

Company No 14259

2010

Interim Report

HSBC Bank plc

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## Interim Report 2010

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### Presentation of Information

This document comprises the Interim Report 2010 for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Interim Management Report and Condensed Financial Statements, together with the Auditor's review report, as required by the Financial Services Authority's ('FSA') Disclosure Rules and Transparency Rules ('DTR'). References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Within the Interim Management Report the company has presented income statement figures for the three most recent 6 month periods to illustrate the current performance compared to recent periods. This compares to the condensed financial statements and related notes prepared in accordance with IAS 34, which include income statement year on year comparatives.

### Cautionary Statement Regarding Forward-Looking Statements

This Interim Report contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Certain statements that are not historical facts, including statements about the group's beliefs and expectations are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible' variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or subsequent events.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement.

## Interim Management Report: Financial Highlights

- Profit before tax at £2,795 million increased by 19 per cent when compared to the first half of 2009 delivering resilient performance in what continues to be a challenging economic environment
- Net interest income of £3,984 million decreased by 4 per cent reflecting continued pressure on deposit spreads in a low interest rate environment and a downward trend on Balance Sheet Management revenues against a backdrop of low interest rates and flattening yield curves
- Loan impairments decreased significantly by £855 million to £940 million as a result of risk mitigation actions and the more stable credit environment, together with the non-recurrence of specific one-off charges made in the first half of 2009
- The capital position continues to be strong, with a total capital ratio of 15.3 per cent as at 30 June 2010
- Loans and advances to customers saw modest growth in the first half of 2010 whilst customer accounts increased by 4 per cent driving an improvement to the advances to deposits ratio

### Profitability and balance sheet data

	Half-year to		
	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
<b>For the period</b>			
Profit before tax	2,795	2,358	1,656
Profit attributable to shareholders of the parent company	2,002	1,806	1,286
<b>At period end</b>			
Total shareholders' equity	30,278	23,059	27,787
Capital resources	31,290	30,165	31,840
Risk-weighted assets	205,161	216,283	203,281
<b>Capital and performance ratio (annualised)</b>	<b>%</b>	<b>%</b>	<b>%</b>
Return on average total shareholders' equity	13.8	17.2	11.0
Loans and advances to customers as a percentage of customer accounts	80.2	79.5	82.5
Capital ratios			
– total capital	15.3	13.9	15.7
– tier 1 capital	10.9	10.0	11.2
– core tier 1 capital	10.0	9.1	10.2
Cost efficiency ratio	55.4	49.5	56.2
	<b>At 30 June 2010 £m</b>	<b>At 30 June 2009 £m</b>	<b>At 31 December 2009 £m</b>
Loans and advances to customers (net of impairment allowances)	277,024	279,509	274,659
Loans and advances to banks (net of impairment allowances)	59,589	49,694	46,994
Trading assets financial instruments designated at fair value and financial investments	273,261	265,059	268,138
Total assets	819,574	774,811	751,928
Deposits by banks	56,202	56,634	57,729
Customer accounts	345,425	351,387	332,896

## Interim Management Report: Operating and Financial Review

### Reconciliation of reported and underlying profit before tax

The group measures its performance internally on a like-for-like basis by eliminating acquisitions and disposals of subsidiaries and businesses and fair value movement on own debt designated at fair value attributable to credit spread where the net result of such movements will be zero upon maturity of the debt, all of which distort period-on-period comparisons. The group refers to this as its underlying performance.

Reported results include the effects of the above items. This approach is used to monitor progress against operating plans and previous period results because management believes that the underlying basis more accurately reflects operating performance.

### Underlying performance

The tables below compare the group's underlying performance for the half year to 30 June 2010 with the half years to 30 June 2009 and 31 December 2009.

The following items comprise the underlying adjustments:

- £180 million gain on the disposal of the residual 49 per cent stake in the UK card acquiring joint venture with Global Payments Inc. in June 2009 in *Other operating income*,
- the change in own credit spread on long-term debt which resulted in a £108 million gain in the first half of 2010 compared with a loss of £128 million for the first half of 2009 and a loss of £311 million for the second half of 2009 in *Net income/(expense) from financial instruments designated at fair value*,
- adjustments across various lines for the disposal of the Insurance Brokers business in April 2010 including the profit on disposal of £83 million.

### Reconciliation of reported and underlying profit before tax

Half year to 30 June 2010 ('1H10') compared with half year to 30 June 2009 ('1H09')								
	1H09 reported £m	1H09 adjust- ments	1H09 underlying £m	1H10 reported £m	1H10 adjust- ments	1H10 underlying £m	Reported change %	Underlying change %
Net interest income	4,149	(1)	4,148	3,984	–	3,984	(4%)	(4%)
Net fee income	2,040	(95)	1,945	2,050	(31)	2,019	0%	4%
Trading income	1,576	–	1,576	1,498	–	1,498	(5%)	(5%)
Net income/(expense) from financial instruments designated at fair value	236	128	364	(5)	(108)	(113)	(102%)	(131%)
Gains less losses from financial investments	(162)	–	(162)	221	–	221	236%	236%
Net earned insurance premiums	1,437	–	1,437	1,403	–	1,403	(2%)	(2%)
Other operating income	502	(181)	321	484	(83)	401	(4%)	25%
Net insurance claims incurred and movement in liabilities to policyholders	(1,580)	–	(1,580)	(1,275)	–	(1,275)	19%	19%
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>8,198</b>	<b>(149)</b>	<b>8,049</b>	<b>8,360</b>	<b>(222)</b>	<b>8,138</b>	<b>2%</b>	<b>1%</b>
Loan impairment charges and other credit risk provisions	(1,795)	–	(1,795)	(940)	–	(940)	48%	48%
<b>Net operating income</b>	<b>6,403</b>	<b>(149)</b>	<b>6,254</b>	<b>7,420</b>	<b>(222)</b>	<b>7,198</b>	<b>16%</b>	<b>15%</b>
<b>Total operating expenses</b>	<b>(4,059)</b>	<b>92</b>	<b>(3,967)</b>	<b>(4,629)</b>	<b>46</b>	<b>(4,583)</b>	<b>(14%)</b>	<b>(16%)</b>
<b>Operating profit</b>	<b>2,344</b>	<b>(57)</b>	<b>2,287</b>	<b>2,791</b>	<b>(176)</b>	<b>2,615</b>	<b>19%</b>	<b>14%</b>
Share of profits in associates and joint ventures	14	–	14	4	–	4	(72%)	(70%)
<b>Profit before tax</b>	<b>2,358</b>	<b>(57)</b>	<b>2,301</b>	<b>2,795</b>	<b>(176)</b>	<b>2,619</b>	<b>19%</b>	<b>14%</b>

**Interim Management Report: Operating and Financial Review** (continued)

<b>Half year to 30 June 2010 ('1H10') compared with half year to 31 December 2009 ('2H09')</b>								
	<b>2H09 reported £m</b>	<b>2H09 adjust- ments</b>	<b>2H09 underlying £m</b>	<b>1H10 reported £m</b>	<b>1H10 adjust- ments</b>	<b>1H10 underlying £m</b>	<b>Reported change %</b>	<b>Underlying change %</b>
Net interest income	3,942	–	3,942	3,984	–	3,984	1%	1%
Net fee income	2,037	(90)	1,947	2,050	(31)	2,019	1%	4%
Trading income	1,050	–	1,050	1,498	–	1,498	43%	43%
Net income/(expense) from financial instruments designated at fair value	307	311	618	(5)	(108)	(113)	(102%)	(118%)
Gains less losses from financial investments	89	–	89	221	–	221	148%	148%
Net earned insurance premiums	1,279	–	1,279	1,403	–	1,403	10%	10%
Other operating income	620	(1)	619	484	(83)	401	(22%)	(35%)
Net insurance claims incurred and movement in liabilities to policyholders	(1,960)	–	(1,960)	(1,275)	–	(1,275)	35%	35%
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>7,364</b>	<b>220</b>	<b>7,584</b>	<b>8,360</b>	<b>(222)</b>	<b>8,138</b>	<b>14%</b>	<b>7%</b>
Loan impairment charges and other credit risk provisions	(1,569)	–	(1,569)	(940)	–	(940)	40%	40%
<b>Net operating income</b>	<b>5,795</b>	<b>220</b>	<b>6,015</b>	<b>7,420</b>	<b>(222)</b>	<b>7,198</b>	<b>28%</b>	<b>20%</b>
<b>Total operating expenses</b>	<b>(4,139)</b>	<b>84</b>	<b>(4,055)</b>	<b>(4,629)</b>	<b>46</b>	<b>(4,583)</b>	<b>(12%)</b>	<b>(13%)</b>
<b>Operating profit</b>	<b>1,656</b>	<b>304</b>	<b>1,960</b>	<b>2,791</b>	<b>(176)</b>	<b>2,615</b>	<b>69%</b>	<b>33%</b>
Share of profits in associates and joint ventures	–	(1)	(1)	4	–	4	–	(500%)
<b>Profit before tax</b>	<b>1,656</b>	<b>303</b>	<b>1,959</b>	<b>2,795</b>	<b>(176)</b>	<b>2,619</b>	<b>69%</b>	<b>34%</b>

## Interim Management Report: Operating and Financial Review (continued)

### Financial summary

#### Summary consolidated income statement

	Half year to		
	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
Net interest income	3,984	4,149	3,942
Net fee income	2,050	2,040	2,037
Trading income	1,498	1,576	1,050
Net income/(expense) from financial instruments designated at fair value	(5)	236	307
Gains less losses from financial investments	221	(162)	89
Net earned insurance premiums	1,403	1,437	1,279
Other operating income	484	502	620
<b>Total operating income</b>	<b>9,635</b>	<b>9,778</b>	<b>9,324</b>
Net insurance claims incurred and movement in liabilities to policy holders	(1,275)	(1,580)	(1,960)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>8,360</b>	<b>8,198</b>	<b>7,364</b>
Loan impairment charges and other credit risk provisions	(940)	(1,795)	(1,569)
<b>Net operating income</b>	<b>7,420</b>	<b>6,403</b>	<b>5,795</b>
<b>Total operating expenses</b>	<b>(4,629)</b>	<b>(4,059)</b>	<b>(4,139)</b>
<b>Operating profit</b>	<b>2,791</b>	<b>2,344</b>	<b>1,656</b>
Share of profit in associates and joint ventures	4	14	–
<b>Profit before tax</b>	<b>2,795</b>	<b>2,358</b>	<b>1,656</b>
Tax Expense	(759)	(516)	(340)
<b>Profit for the period</b>	<b>2,036</b>	<b>1,842</b>	<b>1,316</b>
Profit attributable to shareholders of the parent company	2,002	1,806	1,286
Profit attributable to non-controlling interests	34	36	30

### Economic briefing

The UK economy experienced a modest recovery during the first half of 2010 as economic conditions stabilised following the severe weakness experienced in 2009. Having fallen 6.4 per cent during the recession, by the end of the second quarter, the level of Gross Domestic Product ('GDP') had risen by 1.9 per cent from the low in activity seen in the third quarter of 2009. Labour market conditions also showed signs of stabilisation as the headline rate of unemployment remained around 8 per cent during the half year. Housing market activity proved subdued and after appreciating during the early months of 2010, house prices displayed signs of softening during the second quarter. The Bank of England left interest rates unchanged at 0.5 per cent during the first half of the year while the Asset Purchase Facility also remained steady at £200 billion. Consumer Price Index ('CPI') inflation remained relatively high throughout the period, falling only marginally from 3.5 per cent in January 2010 to 3.2 per cent in June 2010, well above the Bank of England's 2 per cent target.

The pace of economic recovery also proved lacklustre within the eurozone. In the first quarter of 2010, the level of GDP rose by just 0.2 per cent on the previous quarter. There was evidence of an acceleration of growth during the second quarter, although economic performance proved increasingly disparate as concerns mounted over the health of the public finances of some member nations and a number of austerity programmes were implemented. Tensions within government bond markets across the region prompted the creation of a €750 billion stabilisation fund to be used to provide loans to eurozone governments in need of financial assistance. CPI inflation rose from 0.9 per cent in December 2009 to 1.4 per cent in June 2010 while the unemployment rate increased to an 11 year high of 10 per cent in June 2010. The European Central Bank held the refi rate at 1 per cent throughout the period and, from early May, started to purchase small amounts of the government debt of several eurozone nations in the secondary market.

## Interim Management Report: Operating and Financial Review (continued)

### Review of business performance

Reported pre-tax profits in the first half of 2010 were £2,795 million, an increase of 19 per cent compared with the first half of 2009 and 69 per cent compared with the second half of 2009

The following items are significant in a comparison of the first half of 2010's underlying results to 2009

- a change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees generated an accounting gain of £322 million in the first half of 2009 in *Total operating expenses*,
- a gain of £353 million on the sale of the Group's London headquarters building in the second half of 2009 in *Other operating income*,
- a loss of £73 million, booked across various lines, for HSBC Insurance (UK) Limited in the first half of 2009 and £106 million in the second half of 2009 (as the UK motor insurance underwriter was significantly affected by adverse claims experience during the year) compared to £2 million profit in 2010. The motor insurance underwriting business was placed into run-off during the second half of 2009 with no new customer business written in 2010,
- the sale and leaseback of the Paris headquarters building in February 2010 resulted in a gain of £125 million being recognised in *Other operating income* in the first half of 2010
- a bonus tax amounting to £245 million in respect of certain 2009 bonuses was accrued in the first half of 2010 in *Total operating expenses*

The commentary that follows is on an underlying basis

Profit before tax was 14 per cent higher than the first half of 2009 and 34 per cent higher than the second half of 2009. UK Retail Banking and Continental Europe Retail Banking both recorded an increase in underlying profit before tax when compared against both halves of 2009. Compared with the second half of 2009, pre-tax profits have risen across the four major business segments

*Net interest income* fell by 4 per cent compared to the exceptional results reported in the first half of 2009, primarily reflecting a decreasing trend, as forecast, in Balance Sheet Management revenues as interest rates remained low and major yield curves flattened. In Global Banking and Markets, net interest income was also impacted by tighter margins and a reduction in overall lending balances. In Private Banking, the continuing low interest rate environment impacted customer deposit spreads resulting in a fall in net interest income. These decreases were partly offset by higher levels of net interest income in the UK Retail Banking and Continental Europe Retail Banking segments reflecting growth in mortgage lending in the UK, wider asset spreads and improved loan and deposit margins in Continental Europe.

*Net fee income* increased by 4 per cent. Fee income was received for management services provided by HSBC to its Structured Investment Conduits and higher management fees in Global Asset Management. Private Banking and the wealth management segments of the Retail businesses were driven by an increase in funds under management and growth in the target customer base. The general economic uncertainty resulted in a reduction in client activity in the equity capital markets business and the exceptional volumes seen in the first half of 2009 were not repeated.

*Trading income* fell by 5 per cent. Revenues slowed in the second quarter of 2010 as European sovereign debt concerns and widening credit spreads suppressed client activity and demand for Foreign exchange, Credit and Rates products. A net expense was recognised from non-qualifying hedges related to mark-to-market losses on cross-currency and interest rate swaps as the US dollar appreciated against sterling and US dollar long-term interest rates decreased. This compared with income earned from these instruments in the same period in 2009. Non-qualifying hedges are economic hedges which do not qualify for hedge accounting.

Included within net trading income was a fair value gain of £119 million resulting from widening credit spreads on structured liabilities, a loss of £78 million was reported in the first half of 2009. Additionally, foreign exchange gains were reported on trading assets held as economic hedges of foreign currency debt designated at fair value, with the offset reported in *Net income from financial instruments designated at fair value*.

A negative fair value movement of £113 million was recorded within *Financial instruments designated at fair value* on assets held to back insurance and investment contracts, compared with a positive movement of £364 million in the first half of 2009. This negative movement was mainly driven by declining equity markets in the first half of 2010. The negative movement in fair value is offset by a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders* to reflect the extent to which unit-linked policyholders participate in the investment.

## Interim Management Report: Operating and Financial Review (continued)

performance experienced on the linked investment portfolios. In addition, foreign exchange losses on debt designated at fair value were reported in the period, with the offset reported in *Trading income*.

*Gains less losses from financial investments* were £383 million higher than in the first half of 2009 as improved market conditions resulted in lower impairment charges and afforded opportunities to realise private equity investments at a profit. In Balance Sheet Management, revenues benefited from higher gains on the disposal of debt securities.

*Net earned insurance premiums* were broadly in line with the first half of 2009, as increases in France driven by higher premiums per contract offset the lower new premiums written in the UK following the decision made in the second half of 2009 to place the UK motor underwriting business into run-off.

*Other operating income* increased by £80 million mainly due to the £125 million gain made on the sale and leaseback of the 103 Champs Elysees and 15 Rue Vernet, HSBC France's Paris headquarters.

*Net insurance claims incurred and movement in liabilities to policyholders* decreased by £305 million in the first half of 2010. In the first half of 2009, as a consequence of a rising incidence and severity of claims, there was a strengthening of reserves in the UK motor book. The actions taken during 2009 including the decision to place this business into run-off, resulted in no equivalent reserve strengthening being required in the first half of 2010. In addition, declining equity markets led to a negative movement in liabilities to policyholders on unit-linked and, to a certain extent, participating policies where policyholders share in investment performance. The negative movement in the assets held to support insurance contract liabilities are reported in *Financial instruments designated at fair value*.

*Loan impairment charges and other credit risk provisions* decreased by 48 per cent to £940 million reflecting risk mitigation actions taken by management and a more stable credit environment. In Global Banking and Markets, a modest charge against the backdrop of an improved credit outlook and successfully executed restructuring activity, compared favourably to significant charges concentrated amongst a small number of clients in the first half of 2009. In addition, credit risk provisions on certain asset-backed securities held on the available-for-sale portfolio decreased as asset-backed securities prices increased and default rates declined. In the Personal sector, lower loan impairment charges were driven by improved delinquencies across both the secured and unsecured lending portfolios due to enhanced credit risk management practices, improved collections and the impact of the low interest rate environment. In Commercial Banking loan impairments were lower with the property sector which represents 30 per cent of the total portfolio in the UK, experiencing the most significant improvement with impairments declining by 42 per cent.

*Operating expenses* excluding the impact of the two significant items noted below, were broadly in line with the first half of 2009. Operating expenses in the first half of 2010 were impacted by the cost of the payroll tax on certain bonuses paid in respect of 2009, amounting to £218 million in the UK and £27 million in France. Operating expenses in the comparable period in 2009 benefited from a pension accounting gain of £322 million following a change in the basis of delivering death-in-service, ill health and early retirement benefits for certain UK employees. In UK Retail and Continental Europe Retail, strategic investments in people and infrastructure to support customers were offset by cost efficiency savings.

### Outlook

The bank expects global economic conditions to improve during the course of 2010 although the pace of recovery is expected to remain uneven across regions. A subdued pace of growth in both the UK and eurozone is expected to prolong the current period of exceptionally low interest rates.

Eurozone GDP is expected to expand by 1.2 per cent in 2010 following a contraction of 4.1 per cent in 2009. The strength of recovery across the region is expected to prove diverse, however with growth in several smaller eurozone economies likely to be hampered by the implementation of fiscal austerity programmes. Consumption is forecast to rise by just 0.2 per cent in 2010, given the expectation of continued weak labour market conditions across the eurozone.

The bank expects UK GDP to rise by 1.2 per cent in 2010 following a contraction of 4.9 per cent in 2009. Domestic demand is expected to provide most of the impetus to growth with export performance proving lacklustre while the pace of growth in government expenditure is expected to slow substantially beyond 2010. Consumer price inflation is expected to maintain a relatively high level during the remainder of 2010 while labour market conditions are forecast to improve only marginally during the course of 2010 and 2011.

The group is preparing to operate in a period which will be characterised by further intense public and political scrutiny of banks and a complex environment with higher levels of intervention by regulators. In looking to address the systematic failures that caused the financial crisis, governments and regulators are now taking key steps towards meeting the aims set out by the G-20.



## Interim Management Report: Operating and Financial Review (continued)

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### Regulatory Outlook

In Europe the European Union Council of Ministers and European Parliament have commenced negotiations on the establishment of a European Systemic Risk Board for macro-prudential oversight of the financial system, a European Banking Authority a European Insurance and Occupational Pensions Authority and a European Securities and Markets Authority. In February 2010, the European Commission issued a public consultation on the third set of proposed amendments to the EU Capital Requirements Directive ('CRD'), CRD4. This sets out its proposed implementation of Basel III across the EU. In addition, CRD2, covering amendments relating to own funds, large exposures, supervisory arrangements, qualitative standards for liquidity risk management and securitisation, which was adopted by member states and the European Parliament in September 2009, will come into force on 31 December 2010. CRD3, covering disclosure of remuneration, effective 1 January 2011, and capital requirements for the trading book and re-securitisation and disclosure of the securitisation exposures effective 31 December 2010, was adopted by member states and the European Parliament in July 2010. In July 2010, the European Commission proposed further reforms to depositor and investor compensation schemes including regular contributions by banks into the applicable national deposit guarantee schemes. It has also announced plans to propose legislation to promote greater central clearing of derivatives and to strengthen corporate governance.

In June 2010, a joint statement was made by the UK, French and German governments announcing plans for the introduction of a bank levy in each country. The specific design of each country may differ to reflect the different domestic circumstances and tax systems. Detailed legislation has yet to be finalised or enacted in any of the countries.

In the UK, the Financial Services Act 2010 enacted in April 2010, established a requirement for UK banks to prepare recovery and resolution plans. In June 2010, the UK Government announced that the UK Financial Services Authority ('FSA') will cease to exist in its present form and four new supervisory bodies will be established by the end of 2012. Pending these changes to supervision in the UK, the FSA continues to operate as before and, in June 2010, finalised its proposals for a new liquidity regime, including updated quantitative rules coupled with a narrow definition of liquid assets. In July 2010, the FSA announced the implementation of its new powers granted by the Financial Services Act 2010, including the power to impose financial penalties on individuals and firms and more intense information-gathering in relation to financial stability to help identify potential threats to the UK financial markets.

### Credit Environment

As government deficits rose, financial markets became increasingly concerned about the level of sovereign indebtedness, and the credit rating of certain European government debt issues was downgraded. Initially, the debt crisis centred on events in Greece but later extended to other obligors in Southern Europe. The group managed its exposure to the affected countries closely during the period. The overall quality of the group's sovereign portfolio remained strong with most in-country and cross-border limits extended to countries with high grade internal credit risk ratings. The group regularly updates its assessment of higher risk countries and adjusts its risk appetite to reflect such changes.

Continuation of the positive loan impairment trend experienced in the first half of 2010 in the commercial and personal sectors remains sensitive to general economic activity, employment levels, interest rates and house prices.

## Interim Management Report: Operating and Financial Review (continued)

### Business segment discussion

#### Profit before tax

	Half year to					
	30 June 2010 £m Reported	30 June 2009 £m Reported	31 December 2009 £m Reported	30 June 2010 £m Underlying	30 June 2009 £m Underlying	31 December 2009 £m Underlying
UK Retail Banking	647	666	322	593	480	311
Continental Europe Retail Banking	216	142	55	216	142	55
Global Banking and Markets	1,406	1,595	916	1,392	1,596	919
Private Banking	340	401	327	340	401	327
Other	186	(446)	36	78	(318)	347
	<u>2,795</u>	<u>2,358</u>	<u>1,656</u>	<u>2,619</u>	<u>2,301</u>	<u>1,959</u>

#### UK Retail Banking

	Half year to		
	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
Net interest income	1,732	1,645	1,716
Net fee income	930	928	985
Trading income	8	39	(11)
Other operating income	164	201	40
Net operating income before impairments and provisions	<u>2,834</u>	<u>2,813</u>	<u>2,730</u>
Loan impairment charges and credit risk provisions	(616)	(819)	(781)
Net operating income	<u>2,218</u>	<u>1,994</u>	<u>1,949</u>
Total operating expenses	<u>(1,573)</u>	<u>(1 341)</u>	<u>(1 627)</u>
Operating profit	<u>645</u>	<u>653</u>	<u>322</u>
Share of profits in associates and joint ventures	2	13	–
Profit before tax	<u>647</u>	<u>666</u>	<u>322</u>

The above table is on a reported basis

#### Overview

The first half of 2010 remained a challenging period for the UK economy and, in this environment, HSBC's financial strength and diversification enabled the bank to continue to support its personal and commercial customers in managing their financial challenges and planning for the future. This resulted in a resilient financial performance.

UK Retail Banking reported a pre-tax profit of £647 million in the period, compared with £666 million in the first half of 2009, a decrease of 3 per cent, and compared with £322 million in the second half of 2009, an increase of 101 per cent.

On an underlying basis, adjusting for the gain of £180 million on the disposal of the residual 49 per cent stake in the UK card acquiring joint venture and gain and associated adjustments in relation to the disposal of the Insurance Brokers business in April 2010, profit before tax was £593 million in the first half of 2010 compared to £480 million in the first half of 2009 and £311 million in the second half of 2009.

## Interim Management Report: Operating and Financial Review (continued)

For UK Retail Banking the following items are also significant in a comparison of the first half of 2010's results against 2009

- A change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees generated an accounting gain of £264 million in June 2009
- A loss of £73 million for HSBC Insurance (UK) Limited in the first half of 2009 and £106 million in the second half of 2009 (as the UK motor insurance underwriter was significantly affected by adverse claims experience during the year) compared to £2 million profit in 2010

The commentary that follows is on an underlying basis and does not adjust for the significant items above

UK Retail Banking pre-tax profits increased by 24 per cent against the first half of 2009. This was primarily a result of significantly lower loan impairment charges in both the personal and commercial sectors as a result of actions taken over the past few years to improve collections performance, together with the quality of new business and the change in mix towards secured lending away from unsecured lending. Low interest rates in the UK also helped many customers to reduce debt levels.

Underlying revenues increased by 7 per cent primarily as a result of growth in mortgage lending in the personal sector and improved asset margins as well as no further deterioration of claims experience and associated provisions within the UK Motor Insurance underwriter, partly offset by the narrowing of liability spreads.

Adjusting for the £264m accounting gain mentioned above, operating expenses remained broadly flat compared to both the first and second halves of 2009.

In Personal Financial Services, Premier customers increased by 9 per cent while Advance attracted 23,000 new customers to HSBC in the first half of the year as the business focused on building long term sustainable relationships and wealth management revenues in these target segments. The investment business continued to grow, funds under management totalled £15 billion at 30 June 2010, with the World Selection Fund rising by 59 per cent to £1.5 billion in the first half of the year. HSBC took an 8 per cent share of new residential mortgage lending in the UK in the first quarter of 2010 with an average new loan to value of 53 per cent.

In the commercial sector, further progress was made towards the core strategy of becoming the leading bank for international business as the number of UK based customers managed through the international proposition grew by 9 per cent during the first half of 2010. Import and export transactions increased by 7 per cent and 12 per cent, respectively, with Trade and Supply Chain income up 18 per cent on prior year. The bank lent £1.4 billion to small and medium sized enterprises (SMEs), and opened accounts for over 65,000 customers starting new businesses.

### Financial performance

*Net interest income* increased by £88 million or 5 per cent mainly driven by growth in mortgage revenues and wider asset spreads. This was partly offset by a narrowing of liability spreads following interest rate cuts in early 2009. The bank built on its strong deposit base, despite fierce competition for liability balances with *Premier* and *Advance* customer account balances increasing by 4 per cent. In Commercial Banking, net lending has remained broadly flat, despite higher new business advances, reflecting increased customer propensity to reduce borrowing.

Against the second half of 2009, net interest income increased by £16 million or 1 per cent, primarily driven by continued mortgage balance growth. This was partially offset by a narrowing of liability spreads and an increase in the deposit base.

*Net fee income* increased by £48 million or 6 per cent. The bank continued to grow its target customer base, and generated higher fee income from investments and both domestic and international payments flows. This was partially offset by reduced income from overdraft and card fees as the mix continued to move towards secured lending away from unsecured lending. Against the second half of 2009, fee income remained flat.

*Other operating income* increased in the first half of 2010 compared to 2009 due to significantly lower claims provisioning related to the now closed UK motor insurance underwriting book.

*Loan impairment charges and other credit risk provisions* decreased by £203 million or 25 per cent. In Commercial Banking, loan impairment charges decreased by £106 million. The property sector, which represents 30 per cent of the total portfolio, experienced the most significant improvement in impairments, declining 42 per cent year on year. In the Personal sector, loan impairment charges decreased by £97 million due to improved delinquencies across both the secured

## Interim Management Report: Operating and Financial Review (continued)

and unsecured portfolios. Given the weakened state of some commercial and consumer clients, continuing positive impairment trends remain very sensitive to general economic activity, interest rates, employment levels and house prices.

*Operating expenses* increased by £263 million or 21 per cent. Excluding the accounting gain of £264 million following a change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees in June 2009, operating expenses were flat on prior year. The UK business has continued to make strategic investment in people and infrastructure to support its customers whilst delivering sustainable reductions in the cost base through re-engineering business processes.

*Share of profit in associates and joint ventures* decreased by £11 million as a result of the sale of the residual 49 per cent stake in the UK card acquiring joint venture with Global Payments Inc. in June 2009.

### Continental Europe Retail Banking

	Half year to		
	30 June 2010	30 June 2009	31 December 2009
	£m	£m	£m
Net interest income	851	822	859
Net fee income	227	217	206
Trading income	15	14	14
Other operating income	6	37	(31)
Net operating income before impairments and provisions	1,099	1,090	1,048
Loan impairment charges and credit risk provisions	(79)	(162)	(176)
Net operating income	1,020	928	872
Total operating expenses	(804)	(786)	(817)
Operating profit	216	142	55
Share of profits in associates and joint ventures	–	–	–
Profit before tax	216	142	55

The above table is on a reported basis and there is no difference between reported and underlying bases.

### Overview

Continental Europe Retail Banking reported a profit of £216 million for the first half of 2010 against £142 million in the same period in 2009, an increase of 52 per cent and £55 million in the second half of 2009, an increase of 293 per cent. Increased revenues and lower loan impairment charges were partly offset by rising costs, driven largely by bonus taxes.

Since restructuring a number of the bank's Personal Financial Services businesses in 2009, focus has increasingly centred on wealth management, reflecting the demographics of the region. Increased investment drove customer acquisition with 28,000 new-to-bank *Premier* customers acquired in the first half of 2010. Acquisition was particularly strong in Poland, Turkey and France where the bank opened two of HSBC's largest *Premier* centres. The total number of *Premier* customers across the region rose by 30 per cent year-on-year to 444,000. *Advance*, the bank's second tier premium proposition, was launched in Turkey at the start of the year and in Poland in April. The proposition will be rolled out progressively across the region from September.

Commercial Banking continued its focus on expanding relationships with international businesses. Further growth was seen in trade finance as the region showed tentative signs of business expansion in a number of markets. Germany, Turkey and Poland all saw evidence of business revival and transaction flows increased. The bank launched Business Direct in Poland during the first half of the year as a means of expanding its delivery capabilities in that market and maintains a leading position in receivables finance across the region.

### Financial performance

*Net interest income* increased by £29 million or 4 per cent. Improved margins in France and Malta were partially offset by a narrowing of margins in Turkey following the imposition of a government regulated cap on credit card interest rates. The severe deposit spread compression seen in Malta in the first half of 2009 eased substantially in the first half of 2010 and spreads widened as fixed rate deposits rolled over to lower interest rates. The strategic re-focus of the bank's personal

## Interim Management Report: Operating and Financial Review (continued)

banking proposition depressed net interest income but produced a sharp increase in the acquisition of target segment customers across the region

In Commercial Banking, net interest income was broadly in line with the first half of 2009. Strong growth in France was offset by strong competition in Turkey, forcing margins sharply lower than in the first half of 2009. Corporate lending expanded in a number of markets and the pipeline of transactions showed signs of revival following the downturn in 2009. Good revenue growth was seen in Greece where the focus was on the shipping business and larger international clients, and in Kazakhstan, Armenia, Czech Republic and Georgia, each of which saw a revival of corporate lending.

Compared with the second half of 2009, net interest income was £8 million lower due largely to the impact in Turkey of strong competition and the government cap on credit card interest rates.

*Net fee and Other operating income* was 8 per cent lower than in the first half of 2009. Fee income in Personal Financial Services was 6 per cent higher as strong growth in France, Turkey and Malta reflected the expansion of the target segment and wealth management business. This was offset by fair value losses for the insurance business in France. Growth in Germany, Greece, Czech Republic and Spain boosted fee income in Commercial Banking, although this was partly offset by the effects of the tougher competitive environment in Turkey and lower fees in France. Against the second half of 2009, revenues increased by 33 per cent. During this prior period, other income in Personal Financial Services was adversely impacted by a one-off reserve strengthening in the Ireland insurance business.

*Trading income* was broadly in line with both the first and second halves of 2009 as a fall in Personal Financial Services trading revenue in France was more than offset by stronger performance in Commercial Banking in Germany.

*Loan impairment charges and other credit risk provisions* decreased by £83 million or 51 per cent compared with the first half of 2009, and by £97 million or 55 per cent compared with the second half. In Personal Financial Services, impairments were sharply lower in Turkey where limit reductions, changes in approval thresholds and a strong focus on collections yielded substantial improvements in recoveries and a reduction in delinquency rates. The closure of the bank's Consumer Finance business in 2009 also contributed £6 million to the lower impairment charges in 2010. Recovery activity was particularly strong in Poland, Hungary and Czech Republic where the Consumer Finance books are being run-off.

In Commercial Banking, lower impairment charges were a feature of a number of markets in Continental Europe with sharp falls in France, Turkey, Greece and Russia. In France, the improving economic environment resulted in a reassessment of the bank's emergence period resulting in a £9 million release of collective impairment allowances. In Turkey, a general improvement in the economic environment resulted in a substantial fall in impairment charges, while in Germany a single individual impairment compared with a net recovery in the first half of 2009.

*Operating expenses* remained broadly in line with the first half of 2009 as the costs of Personal Financial Services expansion in France, Turkey and Kazakhstan were mitigated by the closure of the Consumer Finance business which delivered a cost reduction of £16 million or 2 per cent in the first half of 2010. In Commercial Banking, business growth in Germany and Turkey resulted in increased costs whilst strong control over the cost base in France, Malta and a number of smaller European markets led to a reduction. Expenses were 2 per cent lower than in the second half of 2009 which bore the costs of business closures and realignment of the Personal Financial Services business in a number of markets.

## Interim Management Report: Operating and Financial Review (continued)

### Global Banking and Markets

	Half year to		
	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
Net interest income <sup>1</sup>	1,088	1,627	1,222
Net fee income	571	548	512
Trading income	1,321	1,221	751
Other operating income	349	427	281
Net operating income before impairments and provisions	3,329	3,823	2,766
Loan impairment charges and credit risk provisions	(238)	(806)	(599)
Net operating income	3,091	3,017	2,167
Total operating expenses	(1,687)	(1,423)	(1,251)
Operating profit	1,404	1,594	916
Share of profits in associates and joint ventures	2	1	–
Profit before tax	1,406	1,595	916

<sup>1</sup> The bank's Balance Sheet Management business, reported within Global Banking and Markets, provides funding to the trading businesses. To report Global Banking and Markets Trading income on a fully funded basis, Net interest income and Trading income are grossed up to reflect internal funding transactions prior to their elimination in the Inter Segment column on Page 16

The above table is on a reported basis

### Overview

Global Banking and Markets reported a pre-tax profit of £1 406 million in the period compared with £1 595 million in the first half of 2009 – a decrease of 12 per cent – and £916 million in the second half – an increase of 53 per cent. This represented its second highest ever half year performance although the 2010 figures did not match the record results of the first half of 2009, which benefited from exceptional market conditions. Market share gains captured in 2009 were broadly maintained and performance significantly exceeded the second half of 2009 delivering stronger revenues and lower loan impairment charges and other credit risk provisions.

Revenues slowed in the second quarter of 2010, as European sovereign debt concerns and widening credit spreads were reflected in lower client activity and a reduction in the level of debt and equity issuance in the market. Operating expenses included a £234 million charge from the UK and French payroll taxes applied on certain 2009 bonus payments.

Loan impairment charges and other credit risk provisions decreased significantly. Loan impairment charges fell reflecting improving credit conditions which – together with capital raising and debt restructuring activity – has strengthened the credit quality of the portfolio. Credit risk provisions on available-for-sale asset-backed securities also decreased.

Global Banking and Markets have been recognised in a number of key industry awards which highlighted the strength of our core businesses and the success of our now well established emerging markets-led and financing-focused strategy. This included being awarded Euromoney's 'Best Debt House' in Greece, Poland, Spain and Turkey. Regionally, these achievements were recognised through the attainment of 'Best Debt House' in Central Eastern Europe.

### Financial performance

The commentary that follows is on an underlying basis, adjusting for the Global Banking and Markets element of the disposal of the Insurance Brokers business in April 2010.

*Net interest income* decreased by £539 million or 33 per cent against the first half of 2009. As forecast, Balance Sheet Management revenues fell against the record first half of 2009 as interest rates remained low and major yield curves flattened. In Global Banking, tighter margins and a reduction in overall lending balances – as clients repaid debt in order to strengthen their balance sheet position – resulted in lower income in the credit and lending business.

*Net fee income* increased by £41 million or 8 per cent against the first half of 2009 with fee income received for management services provided by HSBC to its Structured Investment Conduits, and higher management fees in Global Asset Management driven by a 16 per cent increase in the average value of funds under management. Assets under management amounted to £92 billion, assisted by net inflows in the first six months of 2010 of £2.7 billion. The Equity Capital Markets business, however, was affected by a reduction in client activity as the exceptional volumes seen in the first half of 2009 were not repeated.

## Interim Management Report: Operating and Financial Review (continued)

*Trading income* was £100 million or 8 per cent higher than the first half of 2009 and 76 per cent higher than the second half. Fair value gains of £119 million were reported on structured liabilities as credit spreads widened compared with losses of £78 million in the first half of 2009. In addition, foreign exchange gains were reported on trading assets held as economic hedges of foreign currency debt designated at fair value, with the offset reported in *Other income*. These were partly offset by lower trading income as increasing economic uncertainty and subdued market conditions following the concerns over European sovereign debt in the second quarter of 2010 resulted in lower client activity and demand for Foreign exchange, Credit and Rates products. Rates income decreased following a slow down in client activity as noted above. In Credit trading, a net release of previous write-downs on legacy positions and monoline exposures amounting to £154 million reflected an improvement in asset prices whilst the first half of 2009 had included a net charge of £163 million. This benefit, however, was more than offset by the non-recurrence of gains in other parts of the business. Although performance in the Foreign exchange business remained strong, revenues were affected by a reduction in market volatility and customer driven volumes compared with the unprecedented levels experienced in late 2008 and early 2009.

*Other operating income* decreased by £96 million or 22 per cent due to foreign exchange losses on debt designated at fair value, with the offset reported in *Trading income* above. This was partly offset by higher realisations and lower impairment charges in Principal Investments as market conditions improved.

*Loan impairment charges and other credit risk provisions* decreased by £568 million or 70 per cent. Loan impairment charges fell by £489 million as significant loan impairments taken in relation to a small number of clients in the first half of 2009 did not recur. Credit risk provisions on the available-for-sale portfolio fell by £79 million against the first half of 2009 reflecting a rise in asset prices and a decline in default rates.

*Operating expenses* increased by £279 million or 20 per cent due to the inclusion of £234 million payroll taxes on certain bonuses and the non-recurrence of a £58 million pension accounting gain.

### Private Banking

	Half year to		
	30 June 2010	30 June 2009	31 December 2009
	£m	£m	£m
Net interest income	351	461	354
Net fee income	330	322	304
Trading income	136	94	116
Other operating income	19	20	8
Net operating income before impairments and provisions	836	897	782
Loan impairment charges and credit risk provisions	(7)	(7)	(12)
Net operating income	829	890	770
Total operating expenses	(489)	(489)	(443)
Operating profit	340	401	327
Share of profits in associates and joint ventures	–	–	–
Profit before tax	340	401	327

The above table is on a reported basis and there is no difference between reported and underlying bases.

### Overview

Private Banking reported pre-tax profit of £340 million for the first half of 2010 compared with £401 million for the first half of 2009, a decrease of 15 per cent, and £327 million in the second half of 2009, an increase of 4 per cent. Lower net interest income driven by the narrowing of deposit margins impacted first half year comparisons, whilst increases in net fee and trading income improved performance over the second half of 2009.

Private Banking has continued to focus on providing excellent client experience and global connections with the ability to offer tailor made services including trust and family office services. A Family Office Partnership was launched with Global Banking and Markets, targeting ultra high net worth clients and family offices seeking quasi-institutional services.

## Interim Management Report: Operating and Financial Review (continued)

In the Euromoney Excellence Awards 2010 HSBC Private Bank was named the 'Best Global Wealth Manager' and FT Money and Investors Chronicle Magazine have voted HSBC Private Bank as 'Best Wealth Manager for Alternative Investments'

### Financial performance

*Net interest income* decreased by £110 million or 24 per cent against the first half of 2009 due to the continued low interest rate environment, which affected customer deposit spreads. Compared to the second half of 2009, it remained flat

*Net fee income* increased by £8 million or 2 per cent as market sentiment drove a rise in client activity levels and an increase in client assets under management compared to the same period in 2009. Net new money amounted to £4.9 billion resulting from strong inflows in Asia and other emerging markets and increased client leverage. Switzerland reported a net inflow despite the local data theft incident reported in March. Against the second half of 2009, the increase amounted to £26 million or 9 per cent.

*Trading income* increased by £42 million or 45 per cent in the first half of 2009 driven by higher client activity transaction volumes as client risk appetite returned, particularly in foreign exchange and debt securities trading. Compared to the second half of 2009, income increased by 17 per cent driven by the same reasons detailed above.

*Operating expenses* remained in line with the first half of 2009, despite strategic hiring in emerging markets specifically in Asia, India, Middle East and Latin America. The benefit of various cost management initiatives implemented in 2009 was realised and included cost savings from the merger of two subsidiaries in Switzerland. These benefits were primarily offset by payroll taxes on certain bonuses of £6 million in the UK. Against the second half of the prior year, costs increased by 10 per cent.

### Other

	Half year to		
	30 June 2010 £m	30 June 2009 £m	31 December 2009 £m
Net interest income/(expense)	(32)	(107)	(85)
Net fee income/(expense)	(6)	25	30
Trading income/(expense)	13	(91)	56
Other operating income/(expense)	283	(226)	74
Net operating income before impairments and provisions/(expense)	258	(399)	75
Loan impairment charges and credit risk provisions	-	(1)	(1)
Net operating income/(expense)	258	(400)	74
Total operating expenses	(72)	(46)	(38)
Operating profit/(loss)	186	(446)	36
Share of profits in associates and joint ventures	-	-	-
Profit/(loss) before tax	186	(446)	36

The above table is on a reported basis.

Reported profit before tax in Other was £186 million compared with a loss of £446 million in the first half of 2009 and a profit of £36 million in the second half of 2009.

Other includes the following underlying adjustment which is reported in *Other operating income*

- the change in own credit spread on long-term debt which resulted in a £108 million gain in 2010 compared with a loss of £128 million for the first half of 2009 and a loss of £311 million in the second half of 2009,

In addition, the following items are significant in a comparison of the first half of 2010's results against 2009. These items are also reported in *Other operating income*

- the gain of £125 million on the sale and leaseback of the Paris headquarters building in February 2010,
- a gain of £353 million on the sale of the Group's London headquarters building in the second half of 2009.



## Interim Management Report: Operating and Financial Review (continued)

## Overall segmental analysis

	UK Retail	Continental Europe Retail	Global Banking and Markets	Private Banking	Other	Inter Segment	Total
	£m	£m	£m	£m	£m	£m	£m
<b>Net Operating Income</b>							
Half year to							
30 June 2010	2,218	1,020	3,091	829	258	4	7,420
30 June 2009	1,994	928	3,017	890	(400)	(26)	6,403
31 December 2009	1,949	872	2,167	770	74	(37)	5,795
<b>Profit / (Loss) Before Tax</b>							
Half year to							
30 June 2010	647	216	1,406	340	186	–	2,795
30 June 2009	666	142	1,595	401	(446)	–	2,358
31 December 2009	322	55	916	327	36	–	1,656

The above table is on a reported basis


## Statement of Directors' Responsibilities

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We confirm that to the best of our knowledge

- the condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU,
- the interim management report includes a fair review of the information required by
  - (a) D I R 4 2 7 R of the Disclosure Rules and Transparency Rules being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2010 and their impact on the condensed set of financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year and
  - (b) D I R 4 2 8 R of the Disclosure Rules and Transparency Rules being related parties transactions that have taken place in the first six months of the financial year ending 31 December 2010 and that have materially affected the financial position or performance of the group during that period and any changes in the related parties transactions described in the *Annual Report and Accounts 2009* that could do so

S T Gulliver (Chairman) M F Geoghegan (Deputy Chairman) P A Hurston (Chief Executive), P W Boyles (Director) D C Budd (Director), A A Flockhart (Director), S K Green (Director) Dame Mary Marsh (Independent Non-Executive Director) R E S Martin (Independent Non-Executive Director), A R D Monro-Davies (Independent Non-Executive Director) S P O Sullivan (Director) P M Shawyer (Independent Non-Executive Director), J F Trueman (Independent Non-Executive Director)



On behalf of the Board, S T Gulliver (Chairman)

2 August 2010

## Condensed Financial Statements (unaudited)

### Consolidated income statement for the half-year to 30 June 2010

	Half-year to	
	30 June 2010 £m	30 June 2009 £m
<i>Notes</i>		
Interest income	5,620	6,983
Interest expense	(1,636)	(2,834)
Net interest income	3,984	4,149
Fee income	2,666	2,817
Fee expense	(616)	(777)
Net fee income	2,050	2,040
Trading income excluding net interest income	1,016	622
Net interest income on trading activities	482	954
Net trading income	1,498	1,576
Net income/(expense) from financial instruments designated at fair value	(5)	236
Gains less losses from financial investments	221	(162)
Dividend income	11	17
Net earned insurance premiums	1,403	1,437
Other operating income	473	485
<b>Total operating income</b>	<b>9,635</b>	<b>9,778</b>
Net insurance claims incurred and movement in liabilities to policyholders	(1,275)	(1,580)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>8,360</b>	<b>8,198</b>
Loan impairment charges and other credit risk provisions	4 (940)	(1,795)
<b>Net operating income</b>	<b>7,420</b>	<b>6,403</b>
Employee compensation and benefits	5 (2,648)	(2,252)
General and administrative expenses	(1,668)	(1,515)
Depreciation and impairment of property, plant and equipment	(232)	(223)
Amortisation and impairment of intangible assets	(81)	(69)
<b>Total operating expenses</b>	<b>(4,629)</b>	<b>(4,059)</b>
<b>Operating profit</b>	<b>2,791</b>	<b>2,344</b>
Share of profit in associates and joint ventures	4	14
<b>Profit before tax</b>	<b>2,795</b>	<b>2,358</b>
Tax expense	(759)	(516)
<b>Profit for the period</b>	<b>2,036</b>	<b>1,842</b>
Profit attributable to shareholders of the parent company	2,002	1,806
Profit attributable to non-controlling interests	34	36

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2010**

	Half-year to	
	30 June 2010 £m	30 June 2009 £m
Profit for the period	2,036	1,842
<b>Other comprehensive income</b>		
Available-for-sale investments		
– fair value gains	1,848	1,396
– fair value losses transferred to income statement on disposal	57	90
– amounts transferred to the income statement in respect of impairment losses <sup>1</sup>	443	375
– income taxes	(183)	(138)
Cash flow hedges		
– fair value gains	53	71
– fair value (gains)/ losses transferred to income statement	(21)	2
– income taxes	(16)	(20)
Actuarial gains/ (losses) on defined benefit plans		
– before income taxes	221	(2,396)
– income taxes	(65)	666
Exchange differences and other	(1,149)	(1,567)
Other comprehensive income for the period, net of tax	1,188	(1,521)
Total comprehensive income for the period	3,224	321
Total comprehensive income for the period attributable to		
– shareholders of the parent company	3,218	342
– non-controlling interests	6	(21)
	3,224	321

<sup>1</sup> Included in the impairment losses is an amount of £249 million representing impairment charges allocated to capital note holders where losses would be borne by third-party investors in the Special Purpose Entities (SPE's) as described on Page 157 of the Annual Report and Accounts 2009

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of financial position at 30 June 2010**

	Notes	At 30 June 2010 £m	At 31 December 2009 £m
<b>ASSETS</b>			
Cash and balances at central banks		29,798	14,274
Items in the course of collection from other banks		2,045	2,082
Trading assets	6	159,916	165,008
Financial assets designated at fair value	6	14,151	16,435
Derivatives	6	152,656	118,516
Loans and advances to banks	4 6	59,589	46,994
Loans and advances to customers	4 6	277,024	274,659
Financial investments	6	99,194	86,695
Other assets		6,578	8,013
Current tax assets		134	172
Prepayments and accrued income		3,461	3,357
Interests in associates and joint ventures		79	79
Goodwill and intangible assets		10,713	11,199
Property, plant and equipment		4,004	4,090
Deferred tax assets		232	355
<b>Total assets</b>		<b>819,574</b>	<b>751,928</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Deposits by banks	6	56,202	57,729
Customer accounts	6	345,425	332,896
Items in the course of transmission to other banks		1,244	1,477
Trading liabilities	6	125,472	118,881
Financial liabilities designated at fair value	6	21,572	18,164
Derivatives	6	152,407	118,689
Debt securities in issue	6	52,842	39,340
Other liabilities		5,611	5,867
Current tax liabilities		498	197
Liabilities under insurance contracts issued		15,886	16,505
Accruals and deferred income		3,854	3,752
Provisions		342	368
Deferred tax liabilities		112	158
Retirement benefit liabilities		690	2,678
Subordinated liabilities	6	6,650	6,799
<b>Total liabilities</b>		<b>788,807</b>	<b>723,500</b>
<b>Equity</b>			
Called up share capital		797	797
Share premium account		20,025	20,025
Other equity instruments		1,750	1,750
Other reserves		(1,863)	(2,920)
Retained earnings		9,569	8,135
<b>Total shareholders' equity</b>		<b>30,278</b>	<b>27,787</b>
Non-controlling interests		489	641
<b>Total equity</b>		<b>30,767</b>	<b>28,428</b>
<b>Total equity and liabilities</b>		<b>819,574</b>	<b>751,928</b>

S T Gulliver (Chairman)

2 August 2010

**Condensed Financial Statements (unaudited)** (continued)**Consolidated statement of cash flows for the half-year to 30 June 2010**

	Half-year to	
	30 June 2010 £m	30 June 2009 £m
<b>Cash flows from operating activities</b>		
Profit before tax	2,795	2,358
Adjustments for		
– non-cash items included in profit before tax	1,189	2,179
– change in operating assets	7,882	22,913
– change in operating liabilities	27,881	(41,963)
– elimination of exchange differences <sup>1</sup>	712	14,032
– net gain from investing activities	(435)	(176)
– share of profits in associates and joint ventures	(4)	(14)
– distributions from associates	–	(8)
– contributions paid to defined benefit pension plans (Note 5)	(1,891)	(141)
– tax paid	(570)	(120)
Net cash generated from/(used in) operating activities	37,559	(940)
<b>Cash flows used in investing activities</b>		
Purchase of financial investments	(37,507)	(47,337)
Proceeds from the sale and maturity of financial investments	27,504	50,292
Purchase of property, plant and equipment	(229)	(273)
Proceeds from the sale of property, plant and equipment	146	77
Purchase of intangible assets	(80)	(74)
Net cash outflow from acquisition of or increase in stake of subsidiaries	–	(247)
Net cash outflow from acquisition of or increase in stake of associates	–	(14)
Proceeds from disposal of subsidiaries	123	–
Proceeds from disposal of associates	1	187
Purchase of HSBC Holdings plc shares to satisfy share-based payment transactions	–	(21)
Net cash (used in)/generated from investing activities	(10,042)	2,590
<b>Cash flows from financing activities</b>		
Issue of share capital	–	2,777
Issue of preference share capital	25	–
Subordinated loan capital repaid	(5)	(99)
Net cash outflow from acquisition of or increase in stake of subsidiaries	(176)	–
Dividends paid to shareholders	(918)	(77)
Net cash (used in)/generated from financing activities	(1,074)	2,601
<b>Net increase in cash and cash equivalents</b>	26,443	4,251
Cash and cash equivalents at the beginning of the period	60,806	60,855
Exchange differences in respect of cash and cash equivalents	(2,004)	(5,665)
Cash and cash equivalents at the end of the period	85,245	59,441

<sup>1</sup> Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

## Condensed Financial Statements (unaudited) (continued)

## Consolidated statement of changes in equity for the half-year to 30 June 2010

	Half-year to 30 June 2010									
	Other reserves									Total equity £m
	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Available- for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Total share- holders' equity £m	Non- controlling interests £m	
At 1 January	797	20,025	1,750	8,134	(5,911)	351	2,641	27,787	641	28,428
Profit for the period	-	-	-	2,002	-	-	-	2,002	34	2,036
Other comprehensive income (net of tax)	-	-	-	161	2,165	16	(1,126)	1,216	(28)	1,188
Available-for-sale investments	-	-	-	-	2,165	-	-	2,165	-	2,165
Cash flow hedges	-	-	-	-	-	16	-	16	-	16
Actuarial gains/(losses) on defined benefit plans	-	-	-	161	-	-	-	161	(5)	156
Exchange differences and other	-	-	-	-	-	-	(1,126)	(1,126)	(23)	(1,149)
Total comprehensive income for the year	-	-	-	2,163	2,165	16	(1,126)	3,218	6	3,224
Dividends to shareholders	-	-	-	(918)	-	-	-	(918)	(17)	(935)
Net impact of equity-settled share-based payments	-	-	-	197	-	-	-	197	-	197
Other movements	-	-	-	1	-	-	-	1	8	9
Change in ownership interest in subsidiaries <sup>1</sup>	-	-	-	(27)	-	-	-	(27)	(149)	(176)
Tax on items taken directly to equity	-	-	-	19	-	-	-	19	-	19
At 30 June	797	20,025	1,750	9,569	(3,746)	367	1,515	30,277	489	30,766

<sup>1</sup> Relates to the purchase of non-controlling interests in HSBC Europe B.V. See Note 9 for further details

## Condensed Financial Statements (unaudited) (continued)

Half-year to 30 June 2009											
	Other reserves										
	Called up share capital	Share premium	Other equity instruments	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve	Foreign exchange reserve	Total shareholders' equity	Non-controlling interests	Total equity	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	797	17 249	1 750	7 969	(11 627)	327	3 458	19 923	738	20 661	
Profit for the period	-	-	-	1 842	-	-	-	1 842	35	1 877	
Other comprehensive income (net of tax)	-	-	-	(1 766)	1 723	53	(1 510)	(1 500)	(56)	(1 556)	
Available-for-sale investments	-	-	-	-	1 723	-	-	1 723	-	1 723	
Cash flow hedges	-	-	-	-	-	53	-	53	-	53	
Actuarial losses on defined benefit plans	-	-	-	(1 766)	-	-	-	(1 766)	1	(1 765)	
Exchange differences and other	-	-	-	-	-	-	(1 510)	(1 510)	(57)	(1 567)	
Total comprehensive income for the year	-	-	-	76	1 723	53	(1 510)	342	(21)	321	
Share capital issued net of costs <sup>1</sup>	-	2 777	-	-	-	-	-	2 777	-	2 777	
Capital securities issued	-	-	-	-	-	-	-	-	-	-	
Dividends	-	-	-	(77)	-	-	-	(77)	-	(77)	
Net impact of equity-settled share-based payments	-	-	-	94	-	-	-	94	-	94	
Change in ownership interest in subsidiaries <sup>2</sup>	-	-	-	-	-	-	-	-	(125)	(125)	
Other movements	-	-	-	-	-	-	-	-	-	-	
At 30 June	797	20 026	1 750	8 062	(9 904)	380	1 948	23 059	592	23 651	

<sup>1</sup> All new capital subscribed in the year was issued to HSBC Holdings plc

<sup>2</sup> Relates to the purchase of non-controlling interests in HSBC Private Bank (Suisse) SA. See Note 9 for further details



## Notes on the Condensed Financial Statements (unaudited) (continued)

### 1 Basis of preparation

#### (a) Compliance with International Financial Reporting Standards

The interim consolidated financial statements of the group have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the EU

The consolidated financial statements of the group at 31 December 2009 were prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2009, there were no unendorsed standards effective for the year ended 31 December 2009 affecting the consolidated financial statements at that date, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2009 were prepared in accordance with IFRSs as issued by the IASB.

At 30 June 2010, there were no unendorsed standards effective for the period ended 30 June 2010 affecting these interim consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

During the period ended 30 June 2010, the group adopted the following significant standards and amendments to standards:

- On 1 January 2010, the group adopted the revised IFRS 3 'Business Combinations' and the amendments to IAS 27 'Consolidated and Separate Financial Statements'. The main changes under the standards are that:
  - acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred;
  - all consideration transferred, including contingent consideration, is recognised and measured at fair value at the acquisition date;
  - equity interests held prior to control being obtained are remeasured to fair value at the date of obtaining control, and any gain or loss is recognised in the income statement;
  - changes in a parent's ownership interest in a subsidiary that do not result in a change of control are treated as transactions between equity holders and are reported in equity; and
  - an option is available, on a transaction-by-transaction basis, to measure any non-controlling (previously referred to as minority) interests in the entity acquired either at fair value, or at the non-controlling interests' proportionate share of the net identifiable assets of the entity acquired.

In terms of their application to the group, the revised IFRS 3 'Business Combinations' and the amendments to IAS 27 'Consolidated and Separate Financial Statements' apply prospectively to acquisitions made on or after 1 January 2010, and have no significant effect on these consolidated financial statements.

In addition to the above, during the period ended 30 June 2010, the group adopted a number of standards and interpretations and amendments thereto which had an insignificant effect on these consolidated financial statements.

#### (b) Comparative information

These interim consolidated financial statements include comparative information as required by IAS 34 and the UK Disclosure and Transparency Rules.

#### (c) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates. Actual results in the future may differ from those reported. Management believes that the group's critical

## Notes on the Condensed Financial Statements (unaudited) (continued)

accounting policies where judgement is necessarily applied are those which were described on pages 59 to 62 of the *Annual Report and Accounts 2009*

### (d) Consolidation

The interim consolidated financial statements of the group comprise the condensed financial statements of HSBC Bank Plc and its subsidiaries. The method adopted by the group to consolidate its subsidiaries is described on page 41 of the *Annual Report and Accounts 2009*

### (e) Future accounting developments

At 30 June 2010, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not yet effective to these consolidated financial statements. Except for those described on page 41 to 42 of the *Annual Report and Accounts 2009*, the group does not expect the adoption of any of these to have a significant effect on these consolidated financial statements.

### (f) Changes in composition of the group

There were no material changes in the composition of the group.

## 2 Accounting policies

The accounting policies adopted by the group for these interim consolidated financial statements are consistent with those described on pages 43 to 59 of the *Annual Report and Accounts 2009* except as discussed in Note 1, 'Basis of preparation'. The methods of computation applied by the group for these interim consolidated financial statements are consistent with those applied for the *Annual Report and Accounts 2009*.

## 3 Dividends

Dividends to shareholders of the parent company were as follows:

	Half-year to 30 June 2010		Year to 31 December 2009	
	£ per share	Total £m	£ per share	Total £m
<b>Dividends declared on ordinary shares</b>				
In respect of previous year				
– third interim dividend	1.07	850	–	–
In respect of current year				
– first interim dividend	–	–	0.55	441
– second interim dividend	–	–	0.63	500
	<u>1.07</u>	<u>850</u>	<u>1.18</u>	<u>941</u>

### Dividends on preference shares classified as equity

In the first half of 2010 no dividend was paid on the HSBC Bank plc non-cumulative third dollar preference shares (2009 no dividend was paid in the first half and £1.13 per share, totalling £40m, was paid in the second half).

### Interest on capital securities classified as equity

In the first half of 2010 £68 million interest on perpetual subordinated debt was paid at the sole and absolute discretion of the Board of Directors. (2009 £77 million was paid in the first half and £9m was paid in the second half.)

**Notes on the Condensed Financial Statements (unaudited)** (continued)**4 Loan impairment charges and other credit risk provisions**

	Half-year to	
	30 June 2010	30 June 2009
	£m	£m
Total loans and advances		
– new allowances net of allowance releases	823	1,612
– recoveries of amounts previously written off	(75)	(86)
	748	1,526
Impairment charges on debt securities and other credit risk provisions	192	269
	940	1,795

## Movement in impairment allowances on total loans and advances

	Individually assessed £m	Collectively assessed £m	Total £m
At 1 January 2010	2,369	1,280	3,649
Amounts written off	(164)	(460)	(624)
Recoveries of amounts previously written off	7	68	75
Charge to income statement	333	415	748
Exchange and other movements	(73)	(7)	(80)
At 30 June 2010	2,472	1,296	3,768
At 1 January 2009	1,423	1,122	2,545
Amounts written off	(169)	(570)	(739)
Recoveries of amounts previously written off	15	71	86
Charge to income statement	864	662	1,526
Exchange and other movements	(108)	(38)	(146)
At 30 June 2009	2,025	1,247	3,272

**5 Post-employment benefits**

Included within 'Employee compensation and benefits' are components of net periodic benefit cost related to the group's defined benefit pension plans and other post-employment benefits, as follows

	Half-year to	
	30 June 2010	30 June 2009
	£m	£m
Current service cost	99	121
Interest cost	390	350
Expected return on plan assets	(340)	(320)
Other gains	–	(322)
Net defined benefit cost	149	(171)

The group revalues its defined benefit post-employment plans each year at 31 December, in consultation with the plans' local actuaries. The assumptions underlying the calculations are used to determine the expected income statement charge for the following year.

At 30 June each year, the group revalues all plan assets to current market prices. The group also reviews the assumptions used to calculate the defined benefit obligations (the liabilities of the plans) and updates the carrying amount of the obligations if there have been significant changes as a consequence of changes in assumptions.

Reductions in the average yields of high quality (AA rated or equivalent) debt instruments in certain regions in the first half of 2010, mitigated by a reduction in inflation expectations, resulted in increases in the valuation of the defined benefit obligations. The group has, therefore, revalued certain plan obligations where the impact has been significant.

The change in actuarial assumptions resulted in an increase in the defined benefit obligation for the HSBC Bank (UK) Pension Scheme of £0.4 billion. The actual return on plan assets for the HSBC Bank (UK) Pension Scheme was

**Notes on the Condensed Financial Statements (unaudited)** (continued)

approximately £0.6 billion above expected return. These differences from expected changes were recognised directly in equity as a net actuarial gain.

In February 2010, HSBC Bank plc agreed with the Trustee of the HSBC Bank (UK) Pension Scheme ('the Scheme') to reduce the deficit of the plan by meeting a schedule of future funding payments, as disclosed on page 70 of the *Annual Report and Accounts 2009*.

On 17 June 2010, HSBC Bank plc agreed with the Trustee to accelerate the reduction of the deficit of the plan with a special contribution of £1,760 million in 2010 followed by a revised payment schedule in the following years, as shown below:

	Original Plan £m	Revised plan £m
2010	Nil	1,760
2011	Nil	nil
2012	465	nil
2013	465	nil
2014	465	nil
2015	630	nil
2016	630	495
2017	630	630
2018	630	630

On the same day, HSBC Bank plc made the £1,760 million contribution and the Scheme used the contribution to acquire debt securities with a fair value of £1,760 million from the bank in a transaction at an arm's length value determined by the Scheme's independent third-party advisors. The debt securities sold comprised supranational, agency and government-guaranteed securities, asset backed securities, corporate subordinated debt and auction rate securities.

**6 Fair values of financial instruments**

Fair values are determined in accordance with the methodology set out in the *Annual Report and Accounts 2009* in the accounting policies on pages 43 to 59, and in Note 31 on pages 117 to 125.

**Bases of valuing financial assets and liabilities measured at fair value**

		Valuation techniques		
	Quoted market price Level 1 £m	Using observable inputs Level 2 £m	With significant unobservable inputs Level 3 £m	Total £m
At 30 June 2010				
Assets				
Trading assets	107,555	50,862	1,499	159,916
Financial assets designated at fair value	8,483	5,668	–	14,151
Derivatives	598	150,722	1,336	152,656
Financial investments available-for-sale	47,442	45,334	2,037	94,813
Liabilities				
Trading liabilities	74,467	48,552	2,453	125,472
Financial liabilities at fair value	8,633	12,939	–	21,572
Derivatives	517	149,926	1,964	152,407
At 31 December 2009				
Assets				
Trading assets	107,883	55,615	1,510	165,008
Financial assets designated at fair value	10,870	5,565	–	16,435
Derivatives	795	116,121	1,600	118,516
Financial investments available-for-sale	33,163	50,258	3,274	86,695
Liabilities				
Trading liabilities	60,735	55,362	2,784	118,881
Financial liabilities at fair value	6,694	11,470	–	18,164
Derivatives	714	114,963	3,012	118,689

Trading assets valued using a valuation technique with significant unobservable inputs include various asset-backed securities, leveraged loans underwritten by the group and corporate and mortgage loans held for securitisation.

**Notes on the Condensed Financial Statements (unaudited)** (continued)

Derivative products valued using a valuation technique with significant unobservable inputs include certain types of correlation products, particularly equity and foreign exchange basket options and foreign exchange-interest rate hybrid transactions, long-dated option transactions, particularly equity options, interest rate and foreign exchange options and certain credit derivatives, including tranching credit default swap transactions and credit derivatives executed with certain monoline insurers

Available-for-sale financial investments and financial assets designated at fair value that are valued using unobservable inputs include holdings of private equity and asset-backed securities

**Fair values of financial instruments not carried at fair value**

	30 June 2010		31 December 2009	
	Carrying amount £m	Fair Value £m	Carrying amount £m	Fair Value £m
<b>Assets</b>				
Loans and advances to banks	59,589	59,564	46,994	46,970
Loans and advances to customers	277,024	272,749	274,659	269,542
Financial investments debt securities	4,381	4,622	4,851	5,235
<b>Liabilities</b>				
Deposits by banks	56,202	56,202	57,729	57,730
Customer accounts	345,425	345,479	332,896	333,039
Debt securities in issue	52,842	52,878	39,340	38,702
Subordinated liabilities	6,650	6,166	6,799	6,381

**7 Credit quality of financial instruments**

The five credit quality classifications set out and defined on pages 140 to 141 of the *Annual Report and Accounts 2009* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

## Notes on the Condensed Financial Statements (unaudited) (continued)

The following tables set out the group's distribution of financial instruments by measures of credit quality

30 June 2010								
	Neither past due nor impaired				Past due not impaired £m	Impaired £m	Impairment allowances £m	Total £m
	Strong £m	Medium Good £m	Satisfactory £m	Sub-standard £m				
Cash and balances at central banks	29,798	-	-	-	-	-	-	29,798
Items in the course of collection from other banks	2,045	-	-	-	-	-	-	2,045
Trading assets	104,578	20,383	17,777	300	-	-	-	143,038
– treasury and other eligible bills	148	276	36	-	-	-	-	460
– debt securities	63,882	2,897	5,194	174	-	-	-	72,147
– loans and advances to banks	18,010	10,897	3,094	19	-	-	-	32,020
– loans and advances to customers	22,538	6,313	9,453	107	-	-	-	38,411
Financial assets designated at fair value	3,491	65	4,036	-	-	-	-	7,592
– treasury and other eligible bills	71	-	-	-	-	-	-	71
– debt securities	2,526	65	4,032	-	-	-	-	6,623
– loans and advances to banks	397	-	4	-	-	-	-	401
– loans and advances to customers	497	-	-	-	-	-	-	497
Derivatives	108,428	34,061	9,455	712	-	-	-	152,656
Loans and advances held at amortised cost	206,373	61,807	52,727	10,955	1,683	6,836	(3,768)	336,613
– loans and advances to banks	47,561	8,362	3,541	84	-	97	(56)	59,589
– loans and advances to customers	158,812	53,445	49,186	10,871	1,683	6,739	(3,712)	277,024
Financial investments	89,461	2,039	2,306	1,795	-	1,586	-	97,187
– treasury and other similar bills	6,246	-	191	2	-	1	-	6,440
– debt securities	83,215	2,039	2,115	1,793	-	1,585	-	90,747
Other assets	5,361	836	2,081	355	10	4	-	8,647
– endorsements and acceptances	265	90	106	-	-	-	-	461
– accrued income and other	5,096	746	1,975	355	10	4	-	8,186

## Notes on the Condensed Financial Statements (unaudited) (continued)

31 December 2009

	Neither past due nor impaired							Total £m
	Strong £m	Good £m	Satisfactory £m	Sub- standard £m	Past due not impaired £m	Impaired £m	Impairment allowances £m	
Cash and balances at central banks	14,274	-	-	-	-	-	-	14,274
Items in the course of collection from other banks	2,082	-	-	-	-	-	-	2,082
Trading assets	115,484	13,436	16,202	482	-	-	-	145,604
- treasury and other eligible bills	747	42	-	-	-	-	-	789
- debt securities	66,516	2,781	5,877	392	-	-	-	75,566
- loans and advances to banks	22,268	5,754	2,807	28	-	-	-	30,857
- loans and advances to customers	25,953	4,859	7,518	62	-	-	-	38,392
Financial assets designated at fair value	5,217	63	4,200	-	-	-	-	9,480
- treasury and other eligible bills	35	-	-	-	-	-	-	35
- debt securities	4,450	63	4,193	-	-	-	-	8,706
- loans and advances to banks	207	-	7	-	-	-	-	214
- loans and advances to customers	525	-	-	-	-	-	-	525
Derivatives	82,706	27,368	6,465	1,977	-	-	-	118,516
Loans and advances held at amortised cost	186,225	69,142	49,533	11,625	2,154	6,623	(3,649)	321,653
- loans and advances to banks	36,545	7,546	2,443	420	-	97	(57)	46,994
- loans and advances to customers	149,680	61,596	47,090	11,205	2,154	6,526	(3,592)	274,659
Financial investments	76,591	1,790	3,260	1,336	-	1,402	-	84,379
- treasury and other similar bills	2,345	-	-	1	-	3	-	2,349
- debt securities	74,246	1,790	3,260	1,335	-	1,399	-	82,030
Other assets	5,846	894	2,238	405	16	50	-	9,449
- endorsements and acceptances	190	64	98	-	-	-	-	352
- accrued income and other	5,656	830	2,140	405	16	50	-	9,097

**Notes on the Condensed Financial Statements (unaudited)** (continued)**8 Contingent liabilities, contractual commitments and guarantees**

	At 30 June 2010 £m	At 31 December 2009 £m
<b>Guarantees and other contingent liabilities</b>		
Guarantees and irrevocable letters of credit pledged as collateral security	16,726	20,971
Other contingent liabilities	37	32
	<b>16,763</b>	<b>21,003</b>
<b>Commitments</b>		
Documentary credits and short-term trade-related transactions	1,703	1,515
Forward asset purchases and forward deposits placed	11	492
Undrawn formal standby facilities, credit lines and other commitments to lend	103,638	114,076
	<b>105,352</b>	<b>116,083</b>

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. They are mainly credit-related instruments which include both financial and non financial guarantees and commitments to extend credit. Contingent liabilities arising from litigation are disclosed in Note 10. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

**Financial Services Compensation Scheme**

The UK Financial Services Compensation Scheme (FSCS) has provided compensation to consumers following the collapse of a number of deposit takers such as Bradford & Bingley plc, Heritable Bank plc and Kaupthing Singer & Friedlander Limited. The financial impact on the bank, the basis for estimating costs, and the uncertainties involved in estimating the ultimate FSCS levy to the industry, remain consistent with those disclosed on page 171 of the *Annual Report and Accounts 2009*.

**Payment Protection Insurance Sales**

A summary of actions by UK regulators and the consumer protection agency, together with banking industry response, up until the end of February 2010 is included on page 172 of the *Annual Report and Accounts 2009*.

The FSA subsequently issued a further Consultation Paper ('CP (10/6)') setting out revised proposals in relation to which there was a further consultation period to 22 April 2010. The FSA is currently considering responses to this second consultation. It is not yet known when the FSA will publish a policy statement nor what its form and content will be. In the circumstances, it is not possible for the bank to determine what impact, if any, the FSA's proposals will eventually have.

**Guarantees and other commitments**

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed on page 173 of the *Annual Report & Accounts 2009*.

**9 Related party transactions****Pension scheme swap transactions**

HSBC Bank (UK) Pension Scheme ('the Scheme') enters into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 30 June 2010, the gross notional value of the swaps was £14.7 billion (31 December 2009: £14.6 billion); the swaps had a negative fair value of £1.3 billion to the bank (31 December 2009: negative fair value £647 million) and the bank had delivered collateral of £2.0 billion (31 December 2009: £1.7 billion) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.



**Notes on the Condensed Financial Statements (unaudited)** (continued)

During the year, the bank sold debt security assets to the Scheme at an arm's length value, the details of which are provided in Note 5 'Post-employment benefits'

**Purchase of non-controlling interests**

In June 2010 the group purchased the non-controlling interests in HSBC Europe B V which was owned by HSBC Holdings (Luxembourg) S A , a direct subsidiary of HSBC Overseas Holdings (UK) Limited, for a cash consideration of £176 million

In March 2009, the group purchased the non controlling interests in HSBC Private Bank (Suisse) S A which was owned by HSBC Investor PBRs Corporation (Delaware), a direct subsidiary of HSBC Bank USA, National Association, for a cash consideration of £247 million

**10 Litigation**

A summary of the details of litigation proceedings relating to Bernard L. Madoff was published on pages 175 to 176 of the *Annual Report and Accounts 2009*. There have been no significant developments in this case during the first half of 2010

**11 Event after the balance sheet date**

On 22 June 2010, the UK Government announced its intention to reduce the main rate of corporation tax from 28 per cent to 24 per cent. The fall will be phased in over a period of four years with a 1 per cent reduction in the main corporation tax rate for each year starting on 1 April 2011. The Finance (No 2) Act 2010 enacted on 27 July 2010 included legislation on the initial phase to reduce the main rate of corporation tax from 28% to 27% from 1 April 2011. The tax rate change was not substantively enacted at 30 June 2010, therefore the changes have not been reflected in the amounts recognised as at that date. However, it is not expected that the proposed rate changes will have a significant effect on the net UK deferred tax position recognised at 30 June 2010 of £222 million.

A first interim dividend for the financial year ending 31 December 2010 of £900 million was declared by the Directors after 30 June 2010.

**12 Interim Report 2010 and statutory accounts**

The information in this *Interim Report 2010* is unaudited and does not constitute statutory accounts within the meaning of section 434(3) of the Companies Act 2006. The *Interim Report 2010* was approved by the Board of Directors on 2 August 2010. The statutory accounts for the year ended 31 December 2009 have been delivered to the Registrar of Companies in England and Wales in accordance with section 242 of the Companies Act 1985. The auditor has reported on those accounts. Its report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

## Independent Review Report by KPMG Audit Plc to HSBC Bank plc

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### Introduction

We have been engaged by HSBC Bank plc ('the bank') to review the condensed set of financial statements in the half-yearly interim report for the six months ended 30 June 2010 which comprises the consolidated income statement consolidated statement of comprehensive income consolidated statement of financial position consolidated statement of changes in equity consolidated cash flow statement and the related explanatory notes. We have read the other information contained in the *Interim Report 2010* and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the bank in accordance with the terms of our engagement to assist the bank in meeting the requirements of the Disclosure and Transparency Rules ('the DTR') of the UK's Financial Services Authority ('the UK FSA'). Our review has been undertaken so that we might state to the bank those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the bank for our review work for this report or for the conclusions we have reached.

### Directors' responsibilities

The *Interim Report 2010* is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the *Interim Report 2010* in accordance with the DTR of the UK FSA.

As disclosed in note 1, the annual financial statements of the bank are prepared in accordance with IFRSs as adopted by the European Union ('EU'). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

### Our responsibility

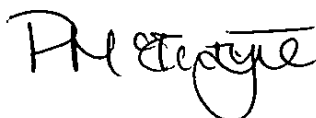
Our responsibility is to express to the bank a conclusion on the condensed set of financial statements in the *Interim Report 2010* based on our review.

### Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the *Interim Report 2010* for the six months ended 30 June 2010 is not prepared in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.



P McIntyre  
For and on behalf of KPMG Audit Plc  
Chartered Accountants  
London, England

2 August 2010