited. A non-executive Director of Market Harborough Building Society.

J F Devaney* (51)
A Director since 1994. Executive Chairman of Eastern Group PLC. Formerly Chairman and Chief Executive Officer of Kelsey-Hayes Corporation.

R Emerson* (48)
A Director since 1996. Director of Taxation and Treasury at Glaxo Wellcome plc. Formerly a partner of Coopers & Lybrand.

Sir Archibald Forster* (retiring on 27 May 1998) (70)
A Director since 1986. A Director of Engen Limited (RSA) and a former Chairman and Chief Executive of Esso UK plc.

S K Green (49)
A Director since 1995. An executive Director of HSBC Holdings plc. Chairman of HSBC Investment Bank Holdings plc. Group Treasurer, HSBC Holdings plc from 1992 to February 1998.

A J Hales* (49)
A Director since 1994. Chief Executive of Allied Domecq PLC and a non-executive Director of Aston Villa plc.

H H Jacobi (retiring on 27 May 1998) (63)
A Director since 1995. Chairman of the Managing Partners, Trinkaus & Burkhardt KGaA. A non-executive Director of Atlanta AG, Braun AG, Guyerzeller Bank AG, The Gillette Company and WILO-Salmson AG. President of the North Rhine-Westphalia Stock Exchange and Director of Deutsche Börse AG in Frankfurt. A Member of the Partnership Council of Freshfields.

Sir Wilfrid Newton* CBE (69)
A Director since 1992. A non-executive Director of HSBC Holdings plc, Chairman of Raglan Properties plc, Jacobs Holdings PLC, Mountcity Holdings Limited and Guy Maunsell International Limited. A non-executive Director of Maunsell Holdings Limited and Sketchley plc. Former Chairman of Mass Transit Railway Corporation and of London Regional Transport. A non-executive Director of The Hongkong and Shanghai Banking Corporation Limited from 1986 to 1992.

Sir William Purves CBE, DSO (retiring on 27 May 1998) (66)
A Director since 1987 and Chairman from 1994 to December 1997. Group Chairman of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited, HSBC Americas, Inc. and Marine Midland Bank. A non-executive Director of The 'Shell' Transport and Trading Company plc and The East Asiatic Company Limited A/S.

A C Reed (Mrs)* (41)
A Director since 1996. Divisional Director, Financial Control at Marks & Spencer plc. A Director of BBC Children in Need Limited.

H A Rose* (57)
A Director since May 1997. Finance & Strategy Director at The Rover Group Limited.

* Independent non-executive Directors

Secretary
I B Marshall (48)
Deputy Secretary HSBC Holdings plc since 1995.

Registered Office
Poultry, London, EC2P 2BX

Senior Executives

D C Budd (44)
General Manager, Central Division. Joined the HSBC Group in 1972.

G S Cardona (46)
General Manager, International. Joined the HSBC Group in 1985.

R L Carlson (53)
Head of Information Technology. Joined the HSBC Group in 1982.

R J Duke (47)
General Manager Operations, Retail Banking Services. Joined Midland in 1971.

M G H Heald (47)
Treasurer, HSBC MIDLAND. Joined the HSBC Group in 1989.

R P Hennessy (44)
Chief Financial Officer. Joined the HSBC Group in 1982.

B E Hine (52)
Head of Human Resources. Joined the HSBC Group in 1985.

A R F Hughes (46)
Head of Marketing. Joined Midland in 1969.

D J Mills (54)
General Manager, Retail Banking Services. Joined Midland in 1962.

N V Moss (42)
General Manager, Personal Financial Services. Joined Midland in 1984.

G E Picken (48)
Chief Executive, Forward Trust Group and Chairman, First Direct. Joined Midland in 1971.

W E Roberts (51)
General Manager, Wales. Joined Midland in 1962.

B Robertson (43)
General Manager, Northern Division. Joined the HSBC Group in 1975.

T Robson (53)
General Manager, Southern Division. Joined Midland in 1962.

C S Smith (51)
Head of Credit & Risk. Joined Midland in 1964.

R G Spence (38)
Head of Card Services. Joined Midland in 1978.

P A Thurston (44)
Head of Strategic Development and Planning. Joined Midland in 1975.

Report of the Directors

Results for 1997

The consolidated profit for the year attributable to the shareholders of Midland Bank plc ('the Bank') and its subsidiary and associated undertakings ('Midland') was £1,051 million.

An interim dividend for 1997 of £250 million has been paid on the ordinary share capital during the year and the Directors have resolved to pay a further interim dividend for 1997 of £350 million.

Further information about the results is given in the accompanying consolidated profit and loss account on page 38.

Principal Activities and Business Review

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

The Bank has some 1,700 branches in the United Kingdom, the Channel Islands and the Isle of Man. Overseas it has branches in Australia, Czech Republic, France, Greece, Italy, Japan, Malta, Panama, Spain, Sweden and the USA; representative offices in Argentina, Brazil, Chile, Colombia, the Hong Kong SAR, Ireland, Mexico, Russia, Singapore, Taiwan and Venezuela; subsidiary undertakings in Armenia, Cayman Islands, Greece, Guernsey, the Isle of Man, Ireland, Jersey and Turkey.

A review of the development of the business of Midland during the year and an indication of likely future developments are given in the 'Financial Review' on pages 23 to 35.

Share Capital

During the year, the Bank issued 4 million non-cumulative second US dollar preference shares of US$0.01 each, credited as fully paid, for total consideration of US$50 million.

Valuation of Freehold and Long Leasehold Land and Buildings

Freehold and long leasehold properties were revalued in November 1997 in accordance with Midland's policy of annual valuation.

Directors

The Directors who served during the year were J R H Bond, K R Whitson, B H Asher, D W Baker, J F Devaney, R Emerson, Sir Archibald Forster, S K Green, A J Hales, H H Jacobi, Sir Wilfrid Newton, R M J Orgill, Sir William Purves, A C Reed and H A Rose.

B H Asher will retire as a Director on 28 February 1998. Sir Archibald Forster, having reached the age of 70, H H Jacobi and Sir William Purves will retire at the forthcoming Annual General Meeting and will not seek re-election. A J Hales will retire by rotation at the Annual General Meeting and will offer himself for re-election.

Directors appointed since the last Annual General Meeting, H A Rose (with effect from 28 May 1997) and W R P Dalton (with effect from 1 April 1998), will retire at the forthcoming Annual General Meeting and offer themselves for re-election.

Brief biographical notes of the Directors are set out on pages 12 and 13.

Corporate Governance

The Bank has complied throughout the year with the provisions of the Code of Best Practice contained in the Report of the Committee on the Financial Aspects of Corporate Governance (the 'Cadbury Committee'), except that it has not appointed a Remuneration Committee. The functions of the Remuneration Committee are fulfilled by the Remuneration Committee of the Board of the Bank's parent company, HSBC Holdings plc.

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 Committee are K R Whitson (Chairman), R M J Orgill, D W Baker, D C Budd, M G H Heald, R P Hennessy, D J Mills, G E Picken, W E Roberts and C S Smith.

Audit Committee

The Audit Committee meets regularly with Midland's senior financial, internal audit and compliance management and the external auditor to consider the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Audit Committee, all of whom are non-executive Directors, are Sir Archibald Forster (Chairman), J F Devaney, R Emerson, A C Reed and H A Rose.

Internal Financial Control

The Directors are responsible for internal financial control within Midland and have designed procedures for the safeguarding of assets against unauthorised use or disposition; for the maintenance of proper accounting records; and for the reliability of financial information used within the business or for publication. Such procedures can only provide reasonable and not absolute assurance against material errors, losses or fraud.

The key procedures that the Directors have established and which are designed to provide effective internal financial control within Midland, include the following:

• Authority to operate Midland is delegated to the Chief Executive within limits set by the Board of Directors. The appointment of executives to the most senior positions within Midland requires the approval of the Board of Directors. Functional operating and financial reporting standards are established by HSBC Holdings plc's Head Office management for application across the whole HSBC Group. These are supplemented by operating standards set by the Midland management, as required.

• Systems and procedures are in place in Midland to report on and control the major financial risks: credit; changes in the market prices of financial instruments; funding of assets; operational error and fraud. Exposure to these risks is monitored by the Asset and Liability Management Committee and the Executive Committee in Midland.

• Comprehensive annual financial plans are prepared, reviewed and approved. Results are monitored regularly and reports on progress compared with plan are prepared monthly. A strategic plan is prepared every three years. Financial accounting and reporting and certain management reporting standards have been established. Centralised functional control is exercised over all computer system developments and operations for the HSBC Group as a whole and common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in Midland 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 the HSBC Group's Head Office set policies and standards in the areas of finance; legal and regulatory compliance; human resources; credit; market 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 Chairman and the Audit Committee. The HSBC Group's and Midland's independent auditor, KPMG Audit Plc, reviews the internal financial controls and conducts such tests and other auditing procedures as it considers necessary to express the opinion in its report on the financial statements. KPMG Audit Plc has free access to the Audit Committee, with and without members of management present, to discuss its audit and its findings as to the integrity of Midland's financial reporting and the adequacy of the internal financial control structure.

The Audit Committee has reviewed the effectiveness of the system of internal financial control throughout 1997 and the subsequent period up to 23 February 1998 when the financial statements were signed.

Remuneration Report

The members of the HSBC Holdings plc Remuneration Committee (the 'Remuneration Committee') are Baroness Dunn (Chairman), H Sohmen and Sir Peter Walters, all of whom are non-executive Directors of HSBC Holdings plc.

Policy

The Remuneration Committee is responsible for determining the remuneration policy of the HSBC Group, including the terms of bonus schemes, share option schemes and other long-term incentive schemes, and for fixing the individual remuneration packages of Midland executive Directors and other senior employees.

In framing the remuneration policy, the Remuneration Committee has continued to give full consideration to the London Stock Exchange's Best Practice Provisions relating to remuneration policy, service contracts and compensation.

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 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 schemes and individual remuneration awards, including retirement benefit arrangements, notice periods and severance terms, the Remuneration Committee considers the practices and levels of remuneration in appropriate comparator companies which operate in similar industry sectors and territories to those in which the individual

HSBC Group company operates and the executive Director or employee is employed. Due regard is paid to advice rendered by external professional consultants.

Basic Salary and Benefits

Salaries are reviewed annually in the context of individual and business performance, market practice and internal relativities. 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, constituent businesses and the individual concerned. Key measures of success include achievement of financial goals, concerning both revenue generation and expense control; maintenance of 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 Group and its staff are aligned with those of its shareholders, and that the Group's approach to risk management serves the interests of all.

Bonus ranges are reviewed in the context of prevailing market practice and overall remuneration.

Long-Term Share Awards

The HSBC Holdings plc Restricted Share Plan is 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 progressive earnings growth without undue volatility. Details of conditional awards and the related performance requirements are set out on pages 18 to 21.

HSBC Holdings' executive Directors and Group General Managers are eligible to receive a conditional award under the Restricted Share Plan, but may no longer participate in the HSBC Holdings Executive Share Option Scheme, although options granted in prior years will remain valid.

Executive Directors are eligible to participate in the HSBC Holdings Savings-Related Share Option Scheme on the same terms as all other eligible employees.

Pensions

Pension arrangements to contractual retirement age of 60 for the executive Directors are provided under the Midland Bank Pension Scheme.

Only basic salary is pensionable. None of the Directors is subject to the earnings cap introduced by the 1989 Finance Act.

The principal Midland pension scheme is the Midland Bank Pension Scheme, the assets of which are held in a separate trust fund. The Pension Scheme is administered by Midland Bank Pension Trust Limited whose Board of nineteen Directors (eight of whom are elected by employees and one by pensioners) meets quarterly. It has three sub-committees which 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.

The pension entitlements earned by the current Directors during the year are shown below.

	Accrued annual pension at 31 December 1997 (£'000)	Increase in accrued pension during 1997, excluding any increase for inflation (£'000)	Transfer value relating to increase in accrued pension (£'000)
D W Baker	86	3	43
H H Jacobi	350	8	86
R M J Orgill	40	8	136
K R Whitson	57	10	141

Directors' Service Contracts

No executive Director has a service contract with the Bank or any of its subsidiaries with a notice period in excess of one year. Non-executive Directors are appointed for fixed terms not exceeding three years.

W R P Dalton, who will be appointed a Director with effect from 1 April 1998, will stand for re-election at the forthcoming Annual General Meeting. He is employed on a contract which provides for twelve months notice to be given by either party.

Directors' individual remuneration and interests

Particulars of the Directors' individual share interests and remuneration are set out on pages 18 to 20.

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.

Directors' Interests

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

	At 1 January 1997	At 31 December 1997
Ordinary shares of HK$10		
B H Asher	2,100	2,100
J R H Bond	17,776	18,259
S K Green	4,042	4,152
Sir Wilfrid Newton	3,767	3,869
Sir William Purves	36,903	37,907
K R Whitson	1,709	1,755
Ordinary shares of 75p		
D W Baker	8,882	9,124
J R H Bond	–	7,884[2]
J F Devaney	–	1,602
Sir Archibald Forster	4,500	4,622
S K Green	–	5,917[2]
A J Hales	1,074	1,103
H H Jacobi	–	2,400
Sir Wilfrid Newton	2,000	2,000
Sir William Purves	1,471	1,831[1]
K R Whitson	–	5,917[2]
11.69% Subordinated Bonds 2002 of £1		
J R H Bond	500,000	500,000
Sir Archibald Forster	2,072	2,072
S K Green	50,000	–
Sir Wilfrid Newton	35,000	35,000
R M J Orgill	250,000	250,000

[1] Includes a non-beneficial interest in 320 ordinary shares of 75p each.

[2] Shares in 1997 conditionally awarded under the HSBC Holdings plc Restricted Share Plan together with additional shares arising from scrip dividends. The monetary value of the shares awarded during 1997 was: J R H Bond £120,000; S K Green £90,000; and K R Whitson £90,000. For these shares to vest in 2000 or 2001, in whole or in part, performance tests described in the Report of the Remuneration Committee in the 1996 HSBC Holdings Annual Report and Accounts must be satisfied.

S K Green has an interest in £100,000 Midland Bank plc 9% Subordinated Notes 2005, £50,000 of which he held at the beginning of the year.

Share Options

At 31 December 1997, the undernamed Directors held options to acquire the number of HSBC Holdings plc ordinary shares of 75p 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 Scheme are exercisable at a 15 per cent discount to the market value at the date of award. Except as otherwise indicated, there are no performance criteria conditional upon which the outstanding options are exercisable. The market value of the ordinary shares of 75p each at 31 December 1997 was 1,571 pence. The highest and lowest market values during the year were 2,347 pence and 1,273 pence. Market value is the mid-market price quoted on the London Stock Exchange on the relevant date.

	Options held at 1 January 1997	Options awarded during the year	Options exercised during the year	Options held at 31 December 1997	Exercise price in pence	Date of Award	Exercisable from[5]	Exercisable until[5]
Executive Directors								
D W Baker	6,559	–	–	6,559	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	6,250	–	–	6,250	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	1,476	–	–	1,476[1]	700.84	11 Apr 1994	1 Jul 1999	31 Dec 1999
	713	–	–	713[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	6,500	–	–	6,500[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
	–	7,000	–	7,000[2]	1,504.80	24 Mar 1997	24 Mar 2000	24 Mar 2007
	–	223	–	223[1]	1,356.18	9 Apr 1997	1 Aug 2002	31 Jan 2003
R M J Orgill	7,063	–	7,063[3]	–	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	10,090	–	10,090[3]	–	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	10,000	–	–	10,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	1,476	–	–	1,476[1]	700.84	11 Apr 1994	1 Jul 1999	31 Dec 1999
	1,273	–	–	1,273[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	10,000	–	–	10,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
K R Whitson	12,613	–	–	12,613	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	20,000	–	–	20,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	–	–	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	20,000	–	–	20,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006

Non-executive Directors

The following hold options awarded by HSBC Holdings plc in respect of their executive responsibilities with that Company:

	Options held at 1 January 1997	Options awarded during the year	Options exercised during the year	Options held at 31 December 1997	Exercise price in pence	Date of Award	Exercisable from[5]	Exercisable until[5]
B H Asher	12,613	–	12,613[4]	–	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	15,136	–	–	15,136	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	15,000	–	–	15,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	–	–	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
J R H Bond	20,181	–	–	20,181	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	20,181	–	–	20,181	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	25,000	–	–	25,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	–	–	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	25,000	–	–	25,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
S K Green	8,012	–	–	8,012	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	12,108	–	–	12,108	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	15,000	–	–	15,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	1,879	–	–	1,879[1]	917.70	3 Apr 1996	1 Aug 2001	31 Jan 2002
	15,000	–	–	15,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
Sir William Purves	25,227	–	–	25,227	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	45,408	–	–	45,408	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	45,000	–	–	45,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	1,476	–	–	1,476[1]	700.84	11 Apr 1994	1 Jul 1999	31 Dec 1999
	1,273	–	–	1,273[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	35,000	–	–	35,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006

[1] Options awarded under the HSBC Holdings Savings-Related Share Option Scheme.

[2] The exercise of these options is conditional upon the growth in earnings per share of HSBC Holdings plc over a three-year period being equal to or greater than a composite rate of inflation (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.

[3] Market price at date of exercise (11 April 1997) was 1,492 pence.

[4] Market price at date of exercise (30 April 1997) was 1,620 pence.

[5] May be advanced to an earlier date in certain circumstances, eg retirement.

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

There have been no changes in Directors' interests since 31 December 1997.

Directors' Emoluments

The emoluments of the Directors of the Bank for 1997 were as follows:

	Fees £'000	Salary and other remuneration £'000	Benefits in kind £'000	Discretionary bonuses[2] £'000	Total £'000	Total 1996[3] £'000
D W Baker	25	155	8	45	233	31
J F Devaney	25	8	–	–	33	25
R Emerson	25	8	–	–	33	6
Sir Archibald Forster	25	10	–	–	35	25
S K Green	25	–	–	–	25	20
A J Hales	25	–	–	–	25	20
H H Jacobi	–	1,184	–	–	1,184	1,287
Sir Wilfrid Newton	25	–	–	–	25	20
R M J Orgill	25	256	28	85	394	368
A C Reed	25	8	–	–	33	17
H A Rose[1]	15	1	–	–	16	–
K R Whitson	–	325	28	100	453	413
Total	240	1,955	64	230	2,489	2,232

[1] Appointed 28 May 1997.

[2] These discretionary bonuses are in respect of 1997 and will be paid in 1998.

[3] Restated to exclude employer pension contributions.

Sir William Purves, B H Asher and J R H Bond received no emoluments from the Bank or from its subsidiary undertakings. H H Jacobi received no emoluments from the Bank. He is Chairman of the Managing Partners of Trinkaus & Burkhardt KGaA (a 73 per cent owned subsidiary undertaking of the Bank throughout 1997, but which was, on 31 December 1997, transferred to another member of the HSBC Group). The major part of his remuneration derives from partnership-related profit sharing.

1998 Conditional Awards under the Restricted Share Plan

The Remuneration Committee has decided that conditional awards under the HSBC Holdings plc Restricted Share Plan should be made in 1998 and that the Trustee to the Plan should be provided with funds to acquire HSBC Holdings plc ordinary shares of 75p each between 23 and 27 February 1998. The 1998 conditional awards of shares to HSBC Holdings' executive Directors and Group General Managers in respect of 1997 will have an aggregate value at the date of award of £1.41 million and will include conditional awards of shares to the following values to Directors of the Bank:

	£'000
J R H Bond	150
S K Green	120
K R Whitson	120
Total	390

Purpose
The Restricted Share Plan is designed to reward the delivery of sustained financial growth of HSBC Holdings plc. A key factor in the creation of superior shareholder return is stable and reliable earnings growth of the HSBC Group. Accordingly, the Restricted Share Plan is focused on rewarding sustained earnings growth and contains particular features which reduce or remove any benefit from volatile earnings growth.

Earnings per share for the purpose of the Restricted Share Plan are defined as headline earnings per share calculated in accordance with the definition in the Institute of Investment Management and Research (IIMR) Statement of Investment Practice No 1 'The Definition of IIMR Headline Earnings' and are disclosed in the Annual Report and Accounts each year of HSBC Holdings plc. Headline earnings per share exclude gains on the sale of tangible fixed assets, subsidiary undertakings, interests in associated undertakings and other participating interests and provisions for permanent diminution in the value of fixed assets.

To illustrate how the Restricted Share Plan is to be applied, particulars of the terms are set out below, together with an example which describes the circumstances necessary for full awards to vest.

Vesting Schedule
Having regard to the HSBC Group's diverse profits stream, the Remuneration Committee has determined that earnings growth will be measured by reference to a composite rate of inflation applicable to the major geographical areas in which the HSBC Group operates. The composite rate of inflation for the 1998 awards will comprise a weighted average of the rates of inflation as measured by the following indices during the performance period:

- 50% of the Hong Kong Composite Consumer Price Index;
- 35% of the UK Retail Price Index; and
- 15% of the USA All Urban Consumer Price Index.

For vesting of the 1998 awards to be achieved in whole or in part, the following tests must be satisfied.

Test 1 Earnings per share in the year 2001 (the fourth year of the performance period) must be greater than earnings per share in 1997 (the base year for the calculation) by a factor equivalent to the composite rate of inflation plus 2 per cent, compounded over each year of the performance period;

Test 2 Earnings per share must increase relative to the previous year in not less than three of the four years of the performance period; and

Test 3 Cumulative earnings per share over the four years of the performance period, 1998 to 2001 inclusive, must exceed an aggregate figure calculated by compounding 1997 earnings per share by a factor equivalent to the annual composite rate of inflation plus 2 per cent for each year of the performance period.

If these tests are met, 50 per cent of the conditional awards will be released to each eligible participant by the Trustees.

If the cumulative earnings per share over the performance period exceed an aggregate figure calculated by compounding 1997 earnings per share by a factor equivalent to the annual composite rate of inflation plus 5 per cent or more, or 8 per cent or more, for each year of the performance period, the Trustees will release 75 per cent or 100 per cent of the conditional awards respectively.

If the tests are not satisfied over the years 1998 to 2001, the same tests will be applied over the years 1999 to 2002. If the tests still have not been satisfied at the end of that period, the conditional share awards will be forfeited.

In the event of any occurrence that would cause awards to vest in whole or in part or not to vest in circumstances which the Committee considers to be anomalous, the right is reserved to the Committee to make such adjustments as in its absolute discretion it deems appropriate to make.

By way of example, if the composite rate of inflation were 5 per cent per annum over the period 1998-2001, 50 per cent of the conditional awards would be released if the following had been achieved:

1 earnings per share for the year 2001 exceeded US$2.68;
2 there had been earnings per share growth in at least three of the four years; and
3 cumulative earnings per share over the four years 1998-2001 exceeded US$9.70.

For the maximum number of shares to vest, the cumulative earnings per share over the four years 1998-2001 would have to exceed US$11.19.

Employment of Disabled Persons
Midland is committed to providing equal opportunities in employment. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons are based on the aptitudes and abilities of the individual. Midland has a rehabilitation policy under which it will make every effort, if existing employees become disabled,

to retain them within the workforce wherever reasonable and practicable. The training, development and promotion of employees with disabilities follows the same pattern as for other employees with the objective of enabling them to realise their potential and to contribute fully to the business.

The enacting of the Disability Discrimination Act during the year has added another dimension to Midland's support and encouragement of its disabled employees with additional disability awareness training, the setting up of a senior executive disability steering group and an extension of services to disabled employees and customers.

Employee Communication and Involvement

A wide variety of communication methods is used to maintain and encourage effective two-way communication with employees on key issues including financial and economic factors affecting performance. Consultation arrangements include the establishment of consultative forum for managers, the continuation of agreed arrangements with the recognised union and Midland's participation in an HSBC European Council. Encouragement for every employee to contribute to the success of the business is made through performance management. Employees are given the opportunity to participate in the HSBC Holdings Savings-Related Share Option Scheme. Ideas from staff for improving Midland's operations and services are sought through 'Bright Ideas', the employee suggestion scheme.

Community Involvement and Donations

During 1997 Midland spent £6.4 million in support of community activities in the United Kingdom. This was provided in the form of donations, sponsorship, secondment of staff and gifts in kind. Within this, donations were made for charitable purposes totalling £1.6 million. This figure includes the amount of £301,000 relating to the £1 for £1 staff charity scheme.

No political donations were made during the year.

The Bank announced last year that it had formed major corporate partnerships with three national charities, Age Concern, the National Deaf Children's Society and Shelter, in a series of agreements under which £1 million would be donated to specific projects over three years. The partnerships make Midland the largest corporate donor of each charitable organisation.

Supplier Payment Policy

The Bank has subscribed to the Confederation of British Industry Prompt Payers Code for all suppliers. Information about the Code may be obtained from the CBI.

The amount due to the Bank's trade creditors at 31 December 1997 represents 28 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. A resolution proposing its reappointment and giving authority to the Directors to fix its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board

I B Marshall, Secretary, 23 February 1998

Financial Review

Summary of Financial Performance

1997 Overview

Operating profit before provisions rose 25 per cent to £1,719 million. Operating profit was 37 per cent higher at £1,583 million.

Net interest income increased by £152 million, or 7 per cent, to £2,203 million mainly as a result of strong balance sheet growth in business, personal and mortgage lending.

Other operating income rose £252 million, or 16 per cent, to £1,839 million. There was higher fee and commission income, largely in UK Banking, mainly from personal and business lending and insurance. Operating lease income rose sharply following the acquisition of £1.2 billion of operating leased assets.

Operating expenses increased by £59 million, or less than 3 per cent, to £2,323 million. Midland achieved a further significant improvement in its cost:income ratio to 57.5 per cent due to tight cost control and higher operating income.

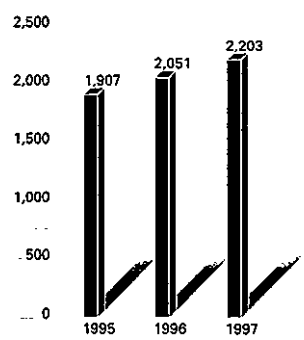
The charge for bad and doubtful debts was lower than 1996 following improved recoveries and a higher net release of provisions resulting from sales of LDC debt.

	1997 £m	1996 £m	1995 £m
Net interest income	**2,203**	2,051	1,907
Other operating income	**1,839**	1,587	1,465
Operating income	**4,042**	3,638	3,372
Operating expenses	**(2,323)**	(2,264)	(2,251)
Operating profit before provisions	**1,719**	1,374	1,121
Provisions for bad and doubtful debts	**(129)**	(172)	(198)
Provisions for contingent liabilities and commitments	**(3)**	(3)	–
Amounts written off fixed asset investments	**(4)**	(40)	(1)
Operating profit	**1,583**	1,159	922
Gains on disposal of investments and tangible fixed assets	**33**	92	54
Income from associated undertakings	**9**	21	22
Profit on ordinary activities before tax	**1,625**	1,272	998
	%	%	%
Post-tax return on average shareholders' funds (equity)	**26.0**	24.5	20.0
Cost:income ratio	**57.5**	62.2	66.8

Net interest income

Net interest income increased, reflecting improved customer recruitment and continued growth in lending and deposit balances, together with the benefit of improved spreads in the branch network, particularly on mortgage lending as discounts rolled off. A reduction in the level of interest suspended and foregone mainly due to lower non-performing loans also contributed to the growth. These increases were partly offset by the funding of operating leased assets (the income from which is included within other operating income) which contributed to an overall reduction in net interest margin of 4 basis points from 2.66 per cent in 1996 to 2.62 per cent in 1997.

Net interest income £m



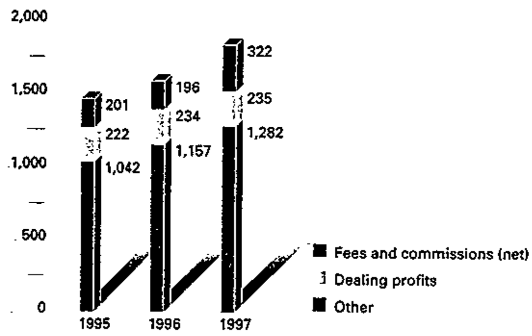
Financial Review (continued)

Other operating income

Within other operating income, net fees and commissions grew, mainly in personal and business lending and insurance. Operating lease income increased by £138 million.

Dealing profits, which excluded net interest income attributable to dealing activities and dividend income on trading equities, were in line with 1996. In HSBC MIDLAND dealing profits improved principally due to higher profits from foreign exchange trading. Dealing profits from international operations, particularly from securities trading, were lower due to difficult trading conditions in the bond markets.

Other operating income £m



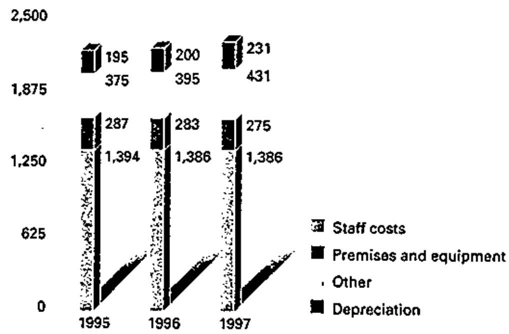
	1997 £m	1996 £m
Dealing profits		
– foreign exchange	236	142
– interest rate derivatives	18	53
– debt securities	(36)	20
– equities and other trading	17	19
	235	234

Operating expenses

Operating expenses were tightly controlled and, in spite of business expansion, increased by less than 3 per cent. Total staff costs were unchanged, while premises and equipment costs reduced due to lower vacant space charges. Depreciation costs increased reflecting the growth in operating leased assets, and higher business volumes contributed to an increase in communications and stationery costs. Marketing costs rose following a range of successful initiatives in 1997 including the launch of the new Midland Bank account and increased spending in First Direct.

Midland continues to make substantial progress managing its cost:income ratio and has achieved an improvement to 57.5 per cent from 62.2 per cent in 1996.

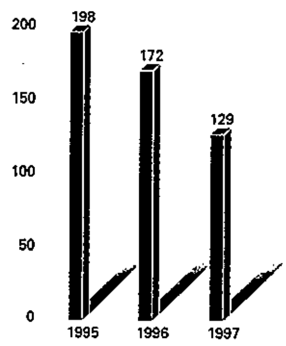
Operating expenses £m



Bad and doubtful debts

The charge for bad and doubtful debts was lower than 1996 following improved recoveries and a higher net release of provisions resulting from sales of LDC debt. New specific provisions fell from £357 million to £340 million. Releases and recoveries rose from £206 million to £248 million, of which £101 million related to LDC debt within International Banking. The general provision charge was £16 million higher than 1996 due to growth in customer advances.

Bad and doubtful debts £m



Taxation

The effective tax rate was 34 per cent, compared with 32 per cent in the previous year. This reflected a charge to provide fully for deferred tax in Forward Trust Group, together with the absence of the profit on the tax-free sale of our investment in 3i in 1996.

Analysis of overall tax charge	1997 £m	1996 £m
Taxation at UK corporation tax rate of 31.5% (1996: 33%)	**512**	420
Non-deductible items including unrelieved losses	**31**	47
Items covered by previously unrecognised capital losses	**(5)**	(27)
Overseas profits subject to higher rates of tax	**8**	16
Advance corporation tax recognised	**–**	(12)
Forward Trust Group deferred tax:		
Full provision	**45**	–
Tax rate reduction	**(34)**	–
Prior year adjustments	**(3)**	(37)
Other items	**5**	1
Overall tax charge	**559**	408

Results of principal business segments

Operating profit of:	1997 £m	1996 £m	1995 £m
Commercial Banking			
– UK Banking	**1,000**	730	513
– International Banking*	**307**	186	204
– HSBC MIDLAND	**152**	146	114
	1,459	1,062	831
Forward Trust Group			
– Asset Finance	**94**	69	66
– Griffin Credit Services	**30**	28	25
	124	97	91
	1,583	1,159	922
Gains on disposal of investments and tangible fixed assets	**33**	92	54
Income from associated undertakings	**9**	21	22
Profit before tax	**1,625**	1,272	998

*The results of 'International Banking' now include LDC Debt Management which was previously reported separately.

Financial Review (continued)

UK Banking

UK Banking achieved good growth in operating profits. Increased net interest income arose from higher customer asset and liability balances, with growth in business, personal and mortgage lending, money market deposits and current accounts. Customer deposit growth in the branch network contributed to increased other operating income through greater cross-selling of other Midland products. Additionally, spreads on mortgage and savings products improved. Higher fee income was also achieved, mainly arising from personal overdrafts, mortgages, cards and insurance. UK Banking's cost:income ratio improved from 63.7 per cent to 58.3 per cent.

	1997 £m	1996 £m
Net interest income	**1,759**	1,475
Other operating income	**1,144**	1,051
Operating income	**2,903**	2,526
Operating expenses	**(1,691)**	(1,608)
Operating profit before provisions	**1,212**	918
Provisions for bad and doubtful debts	**(206)**	(183)
Provisions for contingent liabilities and commitments	**(2)**	(3)
Amounts written off fixed asset investments	**(4)**	(2)
Operating profit	**1,000**	730
Gains on disposal of investments and tangible fixed assets	**11**	76
Income from associated undertakings	**(2)**	4
Profit on ordinary activities before tax	**1,009**	810

International Banking

International Banking's operating profits increased despite the translation effects of the strong pound. Results for France, the Channel Islands and Turkey improved significantly. Corporate banking profits in Greece were enhanced by the acquisition of a shipping portfolio. Germany contributed higher fee income, principally from private client business, but lower dealing profits. Following the HSBC Group's direct investments in Latin America, bad debt recoveries rose on the sale of LDC debt in the market.

	1997 £m	1996 £m
Net interest income	**262**	258
Other operating income	**201**	233
Operating income	**463**	491
Operating expenses	**(238)**	(298)
Operating profit before provisions	**225**	193
Provisions for bad and doubtful debts – release	**83**	31
Provisions for contingent liabilities and commitments	**(1)**	–
Amounts written off fixed asset investments	**–**	(38)
Operating profit	**307**	186
Gains on disposal of investments and tangible fixed assets	**4**	11
Income from associated undertakings	**13**	17
Profit on ordinary activities before tax	**324**	214

HSBC MIDLAND

HSBC MIDLAND reported improved operating profits compared with 1996. Net interest income was lower, reflecting higher money-market short-term funding rates and flatter sterling and US dollar yield curves. Within other operating income, dealing profits of £208 million were £48 million higher. Strong foreign exchange earnings benefited from volatility in the markets. There was a £13 million increase in gains on disposal of investments.

	1997 £m	1996 £m
Net interest income	**170**	204
Other operating income	**169**	122
Operating income	**339**	326
Operating expenses	**(187)**	(180)
Operating profit	**152**	146
Gains on disposal of investments and tangible fixed assets	**18**	5
Profit on ordinary activities before tax	**170**	151

Forward Trust Group

Forward Trust Group's operating profits rose due to growth in its portfolio of leased assets and continued expansion of its invoice finance and debt management services. The rail business contributed £56 million to operating profits since its acquisition in February 1997.

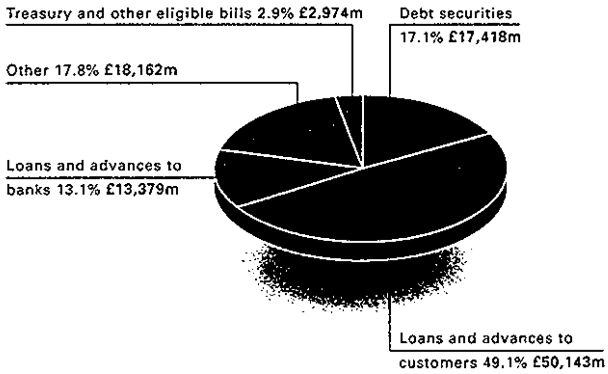
The effect of announcements made in the UK Government's July 1997 Budget reduced reported profit before tax. The change in the rate of corporation tax from 33 per cent to 31 per cent necessitated a provision of £18 million to cover lower rentals from some finance lease customers under tax variation clauses. In addition, costs have been incurred in restructuring the business.

	1997 £m	1996 £m
Net interest income	12	114
Other operating income	325	181
Operating income	337	295
Operating expenses	(207)	(178)
Operating profit before provisions	130	117
Provisions for bad and doubtful debts	(6)	(20)
Operating profit	124	97
Income from associated undertakings	(2)	–
Profit on ordinary activities before tax	122	97

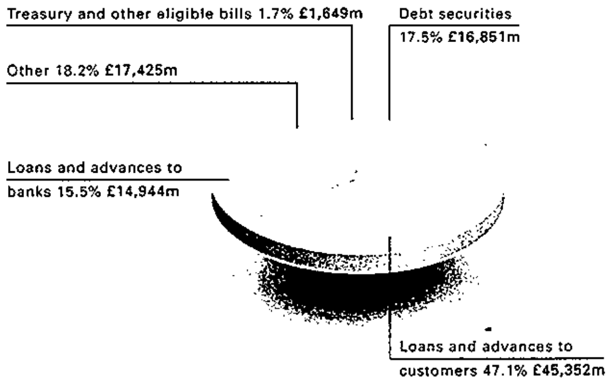
Assets

Total assets were £5.9 billion, or 6 per cent, higher than 31 December 1996. On 31 December 1997, Midland transferred its interests in Trinkaus & Burkhardt KGaA and Guyerzeller Bank AG to fellow members of the HSBC Group. Although the results of these businesses were included within Midland's results for 1997, their year-end balance sheets have been transferred. At constant exchange rates and excluding Trinkaus & Burkhardt KGaA and Guyerzeller Bank AG, assets were £14.2 billion, or 16 per cent, higher than 31 December 1996. Increased customer lending in UK Banking and increased treasury bills and other eligible bills, operating leased assets and debt securities in HSBC MIDLAND were the principal factors behind this growth. Within liabilities, current accounts increased following the launch of the Midland Bank account, and money market deposits and repos grew.

Assets 1997 Total £102,076m



Assets 1996 Total £96,221m



Capital Management

Capital measurement and allocation

The Bank of England is the supervisor of Midland on both a solo and consolidated basis and in this capacity receives information on the capital adequacy of, and sets capital requirements for, Midland as a whole. The UK Government has announced that responsibility for banking supervision is to be transferred from the Bank of England to the Financial Services Authority and this is currently scheduled to come into effect on 1 June 1998. Individual banking subsidiaries are directly regulated by their local banking supervisors, which set and monitor capital adequacy requirements. Similarly, non-banking subsidiaries are subject to the supervision and capital requirements of relevant local regulatory authorities.

Midland's capital adequacy is measured by the ratio of its capital to risk-weighted assets, taking into account both balance sheet assets and off-balance-sheet transactions.

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

Capital structure

The total capital ratio was in line with 1996.

Tier 1 capital increased by £154 million, or 4 per cent, in 1997, mainly due to profit retentions and the proceeds of a US$50 million preference share issue partly offset by a reduction in minority interests mainly arising from the transfer of Trinkaus & Burkhardt KGaA to a fellow member of the HSBC Group.

Qualifying Tier 2 capital increased by £161 million, or 5 per cent. There was an increase in undated subordinated loan capital primarily as a result of the issue of £150 million 8.625 per cent Step-up Undated Subordinated Notes. There was an overall decrease in qualifying dated subordinated debt of £114 million due to the transfer of Trinkaus & Burkhardt KGaA and increased amortisation of dated subordinated loan capital with a residual maturity of less than five years, offset by the issue of £150 million Subordinated Step-up Coupon Floating Rate Notes 2007 and US$50 million Subordinated Step-up Coupon Floating Rate Notes 2007.

Total risk-weighted assets increased by £3,074 million mainly reflecting increased loans and advances to customers partly offset by a reduction due to the transfer of Trinkaus & Burkhardt KGaA.

Composition of capital	**1997 £m**	**1996 £m**
Tier 1:		
Shareholders' funds and minority interests	**4,449**	4,295
Tier 2:		
Fixed asset revaluation reserve	**65**	6
General provisions	**328**	293
Undated subordinated loan capital	**1,259**	1,078
Qualifying dated subordinated loan capital	**1,803**	1,917
Total qualifying Tier 2 capital	**3,455**	3,294
Unconsolidated investments	**(277)**	(241)
Investments in other banks	**(22)**	(16)
Other deductions	**(5)**	–
Total capital	**7,600**	7,332
Total risk-weighted assets	**66,826**	63,752
Capital ratios		
Total capital:risk-weighted assets	**11.4%**	11.5%
Tier 1 capital:risk-weighted assets	**6.7%**	6.7%

Credit Risk Management

Credit risk

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

Midland has a well established credit 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 basis and portfolio basis. Local management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality.

Within the overall framework of HSBC Group policy, credit policy direction is provided by the Head of Credit and Risk in conjunction with other senior executive officers. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products. Midland's concentration of risk to individual countries is controlled within the overall level of HSBC Group country limits with sub-limits by maturity and type of business. Transactions with higher risk countries are considered on a case-by-case basis.

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.

Market Risk Management

Market risk

Market risk is the risk that interest rates, foreign exchange rates or equities and commodity prices will move and result in profits or losses to Midland. 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). Midland makes markets in interest rate and exchange rate derivative instruments, as well as in debt, equities and other securities. Trading risks arise either from customer-related business or from position taking.

Market risk is managed within risk limits approved by the Midland Asset and Liability Management Committee ('MALCO') and by the HSBC Group Executive Committee. HSBC Group Market Risk, an independent unit within HSBC Group Treasury, develops risk management policies and measurement techniques, and reviews limit utilisation.

In addition, a Market Risk Control unit in each office reviews market risk positions on a daily basis and reports limit utilisation to Midland and HSBC Group senior management each day. Market risk exposures are reviewed by a sub-committee of MALCO each week while the utilisation of all market risk limits is reviewed by MALCO each month. 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. Actual risk levels compared with approved limits are monitored daily by the Market Risk Control unit in each office and by HSBC Group Market Risk.

A key component of market risk management is the estimation of potential losses that could occur on risk positions taken due to movements in market rates and prices – generally referred to as 'value at risk'. Value at risk is computed for all Midland treasury centres on a regular basis incorporating positions subject to both mark-

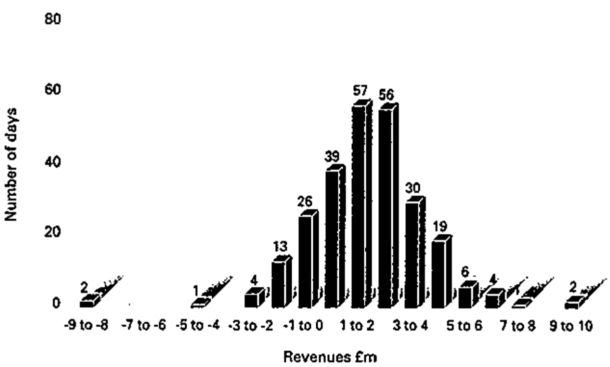
Market risk (continued)

to-market and accrual valuation bases. The value at risk measure employed assesses the potential loss that could occur due to the change in value of portfolios caused by movements in market rates and prices. The calculation uses historical one-day movements in market rates and prices, a 95 per cent confidence level and takes account of correlations between different markets and rates. This analysis is augmented by stress testing, both on individual portfolios and on a consolidated basis. Stress testing looks at the potential profit and loss impact of more extreme moves in market prices.

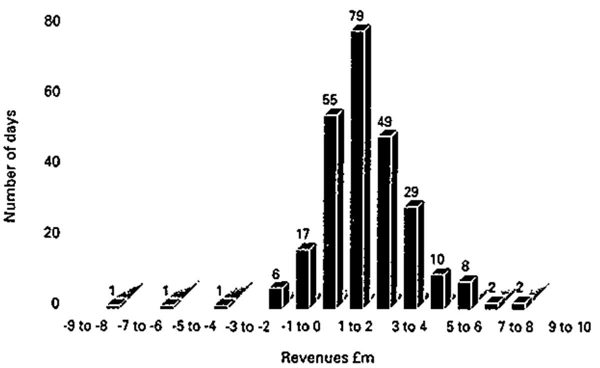
Value at risk measurement techniques have been applied in respect of treasury activities throughout the year. The value at risk for all interest rate risk and foreign exchange risk positions at 31 December 1997 was £5.0 million (£4.0 million at 31 December 1996). The average value at risk during 1997 was £5.2 million (£10.2 million for 1996).

The average daily revenue earned from market risk-related treasury activities in 1997, including accrual book net interest income and funding related to dealing positions, was £1.7 million compared with £1.8 million in 1996. The standard deviation of these daily revenues was £2.2 million (£1.8 million for 1996). An analysis of the frequency distribution of daily revenues shows a maximum daily loss of £8.9 million, with only 46 out of 260 days showing losses. The most frequent result was a daily revenue of between £1 million and £2 million, with 57 occurrences. The highest daily revenue was £9.9 million.

Daily distribution of market risk revenues – 1997



Daily distribution of market risk revenues – 1996



Foreign exchange exposure

Midland's foreign exchange exposure comprises the following: those which arise from foreign exchange dealing within Midland's treasury centres; structural foreign currency translation exposures; and currency exposures originated by Midland's commercial banking businesses. The latter are transferred to local treasury units where they are managed together with exposures which result from dealing within approved limits.

Value at risk related to foreign exchange dealing positions at 31 December 1997 was £1.1 million (£1.2 million at 31 December 1996) and the average for 1997 was £1.7 million with a maximum of £3.0 million and a minimum of £0.8 million in the year. The average one-day foreign exchange profit for 1997 was £0.9 million (£0.6 million for 1996). The value at risk and average dealing profit information noted excludes structural foreign currency exposures, since related gains or losses are taken through reserves.

The Bank's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in branches and subsidiary and associated undertakings. These foreign currency investments amounted to the foreign currency equivalent of £117 million (2.6 per cent of shareholders' funds) at 31 December 1997, a decrease from £576 million (14.6 per cent of shareholders' funds) at 31 December 1996. Gains or losses on structural foreign currency exposures are taken to reserves. The lower level of structural foreign currency exposure is principally due to the transfer of Midland's investments in Trinkaus & Burkhardt KGaA, Guyerzeller Bank AG, Midland Bank SA and Banco Roberts SA to fellow members of the HSBC Group.

Structural foreign currency exposures are managed within Midland with the primary objective of ensuring, where practical, that Midland's and individual banking subsidiary undertakings' Tier 1 capital ratios are protected from the effect of movements in exchange rates. This is achieved by capital being denominated broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets. As a consequence of this policy there was no material effect from foreign exchange movements on Midland's Tier 1 capital ratios. Where appropriate, net foreign currency investments in overseas subsidiaries and associates are hedged to meet this objective or to protect the sterling value of capital invested. The result of this policy, in practice, is that Midland's structural exposures are almost entirely unhedged. Similarly, translation exposures arising from foreign-currency-denominated profits arising during the year are not hedged.

Interest rate exposure

Midland'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 in both dealing portfolios and accrual books.

Value at risk at 31 December 1997 related to interest rate exposures, including interest rate risk related to accrual book positions, was £4.8 million (£3.2 million at 31 December 1996) and the average for 1997 was £4.5 million, the maximum was £8.1 million and the minimum £1.7 million. The average daily revenues earned from treasury-related interest rate activities for 1997 was £0.8 million (£1.2 million for 1996).

Structural interest rate risk arises primarily from the employment of non-interest bearing liabilities, such as shareholders' funds and some current accounts, as well as fixed rate loans and liabilities other than those generated by treasury business.

The Bank and each major subsidiary undertaking assess the structural interest rate risks which arise in their businesses and either transfer such risks to their local treasury centres or to separate books managed by their local asset and liability management committees. These interest rate positions are regularly monitored by these committees and, where necessary, quantitative models are used to assess the potential net interest income and market value effects of these interest rate positions in different interest rate scenarios. While the primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income, the Bank and each major subsidiary undertaking also seek to enhance net interest income, subject to risk limits approved by MALCO and the HSBC Group Executive Committee.

Equities exposure

Midland's equities exposure arises from equity derivatives transactions. Value at risk related to equity derivatives positions as at 31 December 1997 was £0.4 million.

Liquidity Management

Liquidity is managed primarily through HSBC MIDLAND in London to ensure that Midland'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, Midland's policy is for such imbalances to be covered by holdings of defined quality liquid assets in accordance with HSBC Group's established ratios of liquid assets to customer deposits. Midland'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 Midland's overall funding. Considerable importance is attached to this core deposit base which over the years has been stable and predictable. 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 Midland's non-sterling asset base, over half 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 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.

Midland has for some years operated a liquidity management policy based on consolidated net cash flows which conforms to the Bank of England'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 5 working days without the renewal of any net maturing 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 Bank of England requirements on sterling liquidity, Midland also adopts the same consolidated cash flow methodology for managing its all-currency 0-5 working day liquidity exposures and targets 0-30 working day cumulative refinancing exposures on an all-currency basis.

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

Off-Balance-Sheet Financial Instruments

Derivatives

Off-balance-sheet financial instruments, commonly referred to as derivatives, are contracts whose characteristics 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 equities markets. Deals are negotiated directly with customers, with Midland 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.

Midland, through the dealing operations of the Bank and its major subsidiary undertakings, 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, Midland 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, Midland also uses derivatives (principally interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

The following table gives a summary of the outstanding notional principal contract amounts with third parties and the cost of replacing the contracts at current market rates if counterparties were not to meet their commitments under the contracts, as at 31 December 1997 and 31 December 1996. Contract amounts shown indicate the volume of transactions outstanding; they do not represent values at risk.

Derivatives Contracts with third parties (£m)

	1997		1996	
	Contract amount	Replacement cost	Contract amount	Replacement cost
Exchange rate contracts	**332,845**	**4,177**	301,403	3,598
Interest rate contracts	**455,039**	**2,221**	462,466	4,275
Equities contracts	**11,557**	**1,199**	6,233	613
Total	**799,441**	**7,597**	770,102	8,486

At 31 December 1997, the total notional principal of outstanding contracts with third parties was £799 billion, compared with £770 billion at 31 December 1996. The net increase of £29 billion, or 4 per cent, is principally in exchange rate contracts reflecting greater activity in Asian currencies and increased activity in currency options business, partially offset by a reduction arising from the transfer of Trinkaus & Burkhardt KGaA to a fellow subsidiary of the HSBC Group.

The replacement cost amount decreased from £8.5 billion at 31 December 1996 to £7.6 billion at 31 December 1997. The replacement cost of interest rate contracts decreased by £2.1 billion, reflecting increased netting benefits taken and a more stable interest rate environment. The replacement costs of exchange rate and equities contracts each increased by £0.6 billion.

Financial Review (continued)

Derivatives (continued)

Total derivatives contracts outstanding (£m)	Contract amounts		Mark-to-market values	1997
	Trading	Non-trading*	Positive	Negative
Spot and forward foreign exchange	254,739	3,298	2,889	2,542
Currency swaps, futures and options purchased	44,082	473	1,229	615
Currency options written	32,428	–	–	674
Other foreign exchange	1,542	–	59	95
Total exchange rate contracts	332,791	3,771	4,177	3,926
Less: not recognised in the balance sheet			1	–
Balance sheet values			4,176	3,926
Interest rate swaps	239,736	28,527	1,920	2,297
Interest rate futures, forward rate agreements and options purchased	174,675	334	301	55
Interest rate options written	29,984	–	–	180
Total interest rate contracts	444,395	28,861	2,221	2,532
Less: not recognised in the balance sheet			28	31
Balance sheet values			2,193	2,501
Equity futures and options purchased	4,494	–	1,199	–
Equity options written	7,063	–	–	1,363
Total equities contracts	11,557	–	1,199	1,363

* including internal deals

The table above provides an analysis of derivatives by product at 31 December 1997, showing those contracts undertaken for trading purposes and those used for asset and liability management purposes (non-trading). The sum total of the contract amounts outstanding is greater than the total outstanding with third party counterparties shown above since it includes internal deals undertaken for asset and liability management purposes. An analysis of positive and negative mark-to-market values is also shown. Positive amounts represent the replacement cost values, whilst negative amounts represent losses on contracts where the current mark-to-market value is less than the value contracted.

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 is required in cash markets. Recognising this, only certain offices within the Bank and its 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 Midland and by HSBC Group Market Risk, in combination with market risks arising from on-balance-sheet instruments.

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, 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 Midland has executed close-out netting agreements with the majority of these counterparties, notwithstanding the fact that Midland deals only with the most creditworthy counterparties.

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 1997 and 31 December 1996. The table shows that the replacement cost of derivatives is predominantly with banks and under five years.

Replacement Cost (£m)	Residual maturity			1997	1996
	Less than 1 year	1-5 years	Over 5 years	Total	Total
Government	40	36	30	106	35
Banks	3,449	1,792	453	5,694	6,812
Non-bank financial institutions					
– exchanges*	29	4	–	33	23
– other	655	202	72	929	266
Other sectors	520	226	89	835	1,350
Total 1997	4,693	2,260	644	7,597	
Total 1996	4,453	3,008	1,025		8,486

* Exchanges with margining requirements

A maturity profile of the contract amounts of third party derivative contracts outstanding at 31 December 1997 and 31 December 1996 shows that the majority of contracts are executed over the counter and mature within one year.

Contract amount (£m)	Residual maturity			1997	1996
	Less than 1 year	1-5 years	Over 5 years	Total	Total
Exchange and interest rate contracts					
– exchanges*	58,548	15,167	30	73,745	40,722
– other	526,101	166,719	32,876	725,696	729,380
Total 1997	584,649	181,886	32,906	799,441	
Total 1996	558,008	179,031	33,063		770,102

* Exchanges with margining requirements

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the Auditor's statement of its responsibilities set out in its report on the facing page, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditor 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 Midland 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 38 to 76), the Bank has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the 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 Midland and to prevent and detect fraud and other irregularities.

On behalf of the Board

I B Marshall, Secretary, 23 February 1998

Report of the Auditors, KPMG Audit Plc, to the Members of Midland Bank plc

We have audited the financial statements on pages 38 to 76.

Respective Responsibilities of Directors and Auditors

As described on page 36, the Bank's Directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of Opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and of the Midland Bank Group as at 31 December 1997 and of the profit of the Midland Bank Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London, 23 February 1998

Consolidated Profit and Loss Account

For the Year Ended 31 December 1997

	Note	1997 £m	1996 £m
Interest receivable			
– interest receivable and similar income arising from debt securities		1,077	964
– other interest receivable and similar income		4,778	4,151
Interest payable		(3,652)	(3,064)
Net interest income		2,203	2,051
Dividend income	3	11	3
Fees and commissions receivable		1,682	1,391
Fees and commissions payable		(400)	(234)
Dealing profits		235	234
Other operating income		311	193
Other income		1,839	1,587
Operating income		4,042	3,638
Administrative expenses	4	(2,092)	(2,064)
Depreciation and amortisation	19	(231)	(200)
Operating expenses		(2,323)	(2,264)
Operating profit before provisions		1,719	1,374
Provisions			
– provisions for bad and doubtful debts	13	(129)	(172)
– provisions for contingent liabilities and commitments	25	(3)	(3)
Amounts written off fixed asset investments		(4)	(40)
Operating profit		1,583	1,159
Gains on disposal of			
– investments		24	91
– tangible fixed assets		9	1
Income from associated undertakings		9	21
Profit on ordinary activities before tax	5	1,625	1,272
Tax on profit on ordinary activities	6	(559)	(408)
Profit on ordinary activities after tax		1,066	864
Minority interests		(15)	(15)
Profit for the financial year attributable to shareholders		1,051	849
Dividends (including amounts attributable to non-equity shareholders)	8	(644)	(537)
Retained profit for the year	28	407	312
Earnings per ordinary share	9	126.3p	101.9p

Consolidated Balance Sheet

At 31 December 1997

	Note	1997 £m	1996 £m
Assets			
Cash and balances at central banks		559	599
Items in the course of collection from other banks		2,052	1,964
Treasury bills and other eligible bills	10	2,974	1,649
Loans and advances to banks	11	13,379	14,944
Loans and advances to customers	12	50,143	45,352
Debt securities	15	17,418	16,851
Equity shares	16	20	299
Interests in associated undertakings	17	68	122
Tangible fixed assets	19	2,766	1,516
Other assets	20	11,827	11,856
Prepayments and accrued income		870	1,069
Total assets	29	102,076	96,221
Liabilities			
Deposits by banks	21	12,267	12,401
Customer accounts	22	57,902	53,917
Items in the course of transmission to other banks		1,132	1,336
Debt securities in issue	23	4,737	3,065
Other liabilities	24	16,516	16,672
Accruals and deferred income		1,182	997
Provisions for liabilities and charges	25		
– deferred taxation		394	234
– other provisions for liabilities and charges		212	281
Subordinated liabilities	26		
– undated loan capital		1,241	1,061
– dated loan capital		2,056	2,142
Minority interests		2	155
Called up share capital	27	797	797
Share premium account	28	1,976	1,931
Revaluation reserves	28	65	6
Profit and loss account	28	1,597	1,226
Shareholders' funds (including non-equity interests)		4,435	3,960
Total liabilities	29	102,076	96,221
Memorandum items			
Contingent liabilities	30		
– acceptances and endorsements		1,214	764
– guarantees and assets pledged as collateral security		6,344	7,523
– other contingent liabilities		17	130
		7,575	8,417
Commitments	30	30,482	32,145

J R H Bond Chairman
K R Whitson Deputy Chairman and Chief Executive
R M J Orgill Deputy Chief Executive and Director
I B Marshall Secretary

Balance Sheet

At 31 December 1997

Assets	Note	1997 £m	1996 £m
Cash and balances at central banks		**555**	586
Items in the course of collection from other banks		**2,052**	1,964
Treasury bills and other eligible bills	10	**2,952**	1,638
Loans and advances to banks	11	**15,968**	15,645
Loans and advances to customers	12	**46,793**	39,331
Debt securities	15	**16,339**	13,953
Equity shares	16	**19**	20
Interests in associated undertakings	17	**67**	70
Investments in subsidiary undertakings	18	**1,393**	1,033
Tangible fixed assets	19	**1,000**	899
Other assets	20	**8,755**	8,631
Prepayments and accrued income		**788**	879
Total assets	29	**96,681**	84,649
Liabilities			
Deposits by banks	21	**15,637**	12,908
Customer accounts	22	**54,238**	48,350
Items in the course of transmission to other banks		**1,132**	1,336
Debt securities in issue	23	**4,514**	2,436
Other liabilities	24	**12,244**	11,760
Accruals and deferred income		**989**	660
Provisions for liabilities and charges	25		
– other provisions for liabilities and charges		**196**	206
Subordinated liabilities	26		
– undated loan capital		**1,241**	1,061
– dated loan capital		**2,055**	1,972
Called up share capital	27	**797**	797
Share premium account	28	**1,976**	1,931
Revaluation reserves	28	**107**	170
Profit and loss account	28	**1,555**	1,062
Shareholders' funds (including non-equity interests)		**4,435**	3,960
Total liabilities	29	**96,681**	84,649
Memorandum items			
Contingent liabilities	30		
– acceptances and endorsements		**1,197**	632
– guarantees and assets pledged as collateral security		**8,554**	8,956
– other contingent liabilities		**17**	130
		9,768	9,718
Commitments	30	**29,868**	30,907

J R H Bond Chairman
K R Whitson Deputy Chairman and Chief Executive
R M J Orgill Deputy Chief Executive and Director
I B Marshall Secretary

Statement of Total Consolidated Recognised Gains and Losses

For the Year Ended 31 December 1997

	1997 £m	1996 £m
Profit for the financial year attributable to shareholders	1,051	849
Unrealised surplus on revaluation of land and buildings	54	22
Exchange and other movements	(20)	(132)
Total recognised gains and losses for the year	1,085	739

Reconciliation of Movements in Consolidated Shareholders' Funds

For the Year Ended 31 December 1997

	1997 £m	1996 £m
Profit for the financial year attributable to shareholders	1,051	849
Dividends	(644)	(537)
	407	312
Other recognised gains and losses relating to the year	34	(110)
New share capital subscribed	30	524
Goodwill written back on disposal of subsidiary undertakings	11	–
Goodwill written off on acquisition	(7)	(5)
Net addition to shareholders' funds	475	721
Shareholders' funds at 1 January	3,960	3,239
Shareholders' funds at 31 December	4,435	3,960
Shareholders' funds are analysed as follows:		
Equity interests	3,921	3,491
Non-equity interests	514	469
	4,435	3,960

Non-equity interests in shareholders' funds comprise proceeds of the issue of US$ non-cumulative preference shares (Note 27), 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 Midland's results as disclosed in the consolidated profit and loss account and the results on an unmodified historical cost basis.

Notes on the Accounts

1 Basis of preparation

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

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

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

In accordance with Financial Reporting Standard 1 (revised 1996) 'Cash Flow Statements', no cash flow statement is presented as all voting rights are controlled by HSBC Holdings plc which publishes such a statement in its own publicly available accounts.

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

b Midland's consolidated accounts comprise the accounts of Midland Bank plc ('the Bank') and its subsidiary undertakings (together 'Midland'). Accounts of subsidiary undertakings are made up to 31 December.

The consolidated accounts include the attributable share of the results and reserves of associated undertakings, based on accounts made up to dates not earlier than six months prior to 31 December.

All significant intra-group transactions have been eliminated on consolidation.

2 Principal accounting policies

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

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

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

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

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.

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

c Debt securities and equity shares
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.

2 Principal accounting policies (continued)

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. If the date of maturity is at the borrower's option within a specified range of years, the maturity date which 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 which are being hedged.

Other debt securities and equity shares 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' 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 customers' or 'Loans and advances to banks'.

d Subsidiary and associated undertakings

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

Interests in associated undertakings are stated at Midland's attributable share of their net tangible assets.

Goodwill arising on the acquisition of subsidiary or associated undertakings, being the excess of the cost of acquisition over the fair value of Midland's share of separable net assets acquired, is charged against reserves in the year of acquisition. At the date of disposal of subsidiary or associated undertakings, goodwill is reinstated in reserves and included in the calculation of the profit 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;
- buildings and improvements thereto are depreciated on cost or valuation at the greater of 2% 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 5 and 20 years. Certain capital expenditure incurred for the purpose of adapting premises for business use is included in 'Equipment, fixtures and fittings' and depreciated over 10 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 which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where Midland is a lessor under finance leases, the amounts receivable under finance leases, and under hire purchase contracts which are in the nature of finance leases, after deduction of unearned charges, are included under '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.

2 Principal accounting policies (continued)

Where Midland 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 Midland 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 Midland'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'.

Changes in the value placed on Midland'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 the effective rate of taxation.

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

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
Midland 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 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. At 1 January 1993, there was an accumulated obligation in respect of these benefits relating to current and retired employees. This is being charged in the profit and loss account in equal instalments over 20 years.

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 and associated undertakings 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.

2 Principal accounting policies (continued)

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

Accounting for these instruments is dependent upon whether the transactions are undertaken for trading or non-trading purposes. Trading transactions include transactions undertaken for market-making, to service customers' needs and for proprietary purposes, as well as any related hedges. Non-trading transactions are those which are held for hedging purposes as part of Midland's risk management strategy against assets, liabilities, positions or cash flows measured on an accruals basis.

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.

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.

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

3 Dividend income

	1997 £m	1996 £m
Income from equity shares	**11**	3

4 Administrative expenses

a	1997 £m	1996 £m
Staff costs		
– wages and salaries	**1,062**	1,033
– social security costs	**86**	84
– other pension costs (Note 4b below)	**122**	139
– other staff costs	**116**	130
	1,386	1,386
– premises and equipment (excluding depreciation)	**275**	283
– other administrative expenses	**431**	395
	706	678
	2,092	2,064

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

	1997	1996
Commercial Banking	**47,107**	46,839
Forward Trust Group	**2,206**	2,546
	49,313	49,385

4 Administrative expenses (continued)

b Retirement benefits

Within Midland, the Midland Bank Pension Scheme, assets of which are held in a separate trust fund, covers 91% of UK employees. The Midland Bank 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 1996 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 £4,463 million. The actuarial value of the assets represented 107% of the benefits accrued to members, after allowing for expected future increases in earnings and the resulting surplus amounted to £301 million. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 7.6% per annum, salary increases of 4.5% per annum, equity dividend increases and rental growth of 3.5% per annum, and post-retirement pension increases of 3.0% per annum.

As a result of the Finance (No 2) Act 1997 which came into force in July 1997, pension schemes are no longer able to claim a tax credit on UK equity dividend income. The actuaries have estimated that the effect of this on the Principal Scheme will be largely to offset the surplus shown by the 31 December 1996 valuation and the Bank is accounting for this over the average remaining service lives of the employees in the Principal Scheme in accordance with Urgent Issues Task Force Abstract number 18.

In consultation with the actuaries, the Bank has decided to maintain contributions at 16.1% of pensionable salaries until the next actuarial valuation. The next actuarial valuation is due as at 31 December 1999.

The total pension cost for the year ended 31 December 1997 was £122 million (1996: £139 million) which includes £101 million (1996: £104 million) in respect of the Principal Scheme.

Midland 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 £17 million (1996: £17 million).

The latest actuarial assessment as at 31 December 1997 estimated the present value of the post-retirement benefit obligation to be £124 million (1996: £135 million) for Midland and £117 million (1996: £128 million) for the Bank, of which £69 million (1996: £61 million) has been provided for Midland and £65 million (1996: £57 million) has been provided for the Bank. The main financial assumptions used at 31 December 1997 are price inflation of 3% per annum, health-care claims costs escalation of 8.5% per annum, and a discount rate of 7% per annum.

c Directors' emoluments

The aggregate emoluments of the Directors of the Bank, computed in accordance with Part 1 of Schedule 6 of the Act were:

	1997 £'000	1996 £'000
Fees	240	187
Salary and other emoluments	2,019	1,956
Discretionary bonuses	230	153
	2,489	2,296
Gains on exercise of share options	232	47

4 Administrative expenses (continued)

Retirement benefits accrue to four Directors under defined benefit schemes.

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 plc.

Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 20.

In addition, there were annual commitments under retirement benefit agreements with former Directors of £460,198 (1996: £462,944).

d Auditor's remuneration

Auditor's remuneration amounted to £2.3 million (1996: £2.5 million), including £1.1 million (1996: £1.1 million) which relates to the Bank. £2.2 million (1996: £1.3 million) was paid to the Bank's Auditor and its associates for non-audit work as analysed below:

	1997 £'000	1996 £'000
Regulatory work	725	580
Tax services	179	110
Consultancy	471	423
Acquisition services	550	–
Other	307	184
	2,232	1,297

Of fees paid to the Auditor for non-audit work, £0.6 million (1996: £nil) was capitalised as part of the cost of acquisitions made during the year.

5 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after:

a Income	1997 £m	1996 £m
Aggregate rentals receivable, including capital repayments, under		
– finance leases	301	221
– hire purchase contracts	557	560
– operating leases	245	107
Increase in the value of long-term assurance business	39	72
Income from listed investments	1,162	830
Profits less losses on debt securities and equities dealing	(16)	32
Gains on disposal of investment securities	20	94

b Charges	1997 £m	1996 £m
Charges incurred with respect to subordinated liabilities	250	224
Finance charges in respect of finance leases and similar hire purchase contracts	14	7
Hire of plant and machinery	6	21
Rentals payable on premises held under operating leases	76	86
Residential mortgage incentives	45	66

c Gains on disposal of investments and tangible fixed assets

Gains on disposal of investments and tangible fixed assets attracted a tax charge of £8 million (1996: £nil).

6 Tax on profit on ordinary activities

The charge for taxation comprises:	1997 £m	1996 £m
United Kingdom corporation tax charge	455	357
Relief for overseas taxation	(12)	(13)
	443	344
Advance corporation tax written back	–	(12)
United Kingdom corporation tax – prior year	(6)	(24)
	437	308
Overseas taxation	39	43
Deferred taxation (Note 25)	82	52
	558	403
Associated undertakings	1	5
	559	408

During the year Midland provided for UK corporation tax at 31.5% (1996: 33%).

The UK tax charge includes £12 million (1996: £24 million) in respect of the tax attributable to the increase in the value of long-term assurance business attributable to shareholders.

7 Profit of the Bank

The profit of the Bank for the year attributable to ordinary shareholders is £1,107 million (1996: £783 million).

8 Dividends

	1997 £m	1996 £m
Equity		
Ordinary dividends		
– paid	250	200
– proposed	350	300
	600	500
Non-equity		
Preference dividends	36	34
Other finance costs	8	3
	644	537

Non-cumulative dividends of US$1.42 and US$0.355 per share per annum are payable on the Series A1 and the Series A2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.64 and US$0.41 per share per annum are payable on the Series B1 and the Series B2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.46 and US$0.365 per share per annum are payable on the Series C1 and the Series C2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.528 and US$0.382 per share per annum are payable on the Series D1 and the Series D2 US$ preference shares respectively in quarterly instalments.

Non-cumulative dividends of US$1.344 and US$0.336 per share per annum are payable on the Series 1 and the Series 2 US$ Second preference shares respectively in semi-annual instalments until 5 February 1999 and quarterly thereafter.

9 Earnings per ordinary share

Earnings per ordinary share is calculated by dividing the profit for the financial year attributable to equity shareholders, after deducting preference dividends and finance costs, of £1,007 million (1996: £812 million) by the weighted average number of ordinary shares in issue in 1997 of 797 million (1996: 797 million).

10 Treasury bills and other eligible bills

	Midland		Bank	
	1997 £m	1996 £m	1997 £m	1996 £m
Treasury bills and similar securities	1,291	549	1,269	539
Other eligible bills	1,683	1,100	1,683	1,099
	2,974	1,649	2,952	1,638

None of the treasury and other eligible bills have been accounted for as investment securities.

11 Loans and advances to banks

	Midland		Bank	
	1997 £m	1996 £m	1997 £m	1996 £m
Remaining maturity				
– repayable on demand	4,130	5,004	3,987	3,775
– 3 months or less but not repayable on demand	7,696	7,888	9,712	9,731
– 1 year or less but over 3 months	900	1,436	912	1,506
– 5 years or less but over 1 year	216	314	385	368
– over 5 years	456	333	990	280
Specific bad and doubtful debt provisions (Note 13)	(19)	(31)	(18)	(15)
	13,379	14,944	15,968	15,645
Amounts include:				
Subordinated			216	73
Due from subsidiary undertakings				
– subordinated			216	73
– unsubordinated			3,899	3,375
			4,115	3,448
Due from fellow subsidiary undertakings				
– unsubordinated	1,670	746	1,625	610
Due from associated undertakings				
– unsubordinated	–	10	–	10

Notes on the Accounts (continued)

12 Loans and advances to customers

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Remaining maturity				
– repayable on demand or at short notice	**8,211**	9,565	**8,149**	9,068
– 3 months or less but not repayable on demand or at short notice	**7,140**	6,621	**6,891**	5,008
– 1 year or less but over 3 months	**5,261**	4,315	**4,446**	3,178
– 5 years or less but over 1 year	**14,441**	11,882	**12,614**	9,833
– over 5 years	**16,181**	14,216	**15,732**	13,316
General and specific bad and doubtful debt provisions (Note 13)	**(1,091)**	(1,247)	**(1,039)**	(1,072)
	50,143	45,352	**46,793**	39,331
Amounts include:				
Due from subsidiary undertakings				
– unsubordinated			**1,341**	893
Due from fellow subsidiary undertakings				
– unsubordinated	**1,330**	958	**1,330**	936
Due from parent undertaking				
– unsubordinated	**21**	–	**21**	–
Due from associated undertakings				
– unsubordinated	**31**	30	**20**	22
Due from other participating interests				
– unsubordinated	**–**	3	**–**	3

Included within loans and advances to customers are equity shares with a book value of £19 million (1996: £64 million) acquired in exchange for advances with an original face value of £84 million (1996: £144 million).

13 Provisions for bad and doubtful debts

a Movements on provisions for bad and doubtful debts

Midland	Specific 1997 £m	General 1997 £m	Total 1997 £m	Specific 1996 £m	General 1996 £m	Total 1996 £m
At 1 January	991	287	1,278	1,162	268	1,430
Charge to the profit and loss account	92	37	129	151	21	172
Amounts written off	(208)	–	(208)	(316)	–	(316)
Disposal of subsidiary undertakings	(122)	(6)	(128)	–	–	–
Recoveries of amounts written off in previous years	36	–	36	51	–	51
Exchange and other movements	(1)	4	3	(57)	(2)	(59)
At 31 December	788	322	1,110	991	287	1,278
Bank						
At 1 January	836	251	1,087	953	221	1,174
Charge to the profit and loss account	95	40	135	134	31	165
Amounts written off	(193)	–	(193)	(250)	–	(250)
Recoveries of amounts written off in previous years	25	–	25	27	–	27
Exchange and other movements	3	–	3	(28)	(1)	(29)
At 31 December	766	291	1,057	836	251	1,087

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Included in:				
Loans and advances to banks (Note 11)	19	31	18	15
Loans and advances to customers (Note 12)	1,091	1,247	1,039	1,072
	1,110	1,278	1,057	1,087

b Movements on suspended interest account

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
At 1 January	123	152	113	131
Interest suspended in the year	33	39	32	35
Suspended interest recovered	(28)	(52)	(28)	(50)
Amounts written off	(22)	(10)	(22)	1
Disposal of subsidiary undertakings	(10)	–	–	–
Exchange and other movements	(1)	(6)	(1)	(4)
At 31 December	95	123	94	113

13 Provisions for bad and doubtful debts (continued)

c Non-performing loans

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Loans on which interest has been suspended (net of suspended interest)	**865**	960	**848**	856
Provisions	**(516)**	(587)	**(503)**	(556)
	349	373	**345**	300
Other non-performing loans	**556**	834	**536**	627
Provisions	**(272)**	(404)	**(263)**	(280)
	284	430	**273**	347
Total non-performing loans	**633**	803	**618**	647

14 Concentrations of exposure

Midland has the following industry concentrations of loans and advances to customers:

Total gross advances to customers:	1997 £m	1996 £m
Residential mortgages	**11,342**	9,844
Other personal	**5,528**	5,311
Commercial, industrial and international trade	**15,952**	14,416
Commercial real estate	**2,769**	2,515
Other property related	**1,160**	1,127
Non-bank financial institutions	**4,652**	3,532
Other commercial	**9,919**	9,970
	51,322	46,715

The analysis of concentration of exposure is based on the categories used by Midland to manage the associated risks. Of total loans and advances to customers gross of provisions, £49,147 million (1996: £42,426 million) was advanced by operations located in the United Kingdom.

15 Debt securities

	Midland				Bank			
	Book value 1997 £m	Market valuation 1997 £m	Book value 1996 £m	Market valuation 1996 £m	Book value 1997 £m	Market valuation 1997 £m	Book value 1996 £m	Market valuation 1996 £m
Issued by public bodies								
Investment securities								
– government securities	4,613	4,688	4,865	4,912	4,579	4,653	4,795	4,841
– other public sector securities	45	47	290	304	45	47	142	145
	4,658	4.735	5,155	5,216	4,624	4.700	4,937	4.986
Other debt securities								
– government securities	2,392		3,211		1,495		2,267	
– other public sector securities	63		103		63		89	
	2,455		3,314		1,558		2,356	
Issued by other bodies								
Investment securities	1,981	1.990	1,665	1,710	1,921	1.930	1,212	1,221
Other debt securities								
– bank and building society certificates of deposit	6,090		3,122		6,029		3,098	
– other securities	2,234		3,595		2,207		2,350	
	8,324		6,717		8,236		5,448	
	17,418		16,851		16,339		13,953	
Due within 1 year	9,843		5,073		9,624		4,950	
Due 1 year and over	7,575		11,778		6,715		9,003	
	17,418		16,851		16,339		13,953	
Amounts include:								
Subordinated debt securities	64		138		64		136	
Unamortised net premiums/(discounts) on investment securities	3		(28)		3		19	

Notes on the Accounts (continued)

15 Debt securities (continued)

	Midland				Bank			
	Book value 1997	Market valuation 1997	Book value 1996	Market valuation 1996	Book value 1997	Market valuation 1997	Book value 1996	Market valuation 1996
Investment securities	£m	£m	£m	£m	£m	£m	£m	£m
– listed on a recognised UK exchange	3,303	3,313	3,560	3,566	3,209	3,219	3,419	3,425
– listed elsewhere	1,113	1,172	2,186	2,270	1,113	1,172	1,661	1,698
– unlisted	2,223	2,240	1,074	1,090	2,223	2,239	1,069	1,084
	6,639	6,725	6,820	6,926	6,545	6,630	6,149	6,207
Other debt securities								
– listed on a recognised UK exchange	1,706		1,755		781		941	
– listed elsewhere	2,015		4,051		2,015		2,674	
– unlisted	7,058		4,225		6,998		4,189	
	10,779		10,031		9,794		7,804	
	17,418		16,851		16,339		13,953	

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 Midland's investment securities. If these transactions were included, the market valuation of investment securities would be £6,681 million for Midland (1996: £6,886 million) and £6,586 million (1996: £6,167 million) for the Bank.

Investment securities:

Midland	Cost £m	Provisions £m	Book value £m
At 1 January 1997	6,822	(2)	6,820
Additions	5,430	–	5,430
Disposals and amounts repaid	(4,886)	1	(4,885)
Disposal of subsidiary undertakings	(487)	–	(487)
Amortisation of discounts and premiums	(48)	–	(48)
Exchange and other movements	(191)	–	(191)
At 31 December 1997	6,640	(1)	6,639
Bank			
At 1 January 1997	6,149	–	6,149
Additions	5,389	–	5,389
Disposals and amounts repaid	(4,793)	–	(4,793)
Amortisation of discounts and premiums	(49)	–	(49)
Exchange and other movements	(151)	–	(151)
At 31 December 1997	6,545	–	6,545

16 Equity shares

Investment securities	Midland Book value 1997 £m	Midland Market valuation 1997 £m	Midland Book value 1996 £m	Midland Market valuation 1996 £m	Bank Book value 1997 £m	Bank Market valuation 1997 £m	Bank Book value 1996 £m	Bank Market valuation 1996 £m
– listed on a recognised UK exchange	–	–	4	3	–	–	1	–
– listed elsewhere	2	2	100	111	2	2	2	2
– unlisted	18	25	38	40	17	24	16	22
	20	27	142	154	19	26	19	24
Other securities								
– listed other than on a recognised UK exchange	–		142		–		–	
– unlisted	–		15		–		1	
	–		157		–		1	
	20		299		19		20	

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

Investment securities:

Midland	Cost £m	Provisions £m	Book value £m
At 1 January 1997	162	(20)	142
Additions	3	–	3
Disposals	(13)	2	(11)
Disposal of subsidiary undertakings	(122)	17	(105)
Provisions made	–	(1)	(1)
Exchange and other movements	(8)	–	(8)
At 31 December 1997	22	(2)	20
Bank			
At 1 January 1997	21	(2)	19
Additions	3	–	3
Disposals	(3)	1	(2)
Provisions made	–	(1)	(1)
At 31 December 1997	21	(2)	19

Notes on the Accounts (continued)

17 Interests in associated undertakings

a Movements in associated undertakings

	Midland £m	Bank £m
At 1 January 1997	122	70
Additions	2	1
Disposals	(1)	(1)
Disposals of subsidiary undertakings	(59)	–
Provisions released	–	14
Write-down to net asset value	–	(17)
Retained profits	2	–
Exchange and other movements	2	–
At 31 December 1997	68	67

	Midland		Bank	
	1997 £m	1996 £m	1997 £m	1996 £m
Shares in banks	62	108	62	62
Other	6	14	5	8
	68	122	67	70

None of the above associated undertakings are listed.

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

	1997 £m	1996 £m
Cost	83	83
Provisions	(9)	(23)
	74	60

b The principal associated undertakings at 31 December 1997 were:

	Country of incorporation/ registration and operation	Principal activity	Midland's interest in equity capital	Issued equity capital
British Arab Commercial Bank Limited	England	Banking	41.5%	US$81m £32m fully paid, £5m nil paid
Mondex UK Limited	England	Electronic Cash	50%	–†

† Issued equity capital is less than £1 million

The associated undertakings listed above have no loan capital, except for British Arab Commercial Bank Limited which has issued US$44.5 million of subordinated unsecured loan stock in which the Bank has a 34.7% interest.

18 Investments in subsidiary undertakings

a Movements on the Bank's interest in shares in subsidiary undertakings

	£m
At 1 January 1997	1,033
Acquisitions	934
Disposals	(445)
Provisions made	(24)
Write-down to net asset value	(100)
Exchange and other movements	(5)
At 31 December 1997	1,393

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 £14 million (1996: £34 million) representing interests in banks.

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

	1997 £m	1996 £m
Cost	1,392	917
Provisions	(63)	(47)
	1,329	870

b The principal subsidiary undertakings of the Bank at 31 December 1997 were:

	Country of registration/ incorporation and operation
Forward Trust Group Limited (formerly Forward Trust Limited)*	England
Forward Trust Rail Limited (formerly Eversholt Leasing Limited)*	England
Griffin Credit Services Limited*	England
HSBC Greenwell	England
Midland Bank Trust Company Limited	England
Midland Bank Offshore Limited (formerly Midland Bank International Finance Corporation Limited)*	Jersey
Midland Life Limited	England

* Equity capital held indirectly

The issued capital of the above undertakings is wholly-owned by Midland and, except where indicated otherwise, is held by 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.

18 Investments in subsidiary undertakings (continued)

c Acquisitions

On 19 February 1997, Forward Trust Group Limited (formerly Forward Trust Limited), a wholly-owned subsidiary undertaking of the Bank, acquired the issued share capital of Forward Trust Rail Services Limited (formerly Eversholt Holdings Limited) for consideration of £464 million. The consideration comprised cash of £422 million, including acquisition costs, and loan notes of £42 million.

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

	Forward Trust Rail Services Limited			
	Book Value £m	Alignment of accounting policies £m	Revaluation £m	Fair Value £m
Cash and balances at central banks	174	–	–	174
Tangible fixed assets	897	(41)	330	1,186
Total assets	1,071	(41)	330	1,360
Deposits by banks	441	–	6	447
Other liabilities	296	–	18	314
Provision for deferred taxation	176	(41)	–	135
Total liabilities	913	(41)	24	896
Net assets acquired	158	–	306	464
Goodwill written off against reserves				–
Total consideration				464
Satisfied by:				
Cash (including acquisition costs)				422
Loan notes				42
				464

The above table includes a revaluation of train rolling stock acquired to fair value and an accounting policy alignment reflecting compliance with Urgent Issues Task Force Abstract 16 'Income and expenses, subject to non-standard rates of tax' (issued in February 1997).

Midland acquired HSBC Insurance (Ireland) Limited on 1 July 1997, and a shipping loan portfolio on 21 July 1997, on which goodwill of £7 million arose.

The above acquisitions have been accounted for on an acquisitions basis. The pre-acquisition, prior year and post-acquisition results of the above acquisitions were not material in the context of Midland's 1997 operating results.

d Disposals

Midland Bank SA was transferred to a fellow subsidiary undertaking of HSBC Holdings plc on 2 January 1997.

Midland's interests in Trinkaus & Burkhardt KGaA and Guyerzeller Bank AG were both transferred to a fellow subsidiary undertaking of HSBC Holdings plc on 31 December 1997.

19 Tangible fixed assets

a Movements on tangible fixed assets

Midland	Freehold land and buildings £m	Long leasehold land and buildings £m	Short leasehold land and buildings £m	Equipment, fixtures and fittings £m	Equipment on operating leases £m	Total £m
Cost or valuation						
At 1 January 1997	635	49	216	941	503	2,344
Additions	38	–	17	161	254	470
Disposals	(15)	(2)	(12)	(92)	(172)	(293)
(Disposal)/acquisition of subsidiary undertakings	(80)	–	(5)	(34)	1,458	1,339
Transfer of accumulated depreciation arising on revaluation	(12)	(3)	–	–	–	(15)
Surplus on revaluation	46	8	–	–	–	54
Exchange and other movements	–	–	(6)	(9)	–	(15)
At 31 December 1997	612	52	210	967	2,043	3,884
Accumulated depreciation						
At 1 January 1997	–	–	(148)	(552)	(128)	(828)
Disposals	–	–	11	84	79	174
Disposal/(acquisition) of subsidiary undertakings	–	–	3	18	(272)	(251)
Transfer of accumulated depreciation arising on revaluation	12	3	–	–	–	15
Charge to the profit and loss account	(12)	(3)	(9)	(102)	(105)	(231)
Exchange and other movements	–	–	–	3	–	3
At 31 December 1997	–	–	(143)	(549)	(426)	(1,118)
Net book value						
At 31 December 1997	612	52	67	418	1,617	2,766
At 31 December 1996	635	49	68	389	375	1,516
Bank						
Cost or valuation						
At 1 January 1997	443	40	184	844	–	1,511
Additions	37	1	16	142	–	196
Disposals	(15)	(2)	(12)	(86)	–	(115)
Transfer of accumulated depreciation arising on revaluation	(11)	(3)	–	–	–	(14)
Surplus on revaluation	38	7	–	–	–	45
Exchange and other movements	–	(1)	–	(4)	–	(5)
At 31 December 1997	492	42	188	896	–	1,618
Accumulated depreciation						
At 1 January 1997	–	–	(121)	(491)	–	(612)
Disposals	–	–	11	79	–	90
Transfer of accumulated depreciation arising on revaluation	11	3	–	–	–	14
Charge to the profit and loss account	(11)	(3)	(7)	(87)	–	(108)
Exchange and other movements	–	–	–	(2)	–	(2)
At 31 December 1997	–	–	(117)	(501)	–	(618)
Net book value						
At 31 December 1997	492	42	71	395	–	1,000
At 31 December 1996	443	40	63	353	–	899

Notes on the Accounts (continued)

19 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 £5 million (1996: £8 million) for Midland and £49 million (1996: £45 million) for the Bank, on which the depreciation charge was £3 million (1996: £7 million) for Midland and £16 million (1996: £13 million) for the Bank. The net book amount of equipment on operating leases included assets held under finance leases of £132 million (1996: £nil) for Midland, on which the depreciation charge was £nil (1996: £nil).

c Valuations

Cost or valuation of freehold and long leasehold land and buildings at 31 December comprises:

	Midland		Bank	
	1997	1996	**1997**	1996
	£m	£m	**£m**	£m
At valuation	**664**	684	**534**	483
On the historical cost basis, freehold and long leasehold land and buildings would have been included as follows:				
Cost	**653**	717	**452**	449
Accumulated depreciation	**(57)**	(45)	**(54)**	(39)
Provision for permanent diminution in value	**(143)**	(146)	**(67)**	(70)
Net book value	**453**	526	**331**	340

Midland revalues its freehold and long leasehold properties on an annual basis. In November 1997, Midland's freehold and long leasehold properties were revalued on an existing use basis 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, the net book value of land and buildings increased by £54 million (Bank £45 million). A surplus of £54 million (Bank £45 million) was credited to reserves at 31 December 1997.

Permanent diminutions in the value of some properties have been identified and £13 million has been transferred from the revaluation reserve to the profit and loss account reserve eliminating temporary diminutions arising on previous revaluations.

d Land and buildings occupied for own activities

	Midland		Bank	
	1997	1996	**1997**	1996
	£m	£m	**£m**	£m
Net book value	**677**	703	**590**	540

Land and buildings with a net book value of £46 million (1996: £38 million) are occupied by other members of the HSBC Group.

20 Other assets

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Bullion	161	114	161	114
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	7,568	8,426	7,550	7,725
Deferred taxation (Note 25)	–	–	35	39
Long-term assurance assets attributable to policyholders (Note 24)	2,489	1,892	–	–
Other	1,609	1,424	1,009	753
	11,827	11,856	8,755	8,631
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			36	107
Fellow subsidiary undertakings	596	346	558	341

Included in the above table is £3 million (1996: £4 million) for Midland and £1 million (1996: £2 million) for the Bank in respect of other participating interests.

'Other' 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 Midland's interest in long-term assurance business as follows:

	Midland 1997 £m	Midland 1996 £m
Net tangible assets of Midland Life Limited and Midland Life International Limited	49	52
Surplus retained in long-term assurance funds and net present value of policies in force	204	176
Total long-term assurance business attributable to shareholders	253	228

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 £39 million (1996: £72 million) before tax and £27 million (1996: £48 million) after tax.

20 Other assets (continued)

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

	1997	1996
Risk discount rate (net of tax)	12.5%	12.5%
Economic assumptions (gross of tax)		
Investment return on unit-linked funds	8.3%	9.1%
Investment return on non-linked funds	6.3%	7.0%
Expense inflation	4.5%	5.5%

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

	1997 £m	1996 £m
Loans and advances to banks	162	245
Debt securities	959	799
Equity shares	717	533
Other assets	1,271	850
Prepayments and accrued income	24	12
Other liabilities	(644)	(547)
Long-term assurance net assets attributable to policyholders	2,489	1,892

21 Deposits by banks

		Midland		Bank
	1997 £m	1996 £m	1997 £m	1996 £m
Repayable on demand	3,865	3,943	3,890	3,488
With agreed maturity dates or periods of notice by remaining maturity				
– 3 months or less but not repayable on demand	7,018	7,626	9,705	8,227
– 1 year or less but over 3 months	1,268	778	1,493	1,020
– 5 years or less but over 1 year	102	23	268	166
– over 5 years	14	31	281	7
	12,267	12,401	15,637	12,908
Amounts include:				
Due to subsidiary undertakings			3,549	2,693
Due to fellow subsidiary undertakings	1,101	879	1,098	689

22 Customer accounts

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Repayable on demand	**34,399**	37,654	**31,237**	32,408
With agreed maturity dates or periods of notice by remaining maturity				
– 3 months or less but not repayable on demand	**19,822**	13,946	**19,712**	13,153
– 1 year or less but over 3 months	**2,312**	1,305	**1,993**	1,630
– 5 years or less but over 1 year	**992**	839	**1,008**	937
– over 5 years	**377**	173	**288**	222
	57,902	53,917	**54,238**	48,350
Amounts include:				
Due to associated undertakings	**2**	18	**2**	18
Due to subsidiary undertakings			**866**	670
Due to fellow subsidiary undertakings	**458**	507	**456**	389
Due to parent undertaking	**1,714**	2,016	**1,711**	2,016

23 Debt securities in issue

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Bonds and medium-term notes, by remaining maturity				
– within 1 year	**194**	29	**153**	–
– between 1 and 2 years	**–**	51	**–**	–
– between 2 and 5 years	**1,302**	182	**1,301**	–
– over 5 years	**59**	175	**18**	–
	1,555	437	**1,472**	–
Other debt securities in issue, by remaining maturity				
– 3 months or less	**2,311**	1,423	**2,171**	1,383
– 1 year or less but over 3 months	**820**	691	**820**	570
– 5 years or less but over 1 year	**51**	456	**51**	425
– over 5 years	**–**	58	**–**	58
	3,182	2,628	**3,042**	2,436
	4,737	3,065	**4,514**	2,436

Notes on the Accounts (continued)

24 Other liabilities

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Short positions in securities				
Treasury bills and other eligible bills	–	604	–	604
Debt securities				
– government securities	2,819	2,498	1,853	1,056
– other public sector securities	15	23	15	23
– other debt securities	182	156	177	148
Equity shares	–	113	–	–
	3,016	3,394	2,045	1,831
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	7,790	8,626	7,772	7,958
Current taxation	566	486	400	291
Obligations under finance leases	158	29	49	45
Dividend payable	350	300	350	300
Long-term assurance liabilities attributable to policyholders (Note 20)	2,489	1,892	–	–
Other	2,147	1,945	1,628	1,335
	16,516	16,672	12,244	11,760

Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market include amounts due to:

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Subsidiary undertakings			34	106
Fellow subsidiary undertakings	815	379	779	373

Obligations under finance leases fall due as follows:

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
– within 1 year	12	17	17	13
– between 1 to 5 years	1	12	32	32
– over 5 years	145	–	–	–
	158	29	49	45

25 Provisions for liabilities and charges

a Deferred taxation provisions

	Midland £m	Bank £m
At 1 January 1997	234	(39)
Acquisition of subsidiary undertakings	135	–
Disposal of subsidiary undertakings	(42)	–
Charge to the profit and loss account	82	4
Exchange and other movements	(15)	–
At 31 December 1997	394	(35)

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Included in 'Provisions for liabilities and charges'	394	234	–	–
Included in 'Other assets' (Note 20)	–	–	(35)	(39)
	394	234	(35)	(39)

	Unprovided deferred tax/ (relief) 1997 £m	Provided in accounts 1997 £m	Unprovided deferred tax/ (relief) 1996 £m	Provided in accounts 1996 £m
Midland				
Short-term timing differences	(11)	(21)	(41)	15
Accelerated capital allowances	(7)	(1)	(8)	(1)
Leasing transactions	14	447	63	253
Other items	(56)	(31)	(27)	(33)
	(60)	394	(13)	234
Bank				
Short-term timing differences	(11)	(28)	(37)	(22)
Accelerated capital allowances	(7)	–	(8)	–
Other items	(38)	(7)	(16)	(17)
	(56)	(35)	(61)	(39)

It is not considered necessary to provide for taxation on capital gains which might arise on the disposal of subsidiary or associated undertakings at their balance sheet amounts, or for taxation on capital gains which might arise on the disposal of premises, as it is anticipated that any liability will be covered by capital losses or other reliefs; nor is it considered necessary to provide for any liability to UK taxation on overseas earnings which are not expected to be remitted.

Notes on the Accounts (continued)

25 Provisions for liabilities and charges (continued)

b Other provisions for liabilities and charges

Midland	Provisions for pensions and other post-retirement obligations £m	Provisions for contingent liabilities and commitments £m	Premises-related provisions £m	Other provisions £m	Total £m
At 1 January 1997	124	33	107	17	281
Charge to the profit and loss account	26	3	7	-	36
Disposal of subsidiary undertakings	(56)	(1)	-	-	(57)
Provisions utilised	(9)	(12)	(20)	(1)	(42)
Exchange and other movements	(5)	4	(7)	2	(6)
At 31 December 1997	80	27	87	18	212
Bank					
At 1 January 1997	61	30	98	17	206
Charge/(credit) to the profit and loss account	19	2	6	(3)	24
Provisions utilised	(4)	(11)	(20)	-	(35)
Exchange and other movements	1	4	(4)	-	1
At 31 December 1997	77	25	80	14	196

26 Subordinated liabilities

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Undated subordinated loan capital	1,241	1,061	1,241	1,061
Dated subordinated loan capital	2,056	2,142	2,055	1,972
Total subordinated liabilities	3,297	3,203	3,296	3,033
Dated loan capital is repayable:				
- within 1 year	31	2	30	-
- between 1 to 2 years	297	155	297	146
- between 2 to 5 years	250	632	250	560
- over 5 years	1,478	1,353	1,478	1,266
	2,056	2,142	2,055	1,972

26 Subordinated liabilities (continued)

Subordinated borrowings of £100 million or more were as follows:

Bank		1997 £m	1996 £m
US$200m	Guaranteed Floating Rate Notes 1999*	**122**	118
£250m	Subordinated Floating Rate Notes 2001	**250**	250
US$400m	8.625% Subordinated Notes 2004	**241**	233
£200m	9% Subordinated Notes 2005	**200**	200
US$500m	7.625% Subordinated Notes 2006	**304**	294
£100m	14% Subordinated Unsecured Loan Stock 2002/07	**100**	100
£150m	Subordinated Step-up Coupon Floating Rate Notes 2007 †	**149**	–
US$300m	6.95% Subordinated Notes 2011	**182**	176
US$300m	7.65% Subordinated Notes 2025	**181**	175
US$750m	Undated Floating Rate Primary Capital Notes	**455**	441
US$500m	Undated Floating Rate Primary Capital Notes	**304**	294
US$300m	Undated Floating Rate Primary Capital Notes (Series 3)	**182**	176
£150m	9.25% Step-up Undated Subordinated Notes	**150**	150
£150m	8.625% Step-up Undated Subordinated Notes †	**150**	–
Other subordinated liabilities less than £100m *†		**326**	426
		3,296	3,033
Subsidiary undertakings			
Other subordinated liabilities less than £100m		**1**	170
		3,297	3,203

†The proceeds of the issue of £150m 8.625% Step-up Undated Subordinated Notes, £150m Subordinated Step-up Coupon Floating Rates Notes 2007 and a further issue of less than £100 million were used to support the development of Midland and to strengthen further Midland's capital base.
*Issued by subsidiary undertakings under the Bank's subordinated guarantee and on-lent to the Bank on a subordinated basis.

Interest rates on the floating rate loan capital are related to Interbank Offered Rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 14%.

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 Bank of England. The US$300 million 7.65% Subordinated Notes 2025 are repayable in May 2007 at par at the option of the holders.

The dated loan capital of the Bank represents unsecured obligations of the Bank which rank pari passu with the subordinated guarantees given by the Bank in respect of dated loan capital issued by subsidiary undertakings under the Bank's subordinated guarantee and on-lent to the Bank on a subordinated basis. 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 loan capital.

The undated 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 loan capital.

A total of £418 million (1996: £544 million) of dated loan capital was issued by subsidiary undertakings under the Bank's subordinated guarantee and on-lent to the Bank on a subordinated basis.

27 Called up share capital

At 31 December 1996 and 1997	Non-cumulative preference shares of £1 each £m	Non-cumulative preference shares of US$0.01 each £m	Ordinary shares of £1 each £m	Total £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 796,903,203 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.

On 5 February 1997, the Bank issued 2,000,000 Series 1 Second US$ non-cumulative preference shares and 2,000,000 Series 2 Second US$ non-cumulative preference shares of nominal value US$0.01 each, at a premium of US$19.99 and US$4.99 per share respectively. The issue was made in order to support the development of Midland and to strengthen further Midland's capital base.

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$5 per share, in the case of the Series A2, Series B2, Series C2 and Series D2 preference shares and Series 2 Second preference shares, plus an amount equal to any dividends declared but unpaid in respect of the previous dividend for the period and any accrued and unpaid dividends for the period to the date of the commencement of the winding up. With the exception of the above, the preference shares do not carry any right to participate in any surplus of assets on a winding up. The Second preference shares are subordinate, as regards payment of capital and dividends, to the other US$ 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 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, on or after 5 October 1998, 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 between 5 October 1998 and 4 October 2003 inclusive. The dividend amounts to US$1.109 per Series A2 preference share between 5 October 1998 and 4 October 1999, 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, on or after 24 February 2000, 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 between 24 February 2000 and 23 February 2005 inclusive. The dividend amounts to US$1.281 per Series B2 preference share between 24 February 2000 and 23 February 2001, and thereafter decreases for share redemptions made up to 23 February 2005.

The Series C1 and C2 preference shares are redeemable at the option of the Bank, on or after 27 October 2000, 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 between 27 October 2000 and 26 October 2005 inclusive. The dividend amounts to US$1.141 per Series C2 preference share between 27 October 2000 and 26 October 2001, and thereafter decreases for share redemptions up to 26 October 2005.

27 Called up share capital (continued)

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.

28 Reserves

	Midland £m	Bank £m	Associated undertakings £m
Share premium account:			
At 1 January 1997	1,931	1,931	–
New share capital subscribed	30	30	–
Exchange movement	15	15	–
At 31 December 1997	1,976	1,976	–
Revaluation reserves:			
At 1 January 1997	6	170	–
Realisation on disposal of properties	(4)	(4)	–
Unrealised surplus on revaluation of freehold and long leasehold properties	54	45	–
Transfer of permanent diminution in value of land and buildings to the profit and loss account	13	13	–
Net decrease in attributable net assets of subsidiary and associated undertakings	–	(117)	–
Realisation on disposal of subsidiary undertakings	(4)	–	–
At 31 December 1997	65	107	–
Profit and loss account:			
At 1 January 1997	1,226	1,062	14
Retained profit for the year	407	507	2
Goodwill written off on acquisition	(7)	(6)	–
Goodwill written back on disposal of subsidiary undertakings	11	–	–
Transfer of permanent diminution in value of land and buildings from revaluation reserve	(13)	(13)	–
Realisation on disposal of properties	4	4	–
Realisation on disposal of subsidiary and associated undertakings	4	–	(21)
Exchange and other movements	(35)	1	–
At 31 December 1997	1,597	1,555	(5)

Goodwill amounting to £86 million (1996: £90 million) has been charged against reserves in current and prior years in respect of acquisitions.

The reserves of the Bank include distributable reserves of £1,546 million (1996: £1,057 million).

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

Notes on the Accounts (continued)

29 Analysis of total assets and total liabilities

a Assets and liabilities denominated in foreign currency

		Midland		Bank
	1997 £m	1996 £m	1997 £m	1996 £m
Denominated in sterling	71,828	58,313	67,410	54,444
Denominated in currencies other than sterling	30,248	37,908	29,271	30,205
Total assets	102,076	96,221	96,681	84,649
Denominated in sterling	71,461	59,277	67,264	54,705
Denominated in currencies other than sterling	30,615	36,944	29,417	29,944
Total liabilities	102,076	96,221	96,681	84,649

b Assets subject to sale and repurchase transactions

		Midland		Bank
	1997 £m	1996 £m	1997 £m	1996 £m
Total assets subject to sale and repurchase transactions	2,952	2,542	2,946	1,956

c Assets leased to customers

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

		Midland
	1997 £m	1996 £m
Finance leases		
– loans and advances to banks	22	30
– loans and advances to customers	1,979	1,716
Hire purchase agreements		
– loans and advances to customers	1,039	777
Tangible fixed assets		
– equipment on operating leases	1,617	374
	4,657	2,897

The cost of assets acquired during 1997 for letting under finance leases and hire purchase contracts by Midland amounted to £475 million (1996: £714 million) and £797 million (1996: £642 million), respectively.

d Assets charged as security for liabilities

Midland has pledged assets as security for liabilities included under the following headings:

	Amount of liability secured	
	1997 £m	1996 £m
Deposits by banks	210	422
Customer accounts	51	–
Debt securities in issue	41	40
	302	462

The amount of assets pledged to secure these amounts is £4,562 million (1996: £6,281 million), and is mainly made up of items included in 'Debt securities' £3,822 million (1996: 'Debt securities' £4,823 million).

30 Memorandum items and foreign exchange rate, interest rate and equities contracts

a Contingent liabilities and commitments

Midland	Contract amount 1997 £m	Credit equivalent amount 1997 £m	Risk-weighted amount 1997 £m	Contract amount 1996 £m	Credit equivalent amount 1996 £m	Risk-weighted amount 1996 £m
Contingent liabilities						
Acceptances and endorsements	**1,214**	**1,210**	**1,199**	764	764	764
Guarantees and assets pledged as collateral security						
– guarantees and irrevocable letters of credit	**6,344**	**5,004**	**3,323**	7,523	6,122	3,739
Other contingent liabilities	**17**	**17**	**4**	130	–	–
	7,575	**6,231**	**4,526**	8,417	6,886	4,503
Commitments						
Documentary credits and short-term trade-related transactions	**950**	**414**	**215**	1,031	375	190
Forward asset purchases and forward forward deposits placed	**429**	**429**	**236**	304	304	262
Undrawn note issuance and revolving underwriting facilities	**9**	**5**	**5**	19	9	9
Undrawn formal standby facilities, credit lines and other commitments to lend						
– over 1 year	**9,914**	**4,957**	**4,373**	9,582	4,791	3,855
– 1 year or less	**19,180**	**–**	**–**	21,209	–	–
	30,482	**5,805**	**4,829**	32,145	5,479	4,316

	1997 £m	1996 £m
Incurred on behalf of parent and fellow subsidiary undertakings (contract amount)		
– contingent liabilities	**127**	54
– commitments	**992**	–

Notes on the Accounts (continued)

30 Memorandum items and foreign exchange rate, interest rate and equities contracts (continued)

Bank	Contract amount 1997 £m	Credit equivalent amount 1997 £m	Risk-weighted amount 1997 £m	Contract amount 1996 £m	Credit equivalent amount 1996 £m	Risk-weighted amount 1996 £m
Contingent liabilities						
Acceptances and endorsements	1,197	1,194	1,194	632	632	632
Guarantees and assets pledged as collateral security						
– guarantees and irrevocable letters of credit	8,554	5,041	3,342	8,956	6,039	3,527
Other contingent liabilities	17	17	4	130	–	–
	9,768	6,252	4,540	9,718	6,671	4,159
Commitments						
Documentary credits and short-term trade-related transactions	925	410	214	815	332	159
Forward asset purchases and forward forward deposits placed	29	29	29	19	19	4
Undrawn note issuance and revolving underwriting facilities	9	5	5	19	9	9
Undrawn formal standby facilities, credit lines and other commitments to lend						
– over 1 year	9,915	4,958	4,371	10,510	5,255	3,780
– 1 year or less	18,990	–	–	19,544	–	–
	29,868	5,402	4,619	30,907	5,615	3,952

	1997 £m	1996 £m
Incurred on behalf of subsidiary undertakings (contract amount)		
– contingent liabilities	2,179	1,738
Incurred on behalf of parent and fellow subsidiary undertakings (contract amount)		
– contingent liabilities	132	61
– commitments	992	–

30 Memorandum items and foreign exchange rate, interest rate and equities contracts (continued)

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 Bank of England's guidelines which implement the Basle agreement on capital adequacy and depend on the status of the counterparty and the maturity characteristics.

Contingent liabilities and commitments are credit-related instruments which 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.

b Exchange rate, interest rate and equities contracts

	1997		1996	
Midland	Contract amount £m	Replacement cost £m	Contract amount £m	Replacement cost £m
Exchange rate contracts	332,845	4,177	301,403	3,598
Interest rate contracts	455,039	2,221	462,466	4,275
Equities contracts	11,557	1,199	6,233	613
	799,441	7,597	770,102	8,486
Bank				
Exchange rate contracts	332,655	4,167	287,900	3,435
Interest rate contracts	454,500	2,208	432,039	3,766
Equities contracts	11,557	1,199	4,902	591
	798,712	7,574	724,841	7,792

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

Included in the above table there are £332,791 million (Midland) and £332,568 million (Bank) contract amount of exchange rate contracts, £444,395 million (Midland) and £445,146 million (Bank) contract amount of interest rate contracts and £11,557 million (Midland) and £11,557 million (Bank) contract amount of equities contracts which were made for trading purposes. The remaining exchange and interest rate contracts were made for non-trading purposes. In 1996, £301,363 million (Midland) and £287,869 million (Bank) contract amount of exchange rate contracts, £449,431 million (Midland) and £420,597 (Bank) contract amount of interest rate contracts and £6,233 million (Midland) and £4,902 million (Bank) contract amount of equities contracts were made for trading purposes. The remaining exchange and interest rate contracts were made for non-trading purposes.

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.

Replacement cost of contracts represents the mark-to-market assets on all contracts with a positive value. Replacement cost is therefore a close approximation of the credit risk for these contracts as at the balance sheet date. The actual credit risk is monitored internally and is the sum of the positive mark-to-market value and an estimate for the future fluctuation risk, using a future risk factor.

30 Memorandum items and foreign exchange rate, interest rate and equities contracts (continued)

c Contingent liabilities and commitments – geographical analysis

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

	United Kingdom £m	Continental Europe £m	United States £m	Rest of the World £m	Total £m
Contingent liabilities					
1997	**6,577**	**892**	**–**	**106**	**7,575**
1996	6,433	1,324	629	31	8,417
Commitments					
1997	**29,306**	**938**	**–**	**238**	**30,482**
1996	27,710	2,673	1,399	363	32,145

31 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 Midland's financial position is expected to arise from these proceedings.

32 Capital commitments

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Expenditure contracted for	**10**	26	**10**	26

33 Lease commitments

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

	Midland 1997 £m	Midland 1996 £m	Bank 1997 £m	Bank 1996 £m
Leasehold land and buildings				
Operating leases which expire				
– within 1 year	**3**	3	**3**	2
– 1 to 5 years	**8**	10	**8**	8
– over 5 years	**57**	51	**64**	48
	68	64	**75**	58

34 Segmental analysis

a By geographic region

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

1997	United Kingdom £m	Continental Europe £m	United States £m	Rest of the World £m	Total £m
Gross income					
Interest receivable	**5,008**	**504**	**94**	**249**	**5,855**
Dividend income	**1**	**10**	**–**	**–**	**11**
Fees and commissions receivable	**1,493**	**174**	**4**	**11**	**1,682**
Dealing profits	**217**	**17**	**(1)**	**2**	**235**
Other operating income	**310**	**1**	**–**	**–**	**311**
Total gross income	**7,029**	**706**	**97**	**262**	**8,094**
Profit on ordinary activities before tax	**1,503**	**96**	**16**	**10**	**1,625**
Net assets	**4,131**	**135**	**–**	**169**	**4,435**
Total assets	**95,145**	**2,356**	**25**	**4,550**	**102,076**
1996					
Gross income					
Interest receivable	4,328	539	111	137	5,115
Dividend income	1	1	–	1	3
Fees and commissions receivable	1,229	144	14	4	1,391
Dealing profits	155	55	14	10	234
Other operating income	202	(8)	–	(1)	193
Total gross income	5,915	731	139	151	6,936
Profit on ordinary activities before tax	1,173	66	22	11	1,272
Net assets	3,334	314	133	179	3,960
Total assets	80,330	9,646	2,222	4,023	96,221

b By class of business

1997	Commercial Banking £m	Forward Trust Group £m	Total £m
Profit on ordinary activities before tax	**1,503**	**122**	**1,625**
Net assets	**4,116**	**319**	**4,435**
Total assets	**95,790**	**6,286**	**102,076**
1996			
Profit on ordinary activities before tax	1,175	97	1,272
Net assets	3,616	344	3,960
Total assets	91,260	4,961	96,221

Included within profit on ordinary activities before tax and total assets for Forward Trust Group are £56 million and £1,180 million respectively in relation to Forward Trust Rail Services Limited and its subsidiary undertaking Forward Trust Rail Limited which were acquired during 1997.

As Midland is not required to disclose turnover, no segmental analysis of turnover is included.

Notes on the Accounts (continued)

35 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:

	Number	1997 £'000	Number	1996 £'000
Directors and connected persons and companies controlled by them:				
Loans and credit card transactions (including £27,000 in credit card transactions (1996: £27,000))	**10**	**790**	12	533
Officers:				
Loans and credit card transactions (including £56,000 in credit card transactions (1996: £42,000))	**16**	**1,296**	14	1,523

b Associated undertakings

Information relating to associated undertakings can be found in the notes to the accounts where the following are disclosed:

- Notes 11 and 12: amounts due from associated undertakings
- Note 17: interests in associated undertakings; principal associated undertakings and loan capital
- Note 22: amounts due to associated undertakings.

c Transactions with other related parties of Midland

Pension funds

At 31 December 1997, the Midland Bank Pension Scheme had deposits of £80 million with the Bank.

36 Approval of accounts

These accounts were approved by the Board of Directors on 23 February 1998.

37 Ultimate parent company

The ultimate parent company of Midland Bank plc is HSBC Holdings plc, which is incorporated and registered in England.

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

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

Copies of the HSBC Holdings plc *Annual Report and Accounts 1997* can be obtained, when published, from its registered office at 10 Lower Thames Street, London EC3R 6AE.

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