SUPPLEMENTARY LISTING PARTICULARS

HSBC Bank plc

(A company incorporated with limited liability in England with registered number 14259)

as Issuer

PROGRAMME FOR THE ISSUANCE OF NOTES AND WARRANTS

This supplement (the "**Supplement**") to the offering memorandum dated 18 June 2014 as supplemented on 19 August 2014, 9 October 2014, 10 November 2014 and 20 November 2014 relating to the Programme for the Issuance of Notes and Warrants (the "**Offering Memorandum**", which constitutes listing particulars for the purposes of listing on the Official List of the Irish Stock Exchange ("**Listing**") and trading on the Global Exchange Market of the Irish Stock Exchange and, for the avoidance of doubt, which does not constitute (i) a prospectus for the purposes of Part VI of the Financial Services and Markets Act 2000 (as amended) or (ii) a base prospectus for the purposes of Directive 2003/71/EC (as amended)) constitutes supplementary listing particulars (pursuant to rule 3.10 of the Global Exchange Market Listing and Admission to Trading – Rules) for the purposes of Listing.

Terms defined in the Offering Memorandum have the same meaning when used in this Supplement.

This Supplement is supplemental to, and should be read in conjunction with, the Offering Memorandum and any other supplements to the Offering Memorandum prepared by HSBC Bank plc, as issuer (the "**Issuer**") in relation to its Programme for the Issuance of Notes and Warrants.

This Supplement has been approved by the Irish Stock Exchange for the purposes of Listing.

The Issuer accepts responsibility for the information contained in this Supplement. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Supplement is in accordance with the facts and does not omit anything likely to affect the import of such information.

The purpose of this Supplement is to disclose that on 23 February 2015, the Issuer published its annual report and accounts for the year ended 31 December 2014 (the "**Annual Report and Accounts**") and the additional financial information document (the "**Additional Information**"), copies of which are annexed hereto. The Additional Information is additional financial information, which is intended to be read in conjunction with the Annual Report and Accounts, but which is not required to be included in the Annual Report and Accounts by either the UK Companies Act 2006 or by International Financial Reporting Standards. It includes commentary on the results of the Issuer and its subsidiaries in 2013 versus 2012 and certain statistics and other information, including adjusted 2013 and 2012 segmental information comparatives to reflect changes to the Issuer's management structure. The Additional Information has been published by the Issuer together with the Annual Report and Accounts. Any document incorporated by reference into the Annual Report and Accounts or the Additional Information does not form part of this Supplement.

To the extent that there is any inconsistency between (a) any statement in this Supplement and (b) any other statement in or incorporated by reference in the Offering Memorandum prior to the date of this Supplement, the statement in this Supplement will prevail.

Save as disclosed in this Supplement, no significant new factor, material mistake or inaccuracy relating to information included in the Offering Memorandum has arisen or been noted, as the case may be, since the publication of the Offering Memorandum.

19 March 2015

ANNEX

HSBC Bank plc Annual Report and Accounts 2014 and Additional Information

HSBC Bank plc

Annual Report and Accounts 2014

HSBC

Annual Reports and Accounts 2014

Presentation of Information

This document comprises the Annual Report and Accounts 2014 for HSBC Bank plc ('the bank') and its subsidiaries (together 'the group').'We', 'us' and 'our' refer to HSBC Bank plc together with its subsidiaries. It contains the Strategic Report, the Report of the Directors, the statement of Directors' Responsibilities and Financial Statements, together with the Independent Auditor's Report, as required by the UK Companies Act 2006. References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

HM Treasury has transposed the requirements set out under CRD IV and issued the Capital Requirements Country-by-Country Reporting Regulations 2013, effective 1 January 2014. The legislation will require HSBC Holdings to publish additional information, in respect of the year ended 31 December 2014, by 1 July 2015. This information will be available at the time on HSBC's website: www.hsbc.com. This enables HSBC Bank plc to be exempt from the reporting obligation and therefore the bank does not separately disclose this information.

Additional information, including commentary on 2013 versus 2012 and certain statistical and other information, may be found in a separate document entitled 'Additional Information 2014' and can be found at www.hsbc.co.uk.

Cautionary Statement Regarding Forward-Looking Statements

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

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. HSBC Bank plc makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statement.

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.

Contents

Strategic Report: Highlights

	2014	2013
For the year (£m)		
Profit on ordinary activities before tax (reported basis)	**1,953**	3,294
Total operating income	**14,202**	15,868
Net operating income before loan impairment charges and other credit risk provisions	**11,886**	12,840
Profit attributable to shareholders of the parent company	**1,354**	2,495
At year-end (£m)		
Total equity attributable to shareholders of the parent company	**36,078**	32,370
Risk weighted assets[1]	**243,652**	185,879
Loans and advances to customers (net of impairment allowances)	**257,252**	273,722
Customer accounts	**346,507**	346,358
Capital ratios[1] (%)		
Common Equity Tier 1 / Core Tier 1 ratio	**8.7**	12.1
Tier 1 ratio	**10.3**	13.0
Total capital ratio	**13.8**	18.0
Performance ratios (%)		
Risk adjusted revenue growth[2]	**(3.6)**	5.6
Return on average shareholders' equity of the parent company[3]	**4.2**	7.9
Post-tax return on average total assets	**0.2**	0.3
Pre-tax return on average risk-weighted assets	**0.8**	1.7
Dividend payout ratio[4]	**69.7**	48.7
Credit coverage ratios (%)		
Loan impairment charges as a percentage of total operating income	**3.2**	6.1
Loan impairment charges as a percentage of average gross customer advances	**0.2**	0.4
Efficiency and revenue mix ratios (%)		
Cost efficiency ratio (reported basis)[5]	**79.8**	66.8
As a percentage of total operating income:		
- net interest income	**46.7**	43.9
- net fee income	**23.0**	21.0
- net trading income	**11.3**	15.0
Financial ratios (%)		
Ratio of customer advances to customer accounts	**74.2**	79.0
Average total shareholders' equity to average total assets	**4.2**	3.8

1 *Current period RWAs and ratios are based on CRD IV rules (refer to page 86). Comparative period RWAs and ratios are based on CRD III capital rules.*
2 *Risk-adjusted revenue growth is measured as the percentage change in reported net operating income after loan impairment and other credit risk charges compared to the previous year.*
3 *The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by the average total shareholders' equity.*
4 *Dividends declared in respect of or for that year per ordinary share expressed as a percentage of basic earnings per share.*
5 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

Strategic Report: Purpose and Strategic Objectives

Our Purpose and Strategic Objectives

The purpose of HSBC Bank plc is to connect customers to opportunities, enable businesses to thrive and economies to prosper, and ultimately help people to fulfil their hopes and realise their ambitions.

Our strategic priorities

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

In 2013, HSBC announced a set of three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:

- grow the business and dividends;
- implement Global Standards; and
- streamline processes and procedures.

Each priority is complementary and underpinned by initiatives being undertaken within our day-to-day business. Together they create value for our customers and contribute to the long-term sustainability of the group and HSBC.

In Europe the group's aim is to be the leading and most respected international bank connecting Europe with the rest of the world. On an operational level the group has developed a strategy for each of four global businesses following HSBC's strategic priorities while also focusing on increasing capital and cost efficiency.

How we measure performance

We track our progress in implementing our strategy with a range of financial and non-financial measures or key performance indicators. These are set out on page 11. From 2015 we have revised our targets to better reflect the changing regulatory and operating environment.

Value creation

Within the group we continue to follow the vision for the long-term direction of HSBC which was first outlined in 2011 along with a clear strategy that will help us achieve it. Our strategy guides where and how we seek to compete. We constantly assess our progress against this strategy and provide regular updates to stakeholders.

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

How we create value

Banks, and the individuals within them, play a crucial role in the economic and social system, creating value for many parties in different ways.

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

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

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

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

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

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

We charge customers a spread, representing the difference between the price charged to the customer and the theoretical cost of executing an offsetting hedge

Strategic Report: Purpose and Strategic Objectives (continued)

in the market. We retain that spread at maturity of the transaction if the risk management of the position has been effective.

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

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

In addition, we manage risks that arise from the business we do with customers.

Our strategy

The group's strategy and strategic direction is embedded in HSBC's strategy, which is aligned to the following long-term trends.

Long-term trends

- The world economy is becoming ever more interconnected, with growth in world trade and cross-border capital flows continuing to outstrip growth in average gross domestic product. Over the next decade we expect growth in trade and capital flows to outstrip GDP growth, and 35 markets to generate 85% of world trade growth with a similar degree of concentration in cross-border capital flows.
- Of the world's top 30 economies, we expect those of Asia, Latin America, the Middle East and Africa to have increased by around four-fold in size by 2050, benefiting from demographics and urbanisation. By this time they will be larger than those of Europe and North America combined. By 2050, we expect 18 of the 30 largest economies will be from Asia, Latin America or the Middle East and Africa.

Competitive advantages

What matters in this environment is:

- having an international network and global product capabilities to capture international trade and movements in capital; and
- being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest.

The group's competitive advantages come from:

- our meaningful presence in and long-term commitment to HSBC's key strategic markets;
- our business network;
- our balanced business portfolio centred on our global client franchise;
- our strong ability to add to our capital base while also providing competitive rewards to our staff and good returns to our shareholders;
- our stable funding base; and
- our local balance sheet strength and trading capabilities in the most relevant financial hubs.

A two-part strategy

Based on these long-term trends and its competitive advantages, the Group strategy has two parts:

- A network of businesses connecting the world. HSBC is well positioned to capture growing international trade and capital flows. The Group's global reach and range of services place HSBC in a strong position to serve clients as they grow from small enterprises into large multi-nationals through our Commercial Banking and Global Banking & Markets businesses.
- Wealth management and retail with local scale. HSBC aim to capture opportunities arising from social mobility and wealth creation in the Group's priority growth markets, through the Premier proposition and its Global Private Banking business. The Group expects to invest in full scale retail businesses only in markets where it can achieve profitable scale.

HSBC Values

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

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

Be dependable and doing the right thing:

- stand firm for what is right, deliver on commitments, be resilient and trustworthy; and
- take personal accountability, be decisive, use judgment and common sense, empower others.

Be open to different ideas and cultures:

- communicate openly, honestly and transparently, value challenge, learn from mistakes; and
- listen, treat people fairly, be inclusive, value different perspectives.

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

- build connections, be externally focused, collaborate across boundaries; and
- care about individuals and their progress, show respect, be supportive and responsive.

Business principles

HSBC Values describe how we should interact with each other and with customers, regulators and the wider community. Our business principles shape our strategy and commercial decisions. Together, our values and

Strategic Report: Purpose and Strategic Objectives (continued)

business principles delineate our character and define who we are as an organisation and what makes us distinctive. We bring these values and business principles to life through our day-to-day actions.

The emphasis we place on adhering to high behavioural standards and doing the right thing has led HSBC to establish two Board committees: (i) the Conduct & Values Committee to oversee the design and application of HSBC's policies, procedures and standards and ensure that we conduct business responsibly and consistently adhere to HSBC Values; and (ii) the Philanthropic and Community Investment Oversight Committee, which will focus on the Group's philanthropic activities, largely monetary donations made to charitable organisations and the contribution of staff time to volunteering.

Business principles

- **Financial strength** – maintain capital strength and liquidity;
- **Risk-management** – be enterprising and commercial, understand and be accountable for the impact of our actions, take prudent decisions;
- **Responsiveness** – be fast and responsive, make principles-led decisions;
- **Performance-focus** – drive leading, competitive levels of performance, act with urgency and intensity, prioritise, simplify;
- **Efficiency** – focus on cost discipline, process efficiency and quality of execution;
- **Quality** – pursue excellence;
- **Customer-focus** – provide outstanding customer experience;
- **Integrated** – align the Group and break down silos; and
- **Sustainability** – take a long-term outlook, understand impact of actions on stakeholders, brand and reputation.

Market presence

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

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

The strategic focus of our capital deployment will continue to be the UK, one of HSBC's two home markets, and the priority markets of Germany, France and Turkey.

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

Investment criteria

We use the HSBC six filters to guide our decisions about when and where to invest. The first two – international connectivity and economic development – determine whether the business is strategically relevant. The next three – profitability, efficiency and liquidity – determine whether the financial position of the business is attractive. The sixth filter – the risk of financial crime – governs our activities in high risk jurisdictions, and is applied to protect us by restricting the scope of our business where appropriate.

Decisions over where to invest additional resources have three components:

- **Strategic –** we will only invest in businesses aligned to our strategy, mostly in our home and priority growth markets and in target businesses and clients;
- **Financial –** the investment must be value accretive for the Group, and must meet minimum returns, revenue and cost hurdles; and
- **Risk –** the investment must be consistent with our risk appetite.

HSBC conducts an annual geographic and business portfolio review following the six filter approach to update its market and business priorities.

Strategic Report: Products and Services

Products and Services

The group divides its activities into four business segments: Retail Banking and Wealth Management ('RBWM'); Commercial Banking ('CMB'); Global Banking and Markets ('GB&M'); and Global Private Banking ('GPB').

They are responsible for developing, implementing and managing their business propositions consistently across the group, focusing on profitability and efficiency. They set their strategies within the parameters of the Group strategy in liaison with the geographical regions, are responsible for issuing planning guidance regarding their businesses, are accountable for their profit and loss performance, and manage their headcount.

Retail Banking and Wealth Management

Products and services

RBWM takes deposits and provides transactional banking services to enable customers to manage their day-to-day finances and save for the future. We offer credit facilities to assist them in their short or longer-term borrowing requirements, and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

RBWM offers four main types of service:

- **HSBC Premier:** we provide a dedicated relationship manager to our mass affluent customers and their immediate families, offering specialist and tailored advice. Customers can access emergency travel assistance, priority telephone banking and an online 'global view' of their Premier accounts around the world.
- **HSBC Advance:** we offer our emerging affluent customers control over their day-to-day finances and access to a range of preferential products, rates and terms. HSBC Advance is also the start of a relationship where we give customers support and guidance to help them to realise their ambitions.
- **Wealth Solutions & Financial Planning:** a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth. We offer investment and wealth insurance products manufactured by Global Asset Management, Markets and HSBC Insurance and by selected third-party providers.
- **Personal Banking:** we provide reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

RBWM delivers services through four principal channels: branches, self service terminals, telephone service centres and digital (internet and mobile).

Customers

RBWM serves nearly 17.5 million customers in Europe. We are committed to building lifelong relationships with our customers as they move from one stage of their lives to the next, offering tailored products and services appropriate to their diverse goals, aspirations and ambitions. We recognise that some of our customers face financial challenges and, in these cases, we aim to be tolerant, fair and understanding and to support them during difficult times. We put the customer at the heart of everything we do. We constantly carry out research and invest resources to make sure that customers can access our services conveniently, securely and reliably. We have conducted work to ensure that we sell products that meet their needs and at a price that represents a fair exchange of value between customers and shareholders, and have introduced new incentive programmes that have no formulaic links to sales volumes but are focused on assessing how well we are meeting our customers' needs.

We measure customer satisfaction through an independent market research survey of retail banking customers in selected countries and calculate a Customer Recommendation Index to measure performance. This is benchmarked against average scores of a peer group of banks in each market and we set targets for our business relative to our competitor set of banks. We expect continuous improvements across markets in which we operate. We aim to handle customer complaints promptly and fairly, monitoring trends to further improve our services.

Commercial Banking

Products and services

CMB provides a broad range of banking and financial services to enable customers to manage and grow their businesses domestically and internationally. We aim to be recognised as the leading international trade and business bank by connecting customers to markets and by enhancing collaboration within the Group, both geographically and between global businesses. A global operating model increases transparency, enables consistency, improves efficiency and ensures the right outcomes for our customers.

CMB customer offerings typically include:

- **Credit and Lending:** we offer a broad range of domestic and cross-border financing, including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is also offered in selected countries.
- **Global Trade and Receivables Finance:** HSBC supports customers' access to the world's trade flows and provide unrivalled experience in addressing today's most complex trade challenges. Our comprehensive suite of products and services, letters of credit, collections, guarantees, receivables finance, supply chain solutions, commodity and structured finance and risk distribution can be combined into global solutions that make it easier for businesses to manage risk, process transactions and fund activities throughout the trade cycle.
- **Payments and Cash Management:** HSBC are strategically located where most of the world's payments and capital flows originate. We provide local, regional and global transaction banking services including payments, collections, account services, e-commerce and liquidity management via e-enabled platforms to address the needs of our customers.
- **Insurance and Investments:** we offer business and financial protection, trade insurance, employee benefits, corporate wealth management and a variety of other commercial risk insurance products in selected countries.
- **Collaboration:** our CMB franchise represents a key client base for products and services provided by GB&M, RBWM and GPB, including foreign exchange, interest rate, capital markets and advisory services, payroll and personal accounts services and wealth management and wealth transition services.

Strategic Report: Products and Services (continued)

HSBC is leading the development of the renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Our range of products, services and delivery channels is tailored to meet the needs of specific customer segments.

Customers

We have organised ourselves around our customers' needs and degree of complexity by developing three distinct segments within CMB: Business Banking, Mid-Market and Large Corporates.

- Business Banking now has two distinct needs-based servicing models: relationship managers focused on customers with more complex needs; and portfolio management for customers requiring simpler more routine products and services.
- We have brought increased focus to our Mid-Market customers and are re-configuring our organisation and resources across our home and priority growth markets to provide enhanced relationship management.
- For our Large Corporate customers, who typically have complex and multi-country needs, we provide globally managed senior coverage teams, who are also able to coordinate with other global businesses.

To ensure that our customers remain at the heart of our business, we continue to place the utmost value on customer feedback and customer engagement. We are now in the 6th year of our Client Engagement Programme, a global survey of 15 markets designed to deepen our understanding of our customers and reinforce our relationship with them. This initiative, combined with other insight programmes, helps us to identify customers' critical business issues so that we can tailor solutions and services offered to better meet their needs.

Building long-term relationships with reputable customers is core to our growth strategy and organisational values.

Global Banking and Markets

Products and services

GB&M provides wholesale capital markets and transaction banking services organised across eight client-facing businesses.

GB&M products and services include:

- Sales and trading services in the secondary market are provided in **Markets**, which includes four businesses organised by asset class:
  - **Credit** and **Rates** sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They assist clients in managing risk via interest rate and credit derivatives, and facilitate client financing via repurchase ('repo') agreements.
  - **Foreign Exchange** provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of small and medium-sized enterprises ('SMEs'), middle-market enterprises ('MMEs') and large corporates in GB&M and CMB, and the needs of RBWM and GPB customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.
  - **Equities** provides sales and trading services for clients, including direct market access and financing and hedging solutions.
- **Capital Financing** offers strategic financing and advisory services focusing on a client's capital structure. Products include debt and equity capital raising in the primary market, transformative merger and acquisition advisory and execution, and corporate lending and specialised structured financing solutions such as leveraged and acquisition finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.
- **Payments and Cash Management** helps clients move, control, access and invest their cash. Products include non-retail deposit taking and international, regional and domestic payments and cash management services.
- **Securities Services** provides custody and clearing services to corporate and institutional clients and funds administration to both domestic and cross-border investors.
- **Global Trade and Receivables Finance** provides trade services on behalf of GB&M clients to support them throughout their trade cycle.

In addition to the above, Balance Sheet Management is responsible for the management of liquidity and funding for the group. It also manages structural interest rate positions within the Markets limit structure.

Customers

GB&M provides tailored financial solutions to major governmental, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements and strategic goals.

Client coverage is centralised in Banking, which contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together our broad array of product capabilities and utilising our extensive global network.

Our goal is to be a 'Top 5' bank to our priority clients. We strive to achieve this goal by assembling client coverage teams across our geographical network who work alongside product specialists in developing individually tailored solutions to meet client needs. Our client coverage and product teams are supported by a unique customer relationship management platform and comprehensive client planning process. Our teams utilise these platforms to better serve global client relationships, which facilitates our ability to connect clients to international growth opportunities.

Strategic Report: Products and Services (continued)

Global Private Banking

Products and services

Drawing on the strength of HSBC and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage and preserve wealth for today and for the future. Our products and services include Private Banking, Investment Management and Private Wealth Solutions.

GPB products and services include:

- **Private Banking** services comprise multicurrency and fiduciary deposits, account services, and credit and specialist lending. GPB also accesses HSBC's universal banking capabilities to offer products and services such as credit cards, internet banking, and corporate and investment banking solutions.
- **Investment Management** comprises advisory and discretionary investment services, and brokerage across asset classes. This includes a complete range of investment vehicles, portfolio management, securities services and alternatives.
- **Private Wealth Solutions** comprise trusts and estate planning, designed to protect wealth and preserve it for future generations.

Customers

GPB serves the needs of high net worth and ultra-high net worth individuals and their families in our home and priority markets.

Within these broad segments, GPB has teams dedicated to serving HSBC's global priority clients, which include our most significant group relationships, and other clients who benefit from our private banking proposition and services offered by CMB and GB&M. Our aim is to build and grow connectivity with these customers group-wide, establishing strong relationships across all global businesses to meet clients' needs. We aim to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners.

Relationship managers are the dedicated points of contact for our clients, tailoring services to meet their individual needs. They develop a thorough understanding of their clients – including their family, business, lifestyle and ambitions – and introduce them to specialists equipped to help build the best financial strategy. Specialists include:

- investment advisers, who discuss investment ideas in line with a client's investment and risk profile;
- credit advisers, who provide expertise in complex liquidity and lending requirements; and
- wealth planners, who have the knowledge and expertise to design and implement structures to manage wealth now and for future generations.

The use of digital platforms continues to grow in line with strong demand from self-directed clients. These platforms enable clients to access account information, investment research and online transactional capabilities directly. We continue to invest in digital systems to better meet clients' evolving expectations and needs.

Strategic Report: Strategic Priorities

Strategic priorities

As aforementioned, we previously defined three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:

- grow the business and dividends;
- implement Global Standards; and
- streamline processes and procedures.

Each priority is complementary and underpinned by initiatives within our day-to-day business. Together, they create value for our customers and shareholders and contribute to the long-term sustainability of the group.

In the process, we shall maintain a robust, resilient and environmentally sustainable business in which our customers can have confidence, our employees can take pride and our communities can trust.

As at 31 December 2014, the bank had 1,066 branches in the United Kingdom and 13 located in the Isle of Man and the Channel Islands. The bank and its subsidiaries had further banks, branches and offices in Armenia, Belgium, the Channel Islands, Czech Republic, France, Germany, Greece, Hong Kong Special Administrative Region of the People's Republic of China, Ireland, Israel, Italy, Luxembourg, Malta, Netherlands, Poland, Russia, South Africa, Spain, Switzerland and Turkey.

Grow the business and dividends

In growing the business and dividends, our targets are to grow risk-weighted assets ('RWAs') in line with our organic investment criteria and progressively grow dividends while reducing the effect of legacy and non-strategic activities on our profit and RWAs.

Our strategy is to take advantage of the continuing growth of international trade and capital flows, and wealth creation. We aim to achieve growth by leveraging our international network and client franchise to improve HSBC's market position in products aligned to our strategy.

To facilitate this growth, we recycle RWAs from low into high performing businesses within our risk appetite.

In 2014, we launched a number of investment priorities to capitalise on HSBC's global network and accelerate organic growth:

- Global Trade and Receivables Finance: We are investing in our sales and product capabilities, particularly for high-growth products and trade corridors and expanding in trade hubs as a means of reinforcing HSBC's leading position in trade.
- Payments and Cash Management: We aim to deliver improved client coverage and products via investments in better sales coverage and customer proposition and mobile enhancements.
- Foreign Exchange: We aim to improve our services to clients and efficiency by improving our electronic trading platforms and capabilities.
- Renminbi: Building on our market-leading position, we are investing to roll out our renminbi servicing capabilities internationally, with the aim of capturing a larger share of offshore renminbi, foreign exchange and capital markets opportunities.

Industry awards and market share gains have validated our strategy. HSBC's market shares in core international connectivity products such as Payments and Cash Management, Global Trade and Receivables Finance and Foreign Exchange have all improved consistently over the past three years. For three consecutive years, including 2014, HSBC has been voted the top global cash manager for corporate and financial institutions in the Euromoney Cash Management survey. In the same survey HSBC was voted best global cash manager for non-financial institutions for a second consecutive year in 2014. HSBC has also been voted the 'Best Overall for Products and Services' by Asiamoney in its Offshore Renminbi Services survey every year since the survey's inception in 2012.

We aim to continue to invest in key growth markets and align resources to city clusters with fast-growing international revenue pools:

- The UK is our home market: Our goal is to strengthen and develop our home market position in key products, such as mortgages and personal lending.
- Germany: We continue to improve our position in Europe's leading trade nation through the expansion of our corporate franchise. In 2014, we broadened our customer base by enhancing our products, widening our geographical coverage and adjusting our risk appetite. International revenues increased through deeper relationships with customers and developing cross-business collaboration opportunities.

Implement Global Standards

HSBC is adopting the highest or most effective financial crime controls and deploying them everywhere it operates.

Two new global policies set out those controls for anti-money laundering and sanctions. They are HSBC's Global Standards.

In line with our ambition to be recognised as the world's leading international bank, HSBC's aspires to set the industry standard for knowing our customers and detecting, deterring and protecting against financial crime. Delivering on this means introducing a more consistent, comprehensive approach to managing financial crime risk – from understanding more about our customers, what they do and where and why they do it, to ensuring their banking activity matches what we would expect it to be.

We aim to apply our financial crime risk standards throughout the lifetime of our customer relationships: from selecting and onboarding customers, to managing our ongoing relationships and monitoring and assessing the changing risk landscape in the bank. HSBC's new global anti-money laundering policy enhances our ability to stop criminals laundering money through HSBC. It sets out global requirements for carrying out customer due diligence, monitoring transactions and escalating concerns about suspicious activity.

Strategic Report: Strategic Priorities (continued)

HSBC's new global sanctions policy aims to ensure that we comply with local sanctions related laws and regulations in countries where we operate, as well as with global sanctions imposed by the UN Security Council, European Union, US, UK and Hong Kong governments.

In many cases, our policy extends beyond what we are legally required to do, reflecting the fact that HSBC has no appetite for business with illicit actors.

We expect HSBC's Global Standards to underpin our business practices now and in the future, and to provide a source of competitive advantage. Global Standards allow us to:

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

Implementing Global Standards

Each global business, supported by Financial Crime Compliance, has identified where and how it needs to enhance existing procedures to meet the global standards. They are now in the process of deploying the systems, processes, training and support to put the enhanced procedures into practice.

This is being done in two stages:

- delivering policy components with limited infrastructure dependency according to an accelerated timeline; and
- implementing, in parallel, long term strategic enhancements and associated enhancements to infrastructure.

During 2014, HSBC made material progress in a number of areas, including:

- global implementation of customer selection policies and governance;
- first deployment of enhanced customer due diligence procedures for gathering and verifying customer information;
- integration of global sanctions screening lists into our customer and transaction screening tools;
- targeted training for highest risk roles and all-employee campaigns to raise awareness of financial crime risk and encourage escalation;
- global roll out of financial intelligence and investigations units to follow up on escalations and alerts, and identify emerging trends and issues; and
- the establishment of global procedures and governance to exit business that is outside our financial crime risk appetite.

Governance framework

The Global Businesses and Financial Crime Compliance, supported by HSBC Technology and Services, are formally accountable for delivering business procedures, controls and the associated operating environment to implement HSBC's new policies within each Global Business and jurisdiction.

This accountability is overseen by the Global Standards Execution Committee, which is under the chairmanship of the Group Chief Risk Officer and consists of the Chief Executive Officers of each global business and the Global Head of Financial Crime Compliance.

Correspondingly, and to promote closer integration with business as usual, a report on the implementation of Global Standards is a standing item at the Group's Risk Management Meeting. The Financial System Vulnerabilities Committee and the Holdings Board of Directors continue to receive regular reports on the Global Standards programme as part of their continued role in providing oversight.

Risk appetite

Financial crime risk controls are a part of our everyday business and they are governed according to HSBC's global financial crime risk appetite statement. This aims to ensure sustainability in the long-term. Our overarching appetite and approach to financial crime risk is that we will not tolerate operating without the appropriate systems and controls in place to detect and prevent financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

Enterprise-wide risk assessment

The Group has conducted its second annual enterprise-wide assessment of our risks and controls related to sanctions and anti-money laundering ('AML') compliance. The outcome of this assessment has formed the basis for risk management planning, prioritisation and resource allocation for 2015.

The Monitor

Under the agreements entered into with the US Department of Justice ('DoJ'), the UK FCA, formerly the Financial Services Authority ('FSA'), and the US Federal Reserve Board ('FRB') in 2012, including the five-year deferred prosecution agreement with the DoJ ('US DPA'), the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia, an independent compliance monitor ('the Monitor') was appointed to evaluate HSBC's progress in fully implementing its obligations under the agreements, and produce regular assessments of the effectiveness of HSBC's Compliance function.

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

HSBC is continuing to take concerted action to remedy AML and sanctions compliance deficiencies and to implement Global Standards. HSBC is also working to implement the agreed recommendations flowing from the Monitor's 2013 review. HSBC recognises it is only part way through a journey, being two years into the

Strategic Report: Strategic Priorities (continued)

five-year US DPA. The Group looks forward to maintaining a strong, collaborative relationship with the Monitor and his team.

Streamline processes and procedures

We continue to refine our operational processes, develop our functions, implement consistent business models and strengthen IT. The Group's aim is to achieve a cost efficiency ratio in the mid 50's.

Since 2011, the Group has changed how HSBC is managed by introducing a leaner reporting structure and establishing an operating model with global businesses and functions. These changes - together with improvements in software development productivity, process optimisation, and HSBC's property portfolio – realised US$5.7 billion in Group wide sustainable savings, equivalent to US$6.1 billion on an annualised (run rate) basis. This exceeded our commitment to deliver US$2.5–3.5 billon of sustainable savings at the outset of the organisational effectiveness programme included in the first phase of our strategy.

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

The reorganisation of the Group into four global businesses and eleven global functions further allows HSBC to run globally consistent operating models. This establishes the foundation for the next stage of streamlining.

From 2014 to 2016, the Group will continue to streamline processes and procedures with a target to realise an additional US$2-3 billion of sustainable savings. This programme will be applied to:

- improving the end-to-end optimisation of processes and servicing channels;
- technology simplification, reducing the number of applications used across the Group; and
- enhancing infrastructure, including optimising our real estate utilisation and the location where certain activities are carried out.

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

Strategic direction

Retail Banking and Wealth Management

RBWM provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale in our target customer segments to do so cost effectively.

We focus on three strategic imperatives:

- building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our Insurance and Asset Management businesses;
- using our global expertise to improve customer service and productivity, to provide a high standard of banking solutions and service to our customers efficiently; and
- simplifying and re-shaping the RBWM portfolio of businesses globally, to focus our capital and resources on key markets.

Our three growth priorities are customer growth in target segments, deepening customer relationships through wealth management and relationship-led lending, and enhancing distribution capabilities, including digital.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

Commercial Banking

CMB aims to be the banking partner of choice for our customers building on our rich heritage, international capabilities and relationships to enable global connectivity.

We have four growth priorities:

- providing consistency and efficiency for our customers through a business model organised around global customer segments and products;
- utilising our distinctive geographical network to support and facilitate global trade and capital flows;
- delivering excellence in our core flow products – specifically in Trade and Payments and Cash Management; and
- enhancing collaboration with other global businesses.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for CMB.

Global Banking and Markets

GB&M's business model and strategy is well established with the objective of being a 'top 5' bank to our priority clients and in our chosen products and geographies.

We focus on the following growth priorities:

- connecting clients to international growth opportunities;
- continuing to be well positioned in products that will benefit from global trends; and
- leveraging our distinctive International expertise and geographical network which connects developed and faster-growing regions;

Enhancing risk management controls, implementing Global Standards and collaborating with other global businesses also remain top priorities for GB&M.

Global Private Banking

GPB aims to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners by:

Strategic Report: Strategic Priorities (continued)

- capturing growth opportunities in home and priority growth markets, particularly from group collaboration by accessing owners and principals of CMB and GB&M clients; and
- repositioning the business to concentrate on onshore markets and a smaller number of target offshore markets, aligned with Group priorities.

Implementing Global Standards, enhancing risk management controls, tax transparency and simplifying processes also remain top priorities for GPB.

Key Performance Indicators

The Board of Directors tracks the group's progress in implementing its strategy with a range of financial and non-financial measures or key performance indicators. Progress is assessed by comparison with the group strategic priorities, operating plan targets and historical performance.

From time to time the group reviews its key performance indicators ('KPIs') in light of its strategic objectives and may adopt new or refined measures to better align the KPIs to HSBC's strategy and strategic priorities.

Financial KPIs

	2014	2013
	%	%
Risk adjusted revenue growth	**(3.6)**	5.6
Cost efficiency ratio	**79.8**	66.8
Pre-tax return on average risk-weighted assets ratio	**0.8**	1.7
CET 1 / Core tier 1 capital ratio	**8.7**	12.1

Risk-adjusted revenue growth is measured as the percentage change in reported net operating income after loan impairment and other credit risk charges since last year. The group seeks to deliver consistent growth in risk-adjusted revenues.

Outcome: Reported risk-adjusted revenue growth decreased primarily due to weaker trading income compared to 2013.

Cost efficiency ratio is measured as total operating expenses divided by net operating income before loan impairment and other credit risk provisions.

Outcome: The cost efficiency ratio increased principally due to higher costs, most notably from charges for investigations into foreign exchange, combined with lower overall revenues.

Pre-tax return on average risk-weighted assets ratio is measured as pre-tax profit divided by average risk-weighted assets. The group targets a return in the medium term of between 1.8 and 2.0 per cent.

Outcome: The return on average risk-weighted assets was significantly below the target range predominantly due to a fall in profit before tax.

Common equity tier / Core tier 1 capital ratio – represents the ratio of common equity tier / core tier 1 capital comprising shareholders' equity and related non-controlling interests less regulatory deductions and adjustments to total risk weighted assets. The group seeks to maintain a strong capital base to support the development of its business and meet regulatory capital requirements at all times.

Outcome: The Common Equity Tier 1 ratio fell compared to Core Tier 1 ratio from 12.1 to 8.7 per cent primarily reflecting the impact of the transition to CRD IV.

Employee engagement

Strong employee engagement leads to positive commercial outcomes and underpins improved business performance, increased customer satisfaction, higher productivity, talent retention and reduced absenteeism. We assess our employees' engagement through our Global People Surveys, which were held annually from 2007 to 2011 and bi-annually thereafter. The latest Survey, in 2013, focused on supporting a values-led high performance culture by assessing if our employees were engaged in the Group's purpose and felt able to deliver on our ambition to become the world's leading international bank.

The overall Europe engagement score in 2013 was 60 per cent, which was below the financial services norm. Strong scores were registered in risk awareness (78 per cent, 5 percentage points above the external best-in-class), employee development (58 per cent), leadership capability (58 per cent) and living the HSBC Values (78 per cent). Aspects that require concerted attention included pride and advocacy, which had fallen from 2011 levels. The next Global People Survey will be conducted in 2015.

Brand value

HSBC monitors the strength of its brand through an empirical tool (the Brand Equity Index), which combines measurements of perception for customer purchase consideration from the brand, customer advocacy of the brand and emotional connection to the brand to develop an Index Value that can be tracked over time.

The HSBC brand in the UK scores at the competitive average, ranking third, and is strongly differentiated from an International perspective. In both Turkey and France, HSBC's Brand Equity Index improved during 2014 but is below the average of its larger local competitors.

Customer service and satisfaction

In RBWM, customer satisfaction is measured through an independent market research survey of retail banking customers, using a Customer Recommendation Index ('CRI') to score performance. In the UK during 2014 our CRI ranking was poor and for the first half of the year, the bank achieved historic low scores. Following a strong intervention programme in our service channel 'Simplifying Growth' we saw a positive response and finished the year with a very good fourth quarter position ranking us joint third behind Halifax and Santander. Turkey and France both saw significant improvement throughout the year and both achieved their targets to improve their overall score relative to the competitor average. Turkey in particular finished the fourth quarter strongly with a record competitive joint third position in the market.

Throughout 2014, CMB continued to draw insight and metrics from the Client Engagement Programme ('CEP'), conducted by an independent third party. The results

Strategic Report: Strategic Priorities (continued)

showed that CMB has remained differentiated from its key competitors; particularly in the UK and ahead or in line with competitors in France, Germany and Turkey. Satisfaction with our Relationship Managers is ahead of its peer group in the UK, Germany and Turkey. This is a good achievement in terms of supporting CMB's strategic objectives and helping us to drive continuous improvement for our clients.

Awards

HSBC was recognised in several industry awards throughout 2014. A small selection of those follows:

- 'Best Mobile Banking Application 2014' - (Global Finance Magazine)
- 'Best Global Cash Management Bank for Corporates and Financial Institutions for the third consecutive year' - (Euromoney 2014)
- 'Bonds and Derivatives House of the year' – (International Finance Review 2014)
- 'Best Family Office Offering' - (Private Banker International Global Wealth Awards)
- 'Best Provider for Mortgages' - Moneysupermarket Supers Awards 2014
- 'Best High Street Mortgage Provider' - Moneyfacts Consumer Money Awards 2014
- 'Best Remortgage Provider' - Moneyfacts Awards 2014
- 'Best Bank Mortgage Provider' - Moneyfacts Awards 2014
- 'Best Variable Rate Mortgage Provider' - Moneyfacts Awards 2014
- 'Most Trusted Mainstream Bank' - Moneywise Customer Service Awards 2014
- 'Best National Bank – Mortgage' Finance Gazette Awards 2014
- 'Best Debt House in Western Europe for the 2nd consecutive year' - Euromoney Awards 2014
- 'UK Number 1 Trade Bank' – Global Finance Magazine 2014

Strategic Report: Business Review

Financial summary

Summary consolidated income statement for the year ended

	2014 £m	2013 £m
Net interest income	**6,629**	6,961
Net fee income	**3,266**	3,336
Trading income	**1,609**	2,373
Net income from financial instruments designated at fair value	**371**	900
Gains less losses from financial investments	**321**	100
Net insurance premium income	**1,823**	2,022
Other operating income	**183**	176
Total operating income[1]	**14,202**	15,868
Net insurance claims, benefits paid and movement in liabilities to policyholders	**(2,316)**	(3,028)
Net operating income before loan impairment and other credit risk provisions	**11,886**	12,840
Loan impairment charges and other credit risk provisions	**(449)**	(971)
Net operating income	**11,437**	11,869
Total operating expenses[1]	**(9,487)**	(8,575)
Operating profit	**1,950**	3,294
Share of profit in associates and joint ventures	**3**	–
Profit before tax	**1,953**	3,294
Tax expense	**(564)**	(754)
Profit for the year	**1,389**	2,540
Profit attributable to shareholders of the parent company	**1,354**	2,495
Profit attributable to non-controlling interests	**35**	45

1 *Total operating income and expenses include significant items as detailed on pages 18 and 19.*

Economic background

The UK recovery continued through the second half of 2014, though the pace of expansion moderated towards the end of the year. Preliminary estimates indicate that the annual rate of growth of real Gross Domestic Product ('GDP') was 2.6 per cent. The unemployment rate fell to 5.7 per cent in the three months to December and wage growth accelerated slightly from a very low level. The annual Consumer Price Index ('CPI') measure of inflation reached a 14-year low of 0.5 per cent in December. After a period of rapid activity in 2013 and the early months of 2014, there were signs that both economic activity and price inflation in the housing market were moderating as the year ended. The Bank of England kept the Bank Rate steady at 0.5 per cent.

The recovery in eurozone economic activity in 2014 was slow and uneven across member states. Real GDP in the region as a whole grew by 0.9 per cent in the year. The German and Spanish economies grew by 1.6 per cent and 1.5 per cent, respectively, while French GDP grew by a more modest 0.4 per cent. Eurozone inflation fell to minus 0.2 per cent in December, prompting fears that the region could move towards a sustained period of deflation. The likelihood that low growth and inflation could persist for an extended period prompted the European Central Bank ('ECB') to cut the main refinancing rate and the deposit rate to 0.05 per cent and minus 0.2 per cent, respectively, in September and embark on a policy of balance sheet expansion starting with purchases of covered bonds and asset-backed securities.

In Turkey, the annual rate of GDP growth slowed in the third quarter to 1.7 per cent largely driven by a slowdown in private consumption. The annual rate of private investment has been particularly weak throughout 2014, averaging minus 1.6 per cent in the first three quarters. CPI inflation remained elevated at 8.2 per cent in December, well above the Central Bank of Turkey's ('CBRT') target of 5.0 per cent. Despite elevated inflation and the sizeable deficit in Turkey's current account position, the CBRT began easing monetary policy in the second quarter, cutting the key interest rate in May, June and July to reach 8.25 per cent down from 10 per cent at the start of the year.

Review of business performance

HSBC Bank plc and its subsidiary undertakings reported profit before tax of £1,953 million, £1,341 million or 41 per cent lower than 2013.

The decrease in profit before tax was primarily due to a number of significant items including provisions arising from the on-going review of compliance with the Consumer Credit Act ('CCA') in the UK and settlements and provisions in connection with foreign exchange investigations. In addition, there was a reduction in Markets revenues in GB&M and lower insurance revenues in RBWM.

Progress continues to be made in streamlining our processes and procedures. This is designed to reduce complexity and lower costs in a sustainable way. Total restructuring costs of £72 million were incurred as a result of streamlining these businesses and other initiatives which delivered sustainable cost savings of approximately £312 million.

In RBWM we expanded our mortgage distribution channels to include a specific intermediary, in order to reach the growing proportion of the mortgage market in the UK that wish to source its finance through intermediaries. In France, we continued to experience strong growth in home loans. In Turkey, the regulator imposed interest rates caps on overdrafts and credit cards which affected revenue.

In CMB, overall UK lending, both new lending and re-financing, continued to grow compared to 2013. In addition, Business Banking launched a campaign to offer further support and lending to SME customers. Lending in Global Trade and Receivables Finance also grew. In France, the Payments and Cash Management business implemented the Single Euro Payments Area platform ('SEPA') for euro-denominated credit transfer and direct debit payments across European locations. In addition, following the success of the SME fund in 2013, CMB allocated a further fund to support customers seeking international growth.

In GB&M, as part of the re-shaping of the business in 2013, we brought together all our financing businesses in Capital Financing in the UK. We increased our sector expertise and enhanced our geographic spread by appointing two new co-heads of UK Banking. In 2014, the advisory and equity capital markets businesses within Capital Financing experienced volume growth that outstripped the market. In France, GB&M acted as sole advisor on one of the largest M&A transactions in Europe.

GPB continued to reposition its business model and focus its client base by reviewing portfolios and ensuring that all clients comply with Global Standards including financial crime compliance and tax transparency standards.The business continued to focus on clients with wider Group connectivity within the home and priority markets, as well as reducing the number of clients in non-priority markets.

Items which are significant in a comparison of 2014 results to 2013 have been summarised on pages 18 to 19.

Net interest income decreased by £332 million or 5 per cent. The decrease was primarily due to provisions of £379 million arising from the on-going review of compliance with the CCA in 2014. Excluding this, net interest income increased by £47 million mainly due to increased spreads in term lending and growth in deposit volumes in Payments and Cash Management in the UK.

Net fee income decreased by £70 million or 2 per cent. In RBWM the reduction in fee income in the UK was due to a higher level of fees payable under partnership agreements as well as lower overdrafts and investment fees. This was partially offset by an increase in GB&M due to lower fees paid to HSBC entities in other regions relating to reduced Foreign Exchange trading activities undertaken on behalf of their clients.

Trading income decreased by £764 million or 32 per cent. The reduction includes a number of significant items including negative fair value adjustments on non-qualifying hedges in our French home loan portfolio in RBWM of £155 million and an adverse movement in the derivatives debit valuation adjustment ('DVA') of £143 million in GB&M. Excluding this, net trading revenue decreased in GB&M primarily driven by Markets. This included the introduction of the funding fair value adjustment ('FFVA') on certain derivative contracts which resulted in a charge of £152 million affecting Rates and Credit.

Revenues also fell in Foreign Exchange reflecting lower volatility and reduced client flows. In addition, revenue decreased in Equities as 2013 benefited from higher revaluation gains, which more than offset the increase in revenue from increased client flows and higher derivatives income.

This decrease was partially offset by favourable foreign exchange movements on trading assets held as economic hedges against issued foreign currency debt designated at fair value, compared to 2013. These offset adverse foreign exchange movements on the foreign currency debt reported in "Net income from financial instruments designated at fair value".

Net income from financial instruments designated at fair value decreased by £529 million compared to 2013. Of this, £296 million was due to adverse foreign exchange movements on economically hedged foreign currency debt in GB&M. In addition, income arising from financial assets held to meet liabilities under insurance and investment contracts decreased reflecting lower net investment returns in 2014 compared to 2013. These returns reflected weaker equity market movements in the UK and France.

This was partially offset by favourable credit spread-related movements in the fair value of the group's own long-term debt of £17 million compared to adverse fair value movements of £167 million in 2013.

Gains less losses from financial investments increased by £221 million, primarily due to higher net disposal gains in the legacy portfolio partly offset by lower available-for-sale gains in GB&M Balance Sheet Management, notably in the UK.

Net insurance premium income decreased by £199 million or 10 per cent. This was mainly as a result of lower volumes following the run-off of business from

Strategic Report: Business Review (continued)

independent financial advisor distribution channels in the UK in 2013.

Other operating income was broadly in line with 2013. A gain arising from external hedging of an intra-group financing transaction was mostly offset by a decrease in the Present Value of In-Force ('PVIF') long term insurance business in France RBWM.

Net insurance claims, benefits paid and movement in liabilities to policyholders decreased by £712 million or 24 per cent. This reflected a net trading loss on economic hedges and a decrease in business volumes. In addition, there was a decrease in investment returns on assets held to support policyholder contracts where the policyholder bears investment risk from weaker equity market movements in 2014 compared to 2013 in the UK and France.

Loan impairment charges and other credit risk provisions decreased by £522 million or 54 per cent. This was due to lower individually assessed provisions in UK CMB reflecting improved portfolio quality and the economic environment. GB&M in the UK recorded reduced loan impairment charges due to lower individually assessed provisions and higher net releases of credit risk provisions on available-for-sale asset backed securities. This was partly offset by an increase due to a revision in certain estimates in our corporate collective loan impairment calculation. In RBWM, loan impairment charges decreased as a result of lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances.

Total operating expenses increased by £912 million or 11 per cent. This was primarily due to a number of significant items including settlements and provisions in connection with foreign exchange investigations in GB&M and the non-recurrence of a 2013 accounting gain of £280 million arising from a change in basis of delivering ill-health benefits in the UK. In addition expenses were higher due to the timing of the recognition of the Financial Services Compensation Scheme ('FSCS') levy in the UK and from growth in regulatory programmes and compliance related costs across all of our businesses.

The increase in expenses was partially offset by lower litigation costs. Customer redress provisions broadly remained in line with 2013. Litigation related expenses decreased by £365 million, reflecting an insurance recovery recognised in 2014 relating to Madoff litigation costs that had been recognised in 2013, and which did not recur in 2014. Compared to 2013, redress provisions did not include a £96 million charge relating to investment advice redress, but included an additional charge of £583 million (2013: £483 million) for estimated redress for possible mis-selling in previous years of payment protection insurance ('PPI') policies and £175 million (2013: £166 million) in respect of interest rate protection products.

During 2014 the group maintained its strict cost control discipline and benefited from the delivery of organisational effectiveness programmes. The number of employees, expressed in fulltime equivalent numbers at the end of 2014 was 1 per cent higher compared to 2013. This was primarily as a result of the initiatives related to Regulatory Programmes and Compliance in part offset by sustainable savings programmes and business disposals.

Tax expense totalled £564 million in 2014, compared to £754 million in 2013. The effective tax rate for 2014 was 28.9 per cent, compared to 22.9 per cent in 2013.

The effective tax rate for 2014 of 28.9 per cent was higher than the UK corporation tax rate of 21.5 per cent due to the non-deductible settlements and provisions in connection with foreign exchange investigations offset in part by the recognition of losses previously not recognised for tax purposes overseas.

Strategic Report: Business Review (continued)

Review of business position

Summary consolidated balance sheet as at 31 December

	2014 **£m**	2013 £m
Total assets	**797,289**	811,695
Cash and balances at central banks	**42,853**	67,584
Trading assets	**130,127**	134,097
Financial assets designated at fair value	**6,899**	16,661
Derivative assets	**187,736**	137,239
Loans and advances to banks	**25,262**	23,013
Loans and advances to customers	**257,252**	273,722
Reverse repurchase agreements – non-trading	**41,945**	61,525
Financial investments	**76,194**	75,030
Other	**29,021**	22,824
Total liabilities	**760,591**	778,776
Deposits by banks	**27,590**	28,769
Customer accounts	**346,507**	346,358
Repurchase agreements – non-trading	**23,353**	65,573
Trading liabilities	**82,600**	91,842
Financial liabilities designated at fair value	**22,552**	34,036
Derivative liabilities	**188,278**	137,352
Debt securities in issue	**27,921**	32,895
Liabilities under insurance contracts issued	**17,522**	19,228
Other	**24,268**	22,723
Total equity	**36,698**	32,919
Total shareholders' equity	**36,078**	32,370
Non-controlling interests	**620**	549

Movements in 2014

Total reported assets were £797 billion, 2 per cent lower than at 31 December 2013.

The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts slightly decreasing to 74.2 per cent (2013: 79.0 per cent). This was due to customer advances decreasing by 6 per cent whilst the amount of customer deposits remained stable.

The group's Common Equity Tier 1 ratio was 8.7 per cent (2013: Core Tier 1 ratio: 12.1 per cent). Risk-weighted assets of £243,652 million were 31 per cent higher than at 31 December 2013, principally reflecting the transition to CRD IV.

Assets

Cash and balances at central banks decreased by 37 per cent reflecting a reduction in excess liquidity.

Trading assets decreased by 3 per cent predominantly due to maturing reverse repos held for trading. New reverse repo transactions are now classified as 'non-trading' if they are mainly for funding purposes. This was partially offset by an increased holding of equity securities in the UK where there has been a rise in equity positions in respect of forward trading, driven by increased client activity, predominantly in the Equity Finance business.

Financial assets designated at fair value decreased by 59 per cent, primarily reflecting the decision to sell the pension insurance business in the UK as part of a strategic decision to cease manufacturing pensions in the UK insurance business. These assets have been classified as *'Held for sale'* and reported as part of *'Other assets'*. In addition, the termination and derecognition of back-to-back structured trades led to a decline in the amount of financial assets designated at fair value. A corresponding decline is reported in '*financial liabilities designated at fair value'*.

Derivative assets increased by 37 per cent, principally as a result of shifts in yield curves which led to an increase in the fair value of interest rate contracts. In addition, the fair value of foreign exchange contracts increased as a result of favourable exchange rate movements in the currency markets.

Loans and advances to banks increased by 10 per cent principally driven by higher placements with financial institutions.

Loans and advances to customers decreased by 6 per cent, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, resulting in a reduction in corporate overdraft balances as clients reduced their overdraft and deposit balances which were previously subject to net interest arrangements. This was partially offset by an increase in term lending to corporate and commercial customers, notably in the second half of the year.

Reverse repurchase agreements – non trading decreased by 32 per cent due to an underlying reduction in reverse repo trades and an increased level of netting.

Financial investments were stable, with no major movement period-on-period.

Strategic Report: Business Review (continued)

Other assets increased by 27 per cent due to the reclassification of the UK pension insurance business as *'Held for sale'*, the transfer of the precious metal business to the bank and an increase in the surplus of the defined benefit scheme.

Liabilities

Deposits by banks decreased by 4 per cent, reflecting a decrease in money market balances across a number of banks.

Customer accounts remained stable year-on-year. Growth in the Payments and Cash Management business and a rise in RBWM balances reflecting customers' continued preference for holding balances in current and savings accounts was offset by the reduction in deposit balances which were previously subject to net interest arrangements.

Repurchase agreements – non trading decreased by 64 per cent. This reflected maturing repo positions that were not replaced due to lower funding requirements and a higher number of repo trades eligible for netting.

Trading liabilities decreased by 10 per cent due to a reduction in net short bond and stock lending positions and maturing repo held for trading positions.

Financial liabilities designated at fair value decreased by 34 per cent predominately due to the reclassification of the UK pension insurance business as *'Held for sale'* reported as part of '*Other liabilities'*. In addition, as aforementioned, the termination and derecognition of back-to-back structured trades led to a decline in the amount of financial liabilities designated at fair value.

The derivative businesses are managed within market risk limits and the increase in the value of *'Derivative liabilities'* broadly matched that of *'Derivative assets'*.

Debt securities in issue decreased by 15 per cent due to net redemptions of debt securities in issue.

Liabilities under insurance contracts decreased by 9 per cent as a result of the agreed sale of the UK pension insurance business.

Other liabilities increased by 7 per cent predominantly due to the reclassification of the UK pension insurance business as *'Held for sale'* partially offset by net redemptions of subordinated liabilities.

Equity

Total shareholders' equity increased by 11 per cent principally due to the issuance of new tier 1 capital instruments during the year, as well as increases in retained earnings.

Strategic Report: Business Review (continued)

Performance and Business Review

Profit on ordinary activities before tax

	2014 £m	2013 £m
Retail Banking and Wealth Management	**213**	1,177
Commercial Banking	**1,592**	1,333
Global Banking and Markets	**(19)**	1,023
Global Private Banking	**115**	140
Other/Intersegment	**52**	(379)
	1,953	3,294

HSBC Bank plc and its subsidiaries reported a profit before tax of £1,953 million, £1,341 million or 41 per cent lower than 2013.

CMB reported significantly higher profits in 2014 while reported profits reduced across RBWM, GB&M and GPB.

Use of non-GAAP financial measures

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements on page 105. In measuring our business performance, the primary financial measure that we use is 'adjusted performance', which has been derived from our reported results in order to eliminate factors which distort year-on-year comparisons. This is considered to be a non-GAAP financial measure.

Adjusted performance

Adjusted performance is computed by adjusting reported results for the year-on-year effects of significant items which distort year-on-year comparisons.

In 2014, we modified our business performance reporting to better align it with the way we view our performance internally and with feedback received from investors. We use the term 'significant items' to collectively describe the group of individual adjustments which are excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

The following business commentary is on an adjusted basis, all tables are on a reported basis and the graphs provide a reconciliation between reported and adjusted basis, unless stated otherwise.

Significant revenue items by business segment

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Total £m
2014						
Change in credit spread on long-term debt	**–**	**–**	**–**	**–**	**17**	**17**
Debit valuation adjustment on derivative contracts	**–**	**–**	**(143)**	**–**	**–**	**(143)**
Fair value movement on non-qualifying hedges	**(155)**	**1**	**3**	**–**	**–**	**(151)**
Provisions arising from the on-going review of compliance with the Consumer Credit Act in the UK	**(337)**	**(16)**	**–**	**(26)**	**–**	**(379)**
Year ended 31 December	**(492)**	**(15)**	**(140)**	**(26)**	**17**	**(656)**
2013						
Change in credit spread on long-term debt	–	–	–	–	(167)	(167)
Debit valuation adjustment on derivative contracts	–	–	45	–	–	45
Fair value movement on non-qualifying hedges	33	–	(41)	–	–	(8)
Year ended 31 December	33	–	4	–	(167)	(130)

Strategic Report: Business Review (continued)

Significant cost items by business segment

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Total £m
2014						
UK customer redress programmes	**602**	**85**	**90**	**–**	**–**	**777**
Restructuring and other related costs	**15**	**8**	**14**	**–**	**35**	**72**
Madoff related litigation costs	**–**	**–**	**(172)**	**–**	**–**	**(172)**
Settlements and provisions in conncection with foreign exchange investigations	**–**	**–**	**746**	**–**	**–**	**746**
Year ended 31 December	**617**	**93**	**678**	**–**	**35**	**1,423**
2013						
UK customer redress programmes	610	91	84	2	–	787
Restructuring and other related costs	41	18	6	1	30	96
Madoff related litigation costs	–	–	193	–	–	193
Operational losses (dissolved company)	–	(10)	–	–	–	(10)
Gain on change in delivering ill-health benefits	(123)	(104)	(53)	–	–	(280)
Year ended 31 December	528	(5)	230	3	30	786

Net impact on profit before tax by business segment

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Total £m
2014						
Reported profit before tax	**213**	**1,592**	**(19)**	**115**	**52**	**1,953**
Less significant revenue items	**(492)**	**(15)**	**(140)**	**(26)**	**17**	**(656)**
Add significant cost items	**617**	**93**	**678**	**–**	**35**	**1,423**
Adjusted profit before tax year ended 31 December	**1,322**	**1,700**	**799**	**141**	**70**	**4,032**
Net impact on reported profit and loss	**1,109**	**108**	**818**	**26**	**18**	**2,079**
2013						
Reported profit before tax	1,177	1,333	1,023	140	(379)	3,294
Less significant revenue items	33	–	4	–	(167)	(130)
Add significant cost items	528	(5)	230	3	30	786
Adjusted profit before tax year ended 31 December	1,672	1,328	1,249	143	(182)	4,210
Net impact on reported profit and loss	495	(5)	226	3	197	916

Retail Banking and Wealth Management

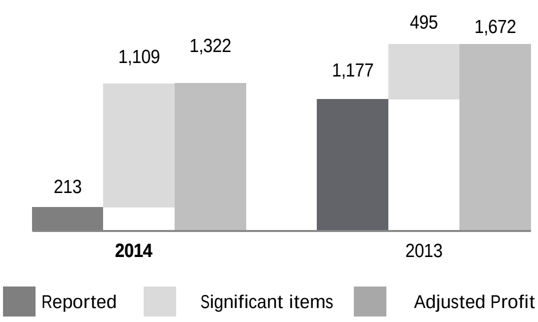
	2014 £m	2013 £m
Net interest income	**3,158**	3,569
Net fee income	**1,356**	1,502
Trading income	**(149)**	147
Other income	**(157)**	(147)
Net operating income before impairments and provisions	**4,208**	5,071
Loan impairment charges and other credit risk provisions	**(162)**	(223)
Net operating income	**4,046**	4,848
Total operating expense	**(3,834)**	(3,673)
Operating profit	**212**	1,175
Share of profit in associates and joint ventures	**1**	2
Profit before tax	**213**	1,177

Profit before tax – by country

	2014 £m	2013 £m
United Kingdom	**381**	995
France	**(113)**	182
Germany	**17**	19
Turkey	**(94)**	(47)
Malta	**16**	22
Other	**6**	6
Profit before tax	**213**	1,177

Review of performance

Profit before tax (£m)



RBWM reported a profit before tax of £213 million, £964 million or 82 per cent lower than 2013.

On an adjusted basis, RBWM profit before tax was £1,322 million compared to £1,672 million in 2013, primarily due to a reduction in UK revenues.

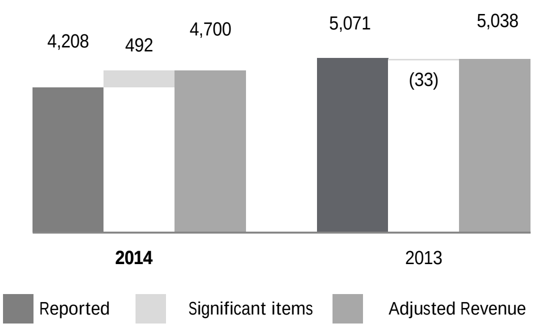
Business highlights

In the UK RBWM approved £11.4 billion of new mortgage lending to over 118,000 customers, including £3.5 billion to over 27,500 first time buyers. Drawn down mortgage balances, however, remained broadly unchanged. The loan-to-value ('LTV') ratio on new lending was 60 per cent compared with an average of 43.7 per cent for the total mortgage portfolio. In 2014, the business expanded its mortgage distribution channels to include a specific intermediary, in order to reach the growing percentage of the mortgage finance market in the UK who wish to source their finance through intermediaries

In France, RBWM continued to experience strong growth in home loans. In Turkey, interest rate caps imposed on credit cards and overdrafts by the regulator resulted in a reduction in revenue.

Review of adjusted performance

Revenue (£m)



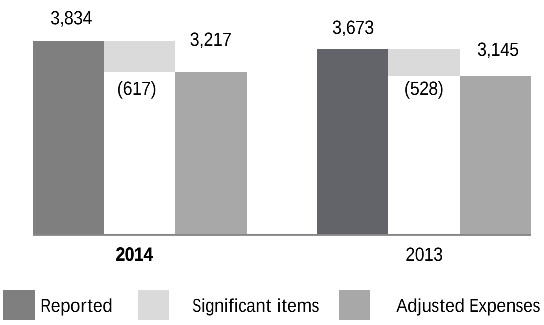
Revenue decreased by £338 million mainly in the UK and to a lesser extent in France and Turkey.

UK revenue reduced marginally due to spread compression, primarily on mortgages. In addition, fee income fell as a result of higher fees payable under partnership agreements and lower fee income from investment products and overdrafts. These factors were partly offset by improved spreads on savings products and higher current account balances.

In France, revenues were lower primarily in the insurance business due to adverse movements in the Present Value of In-Force ('PVIF') business, reflecting a fall in yields which increased the costs of guarantees on the savings business, compared to favourable movements in 2013. In addition, revenues in Turkey were adversely affected by a reduction in net interest income primarily due to interest rate caps on cards and overdrafts imposed by the local regulator, partly offset by an increase in card fees.

Loan impairment charges decreased in the UK due to lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances. This was partly offset by an increase in Turkey due to regulatory changes adversely impacting the card portfolio.

Operating expenses (£m)



Operating expenses were £72 million or 2 per cent higher than 2013. In the UK this reflected the timing of the recognition of the Financial Services Compensation Scheme ('FSCS') levy and an increase in compliance and regulatory programme expenses in line with the implementation of Global Standards. This was partly offset by sustainable cost savings.

Commercial Banking

	2014 £m	2013 £m
Net interest income	**2,195**	2,144
Net fee income	**1,153**	1,143
Trading income	**21**	23
Other income	**65**	60
Net operating income before impairments and provisions	**3,434**	3,370
Loan impairment charges and other credit risk provisions	**(308)**	(601)
Net operating income	**3,126**	2,769
Total operating expenses	**(1,535)**	(1,437)
Operating profit	**1,591**	1,332
Share of profit in associates and joint ventures	**1**	1
Profit before tax	**1,592**	1,333

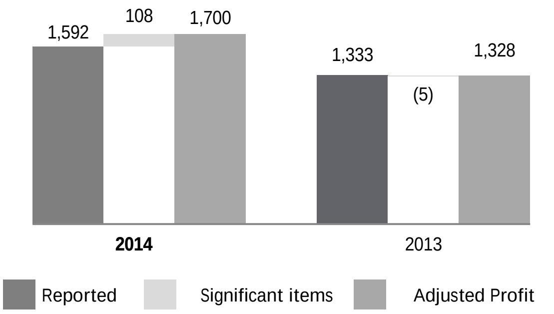
Profit before tax – by country

	2014 £m	2013 £m
United Kingdom	**1,377**	1,075
France	**146**	163
Germany	**43**	45
Turkey	**2**	24
Malta	**10**	33
Other	**14**	(7)
Profit before tax	**1,592**	1,333

Strategic Report: Business Review (continued)

Review of performance

Profit before tax (£m)



CMB reported a profit before tax of £1,592 million, £259 million or 19 per cent higher than 2013.

On an adjusted basis, CMB profit before tax was £1,700 million compared to £1,328 million in 2013, an increase of £372 million or 28 per cent. The increase in profit was primarily due to a reduction in loan impairment charges from lower levels of individually assessed provisions in the UK and Spain.

Business highlights

In the UK overall CMB lending increased by 7 per cent compared with 2013, with new lending and re-financing before attrition and amortisation increasing by 38 per cent and approvals of over 85 per cent for small business loan applications. Business Banking launched a campaign to offer support and lending to SME customers, making £5.8 billion of future lending available to help finance growth across the UK. Lending in Global Trade and Receivables Finance grew by 3 per cent, building on our position in Trade Finance and reducing attrition from our existing clients in Receivables Finance.

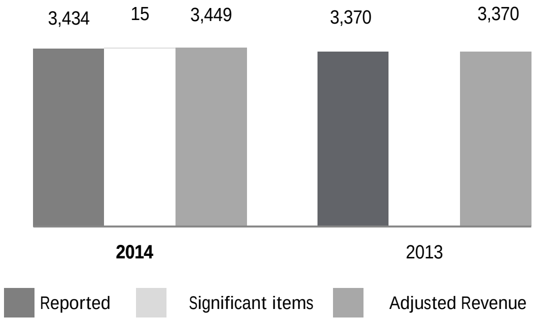
In France, our Payments and Cash Management business implemented the Single Euro Payments Area platform ('SEPA') for euro-denominated credit transfer and direct debit payments across European locations. This allows clients to make and receive payments in euros from their HSBC accounts in the 34 countries that have implemented SEPA, under a consistent set of standards, rules and conditions. In addition, CMB allocated a further £1.2 billion to the SME fund and approved over £1.6 billion of lending in 2014.

In Germany, as part of our growth initiative, we opened three branches in Dortmund, Cologne and Mannheim, increased the number of relationship managers by 26 per cent and held a number of roadshows in countries including France, mainland China and the UK to reinforce Germany as a key international hub.

In Turkey we launched a £0.6 billion International Fund in order to provide sustainable support and global connectivity for international businesses, of which £0.3 billion was drawn down.

Review of adjusted performance

Revenue (£m)



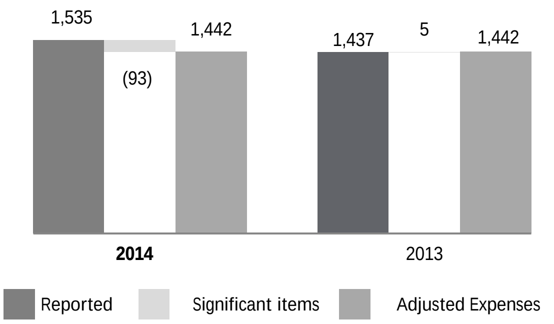
Revenue increased primarily in the UK and Germany partially offset by lower revenues in Turkey.

In the UK revenue increased from wider spreads in term lending and growth in deposit volumes in Payments and Cash Management. In addition, there was an increase in net fee income, partly reflecting higher volumes of new business in the Large Corporate and Mid-Market segments.

In Germany revenue grew by 11 per cent from increased volumes in Credit and Lending, reflecting the growth initiatives implemented earlier in the year. In Turkey revenues were lower due to the impact of the regulatory interest rate cap on overdrafts.

Loan impairment charges decreased primarily in the UK and to a lesser extent in Spain due to lower individually assessed provisions, reflecting the enhanced quality of the portfolio and improved economic conditions. This was partially offset by higher individually assessed provisions in France.

Operating expenses (£m)



Operating expenses of £1,442 million were in line with 2013. An increase in expenses was driven by the timing of the recognition of the FSCS levy in the UK and increased investment in front-line staff in Germany and wage inflation. This was offset by the benefits delivered through re-engineering of business processes.

Strategic Report: Business Review (continued)

Global Banking and Markets

	2014 £m	2013 £m
Net interest income[1]	**1,180**	1,101
Net fee income	**643**	588
Trading income[1]	**1,637**	2,192
Other income	**219**	400
Net operating income before impairments and provisions	**3,679**	4,281
Loan impairment charges and other credit risk provisions	**16**	(133)
Net operating income	**3,695**	4,148
Total operating expenses	**(3,715)**	(3,122)
Operating profit	**(20)**	1,026
Share of profit in associates and joint ventures	**1**	(3)
Profit before tax	**(19)**	1,023

1 The bank's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M 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 (refer to Note 10).

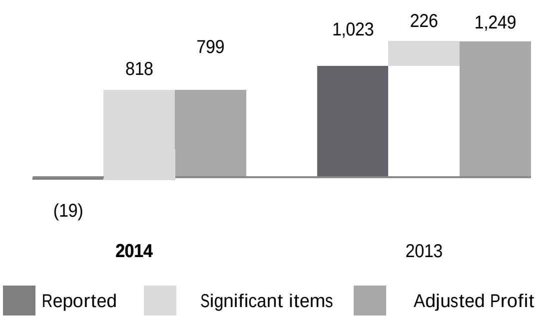
Profit before tax – by country

	2014 £m	2013 £m
United Kingdom	**(708)**	667
France	**212**	227
Germany	**99**	115
Turkey	**56**	70
Malta	**17**	22
Other[1]	**305**	(78)
Profit before tax	**(19)**	1,023

1 Refer to Madoff related litigation costs in the significant items table on pages 18 and 19 for details of year-on-year movement.

Review of performance

Profit before tax (£m)



GB&M reported a loss of £19 million, £1,042 million lower than 2013.

On an adjusted basis, GB&M profit before tax was £799 million compared to £1,249 million in 2013, a decrease of £450 million or 36 per cent primarily due to a reduction in Markets revenues and higher operating expenses.

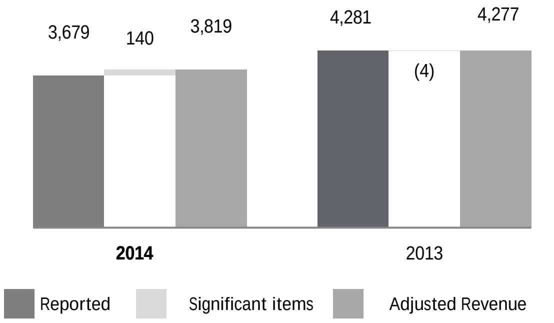
Business highlights

In the UK, as part of the re-shaping of the GB&M business in 2013, we brought together all of the financing businesses in Capital Financing, including lending, debt capital markets and equity capital markets. We increased our sector expertise and enhanced our geographical spread by appointing two new co-heads of UK Banking. In 2014, the advisory and equity capital markets businesses within Capital Financing experienced volume growth that outstripped the market.

In France, we acted as sole advisor on one of the largest M&A transactions in Europe.

Review of adjusted performance

Revenue (£m)

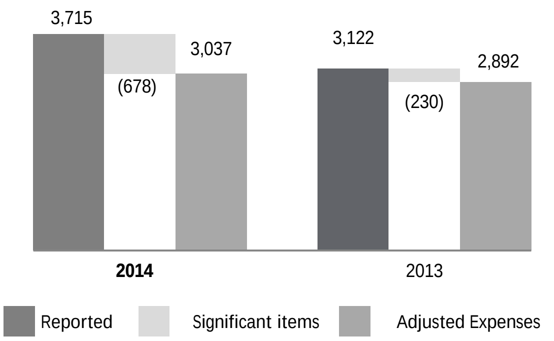


Revenue decreased compared with 2013 primarily driven by Markets. In the UK, this reduction included the introduction of the funding fair value adjustment ('FFVA') on certain derivative contracts which resulted in a charge of £152 million, affecting Rates and Credit. Revenue also fell in Foreign Exchange reflecting lower volatility and reduced client flows. In addition, revenue decreased in Equities as 2013 benefited from higher revaluation gains, which more than offset the increase in revenue from increased client flows and higher derivatives income.

In France, revenue decreased in Rates due to lower volatility and levels of market activity.

Loan impairment charges decreased primarily in the UK due to lower individually assessed provisions and higher net releases of credit risk provisions on available-for-sale Asset-Backed Securities. This was partly offset by an increase in collective impairment charges and higher individually assessed provisions in France.

Operating expenses (£m)



Operating expenses were £145 million or 5 per cent higher than 2013 primarily in the UK reflecting growth in regulatory programmes and compliance related costs along with increased staff costs. This was partly offset by lower litigation costs in France.

Strategic Report: Business Review (continued)

Global Private Banking

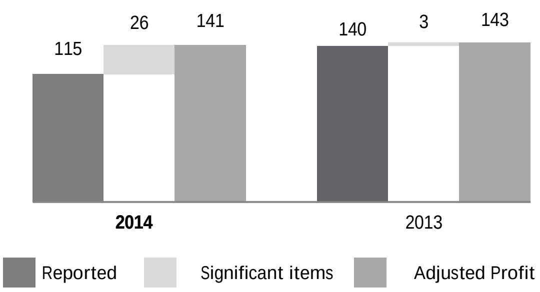
	2014 £m	2013 £m
Net interest income	**203**	224
Net fee income	**112**	100
Trading income	**11**	10
Other income	**(2)**	(4)
Net operating income be-fore impairments and provisions	**324**	330
Loan impairment charges and other credit risk provisions	**4**	(14)
Net operating income	**328**	316
Total operating expenses	**(213)**	(176)
Operating profit	**115**	140
Share of profit in associates and joint ventures	**–**	–
Profit before tax	**115**	140

Profit before tax – by country

	2014 £m	2013 £m
United Kingdom	**100**	99
France	**-**	13
Germany	**16**	28
Turkey	**-**	–
Malta	**-**	–
Other	**(1)**	–
Profit before tax	**115**	140

Review of performance

Profit before tax (£m)



GPB reported a profit before tax of £115 million, £25 million or 18 per cent lower than 2013.

GPB adjusted profit before tax was £141 million compared to £143 million in 2013, a decrease of £2 million.

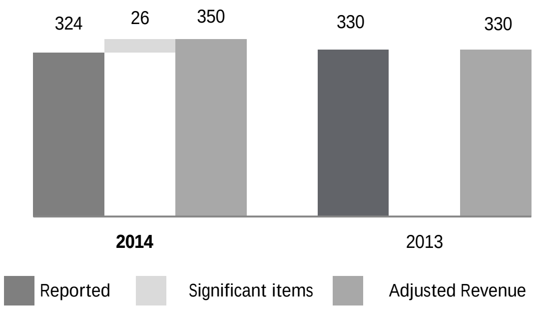
Business highlights

GPB continued to reposition its business model and target its client base by reviewing portfolios and ensuring that all clients comply with Global Standards including financial crime compliance and tax transparency standards.

The business continued to focus on clients with wider Group connectivity within the home and priority markets, as well as reduce the number of clients in non-priority markets.

Review of adjusted performance

Revenue (£m)

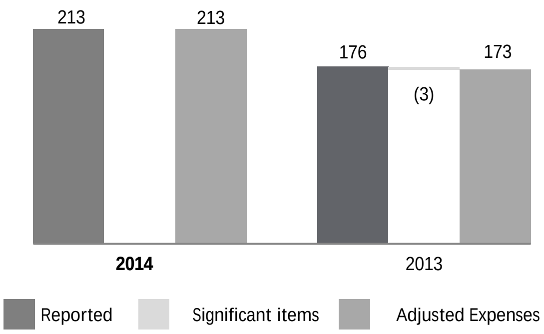


Revenue in the UK increased primarily due to the acquisition of Channel Islands entities from HSBC Private Banking Holdings (Suisse) SA in December 2013.

In Germany, revenues declined reflecting the disposal of an off-shore portfolio by HSBC Trinkaus & Burkhardt AG in 2014.

Loan impairment charges decreased due to collective impairment provision releases and lower individually assessed provisions compared to charges in the UK in 2013.

Operating expenses (£m)



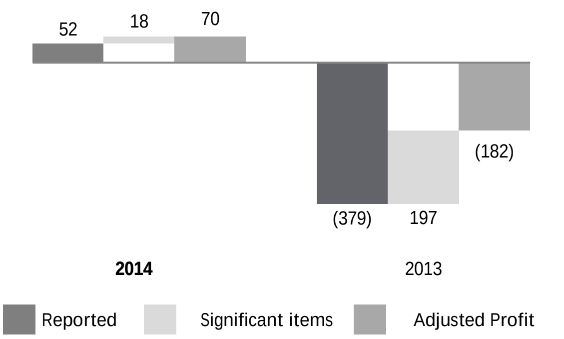
Operating expenses increased by £40 million or 23 per cent compared to 2013. The increase in the UK was principally due to the acquisition of Channel Islands entities from HSBC Private Banking Holdings (Suisse) SA in December 2013. In addition, operating expenses increased in France due to the non-recurrence of a recovery of a litigation provision in 2013. This was partly offset by lower expenses resulting from the disposal of an off-shore portfolio by HSBC Trinkaus & Burkhardt AG, Germany in 2014.

Strategic Report: Business Review (continued)

Other

	2014 £m	2013 £m
Net interest income	**(42)**	(73)
Net fee income	**2**	3
Trading income	**24**	(22)
Change in credit spread on long-term debt	**17**	(167)
Other income	**323**	102
Net operating income before impairments and provisions	**324**	(157)
Loan impairment charges and other credit risk provisions	**1**	–
Net operating income/(expense)	**325**	(157)
Total operating expenses	**(273)**	(222)
Operating (loss)/profit	**52**	(379)
Share of profit in associates and joint ventures	**–**	–
Profit/(loss) before tax	**52**	(379)

Profit before tax (£m)

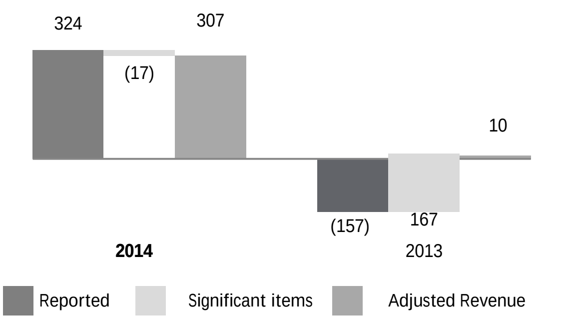


Other profit before tax was £52 million compared to a loss of £379 million in 2013, an increase of £431 million.

Other adjusted profit before tax was £70 million compared to a loss of £182 million in 2013, an increase of £252 million.

Review of adjusted performance

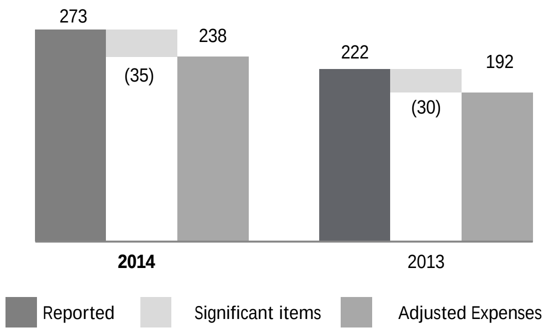
Revenue (£m)



Revenue increased primarily due to gain arising from external hedging of an intra-group financing transaction of £114 million and favourable fair value movements of £25 million from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by the group in 2014 compared to adverse movements of £46 million in 2013.

In addition, other operating income and other operating expenses increased as a result of higher intra-group recharges in line with the increase in costs from centralised activities.

Operating expenses (£m)



Operating expenses increased by £46 million compared to 2013 which was mainly due to intra-group recharges.

Principal Risks and Uncertainties

The group continuously monitors and identifies risks. This process, which is informed by its risk factors and the results of its stress testing programme, gives rise to the classification of certain principal risks. Changes in the assessment of principal risks may result in adjustments to the group's business strategy and, potentially, its risk appetite.

Our principal banking risks are credit risk, operational risk, market risk, liquidity and funding risk, compliance risk and reputational risk. We also incur insurance risk. The exposure to these risks and our risk management are explained in more detail in the Risk section of the Report of the Directors on pages 31 to 83.

Next to these principal banking risks we have identified further principal risks which have the potential to have a material impact on our financial results or reputation and the sustainability of our long-term business model.

During 2014 a number of changes to those risks have been made to reflect its revised assessment of their effect on the group.

Macro-economic and geopolitical risks

Economic outlook and government intervention

Global economic growth remained weak in 2014.

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand-supply imbalances. The precipitous fall in energy prices over such a short span of time changes both the nature and the distribution of risks. It sharpens fiscal and financing challenges for energy exporters, and although it brings benefits for oil importers, it also accentuates deflationary risks among some of these (particularly in the eurozone). The prospect of low oil prices for a prolonged period also may reduce investment in exploration and thus poses the danger of significantly reducing future supply.

The economic recovery in the eurozone is still at risk. Deflationary pressures persist as a result of low oil prices and despite much looser monetary policy. Acceleration in the structural reform agenda could also accentuate deflationary pressures in the short term.

Potential impact on the group

- Our results could be adversely affected by a prolonged period of low or negative interest rates, low inflation levels or deflation and/or low oil prices.

Mitigating actions

- We closely monitor economic developments in key markets to ensure trends are identified, the implications for specific customers, customer segments or portfolios are assessed and appropriate mitigating action is taken as circumstances evolve.

Increased geopolitical risk in certain regions

Our operations are exposed to risks arising from political instability and civil unrest in many parts of the world, which may have a wider effect on regional stability, the stability of the European Union ('EU') membership and regional and global economies.

Geopolitical risk increased during 2014. Military escalation and/or civil war remain a possibility in Ukraine, while sanctions targeting the Russian government, institutions and individuals, together with falling oil prices, have had an adverse effect on the Russian economy.

In the Middle East, the civil war in Syria has been complicated by the seizure of parts of Iraq and Syria by Islamic State, a terrorist group. Elsewhere in the region, chaos in Libya, ongoing tensions between Israel and Palestine and fraught negotiations over Iran's nuclear programme are combining to increase risks to stability.

Civil unrest and demonstrations in a number of countries during 2014, including Turkey, have also contributed to geopolitical risk as governments took measures to contain them.

A number of emerging and developed markets will hold elections in 2015, which could lead to further market volatility. In addition, a sustained period of low oil prices may affect stability in countries that rely heavily on oil production as a significant source of revenue.

Potential impact on the group

- Our results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on matters such as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which we operate.
- Actual conflict could put our staff in harm's way and bring physical damage to our assets.

Mitigating actions

- We continuously monitor the geopolitical outlook, in particular in countries where we have material exposures and/or a physical presence.
- Our internal credit risk rating of sovereign counterparties takes these factors into account and drives our appetite for conducting business in those countries. Where necessary, we adjust our country limits and exposures to reflect our risk appetite and mitigate risks as appropriate.

Macro-prudential, regulatory and legal risks to our business model

Financial service providers face increasingly stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, conduct of business, operational structures and the integrity of financial services delivery. Increased government intervention and control over financial institutions, both on a sector-wide basis and individually, together with measures to reduce systemic risk, may significantly alter the competitive landscape locally, regionally and/or globally for some or all of the group's businesses. These measures may be introduced as formal requirements in a supra-equivalent manner and to differing timetables by different regulatory regimes.

Strategic Report: Principal Risks and Uncertainties (continued)

Regulatory developments affecting our business model and the group profitability

Regulatory changes are likely to affect our activities. These changes include:

- The UK's Financial Services (Banking Reform) Act 2013 which requires the ring-fencing of our UK retail banking activities from wholesale banking, together with the structural separation of other activities as envisaged in the legislation and rules adopted in the US (including the Volcker Rule adopted in December 2013 under the Dodd-Frank Act), measures adopted in France restricting certain trading activities and potential further changes under European Commission proposals for structural measures for larger EU banks.
- The implementation of extra-territorial laws, including the Foreign Account Tax Compliance Act ('FATCA') and other related initiatives to share tax information such as those being pursued by the Organisation for Economic Co-operation and Development ('OECD') more generally.
- Changes in the regime for the operation of capital markets, notably mandatory central clearing of over the counter ('OTC') derivatives, including under the Dodd-Frank Act and the EU's European Market Infrastructure Regulation ('EMIR').
- Changes arising from the increasing focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers, promoting effective competition in the interests of consumers (including the on-going investigation by the UK Competition and Markets Authority ('CMA') into competition in the personal current account and SME banking markets in the UK).
- The outcome of the Fair and Effective Financial Markets Review being undertaken by the Bank of England which will consider changes in the operation of wholesale financial markets in the UK.
- Restrictions on the structure of remuneration imposed under CRD IV and UK regulations and increasing requirements to detail management accountability within the Group to meet the requirements of the Senior Managers' Regime in the UK (including the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards on matters relating to institutional 'culture', employee conduct and obligations more generally such as whistleblowing etc.).
- The implementation of CRD IV, notably the UK application of the capital buffer framework and its interaction with Pillar 2.
- The effect of proposals for the UK Financial Policy Committee ('FPC') to be given more powers to impose leverage constraints on UK banks.
- The proposals from the Financial Stability Board ('FSB') which are subject to consultation and translation into national regulations but which would require global systemically important banks ('G-SIB') to hold minimum levels of capital and subordinated debt as Total Loss Absorbing Capacity ('TLAC').
- Requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries.
- The continuing stress-tests by supervisory authorities and the implication for capital requirements and capital transfers within the Group.
- The tightening by regulators in a number of countries of credit controls on mortgage lending and unsecured portfolios.
- The continued risk of further changes to regulation relating to taxes affecting financial service providers, including financial transaction taxes.
- The continued focus of competition law enforcement agencies at national and European level on the financial sector when enforcing laws against anticompetitive practices (including in the UK the Financial Conduct Authority and the Payment Systems Regulator becoming competition law enforcers for the first time as of 1 April 2015).

Potential impact on the group

- Proposed changes in and/or the implementation of regulations including mandatory central clearing of OTC derivatives, EMIR, ring-fencing and similar requirements, the Volcker Rule, recovery and resolution plans, FATCA and findings from competition orientated enquiries and investigations may affect the manner in which we conduct our activities and how the Group is structured.
- Requirements for higher levels of capital or TLAC may increase the funding costs for the group and reduce our return on equity.
- Mandatory central clearing of OTC derivatives also brings new risks to the group in our role as a clearing member, as we will be required to underwrite losses incurred by central clearing counterparties from the default of other clearing members and their clients. Hence central clearing brings with it a new element of interconnectedness between clearing members and clients which we believe may increase rather than reduce our exposure to systemic risk.
- Increased regulatory scrutiny of conduct of business (including incentive structures, remuneration and product governance and sales processes) and management accountability may affect the industry in areas such as employee recruitment and retention, product pricing and profitability in both retail and wholesale markets. The group's businesses may be affected by these developments.
- Requirements flowing from arrangements for the recovery and resolution strategy of the Group and its individual operating entities, which may have different effects in different countries.

Mitigating actions

- We are engaged closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly and can be implemented in an effective manner.

Strategic Report: Principal Risks and Uncertainties (continued)

- The Group has developed and is implementing a global approach to the management of conduct and have established a Conduct & Values Committee as a sub-committee of the Board to oversee the management of conduct across the Group.
- We have enhanced our governance around central clearing counterparties and appointed specialists to manage the associated liquidity and collateral risks.
- We continue to enhance and strengthen governance and resourcing more generally around regulatory change management and the implementation of required measures, actively to address this ongoing and significant agenda of regulatory change.
- We are implementing a comprehensive programme of risk mitigation measures to raise awareness of – and promote compliance with – competition laws.

Regulatory commitments and consent orders

Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. The incidence of regulatory proceedings against financial service firms is increasing with a consequent increase also in civil litigation arising from or relating to issues which are subject to regulatory investigation, sanction or fine.

In addition, criminal prosecutions of financial institutions for, among other alleged conduct, breaches of anti-money laundering ('AML') and sanctions regulations, antitrust violations, market manipulation, aiding and abetting tax evasion, and providing unlicensed cross-border banking services, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Moreover, financial service providers may face similar or broader legal proceedings, investigations or regulatory actions across many jurisdictions as a result of, among other things, increased media attention and higher expectations from regulators and the public. Any such prosecution or investigation of, or legal proceeding or regulatory action brought against, HSBC or one or more of its subsidiaries could result in substantial fines, penalties and/or forfeitures and could have a material adverse effect on our results, business, financial condition, prospects and reputation, including the potential loss of key licences, requirement to exit certain businesses and withdrawal of funding from depositors and other stakeholders.

In December 2012, HSBC Holdings plc ('HSBC Holdings'), HSBC North America Holdings Inc. ('HNAH') and HSBC Bank USA, N.A. ('HSBC Bank USA') entered into agreements with US and UK authorities regarding past inadequate compliance with the US Bank Secrecy Act (the 'BSA'), AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the US Department of Justice ('DoJ') the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia (the 'US DPA'); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney (the 'DANY DPA'); and HSBC Holdings consented to a cease-and-desist order and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the FSA (the 'FCA Direction') to comply with certain forward-looking obligations with respect to AML and sanctions requirements. HSBC Bank USA is also subject to an agreement entered into with the Office of the Comptroller of the Currency ('OCC'), the Gramm-Leach-Bliley Act ('GLBA') Agreement and other consent orders.

Under the agreements with the DoJ, FCA, and FRB, an independent monitor (who is, for FCA purposes, a 'skilled person' under Section 166 of the Financial Services and Markets Act) is evaluating and regularly assessing the effectiveness of HSBC's AML and sanctions compliance function and HSBC's progress in implementing its remedial obligations under the agreements. The Monitor is discussed on page 9.

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014. If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DoJ charges against those entities will be dismissed at the end of the five-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to any matters that are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA.

While we still have significant work to do to build and improve our AML and sanctions compliance programme, and the US DPA and other settlement agreements remain in place, the expiration of the DANY DPA is an important milestone for the Group.

Potential impact on the group

- It is difficult to predict the outcome of the regulatory proceedings involving our businesses. Unfavourable outcomes may have a material adverse effect on our reputation, brand and results, including loss of business and withdrawal of funding.
- Our significant involvement in facilitating international capital flows and trade exposes the group to the risk of financial crime or inadvertently breaching restrictions and sanctions imposed by the US Office of Foreign assets Control and other regulators.
- Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA.
- The design and execution of AML and sanctions remediation plans is complex and requires major investments in people, systems and other infrastructure. This complexity creates significant execution risk, which could impact our ability to effectively manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact HSBC's ability to satisfy the Monitor or comply with the terms of the US DPA, the FCA Direction, or the FRB Cease and

Strategic Report: Principal Risks and Uncertainties (continued)

Desist Order and may require HSBC to take additional remedial measures in the future.

- Failure to comply with the requirements of consent orders or the GLBA Agreement within the time periods specified in them, or otherwise as may be extended, could result in supervisory action. Any such action could have a material adverse effect on the consolidated results and operations of HSBC.

Mitigating actions

- Steps to address many of the requirements of the US DPA, the FCA Direction and the GLBA Agreement have either already been taken or are under way in consultation with the relevant regulatory agencies. These include simplifying the Group's control structure, strengthening the governance structure with new leadership appointments, revising key policies and implementing Global Standards to detect, deter and protect against financial crime. In addition, HSBC has substantially increased spending and staffing in the Financial Crime Compliance and Regulatory Compliance functions in the past few years.
- During 2014, the Group approved a new global strategy for transaction monitoring. Globally standardised AML investigations processes have been developed and are being implemented, starting in priority countries.

Conduct of business

Regulators in the UK and other countries have continued to increase their focus on 'conduct' matters relating to fair outcomes for customers and orderly/transparent markets, including, for example, attention to sales processes and incentives, product and investment suitability, product governance, employee activities and accountabilities as well as the risks of market abuse in relation to benchmark, index, other rate setting processes, wider trading activities and more general conduct of business concerns. In the UK, this includes increasing focus on whether competition is working effectively in financial markets or whether firm conduct is contributing to poor market outcomes.

In the UK, the FCA is making increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate. Additionally, the FCA and other regulators increasingly take actions in response to customer complaints or where they see poor customer outcomes and / or market abuses, either specific to an institution or more generally in relation to a particular product. There have been examples of this approach by regulators in the context of the possible mis-selling of payment protection insurance ('PPI'), of interest rate hedging products for SMEs and of wealth management products.

The group also remains subject to a number of other regulatory proceedings including investigations and reviews by various national and European regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and Euribor. There are also investigations into currency benchmarks and credit default swaps.

Potential impact on the group

- HSBC may face regulatory censure or sanctions including fines and/or be exposed to legal proceedings and litigation.
- Regulators in the UK and other countries may identify future industry-wide mis-selling, market conduct or other issues that could affect the group. This may lead from time to time to significant direct costs or liabilities and/or changes in the practices of such businesses. Also, decisions taken by the Financial Ombudsman Service in the UK (or similar overseas bodies) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the group.

Mitigating actions

- Programmes to enhance the management of conduct of business are progressing in all global businesses and functions.
- Performance management arrangements for managers and staff are being reviewed, focusing on reward linked to values-based behaviour and good conduct.
- Enhancements to surveillance capabilities and benchmark rate setting processes are ongoing and HSBC and its subsidiaries are cooperating fully with all regulatory investigations and reviews.

Competition Risk

The European Commission and other national level competition authorities in Europe are continuing to focus on the financial sector when enforcing laws against anticompetitive practices. In the UK, the level of scrutiny is likely to rise further when the FCA and the Payment Systems Regulator become enforcers of these laws for the first time as of 1 April 2015. In the UK this is also being accompanied by a rise in private damages litigation relating to alleged competition law infringements, including ongoing litigation by UK retailers regarding consumer credit and debit card interchange fee levels under the Visa and MasterCard schemes.

In the UK, there is also continued intensification of regulatory focus on proactive investigation of concerns that competition may not be functioning effectively in the interests of consumers in financial services markets in the UK. To date their main focus has been on retail banking markets but this is expected to widen to wholesale markets in 2015. The markets subjected to extensive review so far include: personal current accounts and SME banking services; consumer cash savings; and consumer credit cards. Details of these investigations can be found at Note 37 on the Financial Statements.

Strategic Report: Principal Risks and Uncertainties (continued)

Potential impact on the group

- The risk of any infringements of competition laws against anticompetitive agreements being detected and sanctioned will continue to rise.
- Dealing with regulatory investigations into effective functioning of competition will continue to place very significant burdens on resource. Regulators have extensive powers to intervene to force change following such investigations, which in principle could extend to forcing structural change on the industry (e.g. mandating divestments of all or parts of a business), introducing price or tariff regulation, or forcing other changes to business models or business conduct.

Mitigating actions

- We are implementing a comprehensive programme of risk mitigation measures to raise awareness of – and promote compliance with – competition laws.
- HSBC and its subsidiaries are cooperating with all regulatory investigations and reviews.

Dispute Risk

HSBC is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Further details are provided in Note 37 on the Financial Statements.

Potential impact on the group

- Dispute risk gives rise to potential financial loss and significant reputational damage which could adversely affect customer and investor confidence.

Mitigating actions

- We continue to focus on identifying emerging regulatory and judicial trends in order to limit exposure to litigation or regulatory enforcement action in the future.
- We are enhancing our financial crime and regulatory compliance controls and resources.

Risks relating to our business operations, governance and internal control systems

Heightened execution risk

The financial services industry is currently facing an unprecedented period of scrutiny. Regulatory requests, legal matters and business initiatives all require a significant amount of time and resources to implement. The magnitude and complexity of projects within HSBC required to meet these demands has resulted in heightened execution risk. There also remains heightened risk around the execution of a number of disposals across the Group in line with our strategy.

Potential impact on the group

- These factors may affect the successful delivery of our strategic priorities.
- The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel and interruption to systems and processes during business transformation. They can have both financial and reputational implications.

Mitigating actions

- We have strengthened our prioritisation and governance processes for significant projects and have invested in our project implementation and IT capabilities.
- Risks related to organisational change and disposals are subject to close management oversight.

People Risk

The demands being placed on the human capital of the Group are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and still evolving is hugely consumptive of human resources, placing increasingly complex and conflicting demands on a workforce where the expertise is in short supply and globally mobile.

Potential impact on the group

- Changes in remuneration policy and practice resulting from the new regulations under CRD IV apply globally to all employees of EU headquartered banks. The key change is the application of a cap on variable pay that can be paid to any 'material risk-taker' (being employees who have been identified as having a material impact on the institution's risk profile). This presents significant challenges for HSBC given the fact that as a worldwide business, a significant number of our material risk takers are based outside the EU.
- The policy statement issued by the PRA extends the Remuneration Code to require all PRA-authorised firms to apply clawback to vested/paid variable remuneration on a Group-wide basis for any material risk takers receiving variable pay from 1 January 2015.
- The introduction by the PRA and FCA in the UK of the Senior Managers and Certification regimes and of the related Rules of Conduct (the detail of which is currently subject to consultation) should set clearer expectations of the accountabilities and behaviour of both senior and more junior employees. However, there are a number of uncertainties around the precise impact of these regimes at present (including on more senior employees, on non-UK based employees and on non-Executive directors).
- Implementing organisational changes to support the Group's strategy has the potential to lead to increased staff turnover.

Mitigating actions

- The changes in remuneration under the new CRD IV regulations has necessitated a review of our remuneration policy, especially the balance between fixed and variable pay, to ensure we can remain competitive on a total compensation basis and retain our key talent.
- Risks related to organisational change and disposals are subject to close management oversight.
- HSBC continues to increase the level of specialist resources within Financial Crime Compliance, Regulatory Compliance and stress testing and to engage with our regulators as they finalise new regulations.

Strategic Report: Principal Risks and Uncertainties (continued)

Internet crime and fraud

HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile services by customers. We also face the risk of breakdowns in processes or procedures and systems failure or unavailability, and our business is subject to disruption from events that are wholly or partially beyond our control, such as internet crime and acts of terrorism.

Potential impact on the group

- Internet crime could result in financial loss and/or customer data and sensitive information being compromised. They may also give rise to losses in service to customers. The same threats apply equally when the group relies on external suppliers or vendors for services provided to us and our customers.

Mitigating actions

- We continually assess these threats as they evolve and adapt controls to mitigate them.
- We have increased its defences through enhanced monitoring and have implemented additional controls, such as two-factor authentication, to reduce the possibility of losses from fraud.

Information security risk

The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand. HSBC and other multinational organisations continue to be the targets of cyber-attacks, which may disrupt services including the availability of our external facing websites, compromise organisational and customer information or expose security weaknesses.

Potential impact on the group

- Information security risk gives rise to potential financial loss and reputational damage which could adversely affect customer and investor confidence. Loss of customer data would also trigger regulatory breaches which could result in fines and penalties being incurred.

Mitigating actions

- We have invested significantly in addressing this risk through increased training to raise staff awareness of the requirements, enhanced multi-layered controls protecting our information and technical infrastructure, and heightened monitoring and management of potential cyber-attacks and continued vulnerability assessment.

Data management

HSBC must have a clear data strategy to meet the volume, granularity, frequency and scale of regulatory and other reporting requirements. As a G-SIB, HSBC is also required to comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee on Banking Supervision ('the Basel Committee') in its paper.

Potential impact on the group

- Ineffective data management could adversely affect our ability to aggregate and report complete, accurate and consistent data to regulators, investors and senior management on a timely basis; and
- Financial institutions that fail to meet their Basel Committee data obligations by the required deadline may face supervisory measures.

Mitigating actions

- Since the Data Strategy Board was established in 2012, HSBC has set a data strategy for the Group and defined Group-level principles, standards and policies to enable consistent data aggregation, reporting and management; and
- Key initiatives and projects to deliver our data strategy and work towards meeting our Basel Committee data obligations are in progress.

Model risk

HSBC uses models for a range of purposes in managing its business, including regulatory and economic capital calculations, stress testing, granting credit, pricing and financial reporting. Model risk is the potential for adverse consequences as a result of decisions based on incorrect model outputs and reports or the use of such information for purposes for which it was not designed. Model risk could arise from models that are poorly developed, implemented or used, or from the modelled outcome being misunderstood and acted upon inappropriately by management. The regulatory environment and supervisory concerns over banks' use of internal models to determine regulatory capital further contribute to model risk.

Potential impact on the group

- The group may be required to hold additional capital as a result of model limitations or failure; and
- Supervisory concerns over the internal models and assumptions used by banks in the calculation of regulatory capital have led to the imposition of risk weight and loss given default floors. Such changes have the potential to increase our capital requirement and/or make it more volatile.

Mitigating actions

- We mitigate model risk through appropriate governance over model development, usage and validation, together with independent review, monitoring and feedback.

On behalf of the Board

A P S Simoes, *Director*

Registered number 14259

23 February 2015

Results for 2014

The consolidated profit for the year attributable to the shareholders of the bank was £1,354 million.

Interim dividends of £630 million, in lieu of a final dividend in respect of the previous financial year, and £600 million were paid on the ordinary share capital during the year.

A second interim dividend, in lieu of a final dividend, of £315 million was declared after 31 December 2014, payable on 25 February 2015.

Further information about the results is given in the consolidated income statement on page 105. Information about future developments likely to affect the group is given in the Strategic Report.

Risk Management

As a provider of banking and financial services, the group actively manages risk as a core part of its day-to-day activities. The growth in the group's business during 2014 was achieved while risks were assumed in a measured manner in line with the risk appetite and risks, particularly reputational and operational, were mitigated when they exceeded the group's risk appetite.

The group continues to maintain a very strong liquidity position and is well positioned for the changing regulatory landscape.

The group maintained its conservative risk profile by reducing exposure to the most likely areas of stress:

- the group selectively managed its exposure to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;
- the group regularly assessed higher risk countries and adjusted its risk appetite and exposures accordingly;
- the group repositioned certain portfolios and, in addition, made its client selection filters more robust in managing the risk of financial crime; and
- the group mitigated risks, for example reputational and operational, when they were forecast to exceed its risk appetite.

Managing Risk

(Unaudited)

All the group's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks.

An established risk governance framework and ownership structure ensures oversight of and accountability for the effective management of risk. The group's risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. Integral to the group's risk management framework are risk appetite, stress testing and the identification of emerging risks.

The group's risk management framework is designed to provide appropriate risk monitoring and assessment. The bank's Risk Committee focuses on risk governance and provides a forward-looking view of risks and their mitigation.

The Risk Committee is a committee of the Board and has responsibility for oversight and advice to the Board on, inter alia, the bank's risk appetite, tolerance and strategy, systems of risk management, internal control and compliance. Additionally, members of the Risk Committee attend meetings of the Chairman's Nominations and Remuneration Committee at which the alignment of the reward structures to risk appetite is considered. The Risk Committee maintains and develops a supportive culture in relation to the management of risk, appropriately embedded by executive management through procedures, training and leadership actions.

In carrying out its responsibilities, the Risk Committee is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit and the Head of Compliance, together with other business functions on risks within their respective areas of responsibility.

Risk culture

All employees are required to identify, assess and manage risk within the scope of their assigned responsibilities. Global Standards set the tone from the top and are central to the group's approach to balancing risk and reward. Personal accountability is reinforced by the HSBC Values, with employees expected to act with courageous integrity in conducting their duties.

Employees are supported by a disclosure line which enables them to raise concerns in a confidential manner. The group also has in place a suite of mandatory training to ensure a clear and consistent attitude is communicated to staff; mandatory training not only focuses on the technical aspects of risk but also on the group's attitude towards risk and the behaviours expected by its policies.

The risk culture is reinforced by the Group's approach to remuneration; individual awards are based on the achievement of both financial and non-financial (relating to the HSBC Values) objectives which are aligned to the global strategy.

Risk profile

Risks are assumed by the Global Businesses in accordance with their risk appetite and managed at global business and regional levels. Risks are identified through the group's risk map process which sets out the group's risk profile in relation to key risk categories in the regional and global businesses. Risks are regularly assessed through the group's risk appetite framework, stress testing process and in terms of emerging risks. Credit, market and operational risk are measured using the Basel 2 Pillar 1 framework for regulatory capital through the allocation of risk-weighted assets

Other risks are also measured through the group's economic capital model under Pillar 2.

Risk appetite

The Group's risk appetite is set out in the Group's Risk Appetite Statement, which describes the types and levels of risk that the group is prepared to accept in executing its strategy. Quantitative and qualitative metrics are assigned to nine key categories: earnings, capital, liquidity and funding, securitisations, cost of risk, intra-group lending, strategic investments, risk categories and risk diversification and concentration. Measurement against the metrics:

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

The risk appetite statement is approved by the HSBC Board following advice from the Risk Committee, and is a key component of the risk management framework. It is central to the annual planning process, in which global businesses, geographical regions and functions are required to articulate their risk appetite statements. These are aligned with the Group strategy, and provide a risk profile of each global business, region or function in the context of the individual risk categories.

Stress testing

The group's stress testing and scenario analysis programme is central to the monitoring of top and emerging risks. This is achieved by the undertaking of internal as well as regulatory driven stress test exercises during the year.

The major activities of the group's stress test programme during 2014 were focused on the completion of the PRA concurrent stress test, the ECB comprehensive assessment and contribution to the Group's European Banking Authority ('EBA') stress testing exercise. As part of the group's stress testing framework, a number of macroeconomic and event driven scenarios specific to the European region were considered and reported to senior management. These are based on analysis under a range of scenarios including: a Scottish Independence Scenario, a UK exit of the European Union scenario and a move to Negative Interest Rates in the UK and/or the eurozone.

The group also conducts Reverse Stress Testing. Reverse stress tests require a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities

Reverse stress testing is used as part of the risk management process to help inform management actions and contingency plans to mitigate against potential stresses and vulnerabilities which the group might face.

Areas of special interest

(Unaudited)

During 2014, there were a number of particular areas of focus as a result of the effect they have on the group. Whilst these areas may already have been identified as principal risks, further details of the actions taken during the year are provided below.

Financial crime compliance and regulatory compliance

In recent years, we have experienced increasing levels of compliance risk as regulators and other agencies pursued investigations into historical activities, and we continued to work with them in relation to existing issues. This has included the matters giving rise to the DPAs reached with US authorities in relation to investigations regarding inadequate compliance with anti-money laundering and sanctions law, and the related undertaking with the FSA (the 'FCA Direction'). The work of the Monitor, who has been appointed to assess HSBC's progress against our various obligations, including the DPAs, is discussed on page 9.

We continue to respond to a number of investigations by the FCA into the possible mis-selling in the UK of certain products, including sales of PPI, of interest rate hedging products for SMEs and of wealth management products. In addition, we also remain subject to a number of other regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and other interbank offered and benchmark interest rates. There are also investigations in progress into activities related to foreign exchange, precious metals and credit default swaps. Details of these investigations and legal proceedings can be found on note 37.

It is clear from both our own and wider industry experience that the level of activity among regulators and law enforcement agencies in investigating possible breaches of regulations has increased, and that the direct and indirect costs of such breaches can be significant. Coupled with a substantial rise in the volume of new regulation, much of which has some element of extra-territorial reach, and the geographical spread of our businesses, we believe that the level of inherent compliance risk that we face as a Group will continue to remain high for the foreseeable future.

Further information about the Group's compliance risk management may be found on page 76.

Regulatory Stress Tests

The frequency and granularity of information required by supervisors in relation to regulatory stress testing has increased and as part of the Group, HSBC Bank plc is subject to regulatory stress testing exercises in the United Kingdom and Europe.

These exercises, designed to assess the resilience of banks to adverse market development and ensure that they have robust, forward-looking capital planning processes that account for their unique risks, include the programmes of the PRA, the EBA, and the ECB.

In 2014, the Group took part in the first PRA concurrent stress test exercise involving major UK banks. The exercise was run on an enterprise-wide basis and comprised the EBA base scenario and a stress scenario that predominantly followed the EBA stress scenario with an additional overlay of variables for the UK only. This overlay reflected the vulnerabilities facing the UK banking system, including significant declines in the value of sterling, residential and commercial property prices and bond and equity prices, along with a downturn in economic activity and rising unemployment. HSBC's submission, which comprised the base and stress case along with supporting mitigating actions, was made to the PRA at the end of June 2014. The Group also participated in the complementary programme of regular data provision to the Bank of England under its Firm Data Submission Framework.

The Bank of England ('The Bank') disclosed the results of the 2014 Concurrent Stress Test on 16 December 2014. The Bank's results show that, under the hypothetical stress scenario, the Group's CET1 capital ratio would fall to a low point of 8.7 per cent, well above the Bank of England threshold CET1 capital ratio of 4.5 per cent. These results demonstrate the Group's continued capital strength.

The results incorporate management actions that have been accepted by the Bank of England for the purposes of this exercise. Under adverse economic circumstances, we would in practice consider a variety of management actions depending on the particular prevailing circumstances. The Group's intention, as evidenced by past actions, is to maintain a conservative and prudent stance on capital management.

The EBA conducted a Europe-wide stress test in the first half of 2014, run via the PRA for UK banks. The adverse macro-economic scenario included country-specific shocks to sovereign bond spreads, short-term interest rates and residential property prices, together with a decline in world trade, currency depreciation in Central and Eastern Europe and slow-downs or contractions in GDP growth around the world.

The EBA disclosed results of the stress test exercise on 26 October 2014, publishing detailed results for HSBC Group using dedicated templates from the exercise. The Group's stressed CET1 capital ratio was projected to fall to a low point of 8.7 per cent at end-2015, above the EBA minimum threshold of 5.5 per cent. The Group's fully-loaded stressed CET1 ratio at end-2016 was projected to be 9.3 per cent, which compared favourably with other major European banks.

The ECB conducted its comprehensive assessment in the first half of 2014, which comprised an Asset Quality Review and the ECB's stress testing process, the latter using the EBA scenarios. HSBC France and HSBC Bank Malta plc fell within scope and both passed the exercise, the results of which were also published in October 2014. Under the stressed scenario, the CET1 ratio for HBFR was projected to fall from 12.9 per cent in 2013 to 6.6 per cent by the end of 2016, remaining above regulatory minimums. The fall reflected HBFR's business model, namely the group's euro Rates business, and the application of EBA methodology, specifically the application of ECB credit loss benchmarks.

The number, granularity and timelines of these stress tests give rise to a number of risks. Banks that do not meet both the quantitative and qualitative requirements of the stress test exercises may be required to hold additional capital, may have restrictions placed on their planned capital actions including the payment of dividends or may have to implement other remedial measures. The Group created a Stress Testing Management Board in early 2014, chaired by the Group Finance Director, to ensure appropriate senior management oversight and governance of the stress test programmes.

Depressed oil and gas prices

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand and supply imbalances and changes in market sentiment. There is considerable uncertainty regarding the future price levels during 2015 and beyond. Prolonged depressed oil prices will affect countries, industries and individual companies differently:

- Country level: net oil importers are likely to benefit from reduced oil prices. In advanced economies, this is likely to increase consumer disposable income while in emerging market countries it is more likely to benefit the governments' fiscal position. The impact on oil exporting countries will depend on the importance of the oil receipts to fiscal revenues, the extraction costs and the amount of fiscal reserves that the countries are able to draw upon.
- Industry level: the oil and gas industry and supporting services will be affected, though this will vary depending on the relevant sub-sector. Large integrated producers are likely to remain resilient. Within the pure producers sector, the higher cost pure producers are likely to experience higher levels of stress. Similarly, infrastructure and services providers are likely to come under stress as producers curtail capital expenditure. Industries where oil and gas represent major costs, such as haulage, transport and shipping, are likely to benefit if prices remain depressed.

The oil and gas sector has been considered a higher risk sector for some time and has been under enhanced monitoring and controls with risk appetite and new money lending under increased scrutiny.

HSBC has a diversified lending profile to the oil and gas sector. Lending in GB&M is concentrated predominately in upstream activities and with large investment-grade global integrated producers. CMB mainly focuses on lending to service companies and pure producers. The exposures are diversified across a number of countries.

The overall portfolio of the group has drawn risk exposures amounting to about £6.0 billion, with just over 20 per cent consisting of exposures to oil service companies. In-depth client reviews have been conducted on larger clients considered to be potentially vulnerable to depressed oil prices for a period of one to two years, particularly, but not exclusively, focusing on oil service companies, and producers (and their suppliers) reliant on expensive extraction methods. Following these reviews, approximately £35 million of exposures have been identified as being of sufficient concern to require close management. Whilst weakening credit is evident in this population, no new customers were identified as being impaired at this stage.

Structural Reform

Banking structural reform and recovery and resolution planning

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and SME deposits from trading activity (see below). Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

Policy background to recovery and resolution

Following the financial crisis, G20 leaders requested that the FSB establish more effective arrangements for the recovery and resolution of 28 (now 30) designated G-SIBs resulting in a series of policy recommendations in relation to recovery and resolution planning, cross border co-operation agreements and measures to mitigate obstacles to resolution. The HSBC Group has been designated as a G-SIB.

In December 2013, the PRA set out rules for recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

HSBC resolution strategy and corporate structure changes

The Group has been working with the Bank of England and the PRA together with the Group's other primary regulators to develop and agree a resolution strategy for the HSBC Group. It is the Group's view that a resolution strategy whereby HSBC breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a Group at the point of resolution (referred to as a Single Point of Entry strategy) is the optimal approach as it is aligned to the Group's existing legal and business structure.

In common with all G-SIBs, the Group is working with its regulators to understand inter-dependencies between different businesses and subsidiary banking entities in the HSBC Group in order to enhance resolvability.

The Group has initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies where one subsidiary bank provides critical services to another, the Group has determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies ('ServCo group'). The ServCo group will be separately capitalised and funded to ensure continuity of services in resolution. A significant portion of the ServCo already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks, including HSBC Bank plc, into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group

UK ring-fencing

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 ('Banking Reform Act') received Royal Assent. It implements most of the recommendations of the Independent Commission on Banking ('ICB'), which inter alia require large banking groups to 'ring-fence' UK retail banking activity in a separately incorporated banking subsidiary (a 'ring-fenced bank') that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing is to be completed by 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individuals to be transferred to the ring-fenced bank by reference to gross worth and enterprises to be transferred based on turnover, assets and number of employees. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in relation to legal structure, governance, and continuity of services and facilities. The PRA intends to undertake further consultations and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution.

As required by the PRA's consultation paper, the Group presented a provisional ring-fencing project plan to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of the bank, in a separate Group subsidiary.

The plan remains subject to further planning and Group approvals and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

European Banking Structural Reform

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require certain trading activities to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

Report of the Directors: Risk (continued)

The draft proposals contain a provision which would permit derogation by member states which have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the Banking Reform Act.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which any final legislation is agreed.

Russia

During March 2014, tensions rose between the Russian Federation ('Russia') and western countries ('the West') in respect of the Ukraine. The West's response, led by the US and EU plus other countries, was to impose sanctions on a selected list of Russian individuals, banks and corporates, the scope of which was expanded during the course of 2014. In response, Russia imposed restrictions on the import of food and related produce from those countries that have introduced sanctions and restricted measures against Russia. Monitoring and action in response to the sanctions requirements is ongoing and will impose some restrictions on the business in Russia, although the impact on the group has not been significant. Group exposures to counterparties incorporated or domiciled in the Ukraine are not considered material.

The resolution of issues affecting the Ukraine and Russia's relations with the West will take time. Potentially additional sanctions could, if the environment deteriorated, be imposed and reciprocal actions taken by Russia, which may impact upon the activities of the group in Russia and with Russian counterparties.

The fourth quarter of 2014 saw significant falls in the value of the Russian Rouble and the price of crude oil, and multiple interest rate rises implemented by Russia's Central Bank. The impact of these developments is being monitored by management and, combined with the sanctions, mean the outlook for Russia remains highly uncertain and with the economy anticipated to contract in 2015.The group's Russian on-balance sheet exposures within loans and advances to banks was £0.5 billion (31 December 2013: £0.8 billion) and loans and advances to customers was £2.2 billion (31 December 2013: £3.0 billion).

In addition to the above, a number of the group's multinational clients have indirect exposure to Russia through majority or minority stakes in Russia-based entities, via dependency of supply, or from reliance on exports. The operations and businesses of such clients may be negatively impacted should the scope and nature of sanctions and other actions be widened or the Russian economy deteriorate. The group also runs operations in neighbouring countries where the strength of the financial system has strong links to the Russian economy. Management is monitoring the quantum and potential severity of such risks.

Eurozone

In recent years the EU has introduced a series of legislative changes designed to better equip the EU to deal with a financial crisis and to reduce the risks of contagion in the event of an EU member country experiencing financial difficulties.

The final outcome of negotiations on the terms of the Greek bail out is uncertain. The debt may be rescheduled or Greece may default on its debt and there is the possibility that Greece may exit the Euro. We continue to closely monitor the situation.

Overall we have limited exposure to Eurozone countries at highest risk of experiencing financial difficulties. Our exposures to Greece were predominantly in loans and advances and reverse repos. At 31 December 2014, this amounted to £2.3 billion and £1.0 billion respectively. Included in loans and advances is £1.2 billion relating to the shipping industry, denominated in US dollars and booked in the UK. We believe the shipping industry to be less sensitive to the Greek economy as it is mainly dependent on international trade. Our Greece in-country funding exposure is negligible and is set out in the table below.

Exposures to Spain, Ireland, Italy, Portugal and Cyprus were also limited. At 31 December 2014, the group's loans and advances in these countries amounted to less than £7.5 billion, and were principally to multinational corporates. The group's aggregate exposure to debt issuance across these countries was £5 billion, predominantly in Spanish and Italian sovereign debt held by the Group's balance sheet management, market-making and insurance operations. Net exposure to derivatives was less than £2 billion and related principally to derivatives exposures with the Republic of Italy.

Risk Management and Contingency planning

The group has a well-developed framework for dealing with counterparty and systemic crisis situations, both country specific and regionally, which is complemented by regular specific and enterprise-wide stress testing and scenario planning. The framework functions before, during and after crises and ensures that the group has detailed and evolving operational plans in the event of an adverse situation materialising. Management continues to closely monitor and manage eurozone exposures in the higher risk eurozone countries including Greece, and is cautious in lending to this sector. The group regularly updates its assessment of higher risk eurozone banks and adjusts its risk appetite accordingly. Where possible, the group also seeks to play a positive role in maintaining credit and liquidity supply.

Redenomination risk

There is no established legal framework within the European treaties to facilitate a member state exiting from the eurozone. Consequently, it is not possible to predict accurately the course of events and legal consequences that would ensue.

Report of the Directors: Risk (continued)

Key risks associated with an exit by a Eurozone member include:

- *Foreign exchange losses*: an exit would probably be accompanied by the passing of laws in the country concerned establishing a new local currency and providing for a redenomination of euro assets into the new local currency. The value of assets and liabilities in the country would immediately fall assuming the value of the redenominated currency is less than the original euros when translated into the carrying amounts. It is not possible to predict what the total consequential loss might be as it is uncertain which assets and liabilities would be legally redenominated or the extent of the devaluation.
- *External contracts redenomination risk*: contracts entered into between HSBC businesses based outside a country exiting the euro with in-country counterparties or those otherwise closely connected with the relevant country may be affected by redenomination. The effect remains subject to a high level of uncertainty. Factors such as the country law under which the contract is documented, the HSBC entity involved and the payment mechanism may all be relevant to this assessment, as will the precise exit scenario as the consequences for external contracts of a disorderly exit may differ from one sanctioned under EU law. In addition, capital controls could be introduced which may affect the group's ability to repatriate funds including currencies not affected by the redenomination event.

The group continues to identify and monitor potential redenomination risks and, where possible, has taken and will continue to take steps to mitigate them and/or reduce its overall exposure to losses that might arise in the event of a redenomination. Management recognises, however, that a euro exit could take different forms, depending on the scenario. These could have distinct legal consequences which could significantly alter the potential effectiveness of any mitigation initiatives, and it is accordingly not possible to predict how effective particular measures may be until they are tested against the precise circumstances of a redenomination event and the specific in-country assets and liabilities at the date of the event.

We have set out below the group's in-country exposure to Greece as the country with the highest level of redenomination risk. These assets and liabilities predominantly comprise loans and deposits arising from the group's commercial banking operations in these countries, and the net assets represent the net funding exposure. The table also identifies in-country off-balance sheet exposures as these are at risk of redenomination should they be called, giving rise to a balance sheet exposure. It is to be noted that this analysis can only be an indication as it does not include euro-denominated exposures booked by HSBC outside the countries at risk which are connected with those countries.

In-country funding exposure

31 December 2014	**Denominated in:**			
	Euros £bn	**US Dollars £bn**	**Other Currencies £bn**	**Total £bn**
Greece				
In-country assets	**0.9**	**0.1**	**–**	**1.0**
In-country liabilities	**(0.9)**	**(0.3)**	**–**	**(1.2)**
Net in-country funding	**–**	**(0.2)**	**–**	**(0.2)**
Off balance sheet exposure/hedging	**–**	**–**	**–**	**–**

31 December 2013	Denominated in:			
	Euros £bn	US Dollars £bn	Other Currencies £bn	Total £bn
Greece				
In-country assets	0.9	0.1	–	1.0
In-country liabilities	(0.8)	(0.5)	–	(1.3)
Net in-country funding	0.1	(0.4)	–	(0.3)
Off balance sheet exposure/hedging	(0.1)	–	0.2	0.1

Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from off-balance sheet products such as guarantees and credit derivatives, and from the group's holdings of debt securities.

There were no material changes to our policies and practices for the management of credit risk in 2014.

This year we have redesigned the credit risk section in order to enhance clarity and reduce duplication. It now begins with an overview of our credit risk policies followed by an overview of our gross exposures. We describe various measures of credit quality such as past due status, renegotiated loans and impaired loans before analysing impairment allowances. There are specific sections on wholesale lending and personal lending where additional detail is provided and we cover areas of special interest such as our exposure to commercial real estate in wholesale lending. This is followed by a section describing our securitisation exposures and other structured products.

Following the change in balance sheet presentation explained on page 155, non-trading reverse repos are shown separately on the balance sheet and are no longer included in 'Loans and advances to customers' and 'Loans and advances to banks'. Comparative data have been re-presented accordingly. As a result, any analysis that references loans and advances to customers or banks excludes non-trading reverse repos. The amount of the non-trading reverse repos to customers and banks is set out on page 55.

Credit Risk Management

(Audited)

Of the risks in which we engage, credit risk generates the largest regulatory capital requirements.

The principal objectives of our credit risk management are:

- to maintain across the group a strong culture of responsible lending and a robust risk policy and control framework;
- to both partner and challenge Global Businesses in defining, implementing, and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and mitigation.

Within the bank, the Credit Risk function is headed by the European Chief Risk Officer and reports to the Chief Executive Officer, with a functional reporting line to the Group Chief Risk Officer. Its responsibilities include:

- formulating credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with group policies that very closely reflect Group policy;
- guiding operating companies on the group's appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;
- undertaking an independent review and objective assessment of risk. Credit risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;
- monitoring the performance and management of portfolios across the group;
- controlling exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;
- setting policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base, and remain within internal and regulatory limits;
- maintaining and developing the group's risk rating framework and systems through the Regional Model Oversight Committees ('RMOC'), which report to the Risk Management Meeting ('RMM') and oversees risk rating system governance for both wholesale and retail businesses;
- reporting on retail portfolio performance, high risk portfolios, risk concentrations, large impaired accounts, impairment allowances and stress testing results and recommendations to the group's RMM, the group's Risk Committee and the Board; and
- acting on behalf of the group as the primary interface, for credit-related issues, with the Bank of England, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Credit quality of financial instruments

(Audited)

Our credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within the group's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings-based ('IRB') created under Basel 2 (and as updated in Basel 3) adopted by the Group to support calculation of the minimum credit regulatory capital requirement. For further details, see 'Credit quality classification of financial instruments' on page 43.

Special attention is paid to problem exposures in order to accelerate remedial action. Where appropriate, operating companies use specialist units to provide customers with support in order to help them avoid default wherever possible.

The Credit Review and Risk Identification team reviews the robustness and effectiveness of key management, monitoring and control activities.

Periodic risk-based audits of operating companies' credit processes and portfolios are undertaken by the Internal Audit function. Internal Audit discusses with management any risk ratings it considers to be inappropriate; following which its final recommendations for revised ratings must be adopted.

Renegotiated loans and forbearance

(Audited)

A range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures and other forms of loan modifications and re-ageing.

The group's policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay their loan and is expected to be able to meet the revised obligations.

Refinance risk

(Audited)

Personal Lending

Interest only mortgages lending incorporate bullet/balloon payments at the point of final maturity. In the UK interest only lending is recognised as a niche, product that meets a valid customer need. To reduce re-finance risk, initial onboarding assessment of customers' affordability is made on a capital repayment basis and every customer has a credible defined repayment strategy. Additionally the customer is contacted at least once during the mortgage term to check the status of the repayment strategy. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment then the customer will either default on the repayment or it is likely that HSBC may need to apply forbearance to the loan. In either circumstance this gives rise to a loss event and an impairment allowance will be considered where appropriate.

Wholesale Lending

Many types of wholesale lending incorporate bullet/balloon payments at the point of final maturity; often, the intention or assumption is that the borrower will take out a new loan to settle the existing debt. Where this is true the term refinance risk refers generally to the possibility that, at the point that such a repayment is due, a borrower cannot refinance by borrowing to repay existing debt. In situations where it is identified that a borrower is expected not to be able either to repay a bullet/balloon payment or to be capable of refinancing their existing debt on commercial terms then the customer will either default on the repayment or it is likely that HSBC may need to refinance the loan on terms it would not normally offer in the ordinary course of business. In either circumstance this gives rise to a loss event and an impairment allowance will be considered.

Impairment assessment

(Audited)

It is the group's policy that each operating company creates allowances for impaired loans promptly and consistently.

Impairment allowances may be assessed and created either for individually significant accounts or, on a collective basis, for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant.

When impairment losses occur, we reduce the carrying amount of loans and advances through the use of an allowance account. When impairment of available-for-sale financial assets and held-to-maturity financial investments occurs, the carrying amount of the asset is reduced directly. For further details on the accounting policy for impairment of available-for-sale debt and equity securities, see accounting policies in Note 1.

Write-off of loans and advances

(Audited)

For details of our policy on the write-off of loans and advances, see Note 1 on the Financial Statements.

Personal lending

Property collateral for residential mortgages is repossessed and sold on behalf of the borrower only when all normal debt recovery procedures have been unsuccessful. The carrying amounts of residential mortgages in excess of net realisable value are fully provided for, from 180 days contractually past due. We regularly obtain new appraisals for loans (every 180 days) and adjust carrying value to the most recent appraisal whether it has increased or decreased as the best estimate of the cash flows that will be received on the disposal of the collateral for these collateral dependent loans.

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but, in very exceptional circumstances, to longer than that figure in a few countries where local regulation or legislation constrain earlier write off or where the realisation of collateral for secured real estate lending takes this time.

In retail lending, final write-off should occur within 60 months of the default at the latest.

Wholesale Lending

Wholesale loans and advances are written off where normal collection procedures have been unsuccessful to the extent that there appears no realistic prospect of repayment. These procedures may include a referral of the business relationship to a Debt recovery company. Debt reorganisation will be considered at all times and may involve, in exceptional circumstances and in the absence of any viable alternative, a partial write-off in exchange for a commitment to repay the remaining balance.

In the event of bankruptcy or analogous proceedings, write-off for both personal and wholesale lending may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

Maximum exposure to credit risk

(Audited)

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account any collateral held or other credit enhancements (where such credit enhancements do not meet offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the group would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

Maximum exposure to credit risk
(Audited)

The group

	2014			2013		
	Maximum exposure £m	**Offset £m**	**Exposure to credit risk (net) £m**	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m
Cash and balances at central banks	**42,853**	**–**	**42,853**	67,584	–	67,584
Items in the course of collection from other banks	**973**	**–**	**973**	1,948	–	1,948
Trading assets[1]	**85,885**	**–**	**85,885**	98,090	(1,075)	97,015
treasury and other eligible bills	**653**	**–**	**653**	2,623	–	2,623
debt securities	**49,996**	**–**	**49,996**	56,414	–	56,414
loans and advances to banks	**15,640**	**–**	**15,640**	16,067	–	16,067
loans and advances to customers	**19,596**	**–**	**19,596**	22,986	(1,075)	21,911
Financial assets designated at fair value[1]	**1,044**	**–**	**1,044**	6,947	–	6,947
treasury and other eligible bills	**3**	**–**	**3**	–	–	–
debt securities	**987**	**–**	**987**	6,903	–	6,903
loans and advances to banks	**54**	**–**	**54**	44	–	44
Derivatives[2]	**187,736**	**(174,118)**	**13,618**	137,239	(112,931)	24,308
Loans and advances held at amortised cost[3]	**282,514**	**(36,687)**	**245,827**	296,735	(54,462)	242,273
loans and advances to banks	**25,262**	**(37)**	**25,225**	23,013	(92)	22,921
loans and advances to customers	**257,252**	**(36,650)**	**220,602**	273,722	(54,370)	219,352
Reverse repurchase agreements – non-trading[3]	**41,945**	**(3,283)**	**38,662**	61,525	(13,470)	48,055
Financial investments[1]	**75,185**	**–**	**75,185**	74,024	–	74,024
treasury and other similar bills	**2,849**	**–**	**2,849**	2,196	–	2,196
debt securities	**72,336**	**–**	**72,336**	71,828	–	71,828
Other assets	**7,980**	**–**	**7,980**	7,439	–	7,439
endorsements and acceptances	**591**	**–**	**591**	703	–	703
accrued income and other	**7,389**	**–**	**7,389**	6,736	–	6,736
Financial guarantees	**13,452**	**–**	**13,452**	11,846	–	11,846
Loan commitments and other credit-related commitments	**135,522**	**–**	**135,522**	123,017	–	123,017
At 31 December	**875,089**	**(214,088)**	**661,001**	886,394	(181,938)	704,456

Report of the Directors: Risk (continued)

Maximum exposure to credit risk
(Audited)
The bank

	2014			2013		
	Maximum exposure £m	**Offset £m**	**Exposure to credit risk (net) £m**	Maximum exposure £m	Offset £m	Exposure to credit risk (net) £m
Cash and balances at central banks	**41,424**	**–**	**41,424**	60,996	–	60,996
Items in the course of collection from other banks	**630**	**–**	**630**	1,374	–	1,374
Trading assets[1]	**55,858**	**–**	**55,858**	66,865	(1,075)	65,790
treasury and other eligible bills	**154**	**–**	**154**	643	–	643
debt securities	**25,150**	**–**	**25,150**	28,821	–	28,821
loans and advances to banks	**13,039**	**–**	**13,039**	16,568	–	16,568
loans and advances to customers	**17,515**	**–**	**17,515**	20,833	(1,075)	19,758
Financial assets designated at fair value[1]	**9**	**–**	**9**	3,983	–	3,983
debt securities	**9**	**–**	**9**	3,983	–	3,983
loans and advances to banks	**–**	**–**	**–**	–	–	–
Derivatives[2]	**160,232**	**(136,187)**	**24,045**	112,623	(77,990)	34,633
Loans and advances held at amortised cost[3]	**220,447**	**(35,607)**	**184,840**	233,899	(53,637)	180,262
loans and advances to banks	**18,776**	**–**	**18,776**	16,332	–	16,332
loans and advances to customers	**201,671**	**(35,607)**	**166,064**	217,567	(53,637)	163,930
Reverse repurchase agreements – non-trading[3]	**36,391**	**(628)**	**35,763**	47,847	(5,924)	41,923
Financial investments[1]	**48,001**	**–**	**48,001**	44,594	–	44,594
treasury and other similar bills	**2,081**	**–**	**2,081**	1,927	–	1,927
debt securities	**45,920**	**–**	**45,920**	42,667	–	42,667
Other assets	**6,126**	**–**	**6,126**	4,722	–	4,722
endorsements and acceptances	**364**	**–**	**364**	343	–	343
accrued income and other	**5,762**	**–**	**5,762**	4,379	–	4,379
Financial guarantees	**10,968**	**–**	**10,968**	9,366	–	9,366
Loan commitments and other credit-related commitments	**96,785**	**–**	**96,785**	80,417	–	80,417
At 31 December	**676,871**	**(172,422)**	**504,449**	666,686	(138,626)	528,060

1 *Reported amounts exclude equity instruments.*

2 *The derivative offset amount in the 'maximum exposure to credit risk table' relates to exposures where the counterparty has an offsetting derivative exposure with the group, a master netting agreement is in place and the credit risk exposure is managed on a net basis, or the position is specifically collateralised, normally in the form of cash. At 31 December 2014, the total amount of such offsets was £174 billion (2013: £113 billion), of which £147 billion (2013: £93 billion) were offsets under a master netting arrangement, £24 billion (2013: £17 billion) were received in cash and £3 billion (2013: £3 billion) were other collateral. These amounts do not qualify for net presentation for accounting purposes as settlement may not actually be made on a net basis.*

3 *The loans and advances offset adjustment primarily relates to customer loans and deposits, and balances arising from repo and reverse repo transactions. The offset relates to balances where there is a legally enforceable right of offset in the event of counterparty default, and where, as a result there is a net exposure for credit risk management purposes. As there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes. No offset has been applied to off balance sheet collateral.*

Concentration of credit risk exposure

(Unaudited)

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The group uses a number of controls and measures to minimise undue concentration of exposure in the group's portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk occurs when a counterparty's exposures are adversely correlated with its credit quality. There are two types of wrong-way risk:

- general wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as, for example, where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency; and
- specific wrong-way risk occurs when the exposure to a particular counterparty is positively correlated with the probability of counterparty default such as a reverse repo on the counterparty's own bonds. It is HSBC policy that specific wrong-way transactions are approved on a case-by-case basis.

We use a range of procedures to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

Cross-border exposures

We assess the vulnerability of countries to foreign currency payment restrictions, including economic and political factors, when considering impairment allowances on cross-border exposures. Impairment allowances are assessed in respect of all qualifying exposures within vulnerable countries unless these exposures and the inherent risks are:

- performing, trade-related and of less than one year's maturity;
- mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned;
- in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily; and
- performing facilities with a principal (excluding security) of US$1 million or below and/or with maturity dates shorter than three months.

Financial Investments

Our holdings of available-for-sale government and government agency debt securities, corporate debt securities, asset-backed securities ('ABSs') and other securities were spread across a wide range of issuers in 2014, with 61 per cent invested in government or government agency debt securities.

Trading assets

Trading securities remained the largest concentration within trading assets of the group at 73 per cent compared with 71 percent in 2013.

Derivatives

HSBC participates in transactions exposing it counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before completing the satisfactory settlement of the transaction, which varies in value by reference to a market factor such as interest rate, exchange rate or asset price. It arises principally from OTC derivatives and securities financing transactions ('SFTs') and is calculated in both the trading and non-trading books.

Derivative assets were £188 billion at 31 December 2014 (2013: £137 billion).

Items in the course of collection from other banks

Settlement risk arises in any situations where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of transactions with each counterparty on any single day.

The group substantially mitigates settlement risk on many transactions, particularly those involving securities and equities, by settling through assured payment systems, or on a delivery-versus-payment basis.

Loans and advances

The following tables analyse loans and advances by industry sector.

Report of the Directors: Risk (continued)

Gross loans and advances to customers by industry sector

(Audited)

The group

	2014		2013	
	Gross loans and advances to customers £m	**Gross loans by industry sector as a % of total gross loans %**	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
Personal				
Residential mortgages	**83,009**	**31.92%**	83,882	30.28%
Other personal	**24,381**	**9.38%**	25,257	9.11%
	107,390	**41.30%**	109,139	39.39%
Corporate and commercial				
Commercial, industrial and international trade	**74,003**	**28.46%**	79,576	28.72%
Commercial real estate	**17,899**	**6.88%**	18,755	6.77%
Other property-related	**4,572**	**1.75%**	4,421	1.60%
Government	**1,452**	**0.56%**	2,020	0.73%
Other commercial	**38,006**	**14.62%**	40,610	14.66%
	135,932	**52.27%**	145,382	52.48%
Financial				
Non-bank financial institutions	**16,085**	**6.19%**	21,602	7.80%
Settlement accounts	**645**	**0.24%**	935	0.33%
	16,730	**6.43%**	22,537	8.13%
Total gross loans and advances to customers at 31 December	**260,052**	**100.00%**	277,058	100.00%
Impaired loans as a percentage of total	**2.46%**		2.84%	

The bank

	2014		2013	
	Gross loans and advances to customers £m	**Gross loans by industry sector as a % of total gross loans %**	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
Personal				
Residential mortgages	**76,847**	**37.77%**	77,747	35.38%
Other personal	**8,936**	**4.39%**	8,963	4.08%
	85,783	**42.16%**	86,710	39.46%
Corporate and commercial				
Commercial, industrial and international trade	**54,512**	**26.79%**	59,375	27.02%
Commercial real estate	**11,273**	**5.54%**	11,210	5.10%
Other property-related	**3,128**	**1.54%**	3,048	1.39%
Government	**964**	**0.47%**	1,448	0.66%
Other commercial	**26,849**	**13.21%**	32,317	14.70%
	96,726	**47.55%**	107,398	48.87%
Financial				
Non-bank financial institutions	**20,853**	**10.25%**	25,365	11.54%
Settlement accounts	**87**	**0.04%**	281	0.13%
	20,940	**10.29%**	25,646	11.67%
Total gross loans and advances to customers at 31 December	**203,449**	**100.00%**	219,754	100.00%
Impaired loans as a percentage of total	**2.09%**		2.40%	

Credit quality of financial instruments

(Audited)

The five credit quality classifications defined below each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external rating, attributed by external agencies to debt securities. There is no direct correlation between the internal and external ratings at granular level, except to the extent each falls within a single quality classification.

Credit quality

	Debt securities and other bills	Wholesale lending and derivatives		Retail lending	
Quality classification	External credit rating	Internal credit rating	Probability of default %	Internal credit rating	Expected loss %
Strong	A- and above	CRR1 to CRR2	0 – 0.169	EL1 to EL2	0 – 0.999
Good	BBB+ to BBB-	CRR3	0.170 – 0.740	EL3	1.000 – 4.999
Satisfactory	BB+ to B and unrated	CRR4 to CRR5	0.741 – 4.914	EL4 to EL5	5.000 – 19.999
Sub – standard	B- and below	CRR6 to CRR8	4.915 – 99.999	EL6 to EL8	20.000 – 99.999
Impaired	Impaired	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted[1]

1 *The EL percentage is derived through a combination of Probability of Default ('PD') and Loss Given Default ('LGD') and may exceed 100 per cent in circumstances where the LGD is above 100 per cent reflecting the cost of recoveries.*

Quality classification definitions

(Audited)

'Strong': Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

'Good': Exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

'Satisfactory': Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

'Sub-standard': Exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

'Impaired': Exposures have been assessed, individually or collectively, as impaired.

Risk rating scales

(Audited)

The Customer Risk Rating ('CRR') 10-grade scale above summarises a more granular underlying 23-grade scale of obligor probability of default ('PD').

All distinct HSBC customers are rated using one of these two PD scales, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

The Expected Loss ('EL') 10-grade scale for retail business summarises a more granular underlying EL scale for these customer segments; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications. The most recent mapping review resulted in 'B' being mapped to CRR5. Accordingly 'B' ratings are now mapped to 'Satisfactory'. This represents a changes in disclosure mapping unrelated to changes in counterparty creditworthiness.

For the purpose of the following disclosure, retail loans which are past due up to 89 days and are not otherwise classified as EL9 or EL10, are not disclosed within the EL grade to which they relate, but are separately classified as past due but not impaired. The following tables set out the group's distribution of financial instruments by measures of credit quality.

Report of the Directors: Risk (continued)

Distribution of financial instruments by credit quality

(Audited)

The group

	2014							
	Neither past due nor impaired							
		Medium						
	Strong	Good	Satisfactory	Sub-Standard	Past due not impaired	Impaired	Impairment allowances	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	**42,853**	**–**	**–**	**–**				**42,853**
Items in the course of collection from other banks	**973**	**–**	**–**	**–**				**973**
Trading assets	**62,694**	**14,479**	**8,410**	**302**				**85,885**
– treasury and other eligible bills	**249**	**375**	**29**	**–**				**653**
– debt securities	**39,880**	**6,410**	**3,568**	**138**				**49,996**
– loans and advances to banks	**10,064**	**2,387**	**3,117**	**72**				**15,640**
– loans and advances to customers	**12,501**	**5,307**	**1,696**	**92**				**19,596**
Financial assets designated at fair value	**640**	**152**	**247**	**5**				**1,044**
– treasury and other eligible bills	**3**	**–**	**–**	**–**				**3**
– debt securities	**637**	**152**	**193**	**5**				**987**
– loans and advances to banks	**–**	**–**	**54**	**–**				**54**
Derivatives	**150,733**	**28,532**	**8,015**	**456**				**187,736**
Loans and advances held at amortised cost	**164,304**	**57,006**	**49,776**	**6,286**	**1,547**	**6,415**	**(2,820)**	**282,514**
– loans and advances to banks	**19,541**	**3,612**	**2,020**	**92**	**–**	**17**	**(20)**	**25,262**
– loans and advances to customers	**144,763**	**53,394**	**47,756**	**6,194**	**1,547**	**6,398**	**(2,800)**	**257,252**
Reverse repurchase agreement non-trading	**31,177**	**5,856**	**3,891**	**1,021**	**–**	**–**	**–**	**41,945**
Financial investments	**63,823**	**6,340**	**2,197**	**1,410**	**–**	**1,415**	**–**	**75,185**
– treasury and other eligible bills	**760**	**2,054**	**35**	**–**	**–**	**–**	**–**	**2,849**
– debt securities	**63,063**	**4,286**	**2,162**	**1,410**	**–**	**1,415**	**–**	**72,336**
Other assets	**5,711**	**442**	**1,670**	**147**	**6**	**4**	**–**	**7,980**
– endorsements and acceptances	**250**	**29**	**312**	**–**	**–**	**–**	**–**	**591**
– accrued income and other	**5,461**	**413**	**1,358**	**147**	**6**	**4**	**–**	**7,389**
At 31 December	**522,908**	**112,807**	**74,206**	**9,627**	**1,553**	**7,834**	**(2,820)**	**726,115**

Report of the Directors: Risk (continued)

The group

	2013							
	Neither past due nor impaired							
		Medium						
	Strong	Good	Satisfactory	Sub-Standard	Past due not impaired	Impaired	Impairment allowances	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	67,584	–	–	–				67,584
Items in the course of collection from other banks	1,948	–	–	–				1,948
Trading assets	69,228	18,062	10,289	511				98,090
– treasury and other eligible bills	1,182	1,267	174	–				2,623
– debt securities	45,892	7,145	2,991	386				56,414
– loans and advances to banks	9,469	2,762	3,720	116				16,067
– loans and advances to customers	12,685	6,888	3,404	9				22,986
Financial assets designated at fair value	2,599	243	4,101	4				6,947
– treasury and other eligible bills	–	–	–	–				–
– debt securities	2,557	243	4,099	4				6,903
– loans and advances to banks	42	–	2	–				44
Derivatives	109,827	20,714	6,186	512				137,239
Loans and advances held at amortised cost	164,947	67,481	50,718	7,601	1,452	7,893	(3,357)	296,735
– loans and advances to banks	17,414	3,188	2,235	173	–	24	(21)	23,013
– loans and advances to customers	147,533	64,293	48,483	7,428	1,452	7,869	(3,336)	273,722
Reverse repurchase agreements non-trading	45,743	10,225	4,345	1,212	–	–	–	61,525
Financial investments	63,005	5,662	2,122	1,731	–	1,504	–	74,024
– treasury and other eligible bills	834	1,108	254	–	–	–	–	2,196
– debt securities	62,171	4,554	1,868	1,731	–	1,504	–	71,828
Other assets	4,967	431	1,765	257	5	14	–	7,439
– endorsements and acceptances	387	16	300	–	–	–	–	703
– accrued income and other	4,580	415	1,465	257	5	14	–	6,736
At 31 December	529,848	122,818	79,526	11,828	1,457	9,411	(3,357)	751,531

Report of the Directors: Risk (continued)

The bank

	2014							
	Neither past due nor impaired							
		Medium						
	Strong	Good	Satisfactory	Sub-Standard	Past due not impaired	Impaired	Impairment allowances	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	41,424	–	–	–				41,424
Items in the course of collection from other banks	630	–	–	–				630
Trading assets	40,700	9,004	5,858	296				55,858
– treasury and other eligible bills	149	–	5	–				154
– debt securities	19,994	2,357	2,665	134				25,150
– loans and advances to banks	9,611	1,640	1,718	70				13,039
– loans and advances to customers	10,946	5,007	1,470	92				17,515
Financial assets designated at fair value	1	–	8	–				9
– debt securities	1	–	8	–				9
– loans and advances to banks	–	–	–	–				–
Derivatives	127,251	25,372	7,185	424				160,232
Loans and advances held at amortised cost	137,414	37,735	35,991	5,568	498	5,033	(1,792)	220,447
– loans and advances to banks	12,045	1,948	3,204	816	–	777	(14)	18,776
– loans and advances to customers	125,369	35,787	32,787	4,752	498	4,256	(1,778)	201,671
Reverse repurchase agreements non-trading	28,768	3,958	2,645	1,020	–	–	–	36,391
Financial investments	44,387	2,900	382	59	–	273	–	48,001
– treasury and other similar bills	183	1,895	3	–	–	–	–	2,081
– debt securities	44,204	1,005	379	59	–	273	–	45,920
Other assets	5,125	401	599	–	–	1	–	6,126
– endorsements and acceptances	51	19	294	–	–	–	–	364
– accrued income and other	5,074	382	305	–	–	1	–	5,762
At 31 December	425,700	79,370	52,668	7,367	498	5,307	(1,792)	569,118

Report of the Directors: Risk (continued)

The bank

	2013							
	Neither past due nor impaired							
		Medium						
	Strong	Good	Satisfactory	Sub-Standard	Past due not impaired	Impaired	Impairment allowances	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	60,996	–	–	–				60,996
Items in the course of collection from other banks	1,374	–	–	–				1,374
Trading assets	48,701	10,837	6,833	494				66,865
– treasury and other eligible bills	532	–	111	–				643
– debt securities	23,779	2,424	2,232	386				28,821
– loans and advances to banks	12,657	1,960	1,852	99				16,568
– loans and advances to customers	11,733	6,453	2,638	9				20,833
Financial assets designated at fair value	2	–	3,981	–				3,983
– debt securities	2	–	3,981	–				3,983
– loans and advances to banks	–	–	–	–				–
Derivatives	88,217	18,499	5,443	464				112,623
Loans and advances held at amortised cost	136,948	48,296	37,563	6,661	562	6,072	(2,203)	233,899
– loans and advances to banks	9,155	1,678	3,850	918	–	747	(16)	16,332
– loans and advances to customers	127,793	46,618	33,713	5,743	562	5,325	(2,187)	217,567
Reverse repurchase agreements non-trading	35,332	8,272	3,034	1,209	–	–	–	47,847
Financial investments	42,756	1,151	534	43	–	110	–	44,594
– treasury and other similar bills	628	1,099	200	–	–	–	–	1,927
– debt securities	42,128	52	334	43	–	110	–	42,667
Other assets	3,775	390	554	3	–	–	–	4,722
– endorsements and acceptances	44	7	292	–	–	–	–	343
– accrued income and other	3,731	383	262	3	–	–	–	4,379
At 31 December	418,101	87,445	57,942	8,874	562	6,182	(2,203)	576,903

Report of the Directors: Risk (continued)

Past due but not impaired gross financial instruments

Past due but not impaired are those loans where although customers have failed to make payments in accordance with the contractual terms of their facilities, they have not met the impaired loan criteria described below.

Ageing analysis of days past due but not impaired gross financial instruments

(Audited)

The group

	Up to 29 days £m	30-59 days £m	60-89 days £m	90-179 days £m	Over 180 days £m	Total £m
At 31 December 2014						
Loans and advances held at amortised cost	**1,202**	**230**	**112**	**2**	**1**	**1,547**
Personal	**466**	**183**	**95**	**–**	**–**	**744**
Corporate and commercial	**733**	**46**	**17**	**2**	**1**	**799**
Financial	**3**	**1**	**–**	**–**	**–**	**4**
Other assets	**3**	**1**	**–**	**–**	**2**	**6**
	1,205	**231**	**112**	**2**	**3**	**1,553**
At 31 December 2013						
Loans and advances held at amortised cost	1,044	244	150	9	5	1,452
Personal	470	200	110	–	–	780
Corporate and commercial	567	40	40	9	5	661
Financial	7	4	–	–	–	11
Other assets	3	1	–	–	1	5
	1,047	245	150	9	6	1,457

The bank

	Up to 29 days £m	30-59 days £m	60-89 days £m	90-179 days £m	Over 180 days £m	Total £m
At 31 December 2014						
Loans and advances held at amortised cost	**320**	**109**	**69**	**–**	**–**	**498**
Personal	**295**	**104**	**66**	**–**	**–**	**465**
Corporate and commercial	**25**	**5**	**3**	**–**	**–**	**33**
Financial	**–**	**–**	**–**	**–**	**–**	**–**
Other assets	**–**	**–**	**–**	**–**		**–**
	320	**109**	**69**	**–**	**–**	**498**
At 31 December 2013						
Loans and advances held at amortised cost	351	129	82	–	–	562
Personal	347	127	81	–	–	555
Corporate and commercial	4	2	1	–	–	7
Financial	–	–	–	–	–	–
Other assets	–	–	–		–	–
	351	129	82	–	–	562

Impaired loans

(Audited)

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as Customer Risk Rating ('CRR') 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is more than 90 days on any material credit obligation to HSBC.
- retail loans and advances classified as Expected Loss ('EL') 9 or EL 10. These grades are assigned to retail loans and advances greater than 90 days past due unless individually they have been assessed as not impaired.
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Report of the Directors: Risk (continued)

Impaired loans and advances to customers and banks by industry sector
(Audited)

	2014			2013		
	Individually assessed	**Collectively assessed**	**Total**	Individually assessed	Collectively assessed	Total
	£m	**£m**	**£m**	£m	£m	£m
Banks	**17**	**–**	**17**	24	–	24
Customers	**5,487**	**911**	**6,398**	6,847	1,022	7,869
Personal	**683**	**878**	**1,561**	735	1,003	1,738
Corporate and commercial	**4,619**	**33**	**4,652**	5,789	19	5,808
Financial	**185**	**–**	**185**	323	–	323
At 31 December	**5,504**	**911**	**6,415**	6,871	1,022	7,893

Renegotiated loans and forbearance
(Audited)

The contractual terms of a loan may be modified for a number of reasons, including changes in market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. ‘Forbearance’ describes concessions made on the contractual terms of a loan in response to an obligor’s financial difficulties. We classify and report loans on which concessions have been granted under conditions of credit distress as ‘renegotiated loans’ when their contractual payment terms have been modified, because we have significant concerns about the borrowers’ ability to meet contractual payments when due. On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan, for accounting purposes. However, the newly recognised financial asset will retain the renegotiated loan classification. Concessions on loans made to customers which do not affect the payment structure or basis of repayment, such as waivers of financial or security covenants, do not directly provide concessionary relief to customers in terms of their ability to service obligations as they fall due and are therefore not included in this classification.

For retail lending, our credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events.

Credit quality classification of renegotiated loans
(Audited)

Under IFRSs, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired and an impairment allowance is recognised when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. Granting a concession to a customer that we would not otherwise consider, as a result of their financial difficulty, is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider, and
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment.

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

For retail lending the minimum period of payment performance required depends on the nature of loans in the portfolio, but is typically not less than six months. Where portfolios have more significant levels of forbearance activity the minimum repayment performance period required may be substantially more. Payment performance periods are monitored to ensure they remain appropriate to the levels of recidivism observed within the portfolio. These performance periods are in addition to a minimum of two payments which must be received within a 60-day period for the customer to initially qualify for the renegotiation. The qualifying payments are required in order to demonstrate that the renegotiated terms are sustainable for the borrower. For corporate and commercial loans, which are individually assessed for impairment and where non-monthly payments are more commonly agreed, the history of payment performance will depend on the underlying structure of payments agreed as part of the restructuring.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower’s ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of

Report of the Directors: Risk (continued)

time or have been assessed based on all available evidence as having no remaining indicators of impairment.

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated. When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. The following are examples of circumstances that are, individually or in aggregate, likely to result in this test being met and derecognition accounting being applied:

- an uncollateralised loan becomes fully collateralised;
- the addition or removal of cross-collateralisation provisions;
- removal or addition of conversion features attached to the loan agreement;
- a change in the currency in which the principal or interest is denominated;
- a change in the liquidation preference or ranking of the instrument; or
- the contract is altered in any other manner so that the terms under the new or modified contract are substantially different from those under the original contract.

The following are examples of factors that we consider may indicate that the revised loan is a substantially different financial instrument, but are unlikely to be conclusive in themselves:

- changes in guarantees or loan covenants provided;
- less significant changes to collateral arrangements; or
- the addition of repayment provisions or prepayment premium clauses.

Renegotiated loans and recognition of impairment allowances
(Audited)

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, the use of roll rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. As a result of our roll-rate methodology, we recognise collective impairment allowances on homogeneous groups of loans, including renegotiated loans, where there is historical evidence that there is a likelihood that loans in these groups will progress through the various stages of delinquency, and ultimately prove irrecoverable as a result of events occurring before the balance sheet date. This treatment applies irrespective of whether or not those loans are presented as impaired in accordance with our impaired loans disclosure convention. When we consider that there are additional risk factors inherent in the portfolios that may not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience.

In the corporate and commercial sectors, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessment. A distressed restructuring is classified as an impaired loan. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in renegotiated loans.

The following table shows the group's holdings of renegotiated loans and advances to customers by industry sector and credit quality classification.

Renegotiated loans and advances to customers
(Audited)

	2014				2013			
	Neither past due nor impaired £m	**Past due but not impaired £m**	**Impaired £m**	**Total £m**	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Total £m
Residential Mortgages	**339**	**142**	**548**	**1,029**	399	150	551	1,100
Other personal lending	**102**	**26**	**64**	**192**	144	23	85	252
Commercial real estate	**378**	**1**	**875**	**1,254**	396	23	1,148	1,567
Corporate and commercial	**509**	**42**	**1,703**	**2,254**	690	94	2,045	2,829
Financial	**140**	**–**	**124**	**264**	56	–	86	142
Total renegotiated loans and advances at 31 December	**1,468**	**211**	**3,314**	**4,993**	1,685	290	3,915	5,890
Impairment allowance on renegotiated loans				**(930)**				(1,128)
- renegotiated loans and advances as a % of total gross loans				**1.77%**				1.98%

Report of the Directors: Risk (continued)

Impairment of loans and advances

(Audited)

The tables below analyses the loan impairment charges for the year and the impairment allowances recognised for impaired loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

Loan impairment charge to the income statement by industry sector

(Unaudited)

	2014 £m	2013 £m
Personal	**148**	215
– residential mortgages	**(45)**	(9)
– other personal	**193**	224
Corporate and commercial	**472**	921
– manufacturing and international trade and services	**306**	518
– commercial real estate and other property-related	**50**	276
– other commercial	**116**	127
Financial	**27**	(34)
Total loan impairment charge at 31 December	**647**	1,102
Individually assessed impairment allowances	**363**	859
– new allowances	**656**	1,148
– release of allowances no longer required	**(288)**	(257)
– recoveries of amounts previously written off	**(5)**	(32)
Collectively assessed impairment allowances	**284**	243
– new allowances net of allowance releases	**460**	617
– recoveries of amounts previously written off	**(176)**	(374)
Total loan impairment charge at 31 December	**647**	1,102

Movement in impairment allowances on loans and advances to customers and banks

(Audited)

The group

	Banks	Customers		
	Individually assessed £m	Individually assessed £m	Collectively assessed £m	Total £m
Impairment allowance at 1 January 2014	**21**	**2,402**	**934**	**3,357**
Amounts written off	**(1)**	**(827)**	**(457)**	**(1,285)**
Recoveries of loans and advances written off in previous years	**–**	**5**	**176**	**181**
Loan impairment charge	**2**	**361**	**284**	**647**
Exchange and other movements	**(2)**	**(67)**	**(11)**	**(80)**
At 31 December 2014	**20**	**1,874**	**926**	**2,820**
Impairment allowance on loans and advances		**1,874**	**926**	**2,800**
- personal		**186**	**511**	**697**
- corporate and commercial		**1,572**	**389**	**1,961**
- financial		**116**	**26**	**142**
as a percentage of gross loans and advances[1]	**0.08%**	**0.72%**	**0.36%**	**0.99%**
Impairment allowance at 1 January 2013	24	2,327	919	3,270
Amounts written off	(3)	(822)	(561)	(1,386)
Recoveries of loans and advances written off in previous years	–	32	374	406
Loan impairment charge	–	859	243	1,102
Exchange and other movements	–	6	(41)	(35)
At 31 December 2013	21	2,402	934	3,357
Impairment allowance on loans and advances		2,402	934	3,336
- personal		256	585	841
- corporate and commercial		1,947	341	2,288
- financial		199	8	207
as a percentage of gross loans and advances[1]	0.09%	0.87%	0.34%	1.12%

1 *Net of reverse repo transactions, settlement accounts and stock borrowings.*

Report of the Directors: Risk (continued)

The bank

	Banks	Customers		
	Individually assessed £m	Individually assessed £m	Collectively assessed £m	Total £m
Impairment allowance at 1 January 2014	16	1,648	539	2,203
Amounts written off	(1)	(668)	(255)	(924)
Recoveries of loans and advances written off in previous years	–	13	130	143
Loan impairment charge	–	212	146	358
Exchange and other movements	(1)	14	(1)	12
At 31 December 2014	14	1,219	559	1,792
Impairment allowance on loans and advances		1,219	559	1,778
- personal		86	239	325
- corporate and commercial		1,035	299	1,334
- financial		98	21	119
as a percentage of gross loans and advances[1]	0.08%	0.60%	0.27%	0.81%
Impairment allowance at 1 January 2013	19	2,325	599	2,943
Amounts written off	(3)	(1,438)	(473)	(1,914)
Recoveries of loans and advances written off in previous years	–	32	331	363
Loan impairment charge	–	717	76	793
Exchange and other movements	–	12	6	18
At 31 December 2013	16	1,648	539	2,203
Impairment allowance on loans and advances		1,648	539	2,187
- personal		129	301	430
- corporate and commercial		1,362	235	1,597
- financial		157	3	160
as a percentage of gross loans and advances[1]	0.10%	0.75%	0.25%	0.93%

1 *Net of reverse repo transactions, settlement accounts and stock borrowings.*

Wholesale lending

Total wholesale lending

(Unaudited)

	2014 £m	2013 £m
Corporate and commercial (A)	135,932	145,382
– manufacturing	25,271	33,826
– international trade and services	48,732	45,750
– commercial real estate	17,899	18,755
– other property-related	4,572	4,421
– government	1,452	2,020
– other commercial	38,006	40,610
Financial (non-bank financial institutions) (B)	16,730	22,537
Loans and advances to banks (C)	25,282	23,034
Gross loans at 31 December (D)	177,944	190,953
Impairment allowances on wholesale lending		
Corporate and commercial (a)	(1,961)	(2,288)
– manufacturing	(305)	(371)
– international trade and services	(562)	(736)
– commercial real estate	(584)	(676)
– other property-related	(130)	(162)
– government	(2)	(1)
– other commercial	(378)	(342)
Financial (non-bank financial institutions) (b)	(142)	(207)
Loans and advances to banks (c)	(20)	(21)
Impairment allowances at 31 December (d)	(2,123)	(2,516)
(a) as a percentage of (A)	1.44%	1.57%
(b) as a percentage of (B)	0.85%	0.92%
(c) as a percentage of (C)	0.08%	0.09%
(d) as a percentage of (D)	1.19%	1.32%

Report of the Directors: Risk (continued)

Commercial real estate lending

(Unaudited)

Commercial real estate lending includes the financing of corporate, institutional and high net worth individuals investing primarily in income producing assets and, to a lesser extent construction and development of the same. The business focusses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects.

Refinance risk in commercial real estate

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay their debt on maturity, is unable to refinance the debt at commercial rates. We monitor our commercial real estate portfolio closely, assessing those drivers that may indicate potential issues with refinancing. The principal driver is the vintage of the loan, when origination reflected previous market norms which no longer apply in the current market. Examples might be higher loan-to-value ('LTV') ratios and/or lower interest cover ratios. The range of refinancing sources in the local market is also an important consideration, with risk increasing when lenders are restricted to banks and when bank liquidity is limited. In addition, underlying fundamentals such as the reliability of tenants, the ability to let and the condition of the property are important, as they influence property values.

Across the group's commercial real estate portfolios the behaviour of markets and the quality of assets did not cause undue concern in 2014.

At 31 December 2014, the UK business had £14.0 billion of commercial real estate loans, of which £3.8 billion were due to be refinanced within the next 12 months. Within these balances, cases subject to close monitoring within the Loan Management unit amounted to £1.3 billion; £0.8 billion were impaired, against which impairment allowances of £0.4 billion have been raised. Where these loans are not considered impaired it is because there is no evidence to indicate that all contractual cash flows will not be recovered or that the loans will need to be refinanced on terms the group would consider below market norms.

Collateral on loans and advances

It is the group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. For other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of a default, the group may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating exposure to credit risk.

Collateral held is analysed separately for commercial real estate and for other corporate and commercial and financial (non-bank) lending. This reflects the differing nature of collateral held on these portfolios. In each case, the analysis includes off-balance sheet commitments.

The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value. The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility. Where collateral assets are shared by multiple loans and advances, whether specifically or, more generally, by way of an all monies charge, the collateral value is pro- rated across the loans and advances protected by the collateral. Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

Report of the Directors: Risk (continued)

Commercial real estate loans and advances including loan commitments by level of collateral
(Audited)

	2014 £m	2013 £m
Rated CRR[1] 1 to 7		
Not collateralised	**3,433**	2,943
Fully collateralised	**16,414**	14,418
Partially collateralised	**888**	1,611
- collateral value	**662**	1,105
	20,735	18,972
Rated CRR[1] 8 to 10		
Not collateralised	**260**	408
Fully collateralised	**1,001**	1,132
LTV ratio less than 50%	**91**	250
- 51% to 75%	**522**	485
- 76% to 90%	**193**	232
- 90% to 100%	**195**	165
Partially collateralised	**929**	1,315
- collateral value	**616**	947
	2,190	2,855
Total at 31 December	**22,925**	21,827

1 *Customer risk rating ('CRR'). See page 43 for further information.*

Other corporate, commercial and financial (non-bank)

Other Corporate, commercial and financial (non-bank) is analysed separately below reflecting the difference in collateral held on the portfolios. For financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the likely performance of secondary sources of repayment should it prove necessary to rely on them.

The following table shows corporate, commercial and financial (non-bank) lending including off balance sheet loan commitments by level of collateralisation.

Other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/EL 8 to 10 only
(Audited)

	2014 £m	2013 £m
Not collateralised	**4,001**	3,397
Fully collateralised	**797**	473
- LTV ratio less than 50%	**184**	101
- 51% to 75%	**275**	158
- 76% to 90%	**140**	108
- 90% to 100%	**198**	106
Partially collateralised	**468**	819
- collateral value	**249**	415
Total at 31 December	**5,266**	4,689

Loans and advances to banks
(Audited)

The following table shows loans and advances to banks including off-balance sheet loan commitments by level of collateral. The collateral used in the assessment relates primarily to cash and marketable securities. This analysis excludes reverse repo balances.

Loans and advances to banks including loan commitments by level of collateral
(Audited)

	2014 £m	2013 £m
Not collateralised	**25,607**	21,928
Fully collateralised	**67**	1,499
Partially collateralised	**3**	41
- collateral value	**2**	2
Total at 31 December	**25,677**	23,468

Report of the Directors: Risk (continued)

Other credit risk exposures

In addition to collateralised lending, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below:

- some securities issued by governments, banks and other financial institutions benefit from additional credit enhancement provided by government guarantees that cover the assets;
- debt securities issued by corporates are primarily unsecured;
- debt securities issued by banks and financial institutions include ABSs and similar instruments which are supported by underlying pools of financial assets. Credit risk associated with ABSs is reduced through the purchase of CDS protection;
- trading assets include loans and advances held with trading intent. These mainly consist of cash collateral posted to satisfy margin requirements on derivatives, settlement accounts, reverse repos and stock borrowing. There is limited credit risk on cash collateral posted since in the event of default of the counterparty these would be set off against the related liability. Reverse repos and stock borrowing are by their nature collateralised; and
- The group's maximum exposure to credit risk includes financial guarantees and similar arrangements that we issue or enter into, and loan commitments that we are irrevocably committed to. Depending on the terms of the arrangement, we may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults.

Derivatives

HSBC participates in transactions exposing it to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before completing the satisfactory settlement of the transaction, which varies in value by reference to a market factor such as interest rate, exchange rate or asset price. It arises principally from OTC derivatives and SFTs and is calculated in both the trading and non-trading books. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment ('CVA').

The International Swaps and Derivatives Association ('ISDA') Master Agreement is the group's preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over-the-counter products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-agreed termination events occur. It is common, and the group's preferred practice, for the parties to execute a Credit Support Annex ('CSA') in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the market-contingent counterparty risk inherent in the outstanding positions.

We manage the counterparty exposure arising from market risk on our OTC derivative contracts by using collateral agreements with counterparties and netting agreements. Currently, we do not actively manage our general OTC derivative counterparty exposure in the credit markets, although we may manage individual exposures in certain circumstances.

HSBC has historically placed strict policy restrictions on collateral types and as a consequence the types of collateral received and pledged are, by value, highly liquid and of a strong quality, being predominantly cash.

Where a collateral type is required to be approved outside the collateral policy (which includes collateral that includes wrong way risks), a submission to the Documentation Approval Committee ('DAC') for approval is required. The DAC requires the participation and sign-off of senior representatives from the Global Markets Chief Operating Officer, Legal and Risk.

The majority of the counterparties with whom we have a collateral agreement are European. The majority of the group's CSAs are with financial institutional clients.

Reverse repos – non trading

Following the change in balance sheet presentation explained on page 155, non-trading reverse repos are presented separately on the face of the balance sheet and are no longer included in 'Loans and advances to customers' and 'Loans and advances to banks'.

Comparative data have been re-presented accordingly. As a result, any analysis in the Credit Risk section that references loans and advances to customers or banks excludes non-trading reverse repos to customers or banks, respectively. For reference, the amount of non-trading reverse repos to customers and banks is set out below.

Reverse repos – non trading
(Audited)

	2014 **£m**	2013 £m
With customers	**19,468**	31,310
With banks	**22,477**	30,215
31 December	**41,945**	61,525

Report of the Directors: Risk (continued)

Personal lending

Total personal lending

(Unaudited)

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets being acquired. We also offer loans secured on existing assets, such as first charges on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans. The following table shows the levels of personal lending products in the various portfolios in the UK and the rest of Europe.

Total personal lending	**UK £m**	**Continental Europe £m**	**Total £m**
Residential mortgage lending (A)	**79,066**	**3,941**	**83,007**
Of which:			
– Interest-only (including endowment) mortgages	**27,984**	**29**	**28,013**
– Affordability mortgages, including adjustable rate mortgages	**–**	**216**	**216**
Other personal lending (B)	**13,489**	**10,894**	**24,383**
– personal loans and overdrafts	**6,655**	**9,411**	**16,066**
– credit cards	**6,834**	**1,479**	**8,313**
– motor vehicle finance	**–**	**4**	**4**
Total gross loans at 31 December 2014 (C)	**92,555**	**14,835**	**107,390**
Impairment allowances on personal lending			
Residential mortgages (a)	**(155)**	**(41)**	**(196)**
Other personal lending (b)	**(209)**	**(292)**	**(501)**
– personal loans and overdrafts	**(145)**	**(132)**	**(277)**
– credit cards	**(64)**	**(159)**	**(223)**
– motor vehicle finance	**–**	**(1)**	**(1)**
Total impairment allowances at 31 December 2014 (c)	**(364)**	**(333)**	**(697)**
(a) as a percentage of A	**0.20%**	**1.04%**	**0.24%**
(b) as a percentage of B	**1.55%**	**2.68%**	**2.05%**
(c) as a percentage of C	**0.39%**	**2.24%**	**0.65%**
	£m	£m	£m
Residential mortgage lending (D)	79,955	3,927	83,882
Of which:			
– Interest-only (including endowment) mortgages	29,585	33	29,618
– Affordability mortgages, including adjustable rate mortgages	1	306	307
Other personal lending (E)	13,860	11,397	25,257
– personal loans and overdrafts	6,916	9,565	16,481
– credit cards	6,944	1,825	8,769
– motor vehicle finance	–	7	7
Total gross loans at 31 December 2013 (F)	93,815	15,324	109,139
Impairment allowances on personal lending			
Residential mortgages (d)	(222)	(43)	(265)
Other personal lending (e)	(274)	(302)	(576)
– personal loans and overdrafts	(194)	(136)	(330)
– credit cards	(80)	(164)	(244)
– motor vehicle finance	–	(2)	(2)
Total impairment allowances at 31 December 2013 (f)	(496)	(345)	(841)
(d) as a percentage of D	0.28%	1.09%	0.32%
(e) as a percentage of E	1.97%	2.65%	2.28%
(f) as a percentage of F	0.53%	2.25%	0.77%

Mortgage lending

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only, affordability and offset mortgages. Group credit policy prescribes the range of acceptable residential property LTV thresholds with the maximum upper limit for new loans set between 75% and 95%. Specific LTV thresholds and debt-to-income ratios are managed at regional and country levels and, although the parameters must comply with Group policy, strategy and risk appetite, they differ in the various locations in which we operate to reflect the local economic and housing market conditions, regulations, portfolio performance, pricing and other product features.

Other personal lending

Other personal lending consists primarily of credit cards and personal loans, both of which are generally unsecured.

Collateral and other credit enhancements held

(Audited)

The tables below show residential mortgage lending including off-balance sheet loan commitments by level of collateral. They provide a quantification of the value of fixed charges we hold over borrowers' specific assets where we have a history of enforcing, and are able to enforce, collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and

Report of the Directors: Risk (continued)

where the collateral is cash or can be realised by sale in an established market. The LTV ratio is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date divided by the value of collateral. The value of collateral is determined using professional valuations and house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants. Valuations must be updated on a regular basis and, as a minimum, at intervals of every three years. More frequent re-valuations are conducted where market conditions or portfolio performance are subject to significant change or where a loan is identified and assessed as impaired.

Residential mortgage loans including loan commitments by level of collaterals
(Audited)

The group

	2014 £m	2013 £m
Non-impaired loans and advances		
Fully collateralised	**86,200**	87,422
Less than 50% LTV	**41,643**	32,500
51% to 75% LTV	**35,751**	39,893
76% to 90% LTV	**7,606**	13,068
91% to 100% LTV	**1,200**	1,961
Partially collateralised		
greater than 100% LTV	**278**	853
- collateral value	**199**	516
Impaired loans and advances		
Fully collateralised	**585**	827
Less than 50% LTV	**148**	147
51% to 75% LTV	**268**	272
76% to 90% LTV	**105**	194
91% to 100% LTV	**64**	214
Partially collateralised		
greater than 100% LTV	**31**	64
- collateral value	**26**	55
At 31 December	**87,094**	89,166

The bank

	2014 £m	2013 £m
Non-impaired loans and advances		
Fully collateralised	**80,872**	82,749
Less than 50% LTV	**39,984**	31,066
51% to 75% LTV	**33,196**	37,466
76% to 90% LTV	**7,087**	12,510
91% to 100% LTV	**605**	1,707
Partially collateralised		
greater than 100% LTV	**182**	689
- collateral value	**125**	432
Impaired loans and advances		
Fully collateralised	**421**	615
Less than 50% LTV	**112**	124
51% to 75% LTV	**193**	237
76% to 90% LTV	**89**	182
91% to 100% LTV	**27**	72
Partially collateralised		
greater than 100% LTV	**24**	55
- collateral value	**19**	47
At 31 December	**81,499**	84,108

Report of the Directors: Risk (continued)

Securitisation exposures and other structured products

(Audited)

This section contains information about our exposure to asset-backed securities ('ABSs'), some of which are held through consolidated structured entities and summarised in the table below.

Also included within this section is information on the Global Banking and Markets legacy credit activities in respect of Solitaire and the securities investment conduits ('SICs').

For further information on structured entities please refer to note 36.

Overall exposure

	Carrying amount[1] 2014 £bn	2013 £bn
Asset-backed securities		
Fair value through profit and loss	**2**	5
Available for sale	**12**	14
Held to maturity	**–**	–
Loans and receivables	**1**	2
At 31 December[1]	**15**	21

1 *Carrying amount of the Gross Principal exposure*

Analysis of asset-backed securities
(Audited)

	Gross principal exposure[1] £m	Gross principal protection[2] £m	Net principal exposure[3,5] £m	Carrying Amount[4,5] £m	Of which held through consolidated SEs £m
Mortgage-related assets:					
– Sub-prime residential	**2,609**	**–**	**2,609**	**2,211**	**1,331**
– US Alt-A residential	**2,723**	**–**	**2,723**	**1,965**	**1,547**
– Other residential	**1,517**	**–**	**1,517**	**1,454**	**418**
– Commercial property	**3,276**	**–**	**3,276**	**3,050**	**1,831**
Leveraged finance-related assets:	**2,555**	**–**	**2,555**	**2,503**	**1,621**
Student loan-related assets:	**2,792**	**64**	**2,728**	**2,382**	**2,107**
Other assets:	**2,303**	**384**	**1,919**	**1,490**	**486**
At 31 December 2014	**17,775**	**448**	**17,327**	**15,055**	**9,341**
Mortgage-related assets:					
– Sub-prime residential	2,583	–	2,583	2,080	1,683
– US Alt-A residential	3,204	–	3,204	2,083	1,770
– Other residential	2,234	–	2,234	1,608	915
– Commercial property	4,273	–	4,273	3,899	3,113
Leveraged finance-related assets:	3,301	–	3,301	3,196	2,607
Student loan-related assets:	2,876	60	2,816	2,329	2,114
Other assets:	6,786	4,585	2,201	1,587	598
At 31 December 2013	25,257	4,645	20,612	16,782	12,800

1 *The gross principal is the redemption amount on maturity or, in the case of an amortising instrument, the sum of the future redemption amounts through the residual life of the security.*
2 *Gross principal of the underlying instrument that is protected by credit default swaps ('CDSs') or by matching liabilities.*
3 *Net principal exposure is the value of gross principal amount of assets that are not protected by CDSs or by matching liabilities. It includes assets that benefit from monoline protection, except where this protection is purchased with a CDS.*
4 *Carrying amount of the Net Principal exposure. As at 31 December 2014 the carrying amount of the Gross Principal Exposure is £ 15,471 million (2013: £21,367 million).*
5 *The asset backed securities are primarily US dollar ('USD') denominated. Principal and carrying amounts are converted into sterling ('GBP') at the prevailing exchange rates at 31 December (2014: 1GBP: USD 1.5587; 2013: 1GBP: USD 1.6531).*

Included in the above table are securities with a carrying amount of £ 4,205 million (2013: £7,364 million) held through the SICs, excluding Solitaire, that are consolidated by the group. Although the group includes these assets in full on its balance sheet, significant first loss risks are borne by the third party capital notes investors. The carrying amount of the capital notes liability at the year ended 31 December 2014 was £241 million (2013: £276 million). The available-for-sale reserve movement in relation to these ABSs for the year was a decrease of £68 million (2013: decrease of £358 million). The impairment write-back attributed to the group for the year was £67 million (2013: write-back of £13 million).

Liquidity and funding risk

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its obligations as they fall due, or will have access to such resources only at an excessive cost. This risk principally arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the group's liquidity and funding management framework is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. To this end, the group maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity that are held to enable the group to respond quickly and smoothly to unforeseen liquidity requirements.

The group requires its operating entities to maintain strong liquidity positions and to manage the liquidity profiles of their assets, liabilities and commitments with the objective of ensuring that their cash flows are balanced appropriately and that all their anticipated obligations can be met when due. The group adapts its liquidity and funding risk management framework in response to changes in the mix of business that it undertakes, and to changes in the nature of the markets in which it operates. The group also seeks to continuously evolve and strengthen its liquidity and funding risk management framework.

The group employs a number of measures to monitor liquidity risk. The group also manages its intra-day liquidity positions so that it is able to meet payment and settlement obligations on a timely basis. Payment flows in real time gross settlement systems, expected peak payment flows and large time-critical payments are monitored during the day and the intra-day collateral position is managed so that there is liquidity available to meet payments.

The management of liquidity and funding is primarily undertaken locally in the group's operating entities in compliance with policies and limits set by the Risk Management Meeting ('RMM'). These limits vary according to the depth and liquidity of the market in which the entities operate. It is the group's general policy that each banking entity should manage its liquidity and funding risk on a standalone basis. Exceptions are permitted for certain short-term treasury requirements and start-up operations or for branches which do not have access to local deposit markets. These entities are funded from the group's largest banking operations and within clearly defined internal and regulatory guidelines and limits. The limits place formal restrictions on the transfer of resources between group entities and reflect the range of currencies, markets and time zones within which the group operates.

The group's liquidity and funding management process includes:

- projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation to these;
- monitoring balance sheet liquidity and advances to core funding ratios at both a consolidated and major currency level against internal and regulatory requirements;
- maintaining a diverse range of funding sources with back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within pre-determined caps;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

Primary sources of funding
(Audited)

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access wholesale funding markets by issuing senior secured and unsecured debt securities (publically and privately) and borrowing from the secured repo markets against high quality collateral, in order to obtain funding for non-banking subsidiaries that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

Liquidity and funding in 2014
(Unaudited)

The group maintained its liquidity position in 2014 and continued to enjoy strong inflows of customer deposits and maintained good access to wholesale markets. HSBC UK recorded a decrease in its advances to core funding ('ACF') ratio to 97 per cent at 31 December 2014 (2013: 100 per cent) mainly because core deposits increased more than advances, and due to the reduction in legacy assets.

Liquidity regulation
(Unaudited)

The European adoption of the Basel Committee framework (legislative texts known as the Capital Requirements Regulation and Directive – CRR/CRD IV) was published in June 2013, and required the reporting of the liquidity coverage ratio ('LCR') and the net stable funding ratio ('NSFR') to European regulators from January 2014, which was subsequently delayed until 30

Report of the Directors: Risk (continued)

June 2014. A significant level of interpretation has been required to report and calculate the LCR as defined in the CRR text due to areas only addressed by the finalisation of the LCR delegated act in Jan 2015. Although the Basel Committee finalised the recommended calibration of the NSFR in October 2014, the European calibration of NSFR is still pending.

Management of liquidity and funding risk

(Audited)

HSBC's liquidity and funding risk management framework ('LFRF') employs two key measures to define, monitor and control the liquidity and funding risk of our operating entities. The advances to core funding ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses.

Inherent liquidity risk categorisation

The group categorises its operating entities into one of two categories to reflect its assessment of their inherent liquidity risk, considering political, economic and regulatory factors within the operating entities' host country, and also factors specific to the entity itself, such as the local footprint, market share, balance sheet strength and control framework. This assessment is used to determine the severity of the liquidity stress that the group expects its operating entities to be able to withstand.

Core deposits

A key element of our internal framework is the classification of customer deposits into core and non-core based on the expectation of their behaviour during periods of liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the operating entity originating the deposit, the nature of the customer and the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan. The core deposit base is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that we use to calculate our principal liquidity risk metrics.

The three filters considered in assessing whether a deposit in any operating entity is core are:

- *price:* any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- *size:* depositors with total funds above certain monetary thresholds are excluded. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- *line of business:* the element of any deposit remaining after the application of the price and size filters is assessed on the basis of the line of business with which the deposit is associated. The proportion of any customer deposit that can be considered core under this filter is between 35 per cent and 90 per cent.

Repo transactions and bank deposits are not classified as core deposits.

Advances to core funding ratio

The group emphasises the importance of core customer deposits as a source of funds to finance lending to customers and discourages reliance on short-term wholesale funding. This is achieved by placing limits on banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding. This measure is referred to as the 'advances to core funding' ratio.

ACF ratio limits are set by the RMM. The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. Non-trading reverse repurchase arrangements, where the group receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio.

ACF limits set for principal operating entities at 31 December 2014 ranged between 80 per cent and 120 per cent. The table below shows the extent to which loans and advances to customers in our principal banking entities were financed by reliable and stable sources of funding.

Report of the Directors: Risk (continued)

Advances to core funding ratios[1]

(Audited)

	At 31 December	
	2014	2013
	(%)	(%)
HSBC UK[2]		
Year end	**97**	100
Maximum	**102**	107
Minimum	**97**	100
Average	**100**	104
HSBC France		
Year end	**101**	108
Maximum	**108**	114
Minimum	**100**	98
Average	**103**	106
Total of other principal group entities[3]		
Year end	**82**	93
Maximum	**92**	97
Minimum	**76**	92
Average	**84**	94

1 This ratio measures loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. The lower the percentage, the stronger the funding position.
2 The HSBC UK entity shown comprises: HSBC Bank plc (including all overseas branches), Marks and Spencer Financial Services Limited, HFC Bank Limited and HSBC Trust Company (UK) Limited and from 1 April 2013 Private Bank (UK) Limited. It is managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the PRA.
3 Other principal entities are: HSBC Trinkaus & Burkhardt AG, HSBC Bank Malta plc and HSBC Bank A.S. (Turkey).

Core funding represents the core component of customer deposits and any term wholesale funding with a residual contractual maturity beyond one year. Capital is excluded from our definition of core funding.

Stressed coverage ratios

(Audited)

Stressed coverage ratios are derived from stressed cash flow scenario analyses and express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

- inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and
- contractual cash inflows from maturing assets that are not already reflected as a utilisation of liquid assets.

In line with the approach adopted for the advances to core funding ratio, customer loans are generally assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratio, irrespective of the contractual maturity date.

A stressed coverage ratio of 100 per cent or higher reflects a positive cumulative cash flow under the stress scenario being monitored. Group operating entities are required to maintain a ratio of 100 per cent or greater out to three months under the combined market-wide and HSBC-specific stress scenario defined by the inherent liquidity risk categorisation of the operating entity concerned.

Compliance with operating entity limits is monitored by Asset Liability and Capital Management ('ALCM') teams and reported monthly to the RMM for the main operating entities and to the European Asset Liability Committee ('ALCO') for the smaller operating entities.

The stressed coverage ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over a one-month and three-month time horizon.

Inflows included in the numerator of the stressed coverage ratio are generated from liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the time period.

At 31 December 2014, the one-month and three-month stressed coverage ratios for the principal entities shown in the table below were in excess of the 100 per cent target.

Report of the Directors: Risk (continued)

Stressed one-month and three-month coverage ratios[1]

(Audited)

	Stressed one-month coverage ratios at 31 December		Stressed three-month coverage ratios at 31 December	
	2014 (%)	2013 (%)	**2014 (%)**	2013 (%)
HSBC UK				
Year end	**117**	106	**109**	109
Maximum	**117**	114	**109**	109
Minimum	**102**	100	**103**	101
Average	**107**	106	**104**	103
HSBC France				
Year end	**117**	110	**101**	103
Maximum	**117**	112	**106**	104
Minimum	**104**	103	**101**	100
Average	**107**	108	**102**	103
Total of other principal group entities				
Year end	**110**	106	**108**	102
Maximum	**115**	113	**108**	106
Minimum	**104**	104	**102**	102
Average	**109**	108	**105**	103

1 *This ratio measures the liquid assets available to meet net cash outflows over a 30 day/ 90 day period. The higher the percentage, the greater the liquidity.*

The one-month stressed coverage ratio for HSBC UK increased mainly due to lower contractual repos positions. The three-month stressed coverage ratio remained broadly unchanged.

Stressed scenario analysis

(Unaudited)

The group uses a number of standard Group stress scenarios designed to model:

- combined market-wide and HSBC-specific liquidity crisis scenarios; and
- market-wide liquidity crisis scenarios.

The appropriateness of the assumptions for each scenario is reviewed by ALCM regularly and formally approved by the RMM and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group's cash flow model. The group's framework prescribes the use of two market-wide scenarios and two further combined market-wide and HSBC-specific stress scenarios of increasing severity. In addition to the group's standard stress scenarios, individual operating entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

The two combined market-wide and HSBC-specific scenarios model a more severe scenario than the market-wide scenarios. The relevant combined market-wide and HSBC-specific stress scenario that an operating entity manages to is based upon its inherent liquidity risk categorisation. The key assumptions factored into the combined market-wide and HSBC-specific stress scenarios are summarised as follows:

- all non-core deposits are deemed to be withdrawn within three months (80 per cent within one month), with the level of non-core deposits dependent on the operating entity's inherent liquidity risk categorisation;
- the ability to access interbank funding and unsecured term debt markets ceases for the duration of the scenario;
- the ability to generate funds from illiquid asset portfolios (securitisation and secured borrowing) is restricted to 25-75 per cent of the lower of issues in the last six months or expected issues in the next six months. The restriction is based on current market conditions and is dependent on the operating entity's inherent liquidity risk categorisation;
- the ability to access repo funding ceases for any asset not classified as liquid under our liquid asset policy for the duration of the scenario;
- drawdowns on committed lending facilities must be consistent with the severity of the market stress being modelled and dependent on the inherent liquidity risk categorisation of the operating entity;
- outflows are triggered by a defined downgrade in long-term ratings. We maintain an ongoing assessment of the appropriate number of notches to reflect;
- customer loans are assumed to be renewed at contractual maturity;
- interbank loans and reverse repos are assumed to run off contractually; and
- assets defined as liquid assets are assumed to be realised in cash ahead of their contractual maturity, after applying a defined stressed haircut of up to 20 per cent.

Liquid assets

(Audited)

The table of the liquid assets shows the estimated liquidity value (before haircuts) of assets categorised as liquid used for the purposes of calculating the three month stressed coverage ratio, as defined under the Group's LFRF.

Unencumbered assets held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, but are treated as contractual cash inflows. This table is prepared on a different basis to the liquid asset disclosure for HSBC UK in the Group Annual Report and Accounts ('ARA'), which shows the stock of unencumbered liquid assets as at the reporting date, adjusted for the impact of repos, reverse repos and collateral swaps maturing within three months, as for the Group ARA the liquidity value of these transactions is reflected as a contractual cash flow reported in the net contractual cash flow table.

Liquid assets are held and managed on a standalone operating entity basis. The vast majority of liquid assets shown are held directly by each operating entity's Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Liquid assets also include any unencumbered liquid assets held outside Balance Sheet Management for any other purpose. The Group's liquidity risk management framework gives ultimate control of all unencumbered assets and sources of liquidity to Balance Sheet Management.

Liquid assets
(Audited)

	Estimated liquidity value at 31 December	
	2014	2013
	£m	£m
HSBC UK		
Level 1	**94,478**	90,980
Level 2	**2,069**	317
Level 3	**20,091**	19,594
	116,638	110,891
HSBC France		
Level 1	**10,838**	12,087
Level 2	**241**	98
Level 3	**2,221**	2,268
	13,300	14,453
Total of other principal group entities		
Level 1	**7,442**	8,091
Level 2	**490**	614
Level 3	**1,987**	1,144
	9,919	9,849

The Group's liquid asset policy is to apply a more granular classification of liquid assets. These classifications are as follows:

- *Level 1* - Central banks, central government securities of countries and currencies with a highly liquid market and certain supranationals and multilateral development banks;
- *Level 2* – Local and regional governments, public sector entities, secured covered bonds, pass-through ABSs, and gold; and
- *Level 3* – Unsecured non-financial entity securities and equities listed on recognised exchanges and within liquid indices.

All assets held within the liquid asset portfolio are unencumbered.

Liquid assets held by HSBC UK increased as a result of a rise in non-core customer accounts, from which the funds were placed in liquid assets.

Liquidity behaviouralisation

(Unaudited)

Liquidity behaviouralisation is applied to reflect our assessment of the expected period for which we are confident that we will have access to our liabilities, even under a severe liquidity stress scenario, and the expected period for which we must assume that we will need to fund our assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour. Liquidity behaviouralisation is reviewed and approved by local ALCO in compliance with policies set by the RMM. Our approach to liquidity risk management will often mean different behaviouralisation assumptions are applied to assets and liabilities. For example, management may assume a shorter life for liabilities and a longer-term funding requirement for assets. All core deposits are assumed under the Group's core/non-core and advances to core funding frameworks to have a liquidity behaviouralised life beyond one year and to represent a homogeneous source of core funding. The behaviouralisation of assets is more granular and seeks to differentiate the period for which we assume that we will need to fund the asset.

Funds transfer pricing

(Unaudited)

Our funds transfer pricing policies give rise to a two-stage funds transfer pricing approach, reflecting the fact that we separately manage interest rate risk and liquidity and funding risk under different assumptions. They have been developed to be consistent with our risk management frameworks. Each operating entity is required to apply the Group's transfer pricing policy framework to determine for each material currency the most appropriate interest rate risk transfer pricing curve, a liquidity premium curve (which is the spread over the interest rate risk transfer pricing curve) and a liquidity recharge assessment (which is the spread under or over the interest rate risk transfer pricing curve).

The interest rate risk transfer pricing policy seeks to ensure that all market interest rate risk arising structurally from non-trading (banking book) assets and liabilities, which is capable of being neutralised externally in the market or neutralised internally by off-setting transfers, is transferred to Balance Sheet Management ('BSM') to be managed centrally as non-traded market risk. For each material currency each operating entity employs a single interest rate risk transfer pricing curve. The transfer price curve used for this purpose reflects how BSM in each operating entity is best able to neutralise the interest rate risk in the market at the point of transfer. Where basis risk can be identified between the re-pricing basis of an external asset or external liability and the re-pricing basis of the interest rate risk transfer pricing curve, this basis risk may be transferred to BSM provided it can neutralise the basis risk in the market.

Liquidity and funding risk is transfer priced independently from interest rate risk because the liquidity and funding risk of an operating entity is

Report of the Directors: Risk (continued)

transferred to ALCO to be managed centrally. ALCO monitors and manages the advances to core funding ratio and delegates the management of the liquid asset portfolio and execution of the wholesale term debt funding plan to BSM, requiring BSM to ensure the group's stressed coverage ratios remain above 100 per cent out to three months.

The liquidity and funding risk transfer price consists of two components:

- Liquidity recharge: the cost of holding the benchmark liquid asset (the yield under the transfer price) to meet stressed cash outflows. The benchmark liquid asset is decided by ALCO and based on the weighted average duration that can be achieved by investing in level 1 liquid assets, with a residual duration of up to one year.
- Liquidity premium: the assessed cost/value of term funding (the yield over the transfer price) to pay for term debt and core deposits.

The assessed cost of holding liquid assets is allocated to the outflows modelled by the internal stressed coverage ratio framework.

Liquidity premium is charged to any asset that affects the three-month stressed coverage ratios based on the assessed behaviouralised liquidity life of the asset, with any asset affecting the ACF metric required to have a minimum behaviouralised life of at least one year, and the prevailing liquidity premium curve rate set by ALCO (calibrated in line with Group principles). Core deposits therefore share equally in the liquidity premiums charged to the assets they support, after deducting the cost of any term funding.

Contingent liquidity risk arising from committed lending facilities

(Audited)

The group provides customers with committed facilities, including committed backstop lines to conduit vehicles sponsored by the group and standby facilities to corporate customers. These facilities increase the funding requirements of the group when customers choose to raise drawdown levels above their normal utilisation rates. The liquidity risk consequences of increased levels of drawdown are analysed in the form of projected cash flows under different stress scenarios. The RMM sets limits for non-cancellable contingent funding commitments by entity after due consideration of each entity's ability to fund them. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

The group's consolidated securities investment conduits include Solitaire and Mazarin Funding Limited ('Mazarin') (see note 36). They issue asset-backed commercial paper secured against the portfolio of securities held by them. Although HSBC UK provides a liquidity facility, Solitaire and Mazarin have no need to draw on it so long as HSBC purchases the CP issued, which it intends to do for the foreseeable future. At 31 December 2014, the commercial paper issued by Solitaire and Mazarin was entirely held by HSBC UK. Since HSBC controls the size of the portfolio of securities held by these conduits, no contingent liquidity risk exposure arises as a result of these undrawn committed lending facilities.

In relation to commitment to customers, the table below shows the level of undrawn commitments outstanding in terms of the five largest single facilities and the largest market sector.

The group's contractual exposures as at 31 December monitored under the contingent liquidity risk limit structure
(Audited)

	The group	
	2014	2013
	£bn	£bn
Commitments to conduits		
Consolidated multi-seller conduits[1]		
– total lines	**7.9**	7.6
– largest individual lines	**0.6**	0.4
Consolidated securities investment conduits – total lines	**7.1**	7.8
Commitments to customers		
– five largest[2]	**2.6**	2.7
– largest market sector[3]	**10.6**	5.8

1. *These exposures relate to the Regency multi-seller conduit. This vehicle provides funding to group customers by issuing debt secured by a diversified pool of customer-originated assets.*
2. *These figures represent the undrawn balance for the five largest committed liquidity facilities provided to customers, other than those facilities to conduits.*
3. *These figures represent the undrawn balance for the total of all committed liquidity facilities provided to the largest market sector, other than those facilities to conduits.*

Sources of funding

(Audited)

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. The group issues wholesale securities (secured and unsecured), including subordinated debt to supplement its customer deposits and change the currency mix, maturity profile or location of liabilities. The 'Funding sources and uses' table below, which provides a consolidated view of how the group's balance sheet is funded, should be read in the light of the LFRF, which requires the group to manage liquidity and funding risk on a stand-alone basis.

The table analyses the group consolidated balance sheet according to the assets that primarily arise from operating activities and the sources of funding primarily supporting these activities. The assets and liabilities that do not arise from operating activities are presented as a net balancing source or deployment of funds.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets; cash and balances with central banks and financial investments, as required by the LFRF.

Funding sources and uses

(Audited)

The group

	2014 £m	2013 £m
Sources		
Customer accounts	**346,507**	346,358
Deposits by banks	**27,590**	28,769
Repurchase agreements – non-trading	**23,353**	65,573
Debt securities issued	**27,921**	32,895
Subordinated liabilities	**8,858**	10,785
Financial liabilities designated at fair value	**22,552**	34,036
Liabilities under insurance contracts	**17,522**	19,228
Trading liabilities	**82,600**	91,842
– repos	**2,339**	9,426
– stock lending	**11,617**	6,936
– settlement accounts	**3,628**	3,587
– other trading liabilities	**65,016**	71,893
Total equity	**36,698**	32,919
At 31 December	**593,601**	662,405

	2014 £m	2013 £m
Uses		
Loans and advances to customers	**257,252**	273,722
Loans and advances to banks	**25,262**	23,013
Reverse Repurchase agreements – non-trading	**41,945**	61,525
Trading assets	**130,127**	134,097
– reverse repos	**444**	5,607
– stock borrowing	**5,137**	6,241
– settlement accounts	**3,803**	4,447
– other trading assets	**120,743**	117,802
Financial investments	**76,194**	75,030
Cash and balances with central banks	**42,853**	67,584
Net deployment in other balance sheet assets and liabilities	**19,968**	27,434
At 31 December	**593,601**	662,405

Repos and stock lending

GB&M provides collateralised security financing services to its clients, providing them with cash financing or specific securities. When cash is provided to clients against collateral in the form of securities, the cash provided is recognised on the balance sheet as a reverse repo. When securities are provided to clients against cash collateral the cash received is recognised on the balance sheet as a repo or, if the securities are equity securities, as stock lending.

Each operating entity manages its collateral through a central collateral pool, in line with the LFRF. When specific securities need to be delivered and the entity does not have them currently available within the central collateral pool, the securities are borrowed on a collateralised basis. When securities are borrowed against cash collateral the cash provided is recognised on the balance sheet as a reverse repo or, if the securities are equity securities, as stock borrowing.

Operating entities may also borrow cash against collateral in the form of securities, using the securities available in the central collateral pool. Repos and stock lending can be used in this way to fund the cash requirement arising from securities owned outright by Markets to facilitate client business, and the net cash requirement arising from financing client securities activity. Reverse repos, stock borrowing, repos and stock lending are reported net when the IFRSs offsetting criteria are met. In some cases transactions to borrow or lend securities are collateralised using securities. These transactions are off-balance sheet.

Any security accepted as collateral for a reverse repo or stock borrowing transaction must be of very high quality and its value subject to an appropriate haircut. Securities borrowed under reverse repo or stock borrowing transactions can only be recognised as part of the liquidity asset buffer for the duration of the transactions and only if the security received is eligible under the liquid asset policy within the LFRF.

Credit controls are in place to ensure that the fair value of any collateral received remains appropriate to collateralise the cash or fair value of securities given.

Wholesale term debt maturity profile

(Unaudited)

The maturity profile of the wholesale term debt obligations is set out in the table below 'Wholesale funding principal cash flows payable by the group under financial liabilities by remaining contractual maturities'.

The balances in the table will not agree directly with those in the consolidated balance sheet as the table presents gross cash flows relating to principal payments and not the balance sheet carrying value, which includes debt securities and subordinated liabilities measured at fair value.

Wholesale funding cash flows payable by the group under financial liabilities by remaining contractual maturities
(Unaudited)

	Due within 1 month £m	Due between 1 and 3 months £m	Due between 3 and 6 months £m	Due between 6 and 9 months £m	Due between 9 months and 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Due after 5 years £m	Total £m
Debt securities issued	**9,033**	**5,464**	**7,604**	**3,264**	**2,593**	**8,537**	**11,666**	**11,889**	**60,050**
– unsecured CDs and CP	**2,251**	**3,646**	**4,414**	**1,561**	**1,278**	**–**	**–**	**–**	**13,150**
– unsecured senior MTNs	**791**	**1,671**	**2,494**	**1,308**	**1,073**	**6,328**	**5,760**	**6,921**	**26,346**
– unsecured senior structured notes	**423**	**147**	**696**	**264**	**242**	**2,209**	**3,418**	**2,889**	**10,288**
– secured covered bonds	**–**	**–**	**–**	**131**	**–**	**–**	**1,774**	**1,888**	**3,793**
– secured ABCP	**5,519**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**5,519**
– secured ABS	**–**	**–**	**–**	**–**	**–**	**–**	**714**	**–**	**714**
– others	**49**	**–**	**–**	**–**	**–**	**–**	**–**	**191**	**240**
Subordinated liabilities	**–**	**–**	**–**	**2**	**14**	**74**	**102**	**11,210**	**11,402**
– subordinated debt securities	**–**	**–**	**–**	**2**	**14**	**74**	**102**	**8,699**	**8,891**
– preferred securities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,511**	**2,511**
At 31 December 2014	**9,033**	**5,464**	**7,604**	**3,266**	**2,607**	**8,611**	**11,768**	**23,099**	**71,452**
Debt securities issued	12,697	4,213	6,376	5,039	4,816	8,148	15,275	11,767	68,331
– unsecured CDs and CP	3,333	2,635	4,454	1,016	2,580	–	–	–	14,018
– unsecured senior MTNs	2,618	1,035	1,301	2,325	1,632	6,880	10,945	7,585	34,321
– unsecured senior structured notes	400	543	621	640	604	1,132	1,966	1,996	7,902
– secured covered bonds	–	–	–	756	–	136	1,662	2,007	4,561
– secured ABCP	6,281	–	–	–	–	–	–	–	6,281
– secured ABS	–	–	–	302	–	–	702	–	1,004
– others	65	–	–	–	–	–	–	179	244
Subordinated liabilities	–	17	40	10	–	31	214	11,521	11,833
– subordinated debt securities	–	17	40	10	–	31	214	10,498	10,810
– preferred securities	–	–	–	–	–	–	–	1,023	1,023
At 31 December 2013	12,697	4,230	6,416	5,049	4,816	8,179	15,489	23,288	80,164

Report of the Directors: Risk (continued)

Encumbered and unencumbered assets

(Unaudited)

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Summary of assets available to support potential future funding and collateral needs (on and off-balance sheet)
(Unaudited)

	2014 £m	2013 £m
Total on-balance sheet assets at 31 December	**797,289**	811,695
Less:		
– reverse repo/ stock borrowing receivables and derivative assets	**(235,262)**	(208,200)
– other assets that cannot be pledged as collateral	**(89,250)**	(83,249)
Total on-balance sheet assets that can support funding and collateral needs at 31 December	**472,777**	520,246
Add:off-balance sheet assets		
– fair value of collateral received in relation to reverse repo/ stock borrowing / derivatives that is available to sell or repledge	**110,514**	111,244
Total assets that can support future funding and collateral needs	**583,291**	631,490
Less:		
– on-balance sheet assets pledged	**(59,015)**	(91,443)
– re-pledging of off-balance sheet collateral received in relation to reverse repo/ stock borrowing/ derivatives	**(72,281)**	(80,180)
Assets available to support funding and collateral needs at 31 December	**451,995**	459,867

The effect of active collateral management

Collateral is managed on an operating entity basis, consistent with the approach adopted in managing liquidity and funding. Available collateral held by each operating entity is managed as a single collateral pool. In deciding which collateral to pledge, each operating entity seeks to optimise the use of the available collateral pool within the confines of the LFRF, irrespective of whether the collateral pledged is recognised on-balance sheet or was received in respect of reverse repo, stock borrowing or derivative transactions.

Managing collateral in this manner affects the presentation of asset encumbrance in that we may encumber on-balance sheet holdings while maintaining available unencumbered off-balance sheet holdings, even though we are not seeking to directly finance the on-balance sheet holdings pledged.

In quantifying the level of encumbrance of negotiable securities, the encumbrance is analysed by individual security. When a particular security is encumbered and we hold the security both on-balance sheet and off-balance sheet with the right to repledge, we assume for the purpose of this disclosure that the off-balance sheet holding received from third party is encumbered ahead of the on-balance sheet holding.

An on-balance sheet encumbered and off-balance sheet unencumbered asset will occur, for example, if we receive a specific security as a result of a reverse repo/stock borrowing transaction, but finance the cash lent by pledging a generic collateral basket, even if the security received is eligible for the collateral basket pledged. It will also occur if we receive a generic collateral basket as a result of a reverse repo transaction but finance the cash lent by pledging specific securities, even if the securities pledged are eligible for the collateral basket.

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce the group's income or the value of its portfolios.

Exposure to market risk is separated into two portfolios.

- Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.
- Non-trading portfolios including Balance Sheet Management comprise positions that primarily arise from the interest rate management of the group's retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity, and exposures arising from the group's insurance operations.

For market risk arising in our insurance business, refer to page 79.

Where appropriate, we apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the status as one of the world's largest banking and financial services organisations.

The nature of the hedging and risk mitigation strategies performed across the Group corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

Market risk governance

(Audited)

Market risk is managed and controlled through limits approved by the RMM of the Group Management Board ('GMB') for HSBC Holdings and the global businesses. These limits are allocated across business lines and agreed with the Group's legal entities, including HSBC Bank plc.

The management of market risk is principally undertaken in Markets using risk limits allocated from the risk appetite, which is subject to the Group RMM ratification. Limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Group Risk, as an independent, is responsible for HSBC's market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Markets unit for management, or to separate books managed under the supervision of the local ALCO.

The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage them professionally. In certain cases where the market risks cannot be fully transferred, the group identifies the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions.

Monitoring and limiting market risk exposure

(Audited)

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with the group's risk appetite.

We use a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ('VaR'), and stress testing.

Sensitivity analysis

(Unaudited)

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices for example the impact of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

(Audited)

Value at Risk ('VaR') is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and is calculated for all trading positions regardless of how the group capitalises those exposures. Where there is not an approved internal model, the group uses the appropriate local rules to capitalise exposures.

In addition, the group calculates VaR for non-trading portfolios in order to have a complete picture of risk. The models are predominantly based on historical simulation. VaR is calculated at a 99 per cent confidence level for a one-day holding period. Where VaR is not calculated explicitly, alternative tools are used.

The VaR models used by us are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR are calculated with reference to data from the past two years; and
- VaR measures are calculated to a 99 per cent confidence level and use a one-day holding period.

The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

The group routinely validates the accuracy of the VAR models by back-testing the hypothetical daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VaR numbers. The expectation is, on average, to see losses in excess of VAR 1 per cent of the time over a one-year period.

The actual number of losses in excess of VAR over this period can therefore be used to gauge how well the models are performing. In 2014, there were two loss exceptions for the group *(unaudited)*.

Report of the Directors: Risk (continued)

VaR model limitations

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

Risk not in VAR framework
(Unaudited)

The group's VAR model is designed to capture significant basis risks such as credit default swaps versus Bond, asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VAR, such as the Libor tenor basis, are complemented by risk-not-in-VaR ('RNIV') calculations and are integrated into the capital framework.

The RNIV framework therefore aims to capture and capitalise material market risks that are not adequately covered in the VAR model. An example of this is Libor overnight index swap basis risk for minor currencies. In such instances the RNIV framework uses stress tests to quantify the capital requirement. On average in 2014, the capital requirement derived from these stress tests represented 2.0 per cent of the total internal model-based market risk requirement.

Risks covered by RNIV represent 15 per cent of market risk RWAs for models with regulatory approval and include those resulting from underlying risk factors which are not observable on a daily basis across asset classes and products, such as dividend risk and correlation risks.

Risk factors are reviewed on a regular basis and either incorporated directly in the VaR models, where possible, or quantified through the VaR -based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements. The outcome of the VaR -based RNIV is included in the VaR calculation and back-testing; a stressed VaR RNIV is also computed for the risk factors considered in the VaR-based RNIV approach. In 2014, we modified our RNIV model on a non-diversified basis across risk factors to comply with new PRA CRD IV implementation guidelines.

Level 3 assets

The fair value of Level 3 assets and liabilities in trading portfolios represent only a small proportion of the overall trading portfolio. Market risk arising from Level 3 instruments is managed by various market risk techniques such as stress testing and notional limits.

Stress testing
(Audited)

Stress testing is an important tool that is integrated into the groups market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at the legal entity, regional and the overall Group levels. A standard set of scenarios is utilised consistently across all regions within the Group. Scenarios are tailored in order to capture the relevant events or market movements at each level. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

The process is governed by the Stress Testing Review Group forum which, in conjunction with group risk management, determines the scenarios to be applied at portfolio and consolidated level, as follows:

- single risk factor stress scenarios that are unlikely to be captured within the VaR models, such as the break of a currency peg;
- technical scenarios consider the largest move in each risk factor without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macroeconomic events, for example, the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VaR.

Market Risk Reverse stress tests are undertaken based upon the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VaR and stress testing, together with reverse stress testing and the management of gap risk, provide management with insights regarding the 'tail risk' beyond VaR for which HSBC's appetite is limited.

Trading portfolios
(Audited)

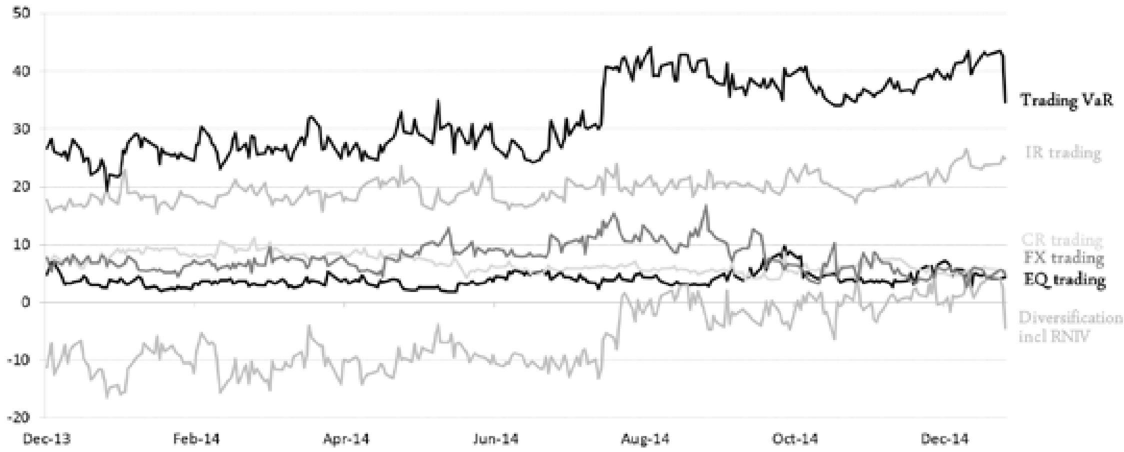
Value at Risk of the trading portfolios

Trading VaR predominantly resides within Global Markets. The total VaR for trading activity was higher at 31 December 2014 compared to 31 December 2013 due to an increase in interest rate trading VaR, and the removal of diversification effects within Risk Not in VaR.

Report of the Directors: Risk (continued)

Daily VaR (trading portfolios), 99% 1 day (£m)
(Unaudited)

HSBC Bank Plc's trading VaR for the year is shown in the table below.



Trading value at risk, 99% 1 day
(Audited)

	Foreign exchange and commodity £m	Interest rate £m	Equity £m	Credit spread £m	Portfolio Diversification incl. RNIV[1] £m	Total[2] £m
At 31 December 2014	**4.7**	**24.9**	**4.4**	**5.1**	**(4.5)**	**34.6**
Average	**7.7**	**19.7**	**4.0**	**6.8**	**(6.0)**	**32.2**
Maximum	**16.9**	**26.6**	**9.8**	**11.1**		**44.1**
At 31 December 2013	7.8	17.7	4.9	7.6	(11.3)	26.7
Average	7.2	19.2	3.1	9.1	(10.3)	28.3
Maximum	13.4	37.0	8.9	13.5		45.2

1 *Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate, equity and foreign exchange, together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum occurs on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for this measure. For presentation purposes, portfolio diversification within the trading portfolio includes VaR-based RNIV.*

2 *The total VaR is non-additive across risk types due to diversification effect, and includes VaR RNIV.*

Gap risk
(Unaudited)

Certain products are structured in such a way that they give rise to enhanced gap risk, being the risk that loss is incurred upon occurrence of a gap event. A gap event is a significant and sudden change in market price with no accompanying trading opportunity. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid. In 2014 gap risk principally arose from non-recourse loan transactions, mostly for corporate clients, where the collateral against the loan is limited to the posted shares. Upon occurrence of a gap event, the value of the equity collateral could fall below the outstanding loan amount.

Given their characteristics, these transactions make little or no contribution to VaR nor to traditional market risk sensitivity measures. We capture their risks within our stress testing scenarios and monitor gap risk on an ongoing basis. We did not incur any material gap loss in 2014.

De-peg risk
(Unaudited)

HSBC has a lot of experience in managing fixed and managed currency regimes. Using stressed scenarios on spot rates, we are able to analyse how de-peg events would impact the positions held by HSBC. We monitor such scenarios to pegged or managed currencies, such as the Hong Kong dollar, renminbi, Middle Eastern currencies and the Swiss franc, the appreciation of which was capped against the euro during 2014, and seek to limit any potential losses that would occur. This complements traditional market risk metrics, such as historical VaR, which may not fully capture the risk involved in holding positions in pegged or managed currencies. Historical VaR relies on past events to determine the likelihood of potential profits or losses. However, pegged or managed currencies may not have experienced a de-peg event during the historical timeframe being considered.

Report of the Directors: Risk (continued)

Non-trading portfolios

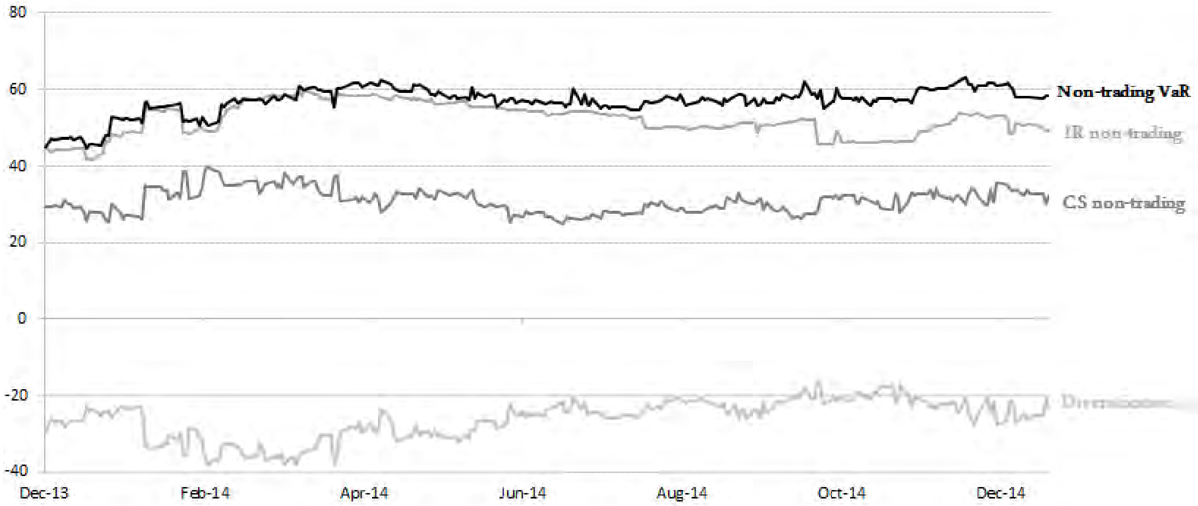
(Audited)

Value at Risk of the non-trading portfolios

Non-trading VaR of the group includes contributions from all global businesses. There is no commodity risk in the non-trading portfolios. The non-trading VAR was higher at 31 December 2014 compared to 31 December 2013 primarily due to increases in interest rate and credit VaR, together with a lower portfolio diversification benefit across asset classes.

Daily VaR (non-trading portfolios), 99% 1 day (£m)
(Unaudited)

HSBC Bank Plc's non-trading VaR for the year is shown in the table below.



Non-trading value at risk, 99% 1 day
(Audited)

	Interest rate £m	Credit spread £m	Portfolio diversification £m	Total £m
At 31 December 2014	**49.5**	**32.4**	**(23.5)**	**58.4**
Average	**52.2**	**31.0**	**(26.2)**	**57.0**
Maximum	**60.1**	**39.6**		**63.1**
At 31 December 2013	44.8	29.4	(29.4)	44.8
Average	41.6	41.3	(28.5)	54.4
Maximum	63.2	52.6		65.4

Non-trading VaR also includes the interest rate risk of non-trading financial instruments held by the global businesses and transferred into portfolios managed by BSM or local treasury functions. In measuring, monitoring and managing risk in our non-trading portfolios, VaR is just one of the tools used. The management of interest rate risk in the banking book is described further in 'Non-trading interest rate risk' below, including the role of BSM.

Non-trading VaR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by the group, the scope and management of which are described in the relevant sections below.

The group's control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid asset held in available for sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available for sale portfolios is reflected within the group's non-traded VaR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and included within the group's non-traded VaR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

The funds transfer pricing policies give rise to a two stage funds transfer pricing approach. For details see page 63.

Credit spread risk for available-for-sale debt securities

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VaR. The VaR shows the effect on income from a one-day movement in credit spreads over a two-year period, calculated to a 99 per cent confidence interval.

The effect of movements in VaR credit spreads on our available-for-sale debt securities was £43.6 million (2013: £49.8 million) at 31 December 2014. This sensitivity includes the gross exposure for the SICs

Report of the Directors: Risk (continued)

consolidated within our balance sheet based on credit spread VaR. This sensitivity excludes losses which would have been absorbed by the capital note holders.

The decrease in this sensitivity at 31 December 2014 compared with 31 December 2013 was mainly due to reducing the overall positions and lower volatilities and credit spread baselines observed during 2014.

Fixed-rate securities

The principal non-trading risk which is not included in the VAR reported for Global Banking and Markets arises out of Fixed Rate Subordinated Notes. The VAR related to these instruments was £19.4 million at 31 December 2014 (2013: £16.6 million); while the average and maximum during the year was £17.5 million and £23.9 million respectively (2013: £24.6 million and £29.7 million).

Equity securities held as available-for-sale

Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio. Regular reviews are performed to substantiate the valuation of the investments within the portfolio and investments held to facilitate on-going business, such as holdings in government-sponsored enterprises and local stock exchanges.

Market risk arises on equity securities held as available-for-sale. The fair value of these securities at 31 December 2014 was £1,009 million (2013: £1,006 million).

The fair value of the constituents of equity securities held as available-for-sale can fluctuate considerably. For details of the impairment incurred on available-for-sale equity securities see the accounting policies in Note 1(j).

Structural foreign exchange exposures

(Unaudited)

Structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than sterling. An entity's functional currency is that of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recognised in other comprehensive income.

The group hedges structural foreign currency exposures only in limited circumstances. The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

The group may also transact hedges where a currency in which the group have structural exposures is considered likely to revalue adversely and it is possible in practice to transact a hedge. Any hedging is undertaken using forward foreign exchange contracts which are accounted for under IFRSs as hedges of a net investment in a foreign operation, or by financing with borrowings in the same currencies as the functional currencies involved.

For details of structural foreign exchange exposures see Note 31 *'Foreign exchange exposures'.*

Non-trading interest rate risk

(Unaudited)

Non-trading interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products. These assumptions around behavioural features are captured in our interest rate risk behaviouralisation framework, which is described below.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Analysis of interest rate risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments.

Interest rate risk behaviouralisation

Unlike liquidity risk which is assessed on the basis of a very severe stress scenario, non-traded market interest rate risk is assessed and managed according to 'business-as-usual' conditions. In many cases the contractual profile of non-traded assets/liabilities arising from assets/liabilities created outside Markets or BSM does not reflect the behaviour observed. Behaviouralisation is therefore used to assess the market interest rate risk of non-traded assets/liabilities and this assessed market risk is transferred to BSM, in accordance with the rules governing the transfer of interest rate risk from the global businesses to BSM.

Behaviouralisation is applied in three key areas:

- the assessed re-pricing frequency of managed rate balances;
- the assessed duration of non-interest bearing balances, typically capital and current accounts; and
- the base case expected prepayment behaviour or pipeline take-up rate for fixed rate balances with embedded optionality.

Interest rate behaviouralisation policies have to be formulated in line with the Group's behaviouralisation policies and approved at least annually by local ALCO, regional ALCM and Group ALCM, in conjunction with local, regional and Group market risk monitoring teams.

The extent to which balances can be behaviouralised is driven by:

- the amount of the current balance that can be assessed as 'stable' under business-as-usual conditions; and
- for managed rate balances the historic market interest rate re-pricing behaviour observed; or
- for non-interest bearing balances the duration for which the balance is expected to remain under business-as-usual conditions. This assessment is often driven by the re-investment tenors available to BSM to neutralise the risk through the use of fixed rate government bonds or interest rate derivatives, and for derivatives the availability of cash flow hedging capacity.

Balance sheet management

Effective governance across BSM is supported by the dual reporting lines it has to the CEO of GB&M and to the Group Treasurer. In each operating entity, BSM is responsible for managing liquidity and funding under the supervision of the local ALCO. It also manages the non-trading interest rate positions transferred to it within a Global Markets limit structure.

In executing the management of the liquidity risk on behalf of ALCO, and managing the non-trading interest rate positions transferred to it, BSM invests in highly-rated liquid assets in line with the Group's liquid asset policy. The majority of the liquidity is invested in central bank deposits and government, supranational and agency securities with most of the remainder held in short-term interbank and central bank loans.

Withdrawable central bank deposits are accounted for as cash balances. Interbank loans, statutory central bank reserves and loans to central banks are accounted for as loans and advances to banks. BSM's holdings of securities are accounted for as available-for-sale assets.

Statutory central bank reserves are not recognised as liquid assets. The statutory reserves that would be released in line with the Group's stressed customer deposit outflow assumptions are reflected as stressed inflows.

BSM is permitted to use derivatives as part of its mandate to manage interest rate risk. Derivative activity is predominantly through the use of vanilla interest rate swaps which are part of cash flow hedging and fair value hedging relationships.

Credit risk in BSM is predominantly limited to short-term bank exposure created by interbank lending, exposure to central banks and high quality sovereigns, supranationals or agencies which constitute the majority of BSM's liquidity portfolio. BSM does not manage the structural credit risk of any Group entity balance sheets.

BSM is permitted to enter into single name and index credit derivatives activity, but it does so to manage credit risk on the exposure specific to its securities portfolio in limited circumstances only. The risk limits are extremely limited and closely monitored. At 31 December 2014 and 31 December 2013 BSM had no open credit derivative index risk.

VaR is calculated on both trading and non-trading positions held in BSM. It is calculated by applying the same methodology used for the Markets business and utilised as a tool for market risk control purposes.BSM holds trading portfolio instruments in only very limited circumstances. Positions and the associated VaR were not significant during 2014 and 2013.

Sensitivity of net interest income

(Unaudited)

A principal element of the group's management of market risk in non-trading portfolios is monitoring the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The group applies a combination of scenarios and assumptions relevant to their local businesses, and standard scenarios which are required throughout HSBC. The latter are consolidated to illustrate the combined pro forma effect on the consolidated net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by BSM or in the business units to mitigate the effect of interest rate risk. In reality, BSM seeks actively to change the interest rate risk profile to minimise losses and optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the 'up-shock' scenario. Rates are not assumed to become negative in the 'down-shock' scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

Defined benefit pension scheme

(Audited)

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary increases and the longevity of scheme members. Pension scheme assets will include equities and debt securities, the cash flows of which change as equity prices and interest rates vary. There are risks that market movements in equity prices and interest rates could result in assets which are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess these risks using reports prepared by independent external actuaries and takes action and, where appropriate, adjust investment strategies and contribution levels accordingly.

The present value of the group's defined benefit pension schemes' liabilities was as follows:

	2014 £bn	2013 £bn
At 31 December		
Liabilities (present value)	**20.1**	18.5
	%	%
Assets:		
Equities	**16**	15
Debt securities	**65**	55
Other (including property)	**19**	30
	100	100

Operational risk

(Unaudited)

Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with group's management and staff. Each country, business unit and function is required to implement appropriate internal controls to manage the operational risks of the business and operational activities for which they are responsible.

Operational risk management framework

The Operational Risk function and the operational risk management framework ('ORMF') directs business management in discharging their responsibilities.

The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control across the Group. To implement the ORMF, a 'three lines of defence' model is used for the management of risk, as described below:

- The first line of defence is the business who are responsible for ensuring that all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment. Every employee is responsible for the risks that are a part of their day-to-day jobs.
- The second line of defence consists of the Functions, such as Risk (including Regulatory and Financial Crime Compliance), Finance and HR who are responsible for providing oversight and challenge of the activities conducted by the first line.
- The third line of defence covers the role of Internal Audit, who provide independent assurance over the first and second lines of defence.
- The ORMF consists of a number of components, including:
- Risk and Control Assessments ('RCAs'), which are used to identify and assess the material business risks and controls;
- Key Indicators, which are used to help monitor the risks and controls;
- Principal Risk Analysis, which provide management with a quantified view of specific operational risks;
- Internal incidents, which are used to forecast typical losses; and
- External data, which is used to inform the group's risk assessments.

Activity to embed the use of our operational risk management framework continued in 2014. At the same time, we are streamlining operational risk management processes and harmonising framework components and risk management processes. This is expected to lead to a stronger operational risk management culture and more forward-looking risk insights to enable businesses to determine whether material risks are being managed within the Group's risk appetite and whether further action is required. In addition, the Security and Fraud Risk and Financial Crime Compliance functions have built a Financial Intelligence Unit ('FIU') which provides intelligence on the potential risks of financial crime posed by customers and business prospects to enable better risk management decision-making. The FIU provides context and expertise to identify, assess and understand financial crime risks holistically in clients, sectors and markets.

Articulating the risk appetite for material operational risks helps the bank's management understand the level of risk that it is willing to accept. Monitoring operational risk exposure against the approved risk appetite measures on a regular basis, and implementing risk acceptance processes, drives risk awareness in a forward-looking manner. It assists management in determining whether further action is required to proactively manage operational risks within acceptable levels.

Operational risk and control assessments are performed by individual business units and functions. The risk and control assessment process is designed to provide business areas and functions with a forward looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels. Risk and control assessments are reviewed and updated at least annually.

Appropriate means of mitigation and controls include:

- making specific changes to strengthen the internal control environment;
- investigating whether cost-effective insurance cover is available to mitigate the risk; and
- other means of protecting us from loss.

A centralised database is used to record the results of the operational risk management process. RCAs are input and maintained by business units, and action plans monitored. To ensure that operational risk losses are consistently reported and monitored at country, regional and group level, all business units/functions are required to report individual losses when the net loss is expected to exceed US$10,000. Reviews (for lessons learnt and root causes) are performed around significant incidents/losses or when trends arise, to improve processes and controls.

Operational risk in 2014

During 2014, our operational risk profile continued to be dominated by compliance and legal risks as referred to in the 'Principal risks' section and Note 37 on the Financial Statements. Losses were realised relating to events that occurred in previous years, albeit at a lower level than in 2013. These events included the possible historical mis-selling of payment protection insurance ('PPI') and interest rate protection products in the UK (see Note 27 on the Financial Statements). A number of mitigating actions continue to be taken to prevent future mis-selling incidents.

The incidence of regulatory and other legal proceedings against financial service firms is increasing. Proposed changes relating to capital and liquidity requirements, remuneration and/or taxes could increase our cost of doing business, reducing future profitability. We remain subject to a number of regulatory proceedings including investigations and reviews by various regulators and competition and law enforcement authorities around the world relating to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor') and other benchmark interest rates. As certain HSBC companies are members of such panels, HSBC has been the subject of regulatory demands for information and is cooperating with those investigations and reviews. Various regulators and competition and law enforcement authorities around the world are also conducting investigations and reviews into a number of firms, including HSBC, related to trading on the foreign exchange markets and activity in the credit derivatives market, and various class actions have been filed in the US related to alleged anti-competitive behaviour related to precious metals In response, we have undertaken a number of initiatives, including the restructuring of our Compliance sub-functions, enhancing our governance and oversight measures to implement Global Standards as described on page 9 and other measures put in place designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business. For further details see 'Compliance risk' on page 76 and for details of the investigations and legal proceedings see Note 37 of the Financial Statements.

On 12 November 2014, the UK FCA and the US Commodity Futures Trading Commission ('CFTC') each announced having concluded regulatory settlements with a number of banks, including HSBC Bank plc, in connection with their respective investigations of trading and other conduct involving foreign exchange benchmark rates. Under the terms of those settlements, HSBC Bank plc agreed to pay a financial penalty to the FCA and a civil monetary penalty to the CFTC and to undertake various remedial actions. For further information, see Note 37 on the Financial Statements.

HSBC has undertaken a review of compliance with the fixed-sum unsecured loan agreement requirements of the UK Consumer Credit Act ('CCA'). A liability has been recognised within 'Other liabilities' for the repayment of interest to customers where annual statements did not remind them of their right to partially prepay the loan, notwithstanding that the customer loan documentation did include this right. There is uncertainty as to whether other technical requirements of the CCA have been met, for which we have assessed an additional contingent liability. For further details see Note 27 on the Financial Statements.

Other operational risks included:

- *fraud risks:* the threat of fraud perpetrated by or against our customers, especially in retail and commercial banking, may grow during adverse economic conditions. We increased monitoring, analysed root causes and reviewed internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. In addition, Group Security and Fraud Risk worked closely with the global businesses to continually assess these threats as they evolved and adapt our controls to mitigate these risks;
- *level of change creating operational complexity*: the Global Risk function is engaged with business management in business transformation initiatives to ensure robust internal controls are maintained, including through participation in all relevant management committees. The Global Transactions Team has developed an enhanced risk management framework to be applied to the management of disposal risks;
- *information security*: the security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand. A failure of the control framework which protects this could have implications for the wider financial sector and result in direct financial loss, and / or the loss of customer data and other sensitive information which could undermine both our reputation and our ability to retain the trust of our customers. Programmes of work have been ongoing to strengthen internal security controls to prevent unauthorised access to our systems which may affect live services or facilitate data loss or fraud. In common with other banks and multinational organisations, we continue to be a target of increasingly sophisticated 'cyber' attacks such as Distributed Denial of Service attacks which affect the availability of customer-facing websites. In addition, reliance on standard internet technologies, protocols and services means we are subject to wide-scale remediation when flaws are reported in these technologies. Lessons learnt from attacks experienced within the industry and information sharing with other financial institutions, government agencies and external intelligence providers allows us to develop a better understanding of our own susceptibilities and to develop scenarios to test against. They will continue to be a focus of ongoing initiatives to strengthen the control environment. Significant investment has already been made in enhancing controls around data access, the heightened monitoring of potential cyber-attacks and continued training to raise staff awareness. This is an area that will require continual investment in our operational processes and contingency plans;
- *vendor risk management:* we continue to focus on the management of vendor risks including making

good progress with the implementation of the supplier performance program with our most important suppliers. Additional focus is put on the identification and exit of sanctioned suppliers. Vendor risk management is a core element of third party risk management.

- *compliance with regulatory agreements and orders*: Failure to implement our obligations under the DPAs could have a material adverse effect on our results and operations. Legal proceedings are discussed in Note 37 on the Financial Statements and further details regarding compliance risk are set out below.

Other operational risks are also monitored and managed through the use of the ORMF.

Compliance risk

Compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.

In 2014, we completed the restructuring of the Compliance sub-function within Global Risk into two new sub-functions: Financial Crime Compliance and Regulatory Compliance, appropriately supported by shared Compliance Chief Operating Officer, Assurance and Reputational Risk Management teams. We continue to ensure that the Compliance sub- functions, through their operation and the execution of the Group strategy, including measures to implement Global Standards, are well positioned to meet increased levels of regulation and scrutiny from regulators and law enforcement agencies. In addition, the measures that have been put in place are designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business.

Enhanced global AML and Sanctions policies, incorporating risk appetite, were approved by the Board in January 2014. The policies adopt and seek to enforce the highest or most effective standards globally, including a globally consistent approach to knowing our customers.

The Policies are being implemented in phases through the development and application of procedures required to embed those policies in our day to day business operations globally. The overriding policy objective is for every employee to engage in only 'the right kind of business, conducted in the right way'.

HSBC Holdings has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014. Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA. For further information, see 'Regulatory commitments and consent orders' on page 27.

In May 2014, the HSBC Board approved a globally consistent approach to the management of regulatory designed to ensure we deliver fair outcomes for our customers and conduct orderly and transparent operations in financial markets. Implementation of the group conduct approach is managed through the global lines of business and functions and covers all our business and operational activities.

It is clear that the level of inherent compliance risk that we face will continue to remain high for the foreseeable future. However, we consider that good progress is being made and will continue to be made in ensuring that we are well placed to effectively manage those risks.

Legal risk

Each operating company is required to have processes and procedures to manage legal risk that conform to Group standards. Legal risk falls within the definition of operational risk and includes:

- contractual risk, which is the risk of a group company suffering financial loss, legal or regulatory action or reputational damage because its rights and/or obligations under a contract to which it is a party are technically defective;
- dispute risk, which is the risk of a group company suffering financial loss, sanction and/or reputational damage due to adverse dispute environment and/or mis-management of disputes;
- legislative risk, which is the risk that a group company fails to adhere to the laws of the jurisdictions in which it operates; and
- non-contractual rights risk, which is the risk that a group company's assets are not properly owned or protected or are infringed by others, or a group company infringes another party's rights.

The group has a legal function, headed by the General Counsel for Europe, to assist management in controlling legal risk. The function provides legal advice and support in managing claims against the group's companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

There are legal departments in all the countries in which the group has significant operations.

The group's operating companies must notify the appropriate legal department and General Counsel immediately if any litigation or contentious regulatory proceeding is either threatened or commenced against the group or an employee. The appropriate legal department and General Counsel must provide appropriate reports to the HSBC Group Legal Head Office on contentious regulatory matters, criminal proceedings, actual or threatened litigation where the amount claimed is (or is likely to be) at or in excess of US$5 million or has significant reputational risk.

In addition, the group's operating companies are required to submit semi-annual returns detailing, among other matters, outstanding claims where the claim (or group of similar claims) exceeds US$10 million, where the action is by a regulatory authority, where the proceedings are criminal or might materially affect the group's reputation. These returns are used for reporting to various committees within the group.

Group security and fraud risk

Security and Fraud Risk, Europe, which has responsibility for physical risk, fraud, information and contingency risk, takes functional direction from Group Security and Fraud Risk. This enables management to identify and mitigate the permutations of these and other non-financial risks across the countries in which the group operates. All group companies manage their risk in accordance with standards set by Security and Fraud Risk, Europe, which also provide expert advice and support.

Fiduciary risk

Business activities in which fiduciary risk is inherent are only permitted within designated lines of business. Fiduciary risk is managed within the designated businesses via a comprehensive policy framework and monitoring of key indicators. The Group's principal fiduciary businesses /activities are:

- HSBC Securities Services, where it is exposed to fiduciary risk via its Funds Services and Corporate Trust and loan agency activities;
- HSBC Global Asset Management, which is exposed to fiduciary risks via its investment management activities on behalf of clients;
- HSBC Global Private Banking, which is exposed to fiduciary risks via its Private Wealth Services division and discretionary investment management;
- HSBC Insurance, which is exposed to fiduciary risks via the investment management activities it undertakes when providing insurance products and services;
- RBWM Trust Investment Wrappers, required by regulation for the provision of normal RBWM Wealth Management products and services; and
- HSBC Employee Pension Scheme activities, where fiduciary duties may arise as part of carrying out a function of discretion or control over an HSBC Employee pension scheme's operations.

Risk management of insurance operations

(Audited)

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). Financial risks include market risk, credit risk and liquidity risk.

There have been no material changes to our policies and practices for the management of risks arising in the insurance operations.

The group's bancassurance model

We operate an integrated bancassurance model which provides wealth and protection insurance products principally for customers with whom the group has a banking relationship. Insurance products are sold through all global businesses, predominantly by RBWM and CMB, through branches and direct channels.

The insurance contracts the group sells relate to the underlying needs of the group's banking customers, which it can identify from its point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts. By focusing largely on personal and SME lines of business, the group is able to optimise volumes and diversify individual insurance risks.

Where we have the operational scale and risk appetite, mostly in life insurance, these insurance products are manufactured by the group's companies. Manufacturing insurance allows the group to retain the risks and rewards associated with writing insurance contracts as both the underwriting profit and the commission paid by the manufacturer to the bank distribution channel are kept within the group.

Where we do not have the risk appetite or operational scale to be an effective manufacturer, a small number of leading external insurance companies are engaged in order to provide insurance products to the group's customers through its banking network and direct channels. These arrangements are generally structured with the group's exclusive strategic partners and earn the group a combination of commissions, fees and a share of profits.

Insurance manufacturers set their own control procedures in addition to complying with guidelines issued by the Group Insurance. Country level oversight is exercised by local Risk Management Committees. Country Chief Risk Officers have direct reporting lines into local Insurance Chief Executive Officers and functional reporting lines into the Group Insurance Chief Risk Officer, who has overall accountability for risk management in insurance operations. The Group Insurance Executive Committee oversees the framework globally and is accountable to the Group Risk Management Committee on risk matters.

In addition, local ALCOs monitor and review the duration and cash flow matching of insurance assets and liabilities.

All insurance products, whether manufactured internally or by a third party, are subjected to a product approval process prior to introduction.

There have been no material changes to our policies and practices for the management of risks arising in the insurance operations.

Risk management of insurance operations in 2014

We measure the risk profile of our insurance manufacturing businesses using an economic capital approach, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a 1 in 200 chance of insolvency over the next year, given the risks that the businesses are exposed to. In 2014 we aligned the measurement approach for market, credit and insurance risks in the economic capital model to the new pan-European Solvency II insurance capital regulations applicable from 2016.

Report of the Directors: Risk (continued)

The overall risk profile of our life insurance manufacturing businesses did not change materially during 2014, however, a notable change arose in the UK where HSBC Life (UK) Ltd entered into an agreement to sell its Pensions business. The transfer is subject to regulatory approvals and is expected to complete in the second half of 2015. HSBC has also entered into a reinsurance agreement with the purchaser transferring certain economic risks and rewards of the business until completion of the transaction. A day-one gain of £25 million was recognised on entering into this reinsurance and the assets and liabilities have been reclassified as held-for-sale.

During 2014 the Irish insurance entity HSBC Life (Europe) Limited's portfolio of insurance policies has been transferred to HSBC Life Assurance (Malta) Limited.

Financial risks of insurance operations

The group's insurance businesses are exposed to a range of financial risks which can be categorised into:

- Market risk – risks arising from changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices;
- Credit risk – risk of financial loss following the default of third parties to meet their obligations; and
- Liquidity risk – risk of not being able to make payments to policyholders as they fall due as a result of insufficient assets that can be realised as cash.

Local regulatory requirements prescribe the type, quality and concentration of assets that the group's insurance manufacturing companies must maintain to meet insurance liabilities. These requirements complement Group-wide policies.

The following table analyses the assets held in the group's insurance manufacturing companies by type of contract, and provides a view of the exposure to financial risk. For unit-linked contracts, which pay benefits to policyholders which are determined by reference to the value of the investments supporting the policies, the group typically designate assets at fair value; for non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

Financial assets held by insurance manufacturing subsidiaries
(Audited)

	2014			
	Unit-linked contracts £m	**Non-linked Contracts[1] £m**	**Other assets £m**	**Total £m**
Financial assets designated at fair value				
Debt securities	**369**	**554**	**28**	**951**
Equity securities	**1,315**	**3,854**	**686**	**5,855**
	1,684	**4,408**	**714**	**6,806**
Financial investments - available-for-sale				
Debt securities	**–**	**10,157**	**716**	**10,873**
Equity securities	**–**	**–**	**–**	**–**
	–	**10,157**	**716**	**10,873**
Derivatives	**–**	**65**	**45**	**110**
Other financial assets	**215**	**1,538**	**209**	**1,962**
At 31 December	**1,899**	**16,168**	**1,684**	**19,751**

1 *Debt securities designated at fair value include £3 million of Treasury Bills.*

	2013			
	Unit-linked contracts £m	Non-linked contracts £m	Other assets £m	Total £m
Financial assets designated at fair value				
Debt securities	2,265	544	25	2,834
Equity securities	5,311	3,871	530	9,712
	7,576	4,415	555	12,546
Financial investments - available-for-sale				
Debt securities	–	10,113	823	10,936
Equity securities	–	–	–	–
	–	10,113	823	10,936
Derivatives	5	130	30	165
Other financial assets	262	1,408	203	1,873
At 31 December	7,843	16,066	1,611	25,520

Report of the Directors: Risk (continued)

Approximately 60 per cent of financial assets were invested in debt securities at 31 December 2014 (2013: 54 per cent), with 30 per cent (2013: 38 per cent) invested in equity securities.

Under unit-linked insurance contracts, premium income less charges levied is invested in a portfolio of assets. The group manages the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 10 per cent of the total financial assets of the group's insurance manufacturing companies at the end of 2014 (2013: 31 per cent).

The reduction of £6 billion in the value of assets backing unit-linked contracts is largely due to the classification of £3.8 billion of assets relating to the UK pension business as held for sale (see page 78) and the transfer of £1.8 billion assets backing other unit-linked investment contracts to a third party during the year.

The remaining financial risks are managed either solely on behalf of the shareholder, or jointly on behalf of the shareholder and policyholders where discretionary participation features exist.

Market risk of insurance operations

Market risk arises when mismatches occur between product liabilities and the investment assets which back them. For example, mismatches between asset and liability yields and maturities give rise to interest rate risk.

The main features of products manufactured by the group's insurance manufacturing companies which generate market risk, and the market risk to which these features expose the companies, are discussed below.

Long-term insurance or investment products may incorporate benefits that are guaranteed. Interest rate risk arises to the extent that yields on the assets supporting guaranteed investment returns are lower than the investment returns implied by the guarantees payable to policyholders.

The following table illustrates the effect of selected interest rates and equity price scenarios on the profits for the year and total equity of insurance manufacturing subsidiaries.

Where appropriate, the impact of the stress on the present value of the in-force long-term insurance business asset ('PVIF') is included in the results of the sensitivity tests. The relationship between the profit and total equity and the risk factors is non-linear and, therefore, the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. The sensitivities are stated before allowance for the effect of management actions which may mitigate the effect of changes in market rates, and for any factors such as policyholder behaviour that may change in response to changes in market risk.

The effects of +/-100 basis points parallel shifts in yield curves have increased from 2013 to 2014, driven mainly by falling yields and a flattening of the yield curve in France during 2014. In the low yield environment the projected costs of options and guarantees described above is particularly sensitive to yield curve movements. The market value of available-for-sale bonds is also sensitive to yield curve movements hence the larger opposite stresses on equity.

Sensitivity of the group's insurance companies to market risk factors
(Audited)

	2014		2013	
	Effect on profit after tax	**Effect on total equity**	Effect on profit after tax	Effect on total equity
	£m	**£m**	£m	£m
+ 100 basis points parallel shift in yield curves	**62**	**52**	(1)	(12)
– 100 basis points parallel shift in yield curves[1]	**(205)**	**(196)**	(30)	(19)
10 per cent increase in equity prices	**18**	**18**	16	16
10 per cent decrease in equity prices	**(20)**	**(20)**	(17)	(17)

1 *Where a 100 basis point parallel shift in the weighted average risk free rate would result in a negative rate, the effect on profit before tax and total equity has been calculated using a minimum rate of 0 per cent.*

Credit quality

The following table presents an analysis of treasury bills, other eligible bills and debt securities within the group's insurance business by measures of credit quality. The five credit quality classifications are defined on page 43. Only assets supporting liabilities under non-linked insurance, investment contracts and shareholders' funds are included in the table, as financial risk on assets supporting unit-linked liabilities is predominantly borne by the policyholder; 86 per cent (2013: 84 per cent) of the assets included in the table are invested in investments rated as 'Strong'.

Report of the Directors: Risk (continued)

Treasury bills, other eligible bills and debt securities in the group's insurance manufacturing companies
(Audited)

	2014			2013		
	Strong £m	Good/ Satisfactory £m	Total[2] £m	Strong £m	Good/ Satisfactory £m	Total[2] £m
Financial assets designated at fair value[1]	**446**	**135**	**581**	418	151	569
– treasury and other eligible bills	**3**	**-**	**3**	–	–	–
– debt securities	**443**	**135**	**578**	418	151	569
Financial investments	**9,350**	**1,522**	**10,872**	9,286	1,650	10,936
– treasury and other similar bills	**–**	**–**	**–**	–	–	–
– debt securities	**9,350**	**1,522**	**10,872**	9,286	1,650	10,936
At 31 December	**9,796**	**1,657**	**11,453**	9,704	1,801	11,505

1 *Impairment is not measured for debt securities designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement.*
2 *Total is the maximum exposure to credit risk on the treasury bills, other eligible bills and debt securities in the group's insurance companies.*

Credit risk also arises when assumed insurance risk is ceded to reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by credit quality, is shown below. The group's exposure to third parties under the reinsurance agreements is included in this table.

Reinsurers' share of liabilities under insurance contracts
(Audited)

	Strong £m	Good/ Satisfactory £m	Past due not impaired £m	Total[1,2] £m
Unit-linked insurance contracts	**47**	**–**	**–**	**47**
Non-linked insurance contracts	**140**	**2**	**–**	**142**
At 31 December 2014	**187**	**2**	**–**	**189**
Reinsurance debtors	**4**	–	**4**	**8**
Unit-linked insurance contracts	43	–	–	43
Non-linked insurance contracts	447	2	–	449
At 31 December 2013	490	2	–	492
Reinsurance debtors	7	–	–	7

1 *No amounts reported within Reinsurers' share of liabilities under insurance contracts were classified as sub-standard or impaired.*
2 *Total is the maximum exposure to credit risk in respect of reinsurers' share of liabilities under insurance contracts.*

Liquidity risk of insurance operations

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities at 31 December 2014. The liquidity risk exposure is borne in conjunction with policyholders for the majority of the business, and wholly borne by the policyholder in the case of unit-linked business.

The profile of the expected maturity of the insurance contracts at 31 December 2014 remained comparable with 2013.

Expected maturity of insurance contract liabilities
(Audited)

	Expected cash flows (undiscounted)				
	Within 1 year £m	1-5 years £m	5-15 years £m	Over 15 years £m	Total £m
Non-linked insurance[1]	**22**	**145**	**211**	**149**	**527**
Unit-linked insurance	**89**	**279**	**400**	**337**	**1,105**
At 31 December 2014	**111**	**424**	**611**	**486**	**1,632**
Non-linked insurance[1]	44	234	394	393	1,065
Unit-linked insurance	271	839	973	697	2,780
At 31 December 2013	315	1,073	1,367	1,090	3,845

1 *Non-linked insurance includes remaining non-life business.*

Report of the Directors: Risk (continued)

Remaining contractual maturity of investment contract liabilities
(Audited)

	Liabilities under investment contracts by insurance underwriting subsidiaries					
	Within 1 year £m	1-5 years £m	5-10 years £m	Over 10 years £m	Undated[1] £m	Total £m
Unit-linked investment contracts	**84**	**85**	**124**	**492**	**231**	**1,016**
Investment contracts with discretionary participation features ('DPFs')	**–**	**–**	**–**	**–**	**16,083**	**16,083**
At 31 December 2014	**84**	**85**	**124**	**492**	**16,314**	**17,099**
Unit-linked investment contracts	130	471	515	1,364	2,819	5,299
Investment contracts with DPFs	–	–	–	–	15,987	15,987
At 31 December 2013	130	471	515	1,364	18,806	21,286

1 *In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies.*

The insurance risk profile of the group's life insurance manufacturing businesses has not changed materially during 2014 despite the decrease in liabilities to policyholders on these contracts to £17.5 billion (2013: £19.2 billion). This decrease is largely due to the changes in the UK pension business as described on pages 78 and 79.

A principal risk faced by the group is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates, expense rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.

The following tables analyse the group's insurance risk exposures by type of business.

Analysis of life insurance risk – liabilities to policy holders
(Audited)

	2014 £m	2013 £m
Non-linked insurance[1]		
– Insurance contracts with DPF [2]	**235**	230
– Credit life	**36**	79
– Annuities	**45**	376
– Term assurance and other long-term contracts	**215**	151
Total non-linked insurance	**531**	836
Unit-linked insurance	**908**	2,405
Investment contracts with DPF [2, 3]	**16,083**	15,987
Liabilities under insurance contracts	**17,522**	19,228

1 *Non-linked insurance includes remaining non-life business.*

2 *Insurance contracts and investment contracts with DPFs give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that are likely to be a significant portion of the total contractual benefits, but whose amount or timing is contractually at the discretion of the group. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.*

3 *Although investment contracts with DPFs are financial investments, the group continues to account for them as insurance contracts as required by IFRS 4.*

Sensitivities to non-economic assumptions

The group's life insurance business is accounted for using the embedded value approach which, inter alia, provides a risk and valuation framework. The sensitivity of the present value of in-force long term insurance business ('PVIF') asset to changes in economic and non-economic assumptions is described in Note 21.

Other material risks

(Unaudited)

Reputational risk

Reputational risk is the failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of HSBC.

Reputational risk relates to perceptions, whether based on fact or otherwise. Stakeholders' expectations are constantly changing and thus reputational risk is dynamic and varies between geographies, groups and individuals. As a global bank HSBC shows unwavering commitment to operate, and be seen to be operating, to the high standards we have set for ourselves in every jurisdiction. Reputational risk might result in financial or non-financial impacts, loss of confidence, adverse effects on our ability to keep and attract customers, or other consequences. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

A number of measures to address the requirements of the DPAs and otherwise to enhance our AML and sanctions compliance framework have been taken and/or are ongoing. These measures, which should also serve over time to enhance our reputational risk management, include the following:

- simplifying our business through the ongoing implementation of our Group strategy, including the adoption of a global financial crime risk filter, which should help to standardise our approach to doing business in higher risk countries;
- a substantial increase in resources and investment allocated to the two Compliance sub-functions (see 'Compliance risk' on page 76);
- an increase in dedicated reputational risk resources in each region in which we operate and the introduction of a central case management and tracking process for reputational risk and client relationship matters;
- the creation of combined Reputational Risk and Client Selection committees within the global businesses

with a clear process to escalate and address matters at the appropriate level;

- the continued roll-out of training and communication about the HSBC Values programme that defines the way everyone in the Group should act and seeks to ensure that the Values are embedded into our business as usual operations; and
- the ongoing development and implementation of the Global Standards around financial crime compliance, which underpin our businesses. This includes ensuring globally consistent application of policies that govern AML and sanctions compliance provisions.

In July 2014, the new Reputational Risk and Customer Selection policies were issued which defines a consistent and structured approach to managing these risks:

- *Reputational Risk (new policy):* defines reputational risk and sets out HSBC's approach to managing it.
- *Customer Selection and Business Acceptance (new policy):* outlines the risk factors to be considered when a new customer relationship is identified.
- *Customer Selection and Exit Management:* establishes the globally sustainable approach to customer selection and exit management for all accounts and relationships in all business lines. This details the criteria under which escalation or approval is required.
- *Sixth Filter:* customers operating in high risk jurisdictions carry particular financial crime risks and may require specific approvals, or be considered for an exit, if the relationship exceeds HSBC's global risk appetite.

HSBC has a zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational damage has not been considered and mitigated. There must be no barriers to open discussion and the escalation of issues that could impact negatively on HSBC. While there is a level of risk in every aspect of business activity, appropriate consideration of potential harm to HSBC's good name must be a part of all business decisions.

Detecting and preventing illicit actors' access to the global financial system calls for constant vigilance and HSBC will continue to cooperate closely with all governments to achieve success. This is integral to the execution of our strategy, to HSBC Values and to preserving and enhancing our reputation.

Pension risk

Pension risk is the risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities. Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk).

The group operates a number of pension plans throughout Europe. Some of them are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme ('the principal plan').

Over 2014, HSBC established a new Global Pension Risk Framework with accompanying new global policies on the management of risks related to defined benefit and defined contribution plans. HSBC also established a new Global Pensions Oversight Committee to oversee the running of all pension plans sponsored by HSBC around the world. In addition the UK Pension Review Committee was replaced by the European Pension Review Committee with an increased scope to oversee the running of pension plans across the group.

In order to fund the benefits associated with these plans, group companies (and, in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme's trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

The level of these contributions has a direct impact on the group's cash flow and is set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. Higher contributions will be required when plan assets are considered insufficient to cover the existing pension liabilities as a deficit exists. Contribution rates are typically revised annually or triennially, depending on the plan. The agreed contributions to the principal plan are revised triennially.

A deficit in a defined benefit plan may arise from a number of factors, including:

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and
- scheme members living longer than expected (known as longevity risk).

A plan's investment strategy is determined after taking into consideration the market risk inherent in the investments and its consequential impact on potential future contributions. The long-term investment objectives of both the group and, where relevant and appropriate, the trustees are:

- to limit the risk of the assets failing to meet the liabilities of the plans over the long-term; and
- to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and, where relevant, desired levels of out-performance. The benchmarks are reviewed at least triennially within 18 months of the date at which an actuarial valuation is made, or more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Ultimate responsibility for investment strategy rests with either the trustees or, in certain circumstances, a management committee. The degree of independence of the trustees from the group varies in different jurisdictions. The HSBC Bank (UK) Pension Scheme (the principal plan) has both defined benefit and defined contribution sections. For example, the principal plan, which accounts for approximately 97 per cent of the obligations of the group's defined benefit pension plans, is overseen by a corporate trustee who regularly monitors the market risks inherent in the scheme.

The defined benefit section was closed to new entrants in 1996 and from 1 July 2015 it will be closed to further accrual for current employees who are in that section, who will join the defined contribution section for future pensions. All new employees have joined the defined contribution section since 1996. The principal plan is overseen by an independent corporate trustee who has a fiduciary responsibility for the operation of the pension plan. The trustee is responsible for monitoring and managing the investment strategy and administration of scheme benefits. The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The trustee of the principal plan is required to produce a written Statement of Investment Principles which governs decision-making about how investments are made and the need for adequate diversification is taken into account in the choice of asset allocation and manager structure in the defined benefit section. Longevity risk in the principal plan is assessed as part of the measurement of the pension liability and managed through the funding process of the plan.

The investment strategy of the principal plan is to hold the majority of assets in bonds, with the remainder in a more diverse range of investments, and includes a portfolio of interest rate and inflation swaps in order to reduce interest rate risk and inflation risk.

Sustainability risk

Sustainability risks arise from the provision of financial services to companies or projects which run counter to the needs of sustainable development; in effect this risk arises when the environmental and social effects outweigh economic benefits. Within Group Head Office, a separate function, Global Corporate Sustainability, is mandated to manage these risks globally working through local offices as appropriate. Sustainability Risk Managers have regional or national responsibilities for advising on and managing environmental and social risks.

Report of the Directors: Capital Management

Capital management and allocation

Capital management

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate.

It is our objective to maintain a strong capital base to support the development of our business and to meet regulatory capital requirements. To achieve this, we manage our capital within the context of an annual capital plan which is approved by the Board and which determines the optimal amount and mix of capital required to support planned business growth and meet local regulatory capital requirements. HSBC Holdings plc is the sole provider of equity capital to the group and also provides non-equity capital where necessary. Capital generated in excess of planned requirements is returned to HSBC Holdings plc in the form of dividends.

Our capital management policy is underpinned by the capital management framework, which enables the group to manage its capital in a consistent manner. The framework incorporates a number of capital measures which govern the management and allocation of capital within the group. These capital measures include invested capital, economic capital and regulatory capital defined by the group as follows:

- invested capital is the equity capital provided to the bank by HSBC;
- economic capital is the internally calculated capital requirement which is deemed necessary by the group to support the risks to which it is exposed; and
- regulatory capital is the minimum level of capital which the group is required to hold in accordance with the rules set by the PRA for the bank and the group and by the local regulators for individual subsidiary companies.

The following risks managed through the capital management framework have been identified as material: credit, market, operational, interest rate risk in the banking book, pension fund, insurance and residual risks.

Stress testing

Stress testing is incorporated into the capital management framework and is an important component of understanding the sensitivities of the core assumptions in the group's capital plans to the adverse effect of extreme, but plausible, events. Stress testing allows senior management to formulate its response, including risk mitigating actions, in advance of conditions starting to reflect the stress scenarios identified. The actual market stresses experienced by the financial system in recent years have been used to inform the capital planning process and further develop the stress scenarios employed by the group.

Other stress tests are also carried out, both at the request of regulators and by the regulators themselves using their prescribed assumptions. The group takes into account the results of all such regulatory stress testing when assessing our internal capital requirements.

Risks to capital

Outside of the stress-testing framework, a list of principal risks is regularly evaluated for their effect on our capital ratios. In addition, other risks may be identified which have the potential to affect our Risk Weighted Assets ('RWAs') and/or capital position. These risks are also included in the evaluation of risks to capital. The downside or upside scenarios are assessed against our capital management objectives and mitigating actions are assigned as necessary.

The group's approach to managing its capital position has been to ensure the bank, regulated subsidiaries and the group exceed current regulatory requirements and is well placed to meet future regulatory requirements from the on-going implementation of CRD IV.

Capital measurement

The PRA is the supervisor of the bank and lead supervisor of the group. The PRA sets capital requirements and receives information on the capital adequacy for the bank and the group. The bank and the group complied with the PRA's capital adequacy requirements throughout 2014.

Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements.

The Basel 3 framework, similarly to Basel 2, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. In 2013, the group calculated capital using the Basel II framework, as amended for CRD III, also referred to as 'Basel 2.5'. From 1 January 2014, the group's capital is calculated under CRD IV.

The CRD IV legislation implemented Basel III in the EU and, in the UK, the 'PRA rulebook CRR Firms Instrument 2013' transposed the various national discretions under the CRD IV legislation into UK law. As a result, unless otherwise stated, comparatives for capital and RWAs at 31 December 2013 are on a Basel 2.5 basis.

Regulatory capital

Our capital base is divided into three main categories, namely Common equity tier 1, Additional tier 1 and Tier 2, depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 ('CET 1') capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV various capital deductions and regulatory adjustments are made against these items which are treated differently for the purposes of capital adequacy – these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under IRB and defined benefit pension fund assets.

- Additional tier 1 capital comprises eligible non-common equity capital securities and any related share premium; it also includes other qualifying instruments subject to certain limits. Holdings of additional tier 1 instruments of financial sector entities are deducted.
- Tier 2 capital comprises eligible capital securities and any related share premium and other qualifying tier 2 capital securities subject to limits. Holdings of tier 2 capital of financial sector entities are deducted.

The basis of consolidation for the purposes of financial accounting under IFRSs, described on page 116, differs from that used for regulatory purposes. Interests in associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes, as per PRA's application of EU legislation. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory consolidation and deducted from regulatory capital subject to thresholds. The regulatory consolidation does not include Special Purpose Entities ('SPEs') where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

Pillar 1 capital requirements

Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes counterparty credit risk and securitisation requirements. These requirements are expressed in terms of RWAs.

Credit risk capital requirements

CRD IV applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are grouped into broad categories and standardised risk weightings are applied to these categories. The next level, the internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's probability of default ('PD'), but their estimates of exposure at default ('EAD') and loss given default ('LGD') are subject to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules which incorporates PD, LGD, EAD and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed total accounting impairment allowances.

For credit risk we have adopted the IRB advanced approach for the majority of our portfolios, with the remainder on either IRB foundation or standardised approaches.

- *Counterparty credit risk ('CCR')*

  CCR arises for OTC derivatives and securities financing transactions. It is calculated in both the trading and non-trading books and is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating CCR and determining exposure values are defined by CRD IV: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

  We use the mark-to-market and internal model method approaches for CCR. Our longer-term aim is to migrate more positions from the mark-to-market to the internal model method approach.

  In addition, CRD IV applies a capital requirement for credit valuation adjustment ('CVA') risk. Where we have both specific risk VaR approval and internal model method approval for a product, the CVA VaR approach has been used to calculate the CVA capital charge. Where we do not hold both approvals, the standardised approach has been applied.

- *Securitisation*

  Securitisation positions are held in both the trading and non-trading books. For non-trading book securitisation positions, CRD IV specifies two methods for calculating credit risk requirements, the standardised and the IRB approaches. Both rely on the mapping of rating agency credit ratings to risk weights, which range from 7 per cent to 1,250 per cent.

  Within the IRB approach, we use the ratings-based method for the majority of our non-trading book securitisation positions, and the internal assessment approach for unrated liquidity facilities and programme-wide enhancements for asset-backed securitisations.

  The majority of securitisation positions in the trading book are treated for capital purposes as if they are held in the non-trading book under the standardised or IRB approaches. Other traded securitisation positions, known as correlation trading, are treated under an internal model approach approved by the PRA.

Market risk capital requirement

The market risk capital requirement is measured using internal market risk models where approved by the PRA, or the PRA's standard rules. Our internal market risk models comprise VaR, stressed VaR, incremental risk charge and the comprehensive risk measure.

Operational risk capital requirement

CRD IV includes a capital requirement for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of total operating income less insurance premiums allocated to each of eight defined business lines. Both these approaches use an average of the last

Report of the Directors: Capital Management (continued)

three financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements. We have adopted the standardised approach in determining our operational risk capital requirements.

Pillar 2 capital requirements

We conduct an internal capital adequacy assessment process ('ICAAP') to determine a forward looking assessment of our capital requirements given our business strategy, risk profile, risk appetite and capital plan. This process incorporates the group's risk management processes and governance framework. A range of stress tests are applied to our base capital plan. These, coupled with our economic capital framework and other risk management practices, are used to assess our internal capital adequacy requirements.

The ICAAP is examined by the PRA as part of its supervisory review and evaluation process, which occurs periodically to enable the regulator to define the individual capital guidance or minimum capital requirements for the group and our capital planning buffer where required.

Pillar 3 disclosure requirements

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to increase market transparency by requiring them to publish, at least annually, wide-ranging information on their risks and capital, and how these are managed. Our *Pillar 3 Disclosures 2014* are published on HSBC's website, www.hsbc.com, under 'Investor Relations'.

Regulation and Supervision

(Unaudited)

On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on the group's interpretation of final CRD IV legislation and final rules issued by the PRA.

The capital and RWAs on a CRD IV basis incorporate the effect of the PRA's final rules as set out in the PRA Rulebook for CRR firms. This transposed various areas of national discretion within the final CRD IV legislation into UK law. In its final rules, the PRA did not adopt most of the CRD IV transitional provisions available, instead opting for an acceleration of the CRD IV end point definition of Common Equity Tier ('CET') 1. However, the CRD IV transitional provisions for unrealised gains were applied, such that unrealised gains on investment property and available-for-sale securities are not recognised for capital until 1 January 2015.

For additional tier 1 and tier 2 capital, the PRA followed the transitional provisions timing as set out in CRD IV to apply the necessary regulatory adjustments and deductions. The effect of these adjustments is being phased in at 20 per cent per annum from 1 January 2014 to 1 January 2018.

Furthermore, non-CRD IV compliant additional tier 1 and tier 2 instruments benefit from a grandfathering period. This progressively reduces the eligible amount by 10 per cent annually, following an initial reduction of 20 per cent on 1 January 2014, until they are fully phased out by 1 January 2022.

Under CRD IV, as implemented in the UK, banks are required to meet a minimum CET1 ratio of 4.0 per cent of RWAs (increasing to 4.5 per cent from 1 January 2015), a minimum tier 1 ratio of 5.5 per cent of RWAs (increasing to 6 per cent from 1 January 2015) and a total capital ratio of 8 per cent of RWAs.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that banks will be required to hold. This relates to the quantification and interaction of capital buffers and Pillar 2. The PRA is currently consulting on their revised approach to Pillar 2, the PRA Buffer and the interaction of this with the CRD IV buffers. Furthermore, there are a notable number of draft and unpublished EBA technical and implementation standards due in 2015 which could have additional impacts on the bank's capital position and RWAs.

CRD IV also introduced the leverage ratio to supplement risk-based capital requirements from 1 January 2018. In January 2014, the Basel Committee published its finalised leverage ratio framework, along with the public disclosure requirements applicable from 1 January 2015. Under CRD IV, the legislative proposals and final calibration of the leverage ratio are expected to be determined following a review of the revised Basel proposals and the basis of the EBA's assessment of the impact and effectiveness of the leverage ratio during a monitoring period, between 1 January 2014 and 30 June 2016.

The table below provides a comparison of the key capital numbers based on the applicable capital requirements for each period.

Key capital numbers
(Unaudited)

	At 31 December	
	2014	2013
Capital resources (£m)		
CET 1[1] /Core Tier 1 Capital	**21,091**	22,438
Tier 1 Capital	**25,138**	24,108
Total Capital	**33,556**	33,543
Risk Weighted Assets (£m)		
Counterparty Credit Risk	**30,364**	16,450
Non-Counterparty Credit Risk	**168,600**	129,459
- IRB	**137,206**	100,159
- Standardised	**31,394**	29,300
Market Risk	**22,437**	17,931
Operational Risk	**22,251**	22,039
Total Risk Weighted Assets	**243,652**	185,879
Capital Ratios (%)		
CET 1/Core Tier 1	**8.7**	12.1
Total Tier 1	**10.3**	13.0
Total Capital	**13.8**	18.0

1 *CET 1 is a new measure of capital introduced by CRD IV which replaces the previous Basel 2 measure, Core Tier 1. Capital measures introduced by CRD IV differ significantly to previous measures.*

Report of the Directors: Capital Management (continued)

Capital structure at 31 December

(Audited)

Composition of regulatory capital	**CRD IV transitional 2014 £m**	Basel 2.5 2013 £m
Tier 1 capital		
Shareholders' equity [1]	**34,562**	31,993
Shareholders' equity per balance sheet	**36,079**	32,370
Foreseeable interim dividend	**(315)**	–
Preference share premium	**(431)**	(431)
Deconsolidation of special purpose entities [2]	**(86)**	53
Deconsolidation of insurance entities	**(685)**	1
Non-controlling interests	**353**	399
Non-controlling interests per balance sheet	**620**	549
Preference share non-controlling interest	**(150)**	(150)
Surplus non-controlling interest disallowed in CET 1	**(117)**	–
Regulatory adjustments to the accounting basis	**(5,444)**	(1,389)
Unrealised gains on available-for-sale debt and equity securities [3]	**(837)**	(656)
Own credit spread	**245**	218
Debit valuation adjustment	**(88)**	–
Defined benefit pension fund adjustment [4]	**(2,400)**	(946)
Cash flow hedging reserve	**(163)**	13
Reserves arising from revaluation of property	**–**	(16)
Other equity instruments classified as Additional Tier 1	**(2,195)**	–
Other regulatory adjustments	**(6)**	(2)
Deductions	**(8,380)**	(8,565)
Goodwill capitalised & intangible assets	**(6,822)**	(7,218)
Deferred Tax assets that rely on future profitability (excludes those arising from temporary differences)	**(21)**	–
Additional valuation adjustment (referred to as PVA)	**(588)**	–
50% of securitisation positions	**–**	(902)
50% of excess expected losses over impairment allowances	**–**	(477)
50% of tax credit adjustment for excess expected losses	**–**	32
Excess of expected losses over impairment allowances	**(949)**	–
Common equity / Core tier 1 capital	**21,091**	22,438
Additional tier 1 capital		
Other tier 1 capital before deductions	**4,047**	2,353
Preference shares & related premium	**464**	581
Other tier 1 capital securities	**3,583**	1,772
Deductions	**–**	(683)
Unconsolidated investments [5]	**–**	(715)
50% of tax credit adjustment for excess expected losses	**–**	32
Tier 1 capital	**25,138**	24,108
Tier 2 capital		
Total qualifying tier 2 capital before deductions	**8,628**	11,582
Reserves arising from unrealised gains on revaluation of property & available-for-sale equities	**–**	221
Collective impairment allowances [6]	**–**	139
Perpetual subordinated debt	**2,844**	2,683
Term subordinated debt	**5,784**	8,539
Total deductions other than from tier 1 capital	**(210)**	(2,147)
Unconsolidated investments [5]	**(210)**	(715)
50% of securitisation positions	**–**	(902)
50% of excess expected losses over impairment allowances	**–**	(477)
Other deductions	**–**	(53)
Total regulatory capital	**33,556**	33,543

1 Includes externally verified profits for the year to 31 December 2014 and the interim dividend of £315 million declared by the Board of Directors after 31 December 2014.
2 Mainly comprises unrealised gains on available-for-sale securities owned by deconsolidated special purpose entities.
3 Under CRD IV transitional rules net unrealised gains on available-for-sale securities must be excluded from capital resources
4 CRD IV rules require banks to exclude from capital resources any surplus in a defined benefit pension scheme.
5 Mainly comprises investment in insurance entities. Under CRD IV rules the value of unconsolidated investments in insurance entities in 2014 falls below the 10% threshold for deductions.
6 Under previous PRA rules collective impairment allowances on loan portfolios under the standardised approach were allowable in tier 2 capital.

Report of the Directors: Capital Management (continued)

Reconciliation of regulatory capital from CRD IV transitional basis to an estimated CRD IV end point basis
(Unaudited)

	At 31 Dec 2014 £m
Common equity tier 1 capital on a transitional basis	**21,091**
Unrealised gains in available for sale reserves	**837**
Common equity tier 1 capital end point basis	**21,928**
Additional tier 1 capital on a transitional basis	**4,047**
Grandfathered instruments:	
Preference share premium	**(345)**
Other tier 1 capital securities	**(1,507)**
Additional tier 1 capital end point basis	**2,195**
Tier 1 capital end point basis	**24,123**
Tier 2 capital on a transitional basis	**8,418**
Grandfathered instruments:	
Term subordinated debt	**(2,326)**
Tier 2 capital end point basis	**6,092**
Total regulatory capital end point basis	**30,215**

Risk Weighted Assets ('RWAs')

RWA movement by business by key driver – non-counterparty credit risk – IRB only
(Unaudited)

	RBWM £bn	CMB £bn	GB&M £bn	GPB £bn	Other £bn	Total £bn
RWAs at 1 January 2014 on Basel 2.5 basis	**14.6**	**38.7**	**42.7**	**3.3**	**0.9**	**100.2**
Foreign exchange movement	**(0.1)**	**(0.6)**	**0.9**	**–**	**–**	**0.2**
Acquisitions and disposals	**–**	**–**	**(0.1)**	**–**	**(0.2)**	**(0.3)**
Book size	**0.6**	**4.2**	**(1.8)**	**(0.6)**	**(0.2)**	**2.2**
Book quality	**(1.4)**	**0.7**	**(1.9)**	**(0.2)**	**0.4**	**(2.4)**
Model new/updated	**(0.1)**	**–**	**–**	**–**	**–**	**(0.1)**
Methodology and policy	**0.7**	**6.0**	**29.4**	**0.2**	**1.1**	**37.4**
– external updates – regulatory	**–**	**7.6**	**5.2**	**0.2**	**–**	**13.0**
– CRD IV impact	**(0.6)**	**(1.9)**	**23.6**	**–**	**0.1**	**21.2**
– NCOA moving from STD to IRB	**1.3**	**0.3**	**0.6**	**–**	**1.0**	**3.2**
Total RWA movement	**(0.3)**	**10.3**	**26.5**	**(0.6)**	**1.1**	**37.0**
RWAs at 31 December 2014 on CRD IV basis	**14.3**	**49.0**	**69.2**	**2.7**	**2.0**	**137.2**

Methodology and policy changes – capital and RWA

Methodology and policy updates mainly related to the implementation of the CRD IV rules at 1 January 2014, and increased RWAs by approximately £37 billion. The main movement arose from non-investment grade securitisation positions which were previously deducted from capital. These are now included in RWAs with a 1,250 per cent risk weight, causing a rise of £22.5 billion.

Further increases in capital requirements stem from other changes such as the need to hold capital against credit valuation adjustment of £9.2 billion, the risk of failure of central counterparties of £2 billion and the £4.9 billion increase in RWAs caused by the asset value correlation multiplier applied to exposures to large or unregulated counterparties in the financial sector.

The change in treatment of non-investment grade securitisation positions was also responsible for an increase in capital of £1.8 billion. This was offset by other CRD IV changes, notably the £1.1 billion impact of a progressive cap on grandfathered capital instruments and a £0.9 billion deduction for a prudential valuation adjustment.

In addition, with effect from 31 March 2014, a 45 per cent loss given default floor has applied to bank exposures and UK corporate portfolios which did not fully meet modelling requirements, resulting in an increase of RWAs of £12.9 billion.

RWAs by key driver – basis of preparation and supporting notes

Credit risk drivers – definitions and quantification

The causal analysis of RWA movements splits the total movement in IRB RWAs into six drivers, described below. The first four relate to specific, identifiable and measurable changes. The remaining two, book size and book quality, are derived after accounting for movements in the first four specific drivers.

1. Foreign exchange movements

This is the movement in RWAs as a result of changes in the exchange rate between the functional currency of the HSBC company owning each portfolio and Sterling, being our presentation currency for consolidated reporting. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question. We hedge structural foreign exchange exposures only in limited circumstances.

2. Acquisitions and disposals

This is the movement in RWAs as a result of the disposal or acquisition of business operations. This can be whole businesses or parts of a business. The movement in RWAs is quantified based on the credit risk exposures as at the end of the month preceding a disposal or following an acquisition.

3. Model updates

New/updated models

RWA movements arising from the implementation of new models and from changes to existing parameter models are allocated to this driver. This figure will also include changes which arise following review of modelling assumptions. Where a model recalibration reflects an update to more recent performance data, the resulting RWA changes are not assigned here, but instead reported under book quality.

RWA changes are estimated based on the impact assessments made in the testing phase prior to implementation. These values are used to simulate the effect of new or updated models on the portfolio at the point of implementation, assuming there were no major changes in the portfolio from the testing phase to implementation phase.

Portfolios moving onto IRB approach

Where a portfolio moves from the standardised approach to the IRB approach, the RWA movement by key driver statement shows the increase in IRB RWAs, but does not show the corresponding reduction in standardised approach RWAs as its scope is limited to IRB only.

The movement in RWAs is quantified at the date at which the IRB approach is applied, and not during the testing phase as with a new/updated model.

4. Methodology and policy

Internal regulatory updates

This captures the effect on RWAs of changing the internal treatment of exposures. This may include, but is not limited to, a portfolio or a part of one moving from an existing IRB model onto a standardised model, identification of netting and credit risk mitigation.

External regulatory updates

This specifies the effect of additional or changing regulatory requirements. This includes, but is not limited to, regulatory-prescribed changes to the RWA calculation. The movement in RWAs is quantified by comparing the RWAs calculated for that portfolio under the old and the new requirements.

5. Book size

RWA movements attributed to this driver are those we would expect to experience for the given movement in exposure, as measured by EAD, assuming a stable risk profile. These RWA movements arise in the normal course of business, such as growth in credit exposures or reduction in book size from run-offs and write-offs.

The RWA movement is quantified as follows:

- RWA and EAD changes captured in the four drivers above are excluded from the total movements to create an adjusted movement in EAD and RWA for the period.
- The average RWA to EAD percentage is calculated for the adjusted position and is applied to the adjusted movement in EAD.

As the calculation relies on averaging, the output is dependent upon the degree of portfolio aggregation and the number of discrete time periods for which the calculation is undertaken. For each quarter of 2014 this calculation was performed for each HSBC company with an IRB portfolio by global businesses, split by the main Basel categories of credit exposures, as described in the table below:

The total of the results is shown in book size within the RWA movement by key driver table.

6. Book quality

This represents RWA movements resulting from changes in the underlying credit quality of customers. These are caused by changes to IRB risk parameters which arise from actions such as, but not limited to, model recalibration, change in counterparty external rating, or the influence of new lending on the average quality of the book. The change in RWAs attributable to book quality is calculated as the balance of RWA movements after taking account of all drivers described above.

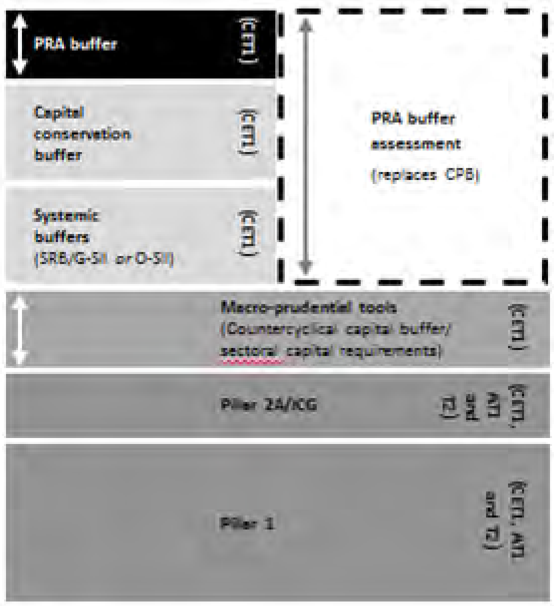
The RWA movement by key driver statement includes only movements which are calculated under the IRB approach. Certain classes of credit risk exposure are treated as capital deductions and therefore reductions are not shown in this statement. If the treatment of a credit risk exposure changes from RWA to capital deduction in the period, then only the reduction in RWAs would appear in the RWA movement by key driver tables. In this instance, a reduction in RWAs does not necessarily indicate an improvement in the capital position.

Report of the Directors: Capital Management (continued)

Regulatory Capital Developments

Regulatory capital buffers

Capital requirements framework



CRD IV establishes a number of capital buffers, to be met with CET1 capital, which is broadly aligned with the Basel III framework. CRD IV contemplates that these will be phased in from 1 January 2016, subject to national discretion.

Automatic restrictions on capital distributions apply if the bank's CET1 capital falls below the level of its CRD IV combined buffer. This is defined as the total of the Capital Conservation Buffer ('CCB'), the Countercyclical Capital Buffer ('CCyB'), Global or Other Systemically Important Institutions Buffer ('G-SII' or 'O-SII'), and the Systemic Risk Buffer ('SRB') as these become applicable. The PRA have proposed that the use of the PRA buffer will not result in any automatic restrictions on capital distributions.

In April 2014, HM Treasury published the statutory instrument 'Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014' transposing into UK legislation the main provisions in CRD IV related to capital buffers, with the exception of the SRB. In January 2015, HM Treasury published amendments to this statutory instrument in order to transpose the SRB.

The PRA is the designated authority for the G-SIIs and O-SII buffers and the CCB. In April 2014, the PRA published rules and supervisory statements implementing the main CRD IV provisions in relation to these buffers. The Bank of England is the designated authority for the CCyB and other macro prudential measures, whilst the PRA and the FCA are the designated authorities for applying and determining the SRB and the FPC is responsible for creating the SRB framework for calibration.

The PRA will be responsible for identifying the O-SIIs from 1 January 2016. However, institutions identified as O-SIIs are currently not subject to an O-SII buffer.

Capital conservation buffer

The CCB was designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred and is set at 2.5 per cent of RWAs. The PRA will phase-in this buffer from 1 January 2016 to 1 January 2019.

Countercyclical and other macro-prudential buffers

The CCyB is a macro-prudential tool at the disposal of national authorities that can be deployed when the Financial Policy Committee ('FPC') judges that threats to financial stability have arisen in the UK increasing system-wide risk, and to protect the banking sector from future potential losses. Should a CCyB be required, it is expected to be set in the range of 0-2.5 per cent of relevant credit exposures RWAs, although it is uncapped.

In June 2014, the FPC set the CCyB rate for UK exposures at 0 per cent. At its September 2014 meeting, the FPC left the CCyB rate for UK exposures unchanged at 0 per cent and recognised the 1 per cent CCyB rates introduced by Norway and Sweden to become effective from 3 October 2015. The FPC also stated its intention to reciprocate any CCyB rates set by other EEA countries before 2016 and to reciprocate foreign CCyB rates, with decisions made on an individual basis. Additionally, FPC indicated its intention to reciprocate foreign macroprudential capital actions, other than the CCyB.

The institution-specific CCyB rate for the group will be based on the weighted average of the CCyB rates that apply in the jurisdictions where relevant credit exposures are located.

The sectoral capital requirements ('SCR') tool is not currently deployed in the UK.

Systemic Risk Buffer

In addition to the measures above, CRD IV sets out a SRB for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigate structural macro-prudential risk.

In January 2015, the legislative changes necessary to transpose the SRB into UK legislation were implemented. The SRB is to be applied to ring fenced banks and building societies (over a certain threshold), which are together defined as 'SRB institutions'. The SRB can be applied on an individual, sub consolidated or consolidated basis and is applicable from 1 January 2019. By 31 May 2016, the FPC is required to create a framework for identifying the extent to which the failure or distress of SRB institutions will pose certain long term non-cyclical systemic or macro-prudential risks. The PRA will apply this framework to determine whether specific SRB institutions would be subject to a SRB rate, the level at which the buffer is applied and is able to exercise supervisory judgment to determine what the rate should be. Where applicable, the buffer rate must be set in the range of 1 per cent to 3 per cent. This would apply to all the SRB institution's exposures unless the PRA has recognised a buffer rate set in another EEA state.

Report of the Directors: Capital Management (continued)

Pillar 2 and the 'PRA buffer'

Under the Pillar 2 framework, banks are already required to hold capital in respect of the internal capital adequacy assessment and supervisory review which leads to a final determination by the PRA of individual capital guidance under Pillar 2A and Pillar 2B. Pillar 2A was previously met by total capital, but since 1 January 2015, in accordance with the PRA's supervisory statement SS 5/13, is met with at least 56 per cent CET1.

Pillar 2A guidance is a point in time assessment of the amount of capital the PRA considers that a bank should hold to meet the overall financial adequacy rule. It is therefore subject to change pending annual assessment and the supervisory review process.

In January 2015, the PRA published a consultation on the Pillar 2 Framework. This sets out the methodologies that the PRA proposed to use to inform its setting of firms' Pillar 2 capital requirements, including proposing new approaches for determining Pillar 2 requirements for credit risk, operational risk, counterparty credit risk and pension obligation risk.

As part of CRD IV implementation, the PRA proposed to introduce a PRA buffer, to replace the previous capital planning buffer ('CPB') (known as Pillar 2B), also to be held in the form of CET1 capital. This was reconfirmed in the recent PRA consultation on the Pillar 2 framework. It is proposed that a PRA buffer will avoid duplication with CRD IV buffers and be set for a particular firm given its vulnerability in a stress scenario or where the PRA has identified risk management and governance failings. In order to address weaknesses in risk management and governance, the PRA propose a scalar applied to firms' CET1 Pillar 1 and Pillar 2A capital requirements. Where the PRA considers there is overlap between the CRD IV buffers and the PRA buffer assessment, the PRA proposes to set the PRA buffer as the excess capital required over and above the CCB and relevant systemic buffers. The PRA buffer will however be in addition to the CCyB and sectoral capital requirements.

The PRA expects to finalise the Pillar 2 framework in July 2015, with implementation expected from 1 January 2016. Until this consultation is finalised and revised rules and guidance issued, there remains uncertainty as to the exact buffer rate requirements, and their ultimate capital impact.

Overall capital requirements

Given the developments outlined above, details are beginning to emerge as to the various elements of the capital requirements framework. However there remains residual uncertainty as to what the group's precise end point CET1 capital requirement will be.

In addition to the capital requirements set out above, it is also necessary to consider the impact of FSB proposals published in November 2014 in relation to total loss absorbing capacity ('TLAC') requirements detailed below.

RWA developments

Throughout 2014, regulators issued a series of recommendations and consultations designed to revise the various components of the RWA regime and increase related reporting and disclosures.

UK

In March 2014, the FPC published that it was minded to recommend that firms report and disclose capital ratios using the standardised approach to credit risk as soon as practicable in 2015 following a Basel review of the standardised approach.

In June 2014, the PRA issued its consultation CP12/14. This proposed changes to the credit risk rules in two areas. Firstly, a proposal that exposures on the advanced internal ratings-based ('AIRB') approach for central governments, public sector entities, central banks and financial sector entities would be moved to the foundation approach from June 2015. Secondly, a proposal to introduce stricter criteria for the application of the standardised risk weight for certain commercial real estate ('CRE') exposures located in non-EEA countries dependent upon loss rates in these jurisdictions over a representative period. In October, the PRA published a policy statement ('PS 10/14') containing final rules on the second proposal, whereby prior to implementation they would consult with the EBA regarding the application of a more stringent risk weights. The EBA will then publish any stricter criteria, allowing for a six month implementation period from the date of publication.

EU

In May 2014, the EBA published a consultation on benchmarks of internal approaches for calculating own funds requirements for credit and market risk exposures (RWAs). This follows a series of benchmarking exercises run in 2013 to better understand the drivers of differences observed in RWAs across EU institutions. The future annual benchmarking exercise outlined in the consultation paper aims to improve the comparability of capital requirements calculated using internal modelled approaches and will be used by regulators to inform their policy decisions.

In June 2014, the EBA published a consultation on thresholds for the application of the Standardised Approach for exposures treated under permanent partial use and the IRB roll-out plan. The finalised RTS is yet to be published.

In December 2014, the list of non-EEA countries deemed to have equivalent regulatory regimes for CRD IV purposes was published in the EU's Official Journal. This equivalence evaluation impacts the treatment of exposures across a number of different areas in CRD IV, such as the treatment of exposures to third country investment firms, credit institutions and exchanges; standardised risk weights applicable to exposures to central governments, central banks, regional governments, local authorities and public sector entities; and the calculation of RWAs for exposures to corporates, institutions, central governments and central banks under the IRB approach.

International

Throughout 2014, the Basel Committee published proposals across all Pillar 1 risk types, to update standardised, non-modelled approaches for calculating capital requirements and to provide the basis for the application of a capital floor.

Report of the Directors: Capital Management (continued)

In particular, in March 2014, the Basel Committee published finalised proposals for the standardised approach for calculating counterparty credit risk exposures for OTC derivatives, exchange traded derivatives and long settlement transactions. Following this, another technical paper on the foundations of the new standard was published in August 2014. The new approach is proposed to replace both the Current Exposure Measure and the Standardised Method and is expected to come into effect on 1 January 2017.

In October 2014, the Committee also published a consultation and a Quantitative Impact Study ('QIS') to revise the standardised approach for calculating operational risk. The proposals seek to establish a new unitary standardised approach to replace the current non-model-based approaches, which comprise the Basic Indicator Approach and the Standardised Approach, including its variant the Alternative Standardised Approach. An implementation date is yet to be proposed.

In December 2014, the Basel Committee undertook a further consultation on its fundamental review of the trading book. This included revisions to the market risk framework that was published for consultation in October 2013. The Committee intends to carry out a further QIS in early 2015 to inform finalised proposals expected at the end of 2015.

In December, the Basel Committee published a revised framework for securitisation risk, which will come into effect on 1 January 2018.

In December 2014, the Basel Committee also published a consultation paper on revisions to the Standardised Approach for credit risk. Proposals include a reduced reliance on external credit ratings; increased granularity and risk sensitivity; and updated risk weight calibrations. Proposed calibration for risk weights are indicative only and will be further informed by responses from this consultation and results from a QIS.

Additionally, in December 2014, the Basel Committee published a consultation on the design of a capital floor framework, which will replace the Basel I floor. The calibration of the floor is however outside the scope of this consultation. The Committee has stated its intention to publish final proposals including calibration and implementation timelines by the end of 2015.

All finalised Basel Committee proposals for standardised approaches for calculating risk requirements and introduction of a revised capital floor would need to be transposed into EU requirements before coming into legal effect.

Leverage ratio proposals

In October 2014 the FPC published final recommendations on the design of a UK specific leverage ratio framework and calibration. This followed an earlier FPC consultation in July 2014 on the design of the framework. The FPC finalised recommendations included a minimum leverage ratio of 3 per cent to be implemented as soon as practicable for UK G-SIBs and major UK banks and building societies, a supplementary leverage ratio buffer applied to systemically important firms of 35 per cent of the relevant risk-weighted systemic risk buffer rates, and a further countercyclical leverage ratio buffer ('CCLB') of 35 per cent of the relevant risk-weighted CCyB. The minimum leverage ratio is to be met 75 per cent with CET1 and 25 per cent with AT1, and both the supplementary leverage ratio buffer and CCLB are to be met 100 per cent with CET1. The FPC recommended that the HM Treasury provide the FPC the necessary powers to direct the PRA to set leverage ratio requirements implementing the above mentioned calibration and framework.

HM Treasury published a consultation paper in November 2014, which responded to and agreed with the FPC recommendations in relation to the design of the leverage ratio framework. Specifically, HM Treasury agreed that the FPC should be granted powers to direct the PRA on a minimum requirement, and additional leverage ratio buffer (for G-SIBs, major UK banks and building societies including ring fenced banks) and a CCLB. HM Treasury did not however provide any views on the calibration. The consultation paper included legislative changes to provide the FPC with new powers. In February 2015, HM Treasury published a summary of responses, alongside the draft instrument which was laid in Parliament. This will need to be approved by both Houses of Parliament before taking legal effect.

Banking structural reform

In the EU, the Bank Recovery and Resolution Directive ('BRRD') was finalised and published in June 2014. This came into effect from 1 January 2015, with the option to delay implementation of bail-in provisions until 1 January 2016. Regardless of this, the UK introduced bail-in powers from 1 January 2015. The UK transposition of the BRRD builds on the resolution framework already in place in the UK.

In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning which revises PRA rules that have been in force since 1 January 2014. In addition, the EBA has produced a number of Regulatory Technical Standards ('RTS'), some of which are yet to be finalised, that will further inform the BRRD requirements.

Total loss absorbency capacity proposals

In November 2014, as part of the 'too big to fail' agenda, the FSB published proposals for TLAC for G-SIBs.

The FSB proposals include a minimum TLAC requirement in the range of 16-20 per cent of RWAs and a TLAC leverage ratio of at least twice the Basel 3 Tier 1 leverage ratio. This is to be applied in accordance with individual resolution strategies. It is expected that a quantitative impact study ('QIS') will be undertaken in early 2015, the results of which will inform finalised proposals. The conformance period for the TLAC requirement will be informed by the QIS, but will not be before 1 January 2019. Once finalised, it is expected that any new TLAC standard should be met alongside the Basel 3 minimum capital requirements.

The draft proposals require G-SIBs and their material subsidiaries to be subject to a minimum TLAC requirement with the precise requirement to be informed by the QIS. There are a number of requirements relating to the types of liabilities which can be used to meet the TLAC requirement, the composition of TLAC, and the location of liabilities within a banking

Report of the Directors: Capital Management (continued)

group, in accordance with its resolution strategy. The TLAC proposals are expected to be finalised in 2015 and will then need to be implemented into national legislation.

Other regulatory updates

In January 2015, the EBA published revised final draft RTS on prudent valuation. Finalised requirements will need to be adopted by the European Commission and published in the EU's official journal before coming into effect.

In June 2014, the EBA and Basel Committee each issued a consultation on the Pillar 3 disclosures. The final EBA guidelines were issued on 23 December 2014 and entail additional processes and governance around the Pillar 3 report, as well as semi-annual or quarterly disclosure of key capital, ratio, risk-weighted asset, leverage and risk model information, exceeding the scope of our current disclosures. The guidelines are subject to implementation by national supervisors and will enter into force during 2015.

The final Basel standards on 'Revised Pillar 3 disclosure requirements' were issued on 28 January 2015. They mandate extensive use of standardised templates to enhance comparability between banks' disclosures as well as requiring a considerable volume of disclosures to be produced semi-annually, rather than annually as hitherto. The revised framework calls for disclosure at the latest from 2016 year-ends, concurrently with financial reports.

Report of the Directors: Corporate Governance

Corporate Governance Report

The statement of corporate governance practices set out on pages 94 to 102 and information incorporated by reference constitutes the Corporate Governance Report of HSBC Bank plc.

The Directors serving as at the date of this report are set out below.

Directors

Jonathan Symonds, 55
Chairman and Independent non-executive Director

Chairman of the Nominations and Remuneration Committee.

Appointed to the Board: 14 April 2014

Jonathan is an independent non-executive director of HSBC Holdings plc. He is Chairman of the Group Audit Committee, a member of the Conduct & Values Committee and was a member of the Group Remuneration Committee from 14 April 2014 until 1 September 2014. He is Chairman of Innocoll AG and a non-executive director of Genomics England Limited and Proteus Digital Health Inc. Former appointments include: a partner and managing director of Goldman Sachs; a partner of KPMG; Chief Financial Officer of Novartis AG and AstraZeneca plc; and a non-executive director and Chairman of the Audit Committee of Diageo plc.

John Trueman, 72
Deputy Chairman and Independent non-executive Director

Member of the Audit Committee, the Risk Committee and the Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 2004. Deputy Chairman since December 2013.

John is Chairman of HSBC Private Bank (UK) Limited and HSBC Global Asset Management Limited. He also serves on certain global risk and audit committees within the HSBC Group. Former appointments include: Deputy Chairman of S.G. Warburg & Co Ltd.

Alan Keir, 56
Chief Executive

Chairman of the Executive Committee.

Appointed to the Board: October 2013

Alan joined HSBC in 1981. A Group Managing Director since 2011. He is a director of HSBC Bank Middle East Limited, HSBC Trinkaus & Burkhardt AG and HSBC France. Alan is a member of the Advisory Council of TheCityUK and the Advisory Board of Bradford University School of Management. Former appointments include: Global Head, Global Commercial Banking; director of HSBC Bank A.S. and HSBC Bank Polska S.A.

Samir Assaf, 54

Appointed to the Board: 28 March 2014

Samir joined HSBC in 1994. A Group Managing Director since 2011. Chief Executive, Global Banking and Markets, HSBC Holdings plc. He is Chairman of the Global Financial Markets Association and HSBC France and a director of HSBC Trinkaus & Burkhardt AG. Former appointments include: a director of HSBC Global Asset Management Limited and HSBC Bank Egypt S.A.E.; Head of Global Markets; and Head of Global Markets for Europe, Middle East and Africa.

Simon Cooper, 47

Appointed to the Board: April 2013

Simon joined HSBC in 1989. A Group Managing Director since October 2013. Chief Executive, Global Commercial Banking, HSBC Holdings plc. Former appointments include: Chairman of HSBC Bank Egypt S.A.E. and HSBC Bank Oman; Deputy Chairman and Chief Executive of HSBC Bank Middle East Limited; Chief Executive of HSBC Korea; Head of Corporate and Investment Banking, HSBC Singapore; and a director of The Saudi British Bank and HSBC Bank Middle East Limited.

Dame Denise Holt, 65
Independent non-executive Director

Member of the Risk Committee.

Appointed to the Board: 2011

Denise is Chairman of Marks and Spencer Financial Services plc, Marks and Spencer Savings and Investments Limited and Marks & Spencer Unit Trust Management Limited. She is a non-executive director of Iberdrola SA and Nuffield Health. Former appointments include: a senior British Ambassador with 40 years' experience of working in Government, including postings in Ireland, Mexico, Brazil and Spain.

Simon Leathes, 67
Independent non-executive Director

Chairman of the Risk Committee and a member of the Audit Committee and the Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 2012

Simon is a director of HSBC Trinkaus & Burkhardt AG and a member of its Audit and Risk Committees. He also serves on certain global risk and audit committees with the HSBC Group. He is Chairman of Assured Guaranty (Europe) Limited and Assured Guaranty (UK) Limited and a non-executive director of Assured Guaranty Limited and HSB Engineering Insurance Limited. Former appointments include: Vice Chairman of Barclays Capital and Group Finance Director of S.G. Warburg Group plc.

Report of the Directors: Corporate Governance (continued)

Dame Mary Marsh, 68
Independent non-executive Director

Appointed to the Board: 2009

Mary is a director of the Clore Social Leadership Programme and a non-executive director and Chair of the International Skills Standards Organisation. Former appointments include: a co-opted non-director member of the Corporate Sustainability Committee of HSBC Holdings plc; and Chief Executive of the National Society for the Prevention of Cruelty to Children.

Rosemary Martin, 54
Independent non-executive Director

Chairman of the IT Infrastructure Committee and a member of the Chairman's Nominations and Remuneration Committee.

Appointed to the Board: 2005

Rosemary is General Counsel and Company Secretary of Vodafone Group plc. Former appointments include: Chief Executive of the Practical Law Group; and a member of the Financial Conduct Authority's Listing Group Advisory Panel.

Thierry Moulonguet, 63
Independent non-executive Director

Chairman of the Audit Committee and a member of the Risk Committee and IT Infrastructure Committee.

Appointed to the Board: 2012

Thierry is a director of HSBC France and Chairman of its Audit and Risk Committees. He is a director of Fitch Rating Group Inc; Fimalac; Groupe Lucien Barrière and Valéo. Former appointments include: Executive Vice-President; and Chief Financial Officer of Renault Group.

Antonio Simoes, 39
Deputy Chief Executive

Appointed to the Board: 2012

Antonio joined HSBC in 2007. A Group General Manager since January 2011. He is Chief Executive Officer, UK; Chairman of HSBC Global Asset Management (UK) Limited since 19 December 2014; and a director of HSBC France and HSBC Bank A.S. Former appointments include: Head of Retail Banking and Wealth Management, Europe and Group Head of Strategy and Planning.

Secretary

Nicola Black, 48
Company Secretary

Nicola joined HSBC in 2000 and was appointed Company Secretary in April 2014. She previously served as Assistant Group Company Secretary, HSBC Holdings plc.

Board of Directors

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

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

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on pages 94 to 95.

All Directors, including those appointed by the Board to fill a casual vacancy, are subject to annual re-election at the bank's Annual General Meeting. Non-executive Directors have no service contracts.

Following the resignation of Jim Leng as Chairman on 31 December 2013, the responsibilities of the Chairman were carried out by John Trueman, as Deputy Chairman, until the appointment of Jonathan Symonds on 14 April 2014. Samir Assaf was appointed as a Director on 28 March 2014.

Peter Shawyer resigned as a Director on 6 January 2014 and Piraye Antika and Alan Thomson resigned as Directors on 31 October 2014. Alan Thomson resigned as a member of the Audit Committee, Risk Committee and Chairman's Nominations and Remuneration Committee on 31 October 2014.

Directors' emoluments

Details of the emoluments of the Directors of the bank for 2014, disclosed in accordance with the Companies Act, are shown in Note 5 *'Employee compensation and benefits'*.

Board committees

The Board has appointed a number of committees, the membership of which comprise certain Directors and, where appropriate, senior executives.

All of the members of the Audit Committee, Risk Committee and Chairman's Nominations and Remuneration Committee, who served during 2014, were independent non-executive Directors.

As at the date of this report, the following are the principal committees:

Audit Committee

The Audit Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on financial reporting related matters and internal controls over financial reporting.

The Audit Committee meets regularly with the bank's senior financial and internal audit management and the external auditor to consider, inter alia, the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control relating to financial reporting.

The current members of the Audit Committee are Thierry Moulonguet (Chairman), Simon Leathes and John Trueman.

Thierry Moulonguet was appointed Chairman of the Committee on 18 November 2014 in succession to Alan Thompson.

Risk Committee

The Risk Committee is accountable to the Board and has non-executive responsibility for oversight of and advice to the Board on high level risk related matters and risk governance.

The Risk Committee meets regularly with the bank's senior financial, risk, internal audit and compliance management and the external auditor to consider, inter alia, risk reports and internal audit reports and the effectiveness of compliance.

The Risk Committee has delegated responsibility for reviewing the risks associated with the bank's IT infrastructure, its performance, appropriateness, resilience, recovery and resolution plans to a sub-committee, the IT Infrastructure Committee. The IT Infrastructure Committee is chaired by Rosemary Martin an independent non-executive Director of the bank.

The current members of the Risk Committee are Simon Leathes (Chairman), Denise Holt, Thierry Moulonguet and John Trueman.

Simon Leathes was appointed Chairman of the Committee on 31 October 2014 in succession to John Trueman who remains as a member.

Chairman's Nominations and Remuneration Committee

The Chairman's Nominations and Remuneration Committee, formerly named the Chairman's Committee, has responsibility for: (i) leading the process for Board appointments and for identifying and nominating, for the approval of the Board, candidates for appointment to the Board; (ii) the endorsement of the appointment of the chairman and any director to the Board of certain subsidiaries of the bank; and (iii) reviewing the implementation and appropriateness of the Group's remuneration policy and the remuneration of the bank's senior executives.

The current members of the Chairman's Nominations and Remuneration Committee are Jonathan Symonds (Chairman), Simon Leathes, Rosemary Martin and John Trueman.

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board, exercising all of the powers, authorities and discretions of the Board in so far as they concern the management and day to day running of the bank, in accordance with such policies and directions as the Board may from time to time determine. The members of the Executive Committee include two of the bank's executive Directors, namely Alan Keir (Committee Chairman) and Antonio Simoes.

Regular Risk Management Meetings of the Executive Committee, chaired by the Chief Risk Officer, EMEA, are held to establish, maintain and periodically review the policy and guidelines for the management of risk within the bank.

Internal control

The Directors are responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the nature and extent of the significant risks the group is willing to take in achieving its strategic objectives. To meet this requirement and to discharge its obligations under the FCA Handbook and PRA Handbook, procedures have been designed for safeguarding assets against unauthorised use or disposal; for maintaining proper accounting records; and for ensuring the reliability and usefulness of financial information used within the business or for publication. These procedures can only provide reasonable and not absolute assurance against material misstatement, errors, losses or fraud.

These procedures are designed to provide effective internal control within the group and accord with the Financial Reporting Council's guidance for directors issued in its revised form in 2005. They have been in place throughout the year and up to 23 February 2015, the date of approval of the Annual Report and Account 2014. This guidance was amended following consultations undertaken by the Financial Reporting Council in November 2013 and April 2014, resulting in revised guidance on risk management, internal control and related financial and business reporting. The revised guidance applies to companies with financial years beginning on or after 1 October 2014.

Key risk management and internal control procedures include the following:

- **Group standards:** Functional, operating, financial reporting and certain management reporting standards are established by HSBC global function management committees, for application throughout the Group. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary.
- **Delegation of authority within limits set by the Board:** Authority to manage the day to day running of the bank is delegated within limits set by the Board to the Chief Executive who has responsibility for overseeing the establishment and maintenance of systems of control appropriate to the business and who has the authority to delegate such duties and responsibilities as he sees fit. The appointments to the most senior positions within the group require the approval of the Board of Directors of HSBC Holdings.
- **Risk identification and monitoring:** Systems and procedures are in place in the group to identify, control and report on the major risks facing the group including credit, market, liquidity and funding, capital, financial management, model, reputational, pension, strategic, sustainability, operational (including accounting, tax, legal, regulatory compliance, financial crime compliance, fiduciary, security and fraud, systems operations, project and people risk) and insurance risk. Exposure to these risks is monitored by risk management committees; asset, liability and capital management committees; and executive committees in subsidiaries, and for the bank, in Risk Management Meetings (the 'RMM') of the Executive Committee which are chaired by the Chief Risk Officer, EMEA. The RMM also monitors the group's operational risk profile and the effective implementation of the group's operational risk management framework.
- **Changes in market conditions/practices:** Processes are in place to identify new risks arising from changes in market conditions/practices or customer behaviours, which could expose the group to heightened risk of loss or reputational damage.

  During 2014, attention was focused on:

  - emerging markets' slowdown;
  - increased geopolitical risk;
  - regulatory developments affecting our business model and Group profitability;
  - regulatory investigations, fines, sanctions commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand;
  - dispute risk;
  - heightened execution risk;
  - internet crime and fraud;
  - information security risk; and
  - model risk.
- **Strategic plans:** Periodic strategic plans are prepared for global businesses, global functions and certain geographical regions, including the home and priority growth markets in Europe, within the framework of the Group's strategy.

  The bank also prepares and adopts an Annual Operating Plan which is informed by detailed analysis of risk appetite, describing the types and quantum of risks that we are prepared to take in executing our strategy, and sets out the key business initiatives and the likely financial effects of these initiatives.
- **Disclosure Committee:** The Disclosure Committee reviews material public disclosures made by the bank for any material errors, misstatements or omissions. The integrity of disclosures is underpinned by structures and processes within the Global Finance and Risk functions that support expert and rigorous analytical review of financial reporting complemented by certified reviews by heads of global businesses, global functions and certain legal entities.
- **Financial reporting:** The group's financial reporting process for preparing the consolidated *Annual Report and Accounts 2014* is controlled using documented accounting policies and reporting formats, supported by a chart of accounts with detailed instructions and guidance on reporting requirements, issued by Global Finance to the bank and all reporting entities within the group in advance of each reporting period end. The submission of financial information from each reporting entity is subject to certification by the

responsible financial officer and analytical review procedures at reporting entity and group levels.

- **Responsibility for risk management:** Management of global businesses and global functions are primarily accountable for managing, measuring and monitoring their risks and controls. Processes consistent with the three lines of defence risk management and internal control model are in place to ensure weaknesses are escalated to senior management and addressed.
- **IT operations:** Centralised functional control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.
- **Functional management:** Global functional management is responsible for setting policies, procedures and standards for the following risks: credit, market, liquidity, capital, financial management, model, reputational, pension, strategic, sustainability and operational risk (including accounting, tax, legal, regulatory compliance, financial crime compliance, fiduciary, information security, security and fraud, systems and people risk). Authorities to enter into credit and market risk exposures are delegated with limits to line management of group companies. The concurrence of the appropriate global function is required for credit proposals with specified higher risk characteristics. Credit and market risks are measured and reported on in subsidiaries and aggregated for review of risk concentrations on a Group-wide basis.
- **Internal Audit:** The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Global Internal Audit function, which is centrally controlled, provides independent and objective assurance in respect of the adequacy of the design and operating effectiveness of the group's framework of risk management, control and governance processes across the group, focussing on the areas of greatest risk to HSBC using a risk-based approach.
- **Internal Audit recommendations:** Executive management is responsible for ensuring that recommendations made by the Global Internal Audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to Global Internal Audit.
- **Reputational risk:** Policies to guide the bank, subsidiary companies and management at all levels in the conduct of business to safeguard the Group's reputation are established by the Board of HSBC Holdings, subsidiary company boards and committees, board committees and senior management. Reputational risks can arise from a variety of causes including environmental, social and governance issues, as a consequence of operational risk events and as a result of employees acting in a manner inconsistent with the HSBC Values. HSBC's reputation depends upon the way in which it conducts its business and may be affected by the way in which clients, to which it provides financial services, conduct their business or use financial products and services.
- During the year, the Risk Committee and the Audit Committee have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. In carrying out their reviews, the Audit Committee and Risk Committee receive regular business and operational risk assessments; regular reports from the heads of key risk functions, which cover all internal controls, both financial and non-financial; internal audit reports; external audit reports; prudential reviews; and regulatory reports.
- The Risk Committee monitors the status of top and emerging risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the Risk Committee and the Audit Committee review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

Health and safety

The maintenance of appropriate health and safety standards remains a key responsibility of all managers and the bank is committed to proactively managing all health and safety risks associated with its business. The bank's objectives are to identify, remove and mitigate material risks relating to fires and accidents or injuries to employees, customers and visitors.

Group policies, standards and guidance for the management of health and safety are set by Global Corporate Real Estate. Achieving these in each country in which the Group operates is the responsibility of the Chief Operating Officer of that country with support and coordination provided by the Health and Safety Coordinator.

In terms of physical and geopolitical risk, Global Security and Fraud Risk provide regular Security Risk Assessments to assist management in judging the level of terrorist and violent criminal threat. Regional Security and Fraud Risk functions conduct regular security reviews of all Group buildings to ensure measures to protect staff, buildings, assets and information are appropriate to the level of threat.

HSBC remains committed to maintaining its preparedness and to ensuring the highest standards of health and safety wherever in the world the Group operates.

Diversity and inclusion

HSBC is building a values-led high performance culture where all employees are valued, respected and where their opinions count. Our culture will be strengthened by employing the best people and optimising their ideas, abilities and differences.

We remain committed to meritocracy, which requires a diverse and inclusive culture where employees' views are heard, their concerns are attended to and they work in an environment where bias, discrimination and harassment on any matter, including gender, age, ethnicity, religion, sexuality and disability, are not tolerated and where advancement is based on objective criteria. Our inclusive culture helps us understand and serve our diverse customer base, while developing and retaining a secure supply of skilled, committed employees.

Oversight of our diversity and inclusion agenda and related activities resides with executives on the Group Diversity Committee, complemented by the Group People Committee and local People/Diversity Committees.

Each executive member of the UK People Committee sponsors an Employee Resource Group. These employees led voluntary networks help raise awareness, build understanding of inclusion issues and opportunities, and provide support to help us create a more inclusive environment, so HSBC people can better connect with our colleagues and our diverse customer base.

Inclusivity in 2014:

Race for Opportunity, the leading Race campaign for racial equality, awarded HSBC with a Silver award and a Responsible Business Award for HSBC's commitment to racial equality in the workplace. This improved on last year's Bronze award, through new activities including executive sponsorship of ethnicity, the activities and focus of the BAME Employee Resource Group, sponsorship of Future Leaders publication profiling UK top 100 black students, and continued focus on enhancing entry level pipeline and BAME career progression.

HSBC is committed to a gender balanced workplace, with a gender target of 25 per cent for women in senior management roles. We were recognized with a Silver award by Opportunity Now, for our commitment and activities to address gender diversity - including raising the visibility of our gender balance policies, new Career Gym online resource which is open to all employees but particularly focused on enabling more choice and flexibility to support female career development, and diverse candidate shortlists.

In Stonewall's annual ranking of the best employers for lesbian, gay and bisexual people in Britain, HSBC was listed as one of the Top 10 Global Employers. Antonio Simoes, UK Chief Executive Officer, was listed as the most influential LGBT person in Business in The Telegraph's Out at Work Top 50, and voted Diversity Champion of the Year at the European Diversity Awards.

Improving youth employment

HSBC apprenticeship programmes are open to all from new starters to longer serving employees. Since the programme started in 2011, 2000 employees have enrolled, of whom 66 per cent are female. We believe that a major contributory factor is meeting the needs of mothers returning to work who want to gain professional qualifications.

For 14-19 year old individuals, we offer 500 work experience placements per year. We connect with 4000 schools and colleges in the UK via the Financial Sector Skills Council, to help ensure applications are received from students from as many diverse backgrounds as possible.

In 2013, HSBC established the Opportunity Partnership - a three year £30 million UK programme with four charities (St Giles Trust, Tomorrow's People, Catch 22 and The Prince's Trust), which aims to provide 25,000 unemployed young people with training and work opportunities by 2016. By June 2014, HSBC had assisted 9,000 people through the programme.

Through the Prince's Trust, HSBC connects with young people not in education, employment or training, to provide one month of training in our 'Get Into Customer Service' programme. 65 per cent of these trainees have gone on to achieve a permanent job with HSBC (exceeding our benchmark of 50 per cent), and this programme has now been extended to run nationwide in 2015.

HSBC is also a founding partner in Movement to Work, a nationwide programme to encourage the country's largest employers to provide training or work opportunities to 100,000 young people not currently in work. Antonio Simoes is one of the trustees and one HSBC staff member is currently seconded full time to Movement to Work's programme office.

In December 2014, HSBC held a reception in the Member's Dining Room of the House of Commons for our trainees, apprentices, work experience students and summer interns, sponsored by the Chair of the APPG Apprenticeships, Gordon Birtwistle MP, and attended by over 20 MPs and Peers including the Skills Minister and the Shadow Minister for Young People.

Employees with disabilities

HSBC continues to work to create an inclusive and enabling working environment for all employees. We recruit, train and develop people with disabilities, and make the appropriate reasonable adjustments to employment terms and working environments that may be needed for employees who are disabled or who become disabled during their employment. We are improving this 'reasonable adjustment' process, to ensure we provide the equipment employees require in a simpler, more streamlined and consistent approach.

We also continue our recruiting work in line with the "two tick symbol" employability campaign, to interview disabled candidates who meet the minimum criteria for any job. This symbol is a recognition given by Jobcentre Plus to employers like HSBC who have agreed to make certain positive commitments regarding the employment, retention, training and career development of people with disabilities.

In 2014, HSBC was accredited Bronze status by the Business Disability Forum, for performing above the industry benchmark.

Employee involvement

To help achieve its business goals, it is vital that HSBC involves and engages its employees.

Among various means of achieving this, coordinated communications to HSBC employees are key. A dedicated global team is responsible for strategy, alignment and delivery of all central communications to HSBC employees and supporting teams are in place.

Within HSBC's employee communications channel portfolio, the global and country staff websites are those most used by employees and therefore are the primary vehicles for systematic dissemination of news and video content relating to HSBC strategy, values, policy and employee matters and industry activity. Feedback and 'listening' channels are increasingly used to ensure communications and certain business activities are responsive to employee views and concerns.

In the UK, HSBC works with a number of employee consultation bodies, along with recognising Unite, an accredited trade union, for collective bargaining purposes for specific groups of employees. Within individual European countries there are a variety of consultation mechanisms through employee representative bodies including, in some countries, with Trade Unions.

Subject to fulfilment of a service requirement, all employees in the UK have been invited annually to participate in HSBC Holdings' Sharesave plan. The Sharesave plan provides employees with an opportunity to buy shares in HSBC Holdings plc at a future date at a discounted option price set immediately prior to the invitation period. Contributions to the Sharesave plan are made from post-tax salary. However, employees are able to buy shares from their pre-tax salary via the Share Incentive Plan up to a maximum of £150 per month. Both of these HMRC tax advantaged plans provide an accessible way for employees to have a stake in the business and the wider HSBC Group through share ownership and actively encourage employees to engage with the company's performance.

To help achieve HSBC's goals, the association between individual, team, business area and company performances must be demonstrated. Therefore, in addition to HSBC's day-to-day communications, specific mechanisms are in place to explain and familiarise employees with internal and external factors affecting the company's performance. These include regular editorials from HSBC's economists, business reviews by senior managers, financial news stories and a share price tracker. Focus is particularly given internally to HSBC's Annual and Interim Results, with dedicated communications and online content designed to provide relevance and understanding for employees.

Employee engagement

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

We regularly monitor and assess employees' engagement through our Global People Surveys, held annually from 2007 to 2011 and now bi-annually and will take place in 2015. In the UK, we also use numerous complementary programmes to involve and seek views and ideas from employees, including: Best Place to Suggest, Idea of the Month, My Health & Wellbeing, a social networking tool and regular Exchange meetings with senior managers where employees set the discussion agenda. Employees can also participate via many of HSBC's internal blogs and communications. Antonio Simoes runs his "Connected" online discussion forum, where employees hear from him on a variety of topics and are able to post their own views, ideas and comments in a lively interactive debate.

This range of feedback opportunities gives HSBC employees a voice that is heard and acted upon. Gathering and reviewing people's views enables managers and leaders to gain insights that better inform ongoing business and people decisions, actions and engagement in delivering the business goals.

Sustainability

Sustainability underpins HSBC's strategic priorities and enables the Group to fulfil its purpose as an international bank.

The way the Group does business is as important as what it does. For HSBC, sustainability means building the Group's business for the long term by balancing social, environmental and economic considerations in the decisions it makes. This enables HSBC to help businesses thrive and contribute to the health and growth of communities.

Approach to Corporate Sustainability

Corporate Sustainability is governed by the Conduct & Values Committee, a sub-committee of the HSBC Holdings Board, which oversees and advises on a range of issues including adherence to HSBC's values and ensuring we respond to the changing expectations of society and key stakeholders.

Sustainability priorities are set and programmes are led by the Global Corporate Sustainability function. HSBC's country operations, global functions and global businesses work together to ensure sustainability is embedded into the Group's business and operations and properly implemented. Executives within the Risk and the HSBC Technology and Services functions hold a specific remit to deliver aspects of the sustainability programme for the Group.

HSBC's sustainability programme focuses on three areas: sustainable finance; sustainable operations and sustainable communities.

Sustainable Finance

HSBC anticipates and manages the risks and opportunities associated with a changing climate, environment and economy. In a rapidly changing world, HSBC recognises the need to ensure the business anticipates and prepares for shifts in environmental priorities and societal expectations.

Sustainability risk framework

HSBC manages the risk that the financial services which it provides to customers may have unacceptable effects on people or the environment. Sustainability risk can also lead to commercial risk for customers, credit risk for the Group and significant reputational risk.

For over 10 years HSBC has been working with its business customers to help them understand and manage their environmental and social impact in relation to sensitive sectors and themes. HSBC assesses and supports customers using the Group's own policies which are regularly reviewed and refined. The Group has policies covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, World Heritage Sites and Ramsar Wetlands and also applies the Equator Principles.

HSBC welcomes constructive feedback from non-governmental organisations and campaign groups and regularly engages with a number of them to discuss matters of shared interest.

In 2014, HSBC published the reports of two independent reviews into the content and implementation of the Group's Forest Land and Forest Products Sector Policy, by Proforest and PricewaterhouseCoopers LLP respectively. HSBC also issued new policies on Forestry, Agricultural Commodities and World Heritage Sites and Ramsar Wetlands, reflecting the recommendations. These documents can be found online at hsbc.com/sus-risk.

Climate business

HSBC understands that in response to climate change there is a shift required towards a lower-carbon economy. HSBC is committed to accelerating that shift by supporting customers involved in 'climate business' by seeking long-term low-carbon commercial business opportunities. HSBC's climate business includes clients in the solar, wind, biomass, energy efficiency, low-carbon transport and water sectors. In 2014, HSBC's Climate Change Research team was recognised as the top team in the industry.

Sustainable Operations

Managing HSBC's own environmental footprint supports business efficiency and is part of the Group's long-term contribution to society. HSBC works together and with its suppliers to find new ways to reduce the impact of its operations on the environment. HSBC is purchasing renewable energy, designing and operating its buildings and data centres more efficiently and reducing waste. The Group has committed to cut its annual per employee carbon dioxide emissions from 3.5 to 2.5 tonnes by 2020. As part of the strategy to achieve this, HSBC has a target to increase energy consumption from renewables to 25 per cent by 2020 from zero. In 2014, HSBC signed three power purchase agreements with renewable energy generators in the UK and India. This is expected to provide 9 per cent of HSBC's energy.

Sustainable Communities

HSBC believes that education and resources such as safe water and sanitation are essential to resilient communities, which are, in turn, the basis of thriving economies and businesses.

HSBC provides financial contributions to community projects, and thousands of employees across the world get involved by volunteering their time and sharing their skills.

Every year, HSBC's UK Young People Programme donates £14 million to charities working on education, life skills and entrepreneurship. The programme helps more than 41,000 young people each year and provides volunteering opportunities for more than 2,000 employees.

As part of this programme, in April 2013 HSBC launched a three-year, £30 million Opportunity Partnership to help young people to get into education, work or training. HSBC is working with charity partners Catch22, St Giles Trust, The Prince's Trust and Tomorrow's People, which specialise in the employment, training and education of disadvantaged 16 to 25 year-olds who face difficulty at school, college or work because they lack confidence, skills or the support of a stable home. In the first eighteen months of the partnership, 28,456 16-25 year olds have been helped, with 12,905 getting into education, training or employment, against a target of 25,000 across three years.

The five-year US$100 million HSBC Water Programme aims to provide safe water to 1.1 million people and sanitation for 1.9 million people in South Asia and West Africa by working with WaterAid; protect freshwater ecosystems in some of the world's most important river basins with WWF; and enable 100,000 HSBC employees across four continents to participate in online freshwater research and learning by working with Earthwatch.

In Europe, HSBC is funding a further nine water-related projects. With the charity Global Action Plan, for example, the US$4.3 million Water Explorer education programme aims to engage and educate school children in 11 countries about the importance of water. In the UK, HSBC is funding projects with both the Wildfowl and Wetlands Trust ($1.6m) and Thames21 ($0.8m) that aim to reach over 90,000 school children, teaching them about the importance of rivers and wetlands and their role in protecting these vital resources.

Volunteering and donations

Thousands of HSBC employees globally are involved every year by volunteering for the Group's Community Investment programmes. Further detail on these programmes is available at hsbc.com and will be updated with information for 2014 in April 2015.

In 2014, the bank supported community activities in the UK through charitable donations and UK employees gave around 48,000 hours to volunteer in work time. In 2014, the UK business gave £4.2 million in charitable donations and in addition the Group Community Investment spend in the UK was £20.8 million.

Auditor

Following a tender process for the audit of HSBC Holdings plc and its subsidiaries that took place in 2013, it was recommended that PricewaterhouseCoopers LLP be appointed as auditors for HSBC Group entities effective for periods ending on or after 1 January 2015. As a result KPMG Audit plc will not be seeking re-appointment as the bank's auditor for the financial year commencing 1 January 2015. A resolution proposing the appointment of PricewaterhouseCoopers LLP as auditor of the bank and giving authority to the Directors to determine its remuneration will be submitted to the forthcoming Annual General Meeting.

Report of the Directors: Corporate Governance (continued)

Conflicts of interest and indemnification of Directors

The bank's Articles of Association give the Board authority to approve Directors' conflicts and potential conflicts of interest. The Board has adopted a policy and procedures for the approval of Directors' conflicts or potential conflicts of interest. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised, including the terms of authorisation, is undertaken by the Board annually.

The Articles of Association provide that Directors are entitled to be indemnified out of the assets of the company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

Statement on going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the group and bank have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions. Further information relevant to the assessment is provided in the 'Strategic Report' and 'Report of the Directors', in particular:

- A description of the group's strategic direction and principal risks and uncertainties.
- A summary of financial performance and review of business performance.
- The group's approach to capital management and allocation.

In addition, the objectives, policies and processes for managing credit, liquidity and market risk are set out in the *'Report of the Directors: Risk'*.

The Directors have also considered future projections of profitability, cash flows and capital resources in making their assessment.

Disclosure of information to the Auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

On behalf of the Board
Nicola Black, *Secretary*

23 February 2015

Registered number 14259

Statement of Directors' Responsibilities in Respect of the *Annual Report and Accounts 2014* and the Financial Statements

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

The Directors are responsible for preparing the *Annual Report and Accounts 2014*, comprising the consolidated financial statements of HSBC Bank plc and its subsidiaries (the 'group') and parent company financial statements for HSBC Bank plc (the 'bank') in accordance with applicable laws and regulations.

Company law requires the Directors to prepare a Strategic Report, a Report of the Directors and group and parent company financial statements for each financial year. The Directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the bank financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on a going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the bank and enable them to ensure that its financial statements comply with the Companies Act 2006.

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

The Directors have responsibility for the maintenance and integrity of the *Annual Report and Accounts* as they appear on the bank's website. UK legislation governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, the names of whom are set out in the *'Report of Directors: Governance'* section on pages 94 and 95 of this *Annual Report and Accounts 2014*, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the Disclosure Rules and Transparency Rules, the consolidated financial statements, which have been prepared in accordance with IFRSs as issued by the IASB and as endorsed by the EU, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and the undertakings included in the consolidation taken as a whole; and
- the management report represented by the Strategic Report and the Report of the Directors has been prepared in accordance with rule 4.1.12(3)(b) of the Disclosure Rules and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the bank and the undertakings included in the consolidation as a whole, together with a description of the principal risks and uncertainties that the group faces.

On behalf of the Board
Nicola Black, *Secretary* 23 February 2015

Independent Auditor's Report to the Member of HSBC Bank plc

We have audited the financial statements of HSBC Bank plc ('the bank') for the year ended 31 December 2014 set out on pages 105 to 195. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the bank's member, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the bank's member those matters we are required to state to them in an auditor's 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 and the bank's member, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 103, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2014 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Nicholas Edmonds, Senior Statutory Auditor

for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
London, England

23 February 2015

Financial Statements

Consolidated income statement for the year ended 31 December 2014

		2014 Total £m	2013 Total £m
Interest income		**9,438**	10,008
Interest expense		**(2,809)**	(3,047)
Net interest income		**6,629**	6,961
Fee income		**4,568**	4,723
Fee expense		**(1,302)**	(1,387)
Net fee income		**3,266**	3,336
Trading income excluding net interest income		**1,142**	1,694
Net interest income on trading activities		**467**	679
Net trading income		**1,609**	2,373
Net income from financial instruments designated at fair value		**371**	900
Gains less losses from financial investments		**321**	100
Dividend income		**20**	18
Net insurance premium income	*2*	**1,823**	2,022
Other operating income		**163**	158
Total operating income		**14,202**	15,868
Net insurance claims, benefits paid and movement in liabilities to policyholders	*3*	**(2,316)**	(3,028)
Net operating income before loan impairment charges and other credit risk provisions		**11,886**	12,840
Loan impairment charges and other credit risk provisions	*4*	**(449)**	(971)
Net operating income	*4*	**11,437**	11,869
Employee compensation and benefits	*5*	**(4,144)**	(3,838)
General and administrative expenses		**(4,811)**	(4,195)
Depreciation and impairment of property, plant and equipment		**(321)**	(331)
Amortisation and impairment of intangible assets		**(211)**	(211)
Total operating expenses		**(9,487)**	(8,575)
Operating profit		**1,950**	3,294
Share of profit in associates and joint ventures		**3**	–
Profit before tax		**1,953**	3,294
Tax expense	*8*	**(564)**	(754)
Profit for the year		**1,389**	2,540
Profit attributable to shareholders of the parent company		**1,354**	2,495
Profit attributable to non-controlling interests		**35**	45

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated statement of comprehensive income for the year ended 31 December 2014

	2014 Total £m	2013 Total £m
Profit for the year	**1,389**	2,540
Other comprehensive income		
Items that will be reclassified subsequently to profit or loss when specific conditions are met		
Available-for-sale investments		
– fair value gain	**1,033**	420
– fair value (gains)/losses transferred to the income statement on disposal	**(407)**	223
– amounts transferred to the income statement in respect of impairment losses	**36**	115
– income taxes	**(218)**	2
Cash flow hedges		
– fair value gains	**838**	46
– fair value (gains) transferred to the income statement	**(575)**	(423)
– income taxes	**(74)**	109
Exchange differences and other	**(820)**	39
Items that will not be reclassified subsequently to profit or loss		
Actuarial gains/(losses) on defined benefit plans		
– before income taxes	**1,638**	(957)
– income taxes	**(322)**	251
Other comprehensive income for the year, net of tax	**1,129**	(175)
Total comprehensive income for the year	**2,518**	2,365
Total comprehensive income for the year attributable to:		
– shareholders of the parent company	**2,504**	2,319
– non-controlling interests	**14**	46
	2,518	2,365

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated statement of financial position at 31 December 2014

	Notes	2014 £m	2013 £m
Assets			
Cash and balances at central banks		**42,853**	67,584
Items in the course of collection from other banks		**973**	1,948
Trading assets	*11*	**130,127**	134,097
Financial assets designated at fair value	*14*	**6,899**	16,661
Derivatives	*15*	**187,736**	137,239
Loans and advances to banks	*29*	**25,262**	23,013
Loans and advances to customers	*29*	**257,252**	273,722
Reverse repurchase agreements – non-trading	*16*	**41,945**	61,525
Financial investments	*17*	**76,194**	75,030
Prepayments, accrued income and other assets	*19*	**20,319**	12,443
Current tax assets		**190**	210
Interests in associates and joint ventures	*20*	**69**	67
Goodwill and intangible assets	*21*	**7,294**	7,934
Deferred tax assets	*8*	**176**	222
Total assets		**797,289**	811,695
Liabilities and equity			
Liabilities			
Deposits by banks	*29*	**27,590**	28,769
Customer accounts	*29*	**346,507**	346,358
Repurchase agreements – non-trading	*16*	**23,353**	65,573
Items in the course of transmission to other banks		**667**	960
Trading liabilities	*23*	**82,600**	91,842
Financial liabilities designated at fair value	*24*	**22,552**	34,036
Derivatives	*15*	**188,278**	137,352
Debt securities in issue	*29*	**27,921**	32,895
Accruals, deferred income and other liabilities	*25*	**12,417**	9,158
Current tax liabilities		**255**	89
Liabilities under insurance contracts issued	*26*	**17,522**	19,228
Provisions	*27*	**1,707**	1,707
Deferred tax liabilities	*8*	**364**	24
Subordinated liabilities	*28*	**8,858**	10,785
Total liabilities		**760,591**	778,776
Equity			
Called up share capital	*32*	**797**	797
Share premium account		**20,733**	20,427
Other equity instruments	*32*	**2,196**	-
Other reserves		**772**	921
Retained earnings		**11,580**	10,225
Total shareholders' equity		**36,078**	32,370
Non-controlling interests		**620**	549
Total equity		**36,698**	32,919
Total equity and liabilities		**797,289**	811,695

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

A P S Simoes, Director 23 February 2015

Financial Statements (continued)

Consolidated cash flow statement for the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Cash flows from operating activities			
Profit before tax		**1,953**	3,294
Adjustments for:			
– non-cash items included in profit before tax	33	**2,918**	2,684
– change in operating assets	33	**19,031**	(53,006)
– change in operating liabilities	33	**(58,960)**	61,035
– elimination of exchange differences[1]		**2,828**	(623)
– net gain from investing activities		**(359)**	(130)
– share of profit in associates and joint ventures		**(3)**	–
– contributions paid to defined benefit plans		**(254)**	(393)
– tax paid		**(579)**	(363)
Net cash (used in)/generated from operating activities		**(33,425)**	12,498
Cash flows from investing activities			
Purchase of financial investments		**(26,890)**	(32,298)
Proceeds from the sale and maturity of financial investments		**26,132**	32,472
Purchase of property, plant and equipment		**(411)**	(322)
Proceeds from the sale of property, plant and equipment		**414**	14
Purchase of goodwill and intangible assets		**(231)**	(199)
Proceeds from the sale of intangible assets		**2**	3
Net cash outflow from acquisition of businesses and subsidiaries		**(61)**	(406)
Proceeds from disposal of subsidiaries		**112**	12
Proceeds from sale of associates		**23**	–
Net cash disposed of on sale of subsidiaries		**(457)**	–
Purchases of HSBC Holdings plc shares to satisfy share-based payment transactions		**(11)**	–
Net cash used in investing activities		**(1,378)**	(724)
Cash flows from financing activities			
Issue of ordinary share capital		**306**	402
Issue of capital securities		**2,196**	–
Subordinated liabilities issued		**203**	542
Subordinated liabilities repaid		**(2,242)**	(7)
Net cash inflow from change in stake of subsidiaries		**77**	–
Dividends paid to shareholders		**(1,274)**	(2,014)
Dividends paid to non-controlling interests		**(16)**	(22)
Net cash used in financing activities		**(750)**	(1,099)
Net (decrease)/increase in cash and cash equivalents		**(35,553)**	10,675
Cash and cash equivalents at 1 January		**108,769**	98,158
Effect of exchange rate changes on cash and cash equivalents		**(1,716)**	(64)
Cash and cash equivalents at 31 December	33	**71,500**	108,769

1 *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.*

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated statement of changes in equity for the year ended 31 December 2014

					Other reserves					
	Called up Share capital	Share premium	Other equity instru-ments	Retained earnings	Available-for-sale fair value reserve	Cash flow hedging reserve[2]	Foreign exchange reserve	Total share-holders' equity	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2014	797	20,427	—	10,225	634	(13)	300	32,370	549	32,919
Profit for the year	–	–	–	1,354	–	–	–	1,354	35	1,389
Other comprehensive income (net of tax)	–	–	–	1,321	436	189	(796)	1,150	(21)	1,129
Available-for-sale investments	–	–	–	–	436	–	–	436	8	444
Cash flow hedges	–	–	–	–	–	189	–	189	–	189
Actuarial gains/(losses) on defined benefit plans	–	–	–	1,321	–	–	–	1,321	(5)	1,316
Exchange differences and other	–	–	–	–	–	–	(796)	(796)	(24)	(820)
Total comprehensive income for the year	–	–	–	2,675	436	189	(796)	2,504	14	2,518
Share capital issued, net of costs[1]	–	306	–	–	–	–	–	306	–	306
Capital securities issued[1]	–	–	2,196	–	–	–	–	2,196	–	2,196
Dividends to shareholders	–	–	–	(1,274)	–	–	–	(1,274)	(16)	(1,290)
Net impact of equity-settled share-based payments	–	–	–	15	–	–	–	15	–	15
Acquisitions and disposals	–	–	–	–	–	–	22	22	–	22
Change in business combinations and other movements	–	–	–	(61)	–	–	–	(61)	73	12
Tax on items taken directly to equity	–	–	–	–	–	–	–	–	–	–
At 31 December 2014	**797**	**20,733**	**2,196**	**11,580**	**1,070**	**176**	**(474)**	**36,078**	**620**	**36,698**
At 1 January 2013	797	20,025	—	10,459	(131)	259	266	31,675	525	32,200
Profit for the year	—	—	—	2,495	—	—	—	2,495	45	2,540
Other comprehensive income (net of tax)	—	—	—	(707)	765	(268)	34	(176)	1	(175)
Available-for-sale investments	—	—	—	—	765	—	—	765	(5)	760
Cash flow hedges	—	—	—	—	—	(268)	—	(268)	—	(268)
Actuarial gains/(losses) on defined benefit plans	—	—	—	(707)	—	—	—	(707)	1	(706)
Exchange differences and other	—	—	—	—	—	—	34	34	5	39
Total comprehensive income for the year	—	—	—	1,788	765	(268)	34	2,319	46	2,365
Share capital issued, net of costs[1]	—	402	—	—	—	—	—	402	—	402
Dividends to shareholders	—		—	(2,014)	—	—	—	(2,014)	(22)	(2,036)
Net impact of equity-settled share-based payments	—	—	—	4	—	—	—	4	—	4
Change in business combinations and other movements	—	—	—	(11)	—	(4)	—	(15)	—	(15)
Tax on items taken directly to equity	—	—	—	(1)	—	—	—	(1)	—	(1)
At 31 December 2013	797	20,427	—	10,225	634	(13)	300	32,370	549	32,919

1 *All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 32 for further details.*
2 *Movements in the cash flow hedging reserve include amounts transferred to the income statement of £575 million (2013:£423 million) comprising a £250 million loss (2013: £232 million loss) taken to 'Net interest income' and a £325 million loss (2013 £191 million loss) taken to 'Net trading income'.*

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

Financial Statements (continued)

HSBC Bank plc statement of financial position at 31 December 2014

	Notes	2014 £m	2013 £m
Assets			
Cash and balances at central banks		**41,424**	60,996
Items in the course of collection from other banks		**630**	1,374
Trading assets	*11*	**97,757**	101,287
Financial assets designated at fair value	*14*	**9**	3,983
Derivatives	*15*	**160,232**	112,623
Loans and advances to banks	*29*	**18,776**	16,332
Loans and advances to customers	*29*	**201,671**	217,567
Reverse repurchase agreements – non-trading	*16*	**36,391**	47,847
Financial investments	*17*	**48,438**	45,048
Prepayments, accrued income and other assets	*19*	**12,908**	8,201
Current tax assets		**125**	424
Interests in associates and joint ventures	*20*	**62**	62
Investments in subsidiary undertakings	*22*	**11,339**	11,206
Goodwill and intangible assets	*21*	**948**	891
Deferred tax assets	*8*	**5**	88
Total assets		**630,715**	627,929
Liabilities and equity			
Liabilities			
Deposits by banks	*29*	**31,383**	32,456
Customer accounts	*29*	**282,687**	280,940
Repurchase agreements – non-trading	*16*	**18,293**	51,198
Items in the course of transmission to other banks		**336**	422
Trading liabilities	*23*	**59,039**	62,414
Financial liabilities designated at fair value	*24*	**16,127**	22,006
Derivatives	*15*	**161,442**	114,710
Debt securities in issue	*29*	**14,950**	19,576
Accruals, deferred income and other liabilities	*25*	**5,289**	5,695
Current tax liabilities		**160**	142
Provisions	*27*	**1,345**	1,271
Deferred tax liabilities	*8*	**345**	2
Subordinated liabilities	*28*	**7,854**	9,903
Total liabilities		**599,250**	600,735
Equity			
Called up share capital	*32*	**797**	797
Share premium account		**20,733**	20,427
Other equity instruments	*32*	**2,196**	-
Other reserves		**389**	(372)
Retained earnings		**7,350**	6,342
Total equity		**31,465**	27,194
Total equity and liabilities		**630,715**	627,929

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

A P S Simoes, Director

23 February 2015

Financial Statements (continued)

HSBC Bank plc cash flow statement for the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Cash flows from operating activities			
Profit before tax		**1,367**	2,913
Adjustments for:			
– non-cash items included in profit before tax	33	**2,527**	2,008
– change in operating assets	33	**18,204**	(52,222)
– change in operating liabilities	33	**(43,561)**	67,495
– elimination of exchange differences[1]		**1,703**	1,407
– net gain from investing activities		**(433)**	(117)
– contributions paid to defined benefit plans		**(242)**	(387)
– tax paid		**(308)**	(169)
Net cash (used in)/generated from operating activities		**(20,743)**	20,928
Cash flows from investing activities			
Purchase of financial investments		**(19,253)**	(28,472)
Proceeds from the sale and maturity of financial investments		**16,188**	19,488
Purchase of property, plant and equipment		**(260)**	(227)
Proceeds from the sale of property, plant and equipment		**401**	3
Purchase of goodwill and intangible assets		**(182)**	(184)
Net cash outflow from acquisition of businesses and subsidiaries		**(61)**	(406)
Proceeds from disposal and liquidation of businesses		**112**	447
Net cash used in investing activities		**(3,055)**	(9,351)
Cash flows from financing activities			
Issue of ordinary share capital		**306**	402
Issue of capital securities		**2,196**	–
Subordinated liabilities issued		**–**	542
Subordinated liabilities repaid		**(2,203)**	(542)
Net cash outflow from increase in stake of subsidiaries		**(244)**	(207)
Dividends paid to shareholders		**(1,271)**	(2,011)
Net cash used in financing activities		**(1,216)**	(1,816)
Net (decrease)/increase in cash and cash equivalents		**(25,014)**	9,761
Cash and cash equivalents at 1 January		**88,017**	78,661
Effect of exchange rate changes on cash and cash equivalents		**(1,061)**	(405)
Cash and cash equivalents at 31 December	33	**61,942**	88,017

1 *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.*

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

HSBC Bank plc statement of changes in equity for the year ended 31 December 2014

	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Other reserves: Available-for-sale fair value reserve £m	Other reserves: Cash flow hedging reserve[2] £m	Other reserves: Foreign exchange reserve £m	Total equity £m
At 1 January 2014	**797**	**20,427**	**–**	**6,342**	**(317)**	**(8)**	**(47)**	**27,194**
Profit for the year	**–**	**–**	**–**	**975**	**–**	**–**	**–**	**975**
Other comprehensive income (net of tax)	**–**	**–**	**–**	**1,353**	**656**	**108**	**(3)**	**2,114**
Available-for-sale investments	**–**	**–**	**–**	**–**	**656**	**–**	**–**	**656**
Cash flow hedges	**–**	**–**	**–**	**–**	**–**	**108**	**–**	**108**
Actuarial gains on defined benefit plans	**–**	**–**	**–**	**1,353**	**–**	**–**	**–**	**1,353**
Exchange differences and other	**–**	**–**	**–**	**–**	**–**	**–**	**(3)**	**(3)**
Total comprehensive income for the year	**–**	**–**	**–**	**2,328**	**656**	**108**	**(3)**	**3,089**
Share capital issued, net of costs[1]	**–**	**306**	**–**	**–**	**–**	**–**	**–**	**306**
Capital securities issued[1]	**–**	**–**	**2,196**	**–**	**–**	**–**	**–**	**2,196**
Dividends to shareholders	**–**	**–**	**–**	**(1,271)**	**–**	**–**	**–**	**(1,271)**
Net impact of equity-settled share-based payments	**–**	**–**	**–**	**12**	**–**	**–**	**–**	**12**
Change in business combinations and other movements	**–**	**–**	**–**	**(61)**	**–**	**–**	**–**	**(61)**
Tax on items taken directly to equity	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2014	**797**	**20,733**	**2,196**	**7,350**	**339**	**100**	**(50)**	**31,465**
At 1 January 2013	797	20,025	–	6,588	(377)	167	(133)	27,067
Profit for the year	–	–	–	2,485	–	–	–	2,485
Other comprehensive income (net of tax)	–	–	–	(709)	62	(175)	86	(736)
Available-for-sale investments	–	–	–	–	62	–	–	62
Cash flow hedges	–	–	–	–	–	(175)	–	(175)
Actuarial gains on defined benefit plans	–	–	–	(709)	–	–	–	(709)
Exchange differences and other	–	–	–	–	–	–	86	86
Total comprehensive income for the year	–	–	–	1,776	62	(175)	86	1,749
Share capital issued, net of costs[1]	–	402	–	–	–	–	–	402
Dividends to shareholders	–	–	–	(2,011)	–	–	–	(2,011)
Net impact of equity-settled share-based payments	–	–	–	(3)	–	–	–	(3)
Change in business combinations and other movements	–	–	–	(8)	(2)	–	–	(10)
Tax on items taken directly to equity	–	–	–	–	–	–	–	–
At 31 December 2013	797	20,427	–	6,342	(317)	(8)	(47)	27,194

1 *All new capital subscribed during the year was issued to HSBC Holdings plc. See Note 32 for further details.*
2 *Movements in the cash flow hedging reserve include amounts transferred to the income statement of £496 million (2013:£317 million) comprising a £213 million loss (2013: £181 million loss) taken to 'Net interest income' and a £283 million loss (2013 £131 million loss) taken to 'Net trading income'.*

The accompanying notes on pages 113 to 195 and the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83 and the 'Report of the Directors: Capital Management' on pages 84 to 93 form an integral part of these financial statements.

Notes on the Financial Statements

1 Basis of preparation and significant accounting policies

(a) Compliance with International Financial Reporting Standards

International Financial Reporting Standards ('IFRSs') comprise accounting standards issued or adopted by the International Accounting Standards Board ('IASB') as well as interpretations issued or adopted by the IFRS Interpretations Committee ('IFRS IC').

The consolidated financial statements of the group and the separate financial statements of HSBC Bank plc have been prepared in accordance with IFRSs as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs could differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs were not to be endorsed by the EU.

At 31 December 2014, there were no unendorsed standards effective for the year ended 31 December 2014 affecting these consolidated and separate financial statements and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2014 are prepared in accordance with IFRSs as issued by the IASB.

Standards adopted during the year ended 31 December 2014

There were no new standards applied during the year ended 31 December 2014.

On 1 January 2014, the group applied 'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)', which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments were applied retrospectively and did not have a material effect on the group's financial statements.

During 2014, HSBC adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc.

(b) Future accounting developments

In addition to the projects to complete financial instrument accounting, discussed below, the IASB is working on projects on insurance and lease accounting which could represent significant changes to accounting requirements in the future.

Standards and amendments issued by the IASB and endorsed by the EU but effective after 31 December 2014

During 2014, the EU endorsed the amendments issued by IASB through the Annual Improvements to IFRSs 2010-2012 Cycle and the 2011-2013 Cycle, and a narrow-scope amendment to IAS 19 Employee Benefits. The group has not early applied any of these amendments and it expects they will have an immaterial effect, when applied, on the consolidated financial statements of the group and the separate statements of HSBC Bank plc.

Standards and amendments issued by the IASB but not endorsed by the EU

In May 2014, the IASB issued IFRS 15 'Revenue from Contracts with Customers'. The standard is effective for annual periods beginning on or after 1 January 2017 with early adoption permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these financial statements.

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss. In many instances, the classification and measurement outcomes will be similar to IAS 39, although differences will arise, for example, since IFRS 9 does not apply embedded derivative accounting to financial assets and equity securities will be measured at fair value through profit or loss or, in limited circumstances, at fair value through other comprehensive income. The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12 month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk, and the estimation of ECL, are required to be unbiased and probability-weighted and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting.

Transition

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date. The group intends to revise the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities as soon as permitted by EU law. If this presentation were applied at 31 December 2014, the effect would be to a decrease profit before tax with the opposite effect on other comprehensive income based on the change in fair value attributable to changes in the group's credit risk for the year, with no effect on net assets. Further information on change in fair value attributable to changes in credit risk, including the group's credit risk, is disclosed in Note 12.

The group is assessing the impact that the rest of IFRS 9 will have on the financial statements through a group-wide project which has been in place since 2012, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible at this stage to quantify the potential effect.

(c) Changes to the presentation of the Financial Statements and Notes on the Financial Statements

In order to make the financial statements and notes thereon easier to understand, the group has changed the location and the wording used to describe certain accounting policies within the notes, removed certain immaterial disclosures and changed the order of certain sections. In applying materiality to financial statement disclosures, we consider both the amount and nature of each item. The main changes to the presentation of the financial statements and notes thereon in 2014 are as follows:

- Consolidated balance sheet and consolidated statement of changes in equity: rationalised separate line item disclosure to focus on material information.
- Credit risk: changed the order of the section and certain disclosures to remove duplication and focus on material information.
- Note 2 Summary of significant accounting policies: accounting policies have been placed, whenever possible, within the relevant Notes on the Financial Statements, and the changes in wording are intended to more clearly set out the accounting policies. These changes in the wording do not represent changes in accounting policies.
- Critical accounting policies: replaced 'Critical accounting policies' with 'Critical accounting estimates and judgements' and placed them within the relevant notes alongside the significant accounting policy to which they relate. The new approach meets the reporting requirements of IAS 1 'Presentation of Financial Statements'.
- Note 5 Employee compensation and benefits: rationalised to remove duplication and focus on material information.
- Note 35 Lease commitments: rationalised to focus on material information.

Notes on the Financial Statements (continued)

- In 2013, the financial statements included Note 14 Analysis of financial assets and liabilities by measurement basis and Note 22 Property, Plant and equipment. In 2014, separate notes for these areas have been removed and relevant information incorporated into other notes.
- In 2013, the financial statements included Note 19 Transfers of financial assets and Note 36 Assets charged as security for liabilities and collateral accepted as security for assets. In 2014, the relevant information for these areas has been included in a single Note 18 Assets charged as security for liabilities, assets transferred and collateral accepted as security for assets.

From 1 January 2014, the group has chosen to present non-trading reverse repos and repos separately on the face of the balance sheet. These items are classified for accounting purposes as loans and receivables or financial liabilities measured at amortised cost. Previously, they were presented on an aggregate basis together with other loans or deposits measured at amortised cost under the following headings in the consolidated balance sheet: 'Loans and advances to banks', 'Loans and advances to customers', 'Deposits by banks' and 'Customer accounts'. The separate presentation aligns disclosure of reverse repos and repos with market practice and provides more meaningful information in relation to loans and advances. Further explanation is provided in Note 16.

(d) Presentation of information

Disclosures under IFRS 4 'Insurance Contracts' and IFRS 7 'Financial Instruments: Disclosures' concerning the nature and extent of risks relating to insurance contracts and financial instruments have been included in the audited sections of the 'Report of the Directors: Risk' on pages 31 to 83.

Capital disclosures under IAS 1 'Presentation of Financial Statements' have been included in the audited sections of 'Report of the Directors: Capital' on pages 84 to 93.

Disclosures relating to the group's securitisation activities and structured products have been included in the audited section of 'Report of the Directors: Risk' on pages 58.

In publishing the parent company financial statements together with the group financial statements, the bank has taken advantage of the exemption in section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes.

The functional currency of the bank is Sterling, which is also the presentation currency of the consolidated financial statements of the group.

(e) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items listed below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in materially different conclusions from those reached by management for the purposes of the 2014 Financial Statements. Management's selection of the group's accounting policies which contain critical estimates and judgements is listed below; it reflects the materiality of the items to which the policies are applied, the high degree of judgement and estimation uncertainty involved:

- Impairment of loans and advances: Note 1(j);
- Valuation of financial instruments: Note 12;
- Goodwill impairment: Note 21;
- Provisions: Note 27;

(f) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

Notes on the Financial Statements (continued)

(g) Consolidation and related disclosures

The group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup.

Where an entity is governed by voting rights, the group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over the relevant activities or holding the power as agent or principal.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of the group's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. For acquisitions achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in the income statement.

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements of the group also include the attributable share of the results and reserves of joint ventures and associates, based on either financial statements made up to 31 December or pro-rated amounts adjusted for any material transactions or events occurred between the date of financial statements available and 31 December.

(h) Foreign currencies

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the income statement depending where the gain or loss on the underlying non-monetary item is recognised.

In the consolidated financial statements, the assets and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not Sterling, are translated into the group's presentation currency at the rate of exchange at the balance sheet date, while their results are translated into Sterling at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net assets, and the retranslation of the results for the reporting period from the average rate to the exchange rate at the period end, are recognised in other comprehensive income. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements and in other comprehensive income in consolidated financial statements. On disposal of a foreign operation, exchange differences previously recognised in other comprehensive income are reclassified to the income statement as a reclassification adjustment.

(i) Loans and advances to banks and customers

These include loans and advances originated by the group, not classified as held for trading or designated at fair value. They are recognised when cash is advanced to a borrower and are derecognised when either the borrower repays its obligations, or the loans are sold, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment allowance.

Loans and advances are reclassified to 'Assets held for sale' when they meet the criteria presented in Note 19; however, their measurement continues to be in accordance with this policy.

The group may commit to underwrite loans on fixed contractual terms for specified periods of time. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative. On drawdown, the loan is classified as held for trading. Where the group intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the group will incur a loss. On inception of the loan, the loan to be held is recorded at its fair value and subsequently measured at amortised cost. For certain transactions, such as leveraged finance and syndicated lending activities, the cash advanced may not be the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced, the difference is charged to the income statement in other operating income. The write-down will be recovered over the life of the loan, through the recognition of interest income, unless the loan becomes impaired.

(j) Impairment of loans and advances and available-for-sale financial assets

Critical accounting estimates and judgements

Impairment of loans and advances

Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet date. Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances.

Collective impairment allowances are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis due to the large number of individually insignificant loans in the portfolio. The estimation methods include the use of statistical analyses of historical information, supplemented with significant management judgement, to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than historical experience.

Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. Different factors are applied in different regions and countries to reflect local economic conditions, laws and regulations. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

For individually assessed loans, judgement is required in determining whether there is objective evidence that a loss event has occurred and, if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, including the consideration of whether payments are contractually past-due and the consideration of other factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

The group might provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximise collection opportunities or avoid default or repossession. Where forbearance activities are significant, higher levels of judgment and estimation uncertainty are involved in determining their effects on loan impairment allowances. Judgements are involved in differentiating the credit risk characteristics of forbearance cases, including those which return to performing status following renegotiation. Where collectively assessed loan portfolios include significant levels of loan forbearance, portfolios are segmented to reflect their specific credit risk characteristics, and estimates are made of the incurred losses inherent within each forbearance portfolio segments. Forbearance activities take place in both retail and wholesale loan portfolios.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive.

Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances that are calculated on individual loans or on groups of loans assessed collectively, are recorded as charges to the income statement and are recorded against the carrying amount of impaired loans on the balance sheet. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include the size of the loan, the number of loans in the portfolio, and the importance of the individual loan relationship, and how this is managed (see below).

Loans that meet these criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

Notes on the Financial Statements (continued)

Loans considered as individually significant are typically to corporate and commercial customers, are for larger amounts and are managed on an individual basis. For these loans, the group considers on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used to make this assessment include:

– known cash flow difficulties experienced by the borrower;
– contractual payments of either principal or interest being past due for more than 90 days;
– the probability that the borrower will enter bankruptcy or other financial realisation;
– a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
– there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

– the group's aggregate exposure to the customer;
– the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
– the amount and timing of expected receipts and recoveries;
– the likely dividend available on liquidation or bankruptcy;
– the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the group and the likelihood of other creditors continuing to support the company;
– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
– the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
– the likely costs of obtaining and selling collateral as part of foreclosure;
– the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
– when available, the secondary market price of the debt.

The determination of the realisable value of security is based on the market value at the time the impairment assessment is performed. The value is not adjusted for expected future changes in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require.

Collectively assessed loans and advances

Impairment is assessed collectively to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment or for homogeneous groups of loans that are not considered individually significant.

Retail lending portfolios are generally assessed for impairment collectively as the portfolio are generally large homogeneous loan pools.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This assessment captures impairment losses that the group has incurred as a result of events occurring before the balance sheet date, which the group is not able to identify on an individual loan basis, and that can be reliably estimated. When information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed individually.

The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);
– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

– management's judgment as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio based on economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period may vary over time as these factors change.

Homogeneous groups of loans and advances

Statistical methods are used to determine collective impairment losses for homogeneous groups of loans not considered individually significant. Losses in these groups of loans are recorded individually when individual loans are removed from the group and written off. The methods that are used to calculate collective allowances are:

– When appropriate empirical information is available, the group utilises roll-rate methodology, which employs statistical analyses of historical data and experience of delinquency and default to reliably estimate the amount of the loans that will eventually be written off as a result of the events occurring before the balance sheet date but which the group is not able to identify individually. Individual loans are grouped using ranges of past due days; statistical analysis is then used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and become irrecoverable. Additionally, individual loans are segmented based on their credit characteristics as described above. In applying this methodology, adjustments are made to estimate the periods of time between a loss event occurring and its discovery, for example through a missed payment, (known as the emergence period) and the period of time between discovery and write-off (known as the outcome period). Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.

– When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, the group adopts a basic formulaic approach based on historical loss rate experience, or a discounted cash flow model. Where a basic formulaic approach is undertaken, the period between a loss event occurring and its identification is explicitly estimated by local management and it is typically between six and twelve months.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date.

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as 'Assets held for sale' and reported in 'Other assets' if those assets are classified as held for sale. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Impairments and reversal of previous impairments are recognised in the income statement, in 'Other operating income', together with any realised gains or losses on disposal.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments required have been received. They are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. Any new agreements arising due to derecognition events will continue to be disclosed as renegotiated loans.

Impairment of available-for-sale financial assets

Available-for-sale financial assets are assessed at each balance sheet date for objective evidence of impairment. If such evidence exists as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact, which can be reliably measured, on the estimated future cash flows of the financial asset an impairment loss is recognised.

If the available-for-sale financial asset is impaired, the difference between its acquisition cost (net of any principal repayments and amortisation) and its current fair value, less any previous impairment loss recognised in the income statement, is recognised in the income statement.

Impairment losses are recognised in the income statement within 'Loan impairment charges and other credit risk provisions' for debt instruments and within 'Gains less losses from financial investments' for equities. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

– **Available-for-sale debt securities.** In assessing objective evidence of impairment at the reporting date, the group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in the recovery of future cash flows. Financial difficulties of the issuer, as well as other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment.

  In addition, the performance of underlying collateral and the extent and depth of market price declines is relevant when assessing objective evidence of impairment of available-for-sale ABSs. The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security, while changes in credit ratings are of secondary importance.

– **Available-for-sale equity securities.** Objective evidence of impairment may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

  A significant or prolonged decline in the fair value of the equity below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the continuous period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the type of asset:

– for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, or the instrument is no longer impaired, the impairment loss is reversed through the income statement;

– for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement, to the extent that further cumulative impairment losses have been incurred.

(k) Funding fair value adjustment

– In line with evolving market practice the group revised its estimation methodology for valuing the uncollateralised derivative portfolios by introducing a funding fair value adjustment ('FFVA'). The FFVA adjustment reflects the estimated present value of the future market funding cost or benefit associated with funding uncollateralised derivative exposure at rates other than the Overnight Index Swap ('OIS') rate. OIS is the benchmark rate used for valuing collateralised derivatives. The impact of introducing FFVA in the 2014 consolidated financial statements is a reduction in net trading income of £152 million. Further details have been provided in Note 12 to the Financial Statements.

(l) Operating income

Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (except for debt securities issued by the group and derivatives managed in conjunction with those debt securities) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective

Notes on the Financial Statements (continued)

interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expense

Fee income is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);

– income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

– income that forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income'.

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends.

Net income from financial instruments designated at fair value includes:

– all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value through profit or loss, including liabilities under investment contracts;

– all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets or liabilities designated at fair value through profit or loss; and

– interest income, interest expense and dividend income in respect of

  - financial assets and liabilities designated at fair value through profit or loss; and
  - derivatives managed in conjunction with the above,
  - except for interest arising from the group's issued debt securities and derivatives managed in conjunction with those debt securities, which is included in 'Interest expense'.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

The accounting policies for **net insurance premium income** are disclosed in Note 2.

Notes on the Financial Statements (continued)

2 Net insurance premium income

Accounting policy

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

Net earned insurance premium income

	Non-linked Insurance[1] £m	Linked life insurance £m	Investment contracts with DPF[2] features £m	Total £m
Gross insurance premium income	**262**	**183**	**1,498**	**1,943**
Reinsurers' share of gross premium income	**(116)**	**(4)**	**–**	**(120)**
Year ended 31 December 2014	**146**	**179**	**1,498**	**1,823**
Gross insurance premium income	310	314	1,526	2,150
Reinsurers' share of gross premium income	(124)	(4)	–	(128)
Year ended 31 December 2013	186	310	1,526	2,022

1 Includes non-life insurance.
2 Discretionary participation features.

3 Net insurance claims, benefits paid and movement in liabilities to policyholders

Accounting policy

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

Net insurance claims, benefits paid and movement in liabilities to policyholders

	Non-linked Insurance[1] £m	Linked life Insurance £m	Investment contracts with DPF[2] features £m	Total £m
Claims, benefits and surrenders paid	**140**	**247**	**1,407**	**1,794**
Movement in liabilities	**83**	**37**	**526**	**646**
Gross claims, benefits paid and movement in liabilities	**223**	**284**	**1,933**	**2,440**
Reinsurers' share of claims, benefits and surrenders paid	**(80)**	**(3)**	**–**	**(83)**
Reinsurers' share of movement in liabilities	**(37)**	**(4)**	**–**	**(41)**
Reinsurers' share of claims, benefits paid and movement in liabilities	**(117)**	**(7)**	**–**	**(124)**
Year ended 31 December 2014	**106**	**277**	**1,933**	**2,316**
Claims, benefits and surrenders paid	141	197	1,473	1,811
Movement in liabilities	48	388	877	1,313
Gross claims, benefits paid and movement in liabilities	189	585	2,350	3,124
Reinsurers' share of claims, benefits and surrenders paid	(76)	(3)	–	(79)
Reinsurers' share of movement in liabilities	(7)	(10)	–	(17)
Reinsurers' share of claims, benefits paid and movement in liabilities	(83)	(13)	–	(96)
Year ended 31 December 2013	106	572	2,350	3,028

1 Includes non-life insurance.
2 Discretionary participation features.

Notes on the Financial Statements (continued)

4 Operating profit

Operating profit is stated after the following items of income, expense, gains and losses, and loan impairment charges and other credit risk provisions:

	2014 £m	2013 £m
Income		
Interest recognised on impaired financial assets	**70**	47
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**2,822**	3,043
Fees earned on trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**680**	703
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**2,508**	2,714
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**523**	511
Fees payable on trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**1**	1
Payments under lease and sublease agreements	**174**	186
Minimum lease payments	**172**	184
Contingent rents and sublease payments	**2**	2
Gains/(losses)		
Impairment of available-for-sale equity shares	**(26)**	(36)
Gains on disposal or settlement of loans and advances	**–**	3
Gains/(losses) on financial liabilities measured at amortised cost	**60**	(5)
Losses recognised on assets held for sale	**(8)**	–
Gains/(losses) on disposal of property, plant and equipment, intangible assets and non-financial investments	**11**	(7)
Loan impairment charges and other credit risk provisions	**(449)**	(971)
Net impairment charge on loans and advances	**(647)**	(1,102)
Net impairment of available-for-sale debt securities	**203**	136
Net impairment in respect of other credit risk provisions	**(5)**	(5)

5 Employee compensation and benefits

Total employee compensation

	2014 £m	2013 £m
Wages and salaries	**3,357**	3,358
Social security costs	**468**	475
Post-employment benefits	**319**	5
Year ended 31 December	**4,144**	3,838

Average number of persons employed by the group during the year

	2014	2013
Retail Banking and Wealth Management	**29,763**	30,991
Commercial Banking	**8,717**	8,744
Global Banking and Markets	**6,795**	6,975
Global Private Banking	**833**	738
Other	**21,927**	22,376
Year ended 31 December	**68,035**	69,824

Notes on the Financial Statements (continued)

Post-employment benefit plans

Accounting policy

The group operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment healthcare.

Payments to defined contribution plans and state-managed retirement benefit plans, where the group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as the employees render service.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the schemes' actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses.

The past service cost which is charged immediately to the income statement, is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or curtailment (a significant reduction by the entity in the number of employees covered by a plan). A settlement is a transaction that eliminates all further legal and constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income.

Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions.

The defined benefit liability recognised on the balance sheet represents the present value of defined benefit obligations reduced by the fair value of plan assets. Any net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment defined benefit plans, such as defined benefit health-care plans, are accounted for on the same basis as defined benefit pension plans.

Income statement charge

	2014 £m	2013 £m
Defined benefit pension plans		
- HSBC Bank (UK) Pension Scheme	**96**	(198)
- Other plans	**20**	21
Defined contribution pension plans	**196**	175
Pension plans	**312**	(2)
Defined benefit healthcare plans	**7**	7
Year ended 31 December	**319**	5

Net assets/(liabilities) recognised on the balance sheet in respect of defined benefit plans

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Total £m
At 31 December 2014			
HSBC Bank (UK) Pension Scheme	**22,611**	**(19,555)**	**3,056**
Other defined benefit pension plans	**364**	**(581)**	**(217)**
Defined benefit healthcare plans	**–**	**(113)**	**(113)**
Total	**22,975**	**(20,249)**	**2,726**
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			**(333)**
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			**3,059**
At 31 December 2013			
HSBC Bank (UK) Pension Scheme	19,156	(17,922)	1,234
Other defined benefit pension plans	354	(547)	(193)
Defined healthcare plans	–	(125)	(125)
Total	19,510	(18,594)	916
Total employee benefit liabilities (within 'Accruals, deferred income and other liabilities')			(318)
Total employee benefit assets (within 'Prepayments, accrued income and other assets')			1,234

Notes on the Financial Statements (continued)

Cumulative actuarial gains/(losses) recognised in other comprehensive income

	2014 £m	2013 £m
At 1 January	**(1,365)**	(408)
HSBC Bank (UK) Pension Scheme	**1,678**	(973)
Other plans	**(52)**	2
Healthcare plans	**12**	14
Total actuarial gains/(losses) recognised in other comprehensive income for the year	**1,638**	(957)
At 31 December	**273**	(1,365)

Pension plans

Defined benefit pension arrangements for bank employees who are members of defined benefit pension plans, as well as certain other employees of the group and HSBC, are provided principally by the HSBC Bank (UK) Pension Scheme (the 'Scheme'), the assets of which are held in a separate trust fund. The Pension Scheme is administered by a corporate trustee, HSBC Bank Pension Trust (UK) Limited (the 'Trustee'), whose Board is comprised of 13 Directors, four of whom are elected by employees and two by pensioners. The Trustee Directors of the Pension Scheme are required to act in the best interest of the Scheme's beneficiaries.

Post-employment defined benefit plans' principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the group's obligations under its UK defined benefit pension and post-employment healthcare plans at 31 December were as follows. These assumptions will also form the basis for measuring periodic costs under the plans in the following year:

	Discount rate %	Inflation rate %	Rate of increase for pensions %	Rate of pay Increase %	Healthcare cost trend rates %
2014	**3.70**	**3.20**	**3.00**	**3.70**	**6.90**
2013	4.45	3.60	3.30	4.10	7.10

The group determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of the current average yield of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations.

The mortality tables used and implied average life expectancy at 65 in the UK at 31 December were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
2014	SAPS S1[1]	**23.6**	**25.2**	**25.0**	**26.9**
2013	SAPS S1[1]	23.6	25.2	24.9	26.8

1 *Adjusted SAPS S1 with CMI_2014 improvements (2013: CMI_2013 improvements) and a 1.25 per cent long-term annual improvement. Light table with 1.01 rating for male pensioners and 1.07 rating for female pensioners.*

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions on the principal plan:

	HSBC Bank (UK) Pension Scheme	
	2014	2013
	£m	£m
Discount rate		
Change in pension obligation at year end from a 25bps increase	**(911)**	(818)
Change in pension obligation at year end from a 25bps decrease	**977**	877
Change in following year pension cost from a 25bps increase	**(48)**	(49)
Change in following year pension cost from a 25bps decrease	**47**	49
Rate of inflation		
Change in pension obligation at year end from a 25bps increase	**658**	601
Change in pension obligation at year end from a 25bps decrease	**(760)**	(688)
Change in following year pension cost from a 25bps increase	**28**	33
Change in following year pension cost from a 25bps decrease	**(31)**	(36)
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at year end from a 25bps increase	**762**	787
Change in pension obligation at year end from a 25bps decrease	**(723)**	(741)
Change in following year pension cost from a 25bps increase	**32**	41
Change in following year pension cost from a 25bps decrease	**(29)**	(38)
Rate of pay increase		
Change in pension obligation at year end from a 25bps increase	**152**	128
Change in pension obligation at year end from a 25bps decrease	**(149)**	(124)
Change in following year pension cost from a 25bps increase	**8**	10
Change in following year pension cost from a 25bps decrease	**(7)**	(9)
Mortality		
Change in pension obligation from each additional year of longevity assumed	**493**	431

Defined benefit pension plans

Net asset/(liability) under defined benefit pension plans

	Fair value of plan assets		Present value of defined benefit obligations		Net benefit asset/(liability)	
	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m
Net defined benefit liability at 1 January 2014	**19,156**	**354**	**(17,922)**	**(547)**	**1,234**	**(193)**
Current service cost	**–**	**–**	**(138)**	**(18)**	**(138)**	**(18)**
Past service cost and (gains)/ losses from settlements	**–**	**–**	**(16)**	**1**	**(16)**	**1**
Service cost	**–**	**–**	**(154)**	**(17)**	**(154)**	**(17)**
Net interest (income)/cost on the net defined benefit liability	**842**	**11**	**(784)**	**(16)**	**58**	**(5)**
Re–measurement effects recognised in other comprehensive income	**2,954**	**10**	**(1,276)**	**(62)**	**1,678**	**(52)**
- return on plan assets (excluding interest income)	**2,954**	**10**	**–**	**–**	**2,954**	**10**
- actuarial losses	**–**	**–**	**(1,408)**	**(55)**	**(1,408)**	**(55)**
- other changes	**–**	**–**	**132**	**(7)**	**132**	**(7)**
Exchange differences	**–**	**(24)**	**–**	**49**	**–**	**25**
Contributions by the group	**240**	**14**	**–**	**–**	**240**	**14**
- normal	**160**	**14**	**–**	**–**	**160**	**14**
- special	**80**	**–**	**–**	**–**	**80**	**–**
Contributions by employees	**23**	**–**	**(23)**	**(7)**	**–**	**(7)**
Benefits paid	**(580)**	**(1)**	**580**	**19**	**–**	**18**
Administrative costs paid by the plan	**(24)**	**–**	**24**	**–**		**–**
At 31 December 2014	**22,611**	**364**	**(19,555)**	**(581)**	**3,056**	**(217)**
Present value of defined benefit obligation relating to :						
actives	**–**	**–**	**(6,276)**	**(374)**	**–**	**–**
deferreds	**–**	**–**	**(5,645)**	**(73)**	**–**	**–**
pensioners	**–**	**–**	**(7,634)**	**(134)**	**–**	**–**

Notes on the Financial Statements (continued)

	Fair value of plan assets		Present value of defined benefit obligations		Net benefit asset/(liability)	
	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m
Net defined benefit liability at 1 January 2013	17,999	298	(16,380)	(478)	1,619	(180)
Current service cost	–	–	(167)	(13)	(167)	(13)
Past service cost and (gains)/ losses from settlements	–	–	280	(3)	280	(3)
Service cost	–	–	113	(16)	113	(16)
Net interest (income)/cost on the net defined benefit liability	806	8	(721)	(13)	85	(5)
Re–measurement effects recognised in other comprehensive income	524	5	(1,497)	(3)	(973)	2
- return on plan assets (excluding interest income)	524	5	–	–	524	5
- actuarial losses	–	–	(1,569)	(5)	(1,569)	(5)
- other changes	–	–	72	2	72	2
Exchange differences	–	38	–	(45)	–	(7)
Contributions by the group	387	6			387	6
- normal	207	6	–	–	207	6
- special	180	–	–	–	180	–
Contributions by employees	24	–	(24)	(5)	–	(5)
Benefits paid	(562)	(1)	565	13	3	12
Administrative costs paid by the plan	(22)	–	22	–	–	
At 31 December 2013	19,156	354	(17,922)	(547)	1,234	(193)
Present value of defined benefit obligation relating to :						
actives			(5,381)	(355)		
deferreds			(5,056)	(70)		
pensioners			(7,485)	(122)		

The group expects to make £146 million of contributions to the HSBC UK Pension Scheme during 2015. Benefits expected to be paid from the HSBC UK Pension Scheme to retirees over each of the next five years and in aggregate for the five years thereafter, are as follows:

	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m	2020–2024 £m
HSBC Bank (UK) Pension Scheme	622	641	660	680	700	3,829

Fair value of plan assets by asset classes

	2014				2013			
	Fair value £m	**Quoted market price in active market £m**	**No quoted market price in active market £m**	**Thereof HSBC £m**	Fair value £m	Quoted market price in active market £m	No quoted market price in active market £m	Thereof HSBC £m
HSBC Bank (UK) Pension Scheme								
Fair value of plan assets	**22,611**				19,156			
Equities	**3,530**	**2,924**	**606**	**–**	2,815	2,218	597	6
Bonds	**14,776**	**14,776**	**–**	**–**	10,712	10,712	–	–
Derivatives	**878**	**33**	**845**	**597**	1,710	–	1,710	1,710
Other	**3,427**	**2,378**	**1,049**	**–**	3,919	3,112	807	–

The actual return on plan assets for the year ended 31 December 2014 was a positive return £3,817 million (2013: positive return of £1,343 million). The group expects to make £166 million of normal contributions to defined benefit pension plans during 2015.

Notes on the Financial Statements (continued)

Triennial valuation

UK regulation requires pension schemes be valued formally every three years and a funding plan agreed between the trustee and scheme sponsor. The most recent triennial actuarial valuation of the UK Scheme performed by the Scheme Actuary on behalf of the Trustee has been carried out as at 31 December 2011. At that date, the market value of the Scheme's assets was £17.2 billion. The market value of the plan represented 100 per cent of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings, and resulted in neither surplus nor deficit. The method adopted for this valuation was the projected unit method.

Ongoing contributions

Following the completion of the 2011 triennial valuation, the bank pays contributions at the rate of 43 per cent of pensionable salaries (less member contributions) which are expected to continue to 30 June 2015 at which point future service accrual for active members of the Defined Benefit Scheme will cease.

Solvency position

As part of the 31 December 2011 valuation, calculations were also carried out as to the amount of assets that might be needed to meet the liabilities if the Scheme was discontinued and the members' benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of the bank. The amount required under this approach was estimated to be £26.2 billion as at 31 December 2011. In estimating the solvency position for this purpose, a more prudent assumption about future mortality was made than for the assessment of the ongoing.

Future accrual

In 2013, following consultation on various employee benefit proposals, the bank announced to employees in the UK that the future service accrual for active members of the Defined Benefit Section ('DBS') would cease with effect from 30 June 2015. As a result, defined benefit pensions based on service to 30 June 2015 will continue to be linked to final salary on retirement (underpinned by increases in CPI) but all active members of the DBS will become members of the Defined Contribution Section from 1 July 2015.

Directors' emoluments

The aggregate emoluments of the Directors of the bank, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No.410, were:

	2014 **£000**	2013 £000
Fees[1]	**1,393**	1,382
Salaries and other emoluments	**3,966**	1,438
Annual incentives[2]	**2,925**	3,334
Year ended 31 December	**8,284**	6,154
Vesting of long-term incentive awards	**–**	–

1 Fees included fees paid to non–executive directors.

2 Incentive awards made to executive directors are delivered in the form of cash and HSBC Holdings plc shares. The amount shown is comprised of £526,420 (2013: £463,875) in cash, £789,629 (2013: £695,813) in deferred cash, £526,420 (2013 £463,875) in Restricted Shares and £789,629 (2013: £695,813) in deferred Restricted Shares, issued under the HSBC Share Plan 2011, and £292,455 (2013: £1,014,212) in shares awarded under the Group Performance Share Plan ('GPSP') and other long term deferred awards under the HSBC Share Plan 2011. The total vesting period of deferred awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. Where the total vesting period is three years, the share awards will be subject to a six month retention period upon vesting. GPSP awards are subject to a five year vesting period. On the vesting date GPSP awards are subject to a retention requirement until cessation of employment.

One Director exercised share options over HSBC Holdings plc ordinary shares during the year.

Awards were made to four Directors under long–term incentive plans in respect of qualifying services rendered in 2014 (2013: four Directors). During 2014, no Directors received shares in respect of awards under long–term incentive plans that vested during the year (2013: no Directors).

Retirement benefits are accruing to one Director under a defined benefit scheme and are accruing to two Directors under money purchase schemes in respect of Directors' qualifying services. Contributions of £48,715 were made during the year to money purchase arrangements in respect of Directors' qualifying services (2013: £158,963).

In addition, there were payments under retirement benefit agreements with former Directors of £805,005 (2013: £809,519), including payments in respect of unfunded pension obligations to former Directors of £686,104 (2013: £693,632). The provision as at 31 December 2014 in respect of unfunded pension obligations to former Directors amounted to £10,849,954 (2013: £11, 664,633).

The salary and other emoluments figure includes Fixed Pay Allowances. Discretionary annual incentives for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's parent company, HSBC Holdings plc. The cost of any conditional awards under the HSBC Share Plan 2011 are recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to

Notes on the Financial Statements (continued)

which the award relates. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc.

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2014 £000	2013 £000
Fees	–	–
Salaries and other emoluments	1,340	501
Annual incentives[1]	941	1,645

1 Awards made to the highest paid Director are delivered in the form of cash and HSBC Holdings plc shares. The amount shown is comprised of £169,416 (2013: £219,305) in cash, £254,124 (2013: £328,958) in deferred cash, £169,416 (2013: £219,305) in Restricted Shares and £254,124 (2013: £328,958) in deferred Restricted Shares issued under the HSBC Share Plan 2011, and £94,120 (2013: £548,180) in shares awarded under the Group Performance Share Plan ('GPSP') which is the long–term incentive under the HSBC Share Plan 2011. The total vesting period of deferred awards is no less than three years, with 33% of the award vesting on each of the first and second anniversaries of the date of the award and the balance vesting on the third anniversary of the date of the award. Where the total vesting period is three years, the share awards will be subject to a six month retention period upon vesting. GPSP awards are subject to a five year vesting period. On the vesting date GPSP awards are subject to a retention requirement until cessation of employment.

The highest paid Director did not receive any shares as the result of awards under long–term incentive plans that vested during the year. The highest paid Director exercised 708 share options over HSBC Holdings plc ordinary shares during the year.

No pension contributions were made by the bank in respect of services by the highest paid Director during the year.

6 Auditors' remuneration

	2014 £m	2013 £m
Audit fees payable to KPMG[1]	6.9	7.1
Audit fees payable to non–KPMG entities	0.6	0.5
Total auditors remuneration	7.5	7.6

1 Fees payable to KPMG for HSBC Bank plc's statutory audit and the audit of the bank's subsidiaries.

The following fees were payable by the group to the group's principal auditor, KPMG Audit Plc and its associates (together 'KPMG'):

	2014 £m	2013 £m
Audit fees for HSBC Bank plc statutory audit[1]:	3.7	3.8
– fees relating to current year	3.4	3.4
– fees relating to prior year	0.3	0.4
Fees for other services provided to the group	8.4	8.9
– audit of the group's subsidiaries, pursuant to legislation[2]	3.1	3.2
– audit–related assurance services[3]	3.9	4.4
– audit of pension schemes associated with the group	0.1	0.1
Tax services		
– taxation compliance services	0.1	0.1
– taxation advisory services	0.1	0.2
All other services		
– services relating to information technology	0.4	0.0
– all other services	0.7	0.9
Total fees payable	12.1	12.7

1 Fees payable to KPMG Audit Plc for the statutory audit of the consolidated financial statements of the group and the separate financial statements of the HSBC Bank plc. They exclude amounts payable for the statutory audit of the bank's subsidiaries which have been included in 'Fees payable to KPMG for other services provided to the group'.

2 Including fees payable to KPMG for the statutory audit of the bank's subsidiaries.

3 Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.

Fees payable to KPMG for non–audit services for HSBC Bank plc are not disclosed separately because such fees are disclosed on a consolidated basis for the group.

Notes on the Financial Statements (continued)

7 Share-based payments

Accounting policy

The group enters into both equity-settled and cash-settled share-based payment arrangements with its employees as compensation for services provided by employees.
The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to 'Retained Earnings'.
For cash-settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as the employees render services. Until settlement, the fair value of the liability is re-measured over the vesting period with a corresponding credit to 'Retained earnings'.
Fair value is determined by using appropriate valuation models. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions.
Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of the award. Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction
A cancellation that occurs during the vesting period is treated as an acceleration of vesting and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.
HSBC Holdings is the grantor of its equity instrument for all share awards and share options across the group. The credit to 'Retained earnings' over the vesting period on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the group will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'.

Income statement charge

The share-based payment income statement charge is recognised in wages and salaries (Note 5) as follows:

	2014	2013
	£m	£m
Restricted share awards	**147**	127
Savings-related and other share option plans	**15**	20
Year ended 31 December	**162**	147

HSBC Share Awards

Award	**Policy**	**Purpose**
Restricted share awards (including Annual incentive awards delivered in shares) and GPSP awards	· An assessment of performance over the relevant period ending on 31 December is used to determine the amount of the award to be granted. · Deferred awards generally require employees to remain in employment over the vesting period and are not subject to performance conditions after the grant date. · Deferred Annual incentive awards generally vest over a period of three years and GPSP awards vest after five years. · Vested shares may be subject to a retention requirement (restriction) post-vesting. GPSP awards are retained until cessation of employment. · Awards granted from 2010 onwards are subject to malus provision prior to vesting.	· To drive and reward performance consistent with strategy and align to shareholder interests. · Deferral provides an incentive for a longer-term commitment and the ability to apply malus.

Movement on HSBC share awards

	Restricted share awards	
	2014	2013[1]
	Number	Number
	000s	000s
Outstanding at 1 January	**38,148**	58,494
Additions during the year	**28,857**	17,380
Released in the year	**(27,375)**	(37,620)
Forfeited in the year	**(852)**	(775)
Transferred	**(516)**	669
Outstanding at 31 December	**38,262**	38,148
Weighted average fair value of awards granted (£)	**6.19**	7.17

1 *Revised to only present share-based awards. Restricted awards previously reported included deferred performance awards payable in cash.*

Notes on the Financial Statements (continued)

HSBC Share Option Plans

Main plans	Policy	Purpose
Savings-related share option plans	· Two plans: the UK plan and the International Plan. The last grant of options under the International Plan was in 2012. · Eligible employees save up to £500 per month (or for options granted prior to 2013, the equivalent in euros), with the option to use the savings to acquire shares. · Exercisable within six months following either the third or fifth anniversaries of the commencement of a three-year or five-year contract, respectively, (or for options granted prior to 2013, three months following the first anniversary of the commencement of a one-year savings contract). · The exercise price is set at a 20% (2013: 20%) discount to the market value immediately preceding the date of invitation (except for the one-year options granted under the US sub-plan prior to 2013 where a 15% discount was applied).	· To align the interests of all employees with the creation of shareholder value.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share option plans		HSBC Holdings Group share option plan	
	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] £
2014				
Outstanding at 1 January	**53,305**	**4.21**	**25,969**	**7.23**
Granted during the year	**26,396**	**5.19**	**–**	–
Exercised during the year	**(24,416)**	**3.51**	**–**	**–**
Transferred during the year	**(337)**	**4.42**	**(359)**	**7.26**
Expired during the year	**(3,629)**	**4.90**	**(20,773)**	**7.22**
Outstanding at 31 December	**51,319**	**4.98**	**4,837**	**7.29**
Weighted average remaining contractual life (years)	**2.44**			

	Savings-related share option plans		HSBC Holdings Group share option plan	
	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] £
2013				
Outstanding at 1 January	56,119	4.22	40,257	6.87
Granted during the year	8,205	5.47	–	
Exercised during the year	(5,668)	4.68	(10,026)	6.18
Transferred during the year	(164)	4.17	(123)	7.17
Expired during the year	(5,187)	4.61	(4,139)	6.15
Outstanding at 31 December	53,305	4.21	25,969	7.23
Weighted average remaining contractual life (years)	1.52			

1 Weighted average exercise price

Notes on the Financial Statements (continued)

8 Tax

Accounting policy

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the group intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the balance sheet date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when the group has a legal right to offset.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised in other comprehensive income. Deferred tax relating to share-based payment transactions is recognised directly in equity to the extent that the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense. Deferred tax relating to fair value remeasurements of available-for-sale investments and cash flow hedging instruments is credited or charged directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

	2014 £m	2013 £m
Current tax		
UK corporation tax	**249**	64
– for this year	**225**	176
– adjustment in respect of prior years	**24**	(112)
Overseas tax	**349**	360
– for this year	**344**	361
– adjustment in respect of prior years	**5**	(1)
	598	424
Deferred tax	**(34)**	330
origination and reversal of temporary differences	**(2)**	254
– effect of changes in the tax rates	**(13)**	47
– adjustment in respect of prior years	**(19)**	29
Total tax expense for the year ended 31 December	**564**	754

The UK corporation tax rate applying to HSBC Bank plc and its subsidiaries was 21.5 per cent (2013: 23.25 per cent). Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

The main rate of corporation tax in the UK was reduced from 23% to 21% on 1 April 2014 and will be further reduced to 20% on 1 April 2015. The reduction in the corporation tax rate to 20% was enacted through the 2013 Finance Act on 17 July 2013. It is not expected that the future rate reduction will have a significant effect on the group.

The Group's legal entities are subject to routine review and audit by tax authorities in the territories in which the Group operates. Where the ultimate tax treatment is uncertain the Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters.

Notes on the Financial Statements (continued)

The following table reconciles the tax expense which would apply if all profits had been taxed at the UK corporation tax rate:

	2014		2013	
	£m	**%**	£m	%
Taxation at UK corporation tax rate of 21.5% (2013: 23.25%)	**420**	**21.5**	766	23.25
Effect of taxing overseas profit at different rates	**15**	**0.8**	84	2.6
Non-taxable income and gains subject to tax at a lower rate	**(30)**	**(1.5)**	(28)	(0.9)
Deferred tax temporary differences not provided	**(43)**	**(2.2)**	49	1.5
Permanent disallowables	**198**	**10.1**	4	0.1
Changes in tax rates	**13**	**0.7**	49	1.5
Local taxes and overseas withholding taxes	**30**	**1.5**	33	1.0
Other items	**(49)**	**(2.5)**	(120)	(3.6)
Adjustment in respect of prior years	**10**	**0.5**	(83)	(2.5)
Total tax charged/(credited) to the income statement	**564**	**28.9**	754	22.9

The effective tax rate for 2014 of 28.9% was higher than the UK corporation tax rate of 21.5% due to the non-deductible settlements and provisions in connection with foreign exchange investigations offset in part by losses previously not recognised for tax purposes overseas.

Movement of net deferred tax assets/(liabilities) before offsetting balances within countries

The group

	Retirement benefits £m	**Loan impairment allowances £m**	**Unused tax losses £m**	**Property, plant and equipment £m**	**Available-for-sale investments £m**	**Cash flow hedges £m**	**Share-based payments £m**	**Goodwill and intangibles £m**	**Other £m**	**Total £m**
Assets	**–**	**88**	**14**	**292**	**–**	**25**	**51**	**71**	**–**	**541**
Liabilities	**(186)**	**–**	**–**	**(3)**	**(92)**	**–**	**–**	**(14)**	**(48)**	**(343)**
At 1 January 2014	**(186)**	**88**	**14**	**289**	**(92)**	**25**	**51**	**57**	**(48)**	**198**
Income statement	**(30)**	**(6)**	**8**	**(15)**	**–**	**1**	**(7)**	**14**	**69**	**34**
Other comprehensive income	**(322)**	**–**	**–**	**–**	**(29)**	**(74)**	**–**	**–**	**–**	**(425)**
Equity	**–**	**–**	**–**	**–**	**–**	**–**	**(9)**	**–**	**–**	**(9)**
Foreign exchange and other	**(4)**	**(4)**	**1**	**(5)**	**7**	**–**	**–**	**14**	**5**	**14**
At 31 December	**(542)**	**78**	**23**	**269**	**(114)**	**(48)**	**35**	**85**	**26**	**(188)**
Assets	**–**	**78**	**23**	**269**	**–**	**–**	**35**	**99**	**46**	**550**
Liabilities	**(542)**	**–**	**–**	**–**	**(114)**	**(48)**	**–**	**(14)**	**(20)**	**(738)**
2013										
Assets	–	80	294	141	35	–	76	20	10	656
Liabilities	(243)	–	–	(1)	(61)	(82)	–	–	(94)	(481)
At 1 January	(243)	80	294	140	(26)	(82)	76	20	(84)	175
Income statement	(220)	8	(284)	149	7	–	(18)	51	(23)	(330)
Other comprehensive income	251	–	–	–	11	109	–	–	–	371
Equity	–	–	–	–	–	–	(8)	–	–	(8)
Foreign exchange and other	26	–	4	–	(84)	(2)	1	(14)	59	(10)
At 31 December	(186)	88	14	289	(92)	25	51	57	(48)	198
Assets	–	*88*	*14*	*292*	–	*25*	*51*	*71*	–	*541*
Liabilities	(186)	–	–	(3)	(92)	–	–	(14)	(48)	(343)

Notes on the Financial Statements (continued)

The bank

	Retirement benefits £m	Loan impairment allowances £m	Unused tax losses £m	Property, plant and equipment £m	Share-based payments £m	Goodwill and intangibles £m	Other £m	Total £m
Assets	**–**	**11**	**–**	**176**	**42**	**87**	**17**	**333**
Liabilities	**(246)**	**–**	**–**	**–**	**–**	**–**	**(1)**	**(247)**
At 1 January	**(246)**	**11**	**–**	**176**	**42**	**87**	**16**	**86**
Income statement	**(30)**	**(11)**	**18**	**(13)**	**(6)**	**11**	**(20)**	**(51)**
Other comprehensive income	**(338)**	**–**	**–**	**–**	**–**	**–**	**(27)**	**(365)**
Equity	**–**	**–**	**–**	**–**	**(9)**	**–**	**–**	**(9)**
Foreign exchange and other	**–**	**–**	**–**	**–**	**–**	**–**	**(1)**	**(1)**
At 31 December	**(614)**	**-**	**18**	**163**	**27**	**98**	**(32)**	**(340)**
Assets	**–**	**–**	**18**	**163**	**27**	**98**	**–**	**306**
Liabilities	**(614)**	**–**	**–**	**–**	**–**	**–**	**(32)**	**(646)**
2013								
Assets	–	18	280	105	62	38	23	526
Liabilities	(274)	–	–	–	–	–	(50)	(324)
At 1 January	(274)	18	280	105	62	38	(27)	202
Income statement	(220)	(7)	(285)	71	(11)	48	(7)	(411)
Other comprehensive income:	250	–	–	–	–	–	52	302
Equity	–	–	–	–	(9)	–	–	(9)
Foreign exchange and other	(2)	–	5	–	–	1	(2)	2
At 31 December	(246)	11	–	176	42	87	16	86
Assets	–	11	–	176	42	87	17	333
Liabilities	(246)	–	–	–	–	–	(1)	(247)

After netting off balances within countries, the balances as disclosed in the accounts are as follows:

	The Group		The Bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Deferred tax assets	**176**	222	**5**	88
Deferred tax liabilities	**(364)**	(24)	**(345)**	(2)
	(188)	198	**(340)**	86

For the group, a deferred tax asset of £298 million (2013: £246 million) has not been recognised on the balance sheet for temporary timing differences in respect of losses and unused foreign tax credits where the recoverability of potential benefits is not considered likely.

For the bank, a deferred tax asset of £43 million (2013: £nil) has not been recognised on the balance sheet.

Deferred tax is not recognised in respect of the group's investments in subsidiaries and branches, where remittance is or other realisation is not probable, and for associates and interests in joint ventures where it has been determined that no additional tax will arise. No amount is disclosed for the unrecognised deferred tax for the 2014 and 2013 temporary differences associated with such investments as it is impracticable to determine the amount of income taxes that would be payable when any temporary differences reverse.

9 Dividends

Dividends to shareholders of the parent company were as follows:

	2014		2013	
Dividends declared on ordinary shares	**£ per share**	**£m**	£ per share	£m
Second interim dividend in respect of the previous year	**0.79**	**630**	–	–
Third interim dividend in respect of the previous year	–	–	1.76	1,400
First interim dividend in respect of the current year	**0.75**	**600**	0.71	570
	1.54	**1,230**	2.47	1,970

	2014		2013	
Dividends on preference shares classified as equity	**£ per share**	**£m**	£ per share	£m
Dividend on HSBC Bank plc non-cumulative third dollar preference shares	**1.16**	**41**	1.16	41
	1.16	**41**	1.16	41

A second interim dividend for 2014 of £315 million to shareholders of the parent company was declared by the Directors after 31 December 2014 (Note 39). The total dividend declared on ordinary shares in respect of 2014 was £915 million (2013: £1,200 million).

Notes on the Financial Statements (continued)

10 Segment analysis

Accounting policy

Measurement of segmental assets, liabilities, income and expenses is in accordance with the group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

The types of products and services from which each reportable segment derives its revenue are discussed in the 'Report of the Directors: Operating and Financial Review – Products and Services'.

Profit/(loss) for the year

	Year ended 31 December 2014						
	RBWM £m	**CMB £m**	**GB&M £m**	**GPB £m**	**Other £m**	**Inter-segment £m**	**Total £m**
Net interest income	**3,158**	**2,195**	**1,180**	**203**	**(42)**	**(65)**	**6,629**
Net fee income	**1,356**	**1,153**	**643**	**112**	**2**	**–**	**3,266**
Net trading income	**(149)**	**21**	**1,637**	**11**	**24**	**65**	**1,609**
Other income	**(157)**	**65**	**219**	**(2)**	**340**	**(83)**	**382**
Net operating income before loan impairment charges and other credit risk provisions	**4,208**	**3,434**	**3,679**	**324**	**324**	**(83)**	**11,886**
Loan impairment charges and other credit risk provisions	**(162)**	**(308)**	**16**	**4**	**1**	**–**	**(449)**
Net operating income	**4,046**	**3,126**	**3,695**	**328**	**325**	**(83)**	**11,437**
Employee compensation and benefits	**(1,020)**	**(564)**	**(1,070)**	**(98)**	**(1,392)**	**–**	**(4,144)**
General and administrative expenses[1]	**(2,730)**	**(940)**	**(2,582)**	**(114)**	**1,472**	**83**	**(4,811)**
Depreciation and impairment of property, plant and equipment	**(6)**	**(9)**	**(2)**	**(1)**	**(303)**	**–**	**(321)**
Amortisation and impairment of intangible assets	**(78)**	**(22)**	**(61)**	**–**	**(50)**	**–**	**(211)**
Total operating expenses	**(3,834)**	**(1,535)**	**(3,715)**	**(213)**	**(273)**	**83**	**(9,487)**
Operating profit	**212**	**1,591**	**(20)**	**115**	**52**	**–**	**1,950**
Share of profit in associates and joint ventures	**1**	**1**	**1**	**–**	**–**	**–**	**3**
Profit before tax	**213**	**1,592**	**(19)**	**115**	**52**	**–**	**1,953**
Cost efficiency ratio	**91.11%**	**44.70%**	**100.98%**	**65.74%**			**79.82%**

1 *The reallocation and recharging of employee and other expenses incurred directly in the 'Other' reporting segment is shown in 'General and administrative expenses'.*

	Year ended 31 December 2013						
	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter-segment £m	Total £m
Net interest income	3,569	2,144	1,101	224	(73)	(4)	6,961
Net fee income	1,502	1,143	588	100	3	–	3,336
Net trading income	147	23	2,192	10	(22)	23	2,373
Other income	(147)	60	400	(4)	(65)	(74)	170
Net operating income before loan impairment charges and other credit risk provisions	5,071	3,370	4,281	330	(157)	(55)	12,840
Loan impairment charges and other credit risk provisions	(223)	(601)	(133)	(14)	–	–	(971)
Net operating income	4,848	2,769	4,148	316	(157)	(55)	11,869
Employee compensation and benefits	(1,066)	(554)	(1,067)	(82)	(1,069)	–	(3,838)
General and administrative expenses[1]	(2,517)	(832)	(1,998)	(93)	1,190	55	(4,195)
Depreciation and impairment of property, plant and equipment	(7)	(10)	(3)	(1)	(310)	–	(331)
Amortisation and impairment of intangible assets	(83)	(41)	(54)	–	(33)	–	(211)
Total operating expenses	(3,673)	(1,437)	(3,122)	(176)	(222)	55	(8,575)
Operating profit	1,175	1,332	1,026	140	(379)	–	3,294
Share of profit in associates and joint ventures	2	1	(3)	–	–	–	–
Profit before tax	1,177	1,333	1,023	140	(379)	–	3,294
Cost efficiency ratio	72.43%	42.64%	72.93%	53.33%			66.78%

1 *The reallocation and recharging of employee and other expenses incurred directly in the 'Other' reporting segment is shown in 'General and administrative expenses'.*

Notes on the Financial Statements (continued)

Other information about the profit/(loss) for the year

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter-segment £m	Total £m
Year ended 31 December 2014							
Net operating income:	**4,046**	**3,126**	**3,695**	**328**	**325**	**(83)**	**11,437**
– external	**3,724**	**3,294**	**4,401**	**308**	**(290)**	**–**	**11,437**
– inter-segment	**322**	**(168)**	**(706)**	**20**	**615**	**(83)**	**–**
Year ended 31 December 2013							
Net operating income:	4,848	2,769	4,148	316	(157)	(55)	11,869
– external	4,446	3,000	4,631	301	(509)	–	11,869
– inter-segment	402	(231)	(483)	15	352	(55)	–

Balance sheet information

	RBWM £m	CMB £m	GB&M £m	GPB £m	Other £m	Inter-segment £m	Total £m
Year ended 31 December 2014							
Loans and advances to customers (net)	**105,929**	**68,225**	**75,044**	**7,811**	**243**	**–**	**257,252**
Investment in associates and joint venture	**21**	**18**	**30**	**–**	**–**	**–**	**69**
Total assets	**153,325**	**74,996**	**608,140**	**15,905**	**14,811**	**(69,888)**	**797,289**
Customer accounts	**129,481**	**87,148**	**116,558**	**12,778**	**182**	**–**	**346,507**
Total liabilities	**143,616**	**67,141**	**593,122**	**15,107**	**11,493**	**(69,888)**	**760,591**
Year ended 31 December 2013							
Loans and advances to customers (net)	107,287	63,819	93,600	8,515	501	–	273,722
Investment in associates and joint venture	20	18	29	–	–	–	67
Total assets	148,065	81,509	631,114	16,174	22,335	(87,503)	811,695
Customer accounts	124,183	81,133	127,114	13,311	617	–	346,358
Total liabilities	152,599	108,662	555,911	16,108	15,308	(69,812)	778,776

Information by country

	31 December 2014		31 December 2013	
	External net Operating income[1,3] £m	**Non-current assets[2] £m**	External net Operating income[1,3] £m	Non-current assets[2] £m
United Kingdom	**8,817**	**4,760**	9,149	3,385
France	**1,532**	**6,046**	1,990	6,365
Switzerland	**10**	**–**	6	–
Germany	**509**	**171**	542	177
Turkey	**559**	**71**	701	75
Other countries	**459**	**209**	452	232
Total	**11,886**	**11,257**	12,840	10,234

1 Net operating income is attributed to countries on the basis of the customers' location.
2 Non-current assets consist of property, plant and equipment, goodwill, other intangible assets and certain other assets expected to be recovered more than twelve months after the reporting period.
3 Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.

Notes on the Financial Statements (continued)

11 Trading assets

Accounting policy

Financial assets are classified as held for trading if they have been acquired principally for the purpose of selling in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. They are recognised on trade date, when the group enters into contractual arrangements with counterparties and are normally derecognised when sold. They are initially measured at fair value, with transaction costs taken to the income statement. Subsequent changes in their fair value are recognised in the income statement in 'Net trading income'.
For trading assets, the interest is shown in 'Net trading income'.

Trading assets

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Trading assets:				
– which may be repledged or resold by counterparties	**24,182**	53,174	**9,555**	31,232
– not subject to repledge or resale by counterparties	**105,945**	80,923	**88,202**	70,055
	130,127	134,097	**97,757**	101,287
Treasury and other eligible bills	**653**	2,623	**154**	643
Debt securities	**49,996**	56,414	**25,150**	28,821
Equity securities	**44,242**	36,007	**41,899**	34,422
Loans and advances to banks	**15,640**	16,067	**13,039**	16,568
Loans and advances to customers	**19,596**	22,986	**17,515**	20,833
	130,127	134,097	**97,757**	101,287

1 Included within the above figures for the group are debt securities issued by banks and other financial institutions of £11,278 million (2013: £12,062 million), of which £1,857 million (2013: £2,382 million) are guaranteed by various governments.
2 Included within the above figures for the bank are debt securities issued by banks and other financial institutions of £7,228 million (2013: £6,456 million), of which nil (2013: nil) are guaranteed by governments.

12 Fair value of financial instruments carried at fair value

Accounting policy

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is, the fair value of the consideration given or received). However, sometimes the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or the group enters into an offsetting transaction.
The fair value of financial instruments is generally measured on an individual basis. However, in cases where the group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the IFRS offsetting criteria as described in Note 30.

Critical accounting estimates and judgements

Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market, the fair value of the total holding of the financial instrument is calculated as the product of the number of units and quoted price. The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. Valuation techniques may incorporate assumptions about factors that other market participants would use in their valuations, including:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument: Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate;
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

A range of valuation techniques is employed, dependent on the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analyses, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to considering credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. 'Projection' utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products is dependent on more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may affect the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates. For interest rate derivatives with collateralised counterparties and in significant currencies, HSBC uses a discounting curve that reflects the overnight interest rate ('OIS').

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit or greater than 5% of the instrument's valuation is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are*, inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and, where possible, (iv) model outputs. Valuation models are subject to a process of due diligence and calibration before becoming data on an ongoing basis.

Financial liabilities measured at fair value

In certain circumstances, the group records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, where available. An example of this is where own debt in issue is hedged with interest rate derivatives. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the group's liability. The change in fair value of issued debt securities attributable to the group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a LIBOR-based discount curve. The difference in the valuations is attributable to the group's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by the group reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

Changes in fair value are generally subject to a profit and loss analysis process. This process disaggregates changes in fair value into three high level categories; (i) portfolio changes, such as new transactions or maturing transactions, (ii) market movements, such as changes in foreign exchange rates or equity prices, and (iii) other, such as changes in fair value adjustments, discussed below.

Fair value hierarchy

Fair values are determined according to the following hierarchy:

- *Level 1 – quoted market price*: financial instruments with quoted prices for identical instruments in active markets.
- *Level 2 – valuation technique using observable inputs*: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- *Level 3 – valuation technique with significant unobservable inputs*: financial instruments valued using models where one or more significant inputs are unobservable.

Notes on the Financial Statements (continued)

The following table sets out the financial instruments by fair value hierarchy

Financial instruments carried at fair value

The group

	Valuation techniques			
	Level 1 quoted market price £m	Level 2 using observable inputs £m	Level 3 with significant unobservable inputs £m	Total £m
Recurring fair value measurement at 31 December 2014				
Assets				
Trading assets	**83,749**	**44,225**	**2,153**	**130,127**
Financial assets designated at fair value	**6,618**	**276**	**5**	**6,899**
Derivatives	**1,949**	**184,173**	**1,614**	**187,736**
Financial investments: available-for-sale	**56,996**	**17,652**	**1,546**	**76,194**
Liabilities				
Trading liabilities	**22,669**	**58,638**	**1,293**	**82,600**
Financial liabilities at fair value	**1,107**	**21,440**	**5**	**22,552**
Derivatives	**1,935**	**185,122**	**1,221**	**188,278**
Recurring fair value measurement at 31 December 2013				
Assets				
Trading assets	83,241	49,294	1,562	134,097
Financial assets designated at fair value	10,818	5,843	–	16,661
Derivatives	323	135,844	1,072	137,239
Financial investments: available-for-sale	55,737	17,640	1,653	75,030
Liabilities				
Trading liabilities	42,064	48,417	1,361	91,842
Financial liabilities at fair value	4,078	29,958	–	34,036
Derivatives	1,236	134,819	1,297	137,352

The bank

	Valuation techniques			
	Level 1 quoted market price £m	Level 2 using observable inputs £m	Level 3 with significant un-observable inputs £m	Total £m
Recurring fair value measurement at 31 December 2014				
Assets				
Trading assets	**56,908**	**38,717**	**2,132**	**97,757**
Financial assets designated at fair value	**–**	**9**	**–**	**9**
Derivatives	**1,900**	**156,711**	**1,621**	**160,232**
Financial investments: available-for-sale	**36,276**	**9,801**	**2,361**	**48,438**
Liabilities				
Trading liabilities	**11,433**	**46,370**	**1,236**	**59,039**
Financial liabilities at fair value	**–**	**16,127**	**–**	**16,127**
Derivatives	**1,920**	**158,145**	**1,377**	**161,442**
Recurring fair value measurement at 31 December 2013				
Assets				
Trading assets	47,843	51,881	1,563	101,287
Financial assets designated at fair value	–	3,983	–	3,983
Derivatives	283	111,257	1,083	112,623
Financial investments: available-for-sale	33,724	8,607	2,717	45,048
Liabilities				
Trading liabilities	18,346	42,778	1,290	62,414
Financial liabilities at fair value	–	22,006	–	22,006
Derivatives	1,214	112,129	1,367	114,710

Notes on the Financial Statements (continued)

Transfers between Level 1 and Level 2 fair values:

	Assets				Liabilities		
	Available for sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m
At 31 December 2014							
Transfers from Level 1 to Level 2	**1,641**	**11,024**	**–**	**–**	**18,989**	**–**	**–**
Transfers from Level 2 to Level 1	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2013							
Transfers from Level 1 to Level 2	46	14,151	–	1	21,848	–	–
Transfers from Level 2 to Level 1	548	368	–	–	–	–	–

Fair value adjustments

Fair value adjustments are adopted when HSBC considers that there are additional factors that would be considered by a market participant which are not incorporated within the valuation model. HSBC classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to GB&M.
Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

Risk-related adjustments

Bid-offer

IFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the group may not receive the full market value of the transactions (see below).

Debit valuation adjustment

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the group may default, and that the group may not pay the full market value of the transactions (see below).

Model-related adjustments

Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted when the fair value estimated by a valuation model is based on one or more significant unobservable inputs. The accounting for inception profit adjustments is discussed on page 137.

Credit valuation/debit valuation adjustment methodology

The group calculates a separate credit valuation adjustment ('CVA') and debit valuation adjustment ('DVA') for each group legal entity, and within each entity for each counterparty to which the entity has exposure. The group calculates the CVA by applying the probability of default ('PD') of the counterparty, conditional on the non-default of the group, to the group's expected positive exposure to the counterparty and multiplying the result by the loss expected in the event of default. Conversely, the group calculates the DVA by applying the PD of the group, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to the group and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

For most products, the group uses a simulation methodology to calculate the expected positive exposure to a counterparty. This incorporates the range of potential exposures across the portfolio of transactions with the counterparty over the life of the portfolio. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty. A standard loss given default assumption of 60% is generally adopted for developed market exposures, and 75% for emerging market exposures. Alternative loss given default assumptions may be adopted where both the nature of the exposure and the available data support this.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, the group adopts alternative methodologies. These may involve mapping to the results for similar products from the simulation tool or where the mapping approach is not appropriate, using a simplified methodology which generally follows the same principles as the simulation methodology. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the simulation methodology.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises where the underlying value of the derivative prior to any CVA is positively correlated to the probability of default of the counterparty. When there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation.

With the exception of certain central clearing parties, the group includes all third party counterparties in the CVA and DVA calculations and does not net these calculations across group entities. The group reviews and refines the CVA and DVA methodologies on an ongoing basis.

Valuation of uncollateralised derivatives

Historically, the group has valued uncollateralised derivatives by discounting expected future cash flows at a benchmark interest rate, typically Libor or its equivalent. In line with evolving industry practice, the group changed this approach in the second half of 2014. The group now views the OIS curve as the base discounting curve for all derivatives, both collateralised and uncollateralised, and has adopted a 'funding fair value adjustment' to reflect the funding of uncollateralised derivative exposure at rates other than OIS. As at 31 December 2014, the funding fair value adjustment was £152 million. The impact of adopting the funding fair value adjustment was a one-off reduction in trading revenues of £152 million. This is an area in which a full industry consensus has not yet emerged. The group will continue to monitor industry evolution and refine the calculation methodology as necessary.

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

The group

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	At fair value £m	Derivatives £m	Held for trading £m	At fair value £m	Derivatives £m
Private equity investments	**595**	**96**	**–**	**–**	**28**	**–**	**–**
Asset-backed securities	**934**	**275**	**–**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**1,265**	**–**	**–**
Derivatives	**–**	**–**	**–**	**1,614**	**–**	**–**	**1,221**
Other portfolios	**17**	**1,782**	**5**	**–**	**–**	**5**	**–**
At 31 December 2014	**1,546**	**2,153**	**5**	**1,614**	**1,293**	**5**	**1,221**
Private equity investments	642	56	–	–	–	–	–
Asset-backed securities	1,011	264	–	–	–	–	–
Structured notes	–	–	–	–	1,361	–	–
Derivatives	–	–	–	1,072	–	–	1,297
Other portfolios	–	1,242	–	–	–	–	–
At 31 December 2013	1,653	1,562	–	1,072	1,361	–	1,297

Notes on the Financial Statements (continued)

The bank

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	At fair value £m	Derivatives £m	Held for trading £m	At fair value £m	Derivatives £m
Private equity investments	**415**	**68**	**–**	**–**	**–**	**–**	**–**
Asset-backed securities	**1,946**	**275**	**–**	**–**	**–**	**–**	**–**
Structured notes	**–**	**7**	**–**	**–**	**1,236**	**–**	**–**
Derivatives	**–**	**–**	**–**	**1,621**	**–**	**–**	**1,377**
Other portfolios	**–**	**1,782**	**–**	**–**	**–**	**–**	**–**
At 31 December 2014	**2,361**	**2,132**	**–**	**1,621**	**1,236**	**–**	**1,377**
Private equity investments	457	56	–	–	–	–	–
Asset-backed securities	2,260	265	–	–	–	–	–
Structured notes	–	–	–	–	1,290	–	–
Derivatives	–	–	–	1,083	–	–	1,367
Other portfolios	–	1,242	–	–	–	–	–
At 31 December 2013	2,717	1,563	–	1,083	1,290	–	1,367

Level 3 instruments are present in both ongoing and legacy businesses. Loans held for securitisation, certain derivatives and all Level 3 asset-backed securities are legacy. The group has the capability to hold these positions.

Private equity including strategic investments

The group's private equity and strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Asset-backed securities

While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For ABSs including residential MBSs, the valuation uses an industry standard model and the assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

Loans, including leveraged finance and loans held for securitisation

Loans held at fair value are valued from broker quotes and/or market data consensus providers when available. In the absence of an observable market, the fair value is determined using alternative valuation techniques. These techniques include discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan, derived from other market instruments issued by the same or comparable entities.

Structured notes

The fair value of structured notes valued using a valuation technique with significant unobservable inputs is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices.

Notes on the Financial Statements (continued)

Derivative products valued using valuation techniques with significant unobservable inputs included certain types of correlation products, such as foreign exchange basket options, equity basket options, foreign exchange interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options and certain credit derivatives. Credit derivatives include certain tranched CDS transactions.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The group

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m
At 1 January 2014	**1,653**	**1,562**	**–**	**1,072**	**1,361**	**–**	**1,297**
Total gains or losses recognised in profit or loss	**(7)**	**123**	**–**	**734**	**57**	**–**	**193**
- trading income excluding net interest income	**–**	**123**	**–**	**734**	**57**	**–**	**193**
- gains less losses from financial investments	**(7)**	**–**	**–**	**–**	**–**	**–**	**–**
Total gains or losses recognised in other comprehensive income	**104**	**(2)**	**–**	**–**	**(4)**	**–**	**(2)**
- available-for-sale investments: fair value gains/(losses)	**66**	**–**	**–**	**–**	**–**	**–**	**–**
- exchange differences	**38**	**(2)**	**–**	**–**	**(4)**	**–**	**(2)**
Purchases	**666**	**27**	**5**	**–**	**–**	**5**	**–**
Issues	**–**	**–**	**–**	**–**	**439**	**–**	**–**
Sales	**(259)**	**(204)**	**–**	**–**	**–**	**–**	**–**
Settlements	**(79)**	**(16)**	**–**	**15**	**(385)**	**–**	**(90)**
Transfer out	**(1,023)**	**(58)**	**–**	**(281)**	**(202)**	**–**	**(233)**
Transfer in	**491**	**721**	**–**	**74**	**27**	**–**	**56**
At 31 December 2014	**1,546**	**2,153**	**5**	**1,614**	**1,293**	**5**	**1,221**
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December 2014	**(1)**	**5**	**–**	**612**	**(108)**	**–**	**118**
- trading income excluding net interest income	**–**	**5**	**–**	**612**	**(108)**	**–**	**118**
- loan impairment charges and other credit risk provisions	**(1)**	**–**	**–**	**–**	**–**	**–**	**–**
At 1 January 2013	2,071	1,375	–	1,160	1,517	–	1,308
Total gains or losses recognised in profit or loss	(39)	259	–	(209)	(220)	–	(88)
- trading income excluding net interest income	–	259	–	(209)	(220)	–	(88)
- gains less losses from financial investments	(39)	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income	107	–	–	–	–	–	–
- available-for-sale investments: fair value gains/(losses)	107	–	–	–	–	–	–
Purchases	294	89	–	–	–	–	–
Issues	–	–	–	–	683	–	–
Sales	(91)	(110)	–	–	(9)	–	–
Settlements	(251)	(48)	–	87	(603)	–	84
Transfer out	(638)	(43)	–	(14)	(8)	–	(61)
Transfer in	175	105	–	48	–	–	41
Exchange differences	25	(65)	–	–	1	–	13
At 31 December 2013	1,653	1,562	–	1,072	1,361	–	1,297
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	(93)	139	–	5	(264)	–	68
- trading income excluding net interest income	–	139	–	5	(264)	–	68
- loan impairment charges and other credit risk provisions	(93)	–	–	–	–	–	–

Notes on the Financial Statements (continued)

The bank

	Assets				Liabilities		
	Available-for-sale £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m	Held for trading £m	Designated at fair value through profit or loss £m	Derivatives £m
At 1 January 2014	**2,717**	**1,563**	**–**	**1,083**	**1,290**	**–**	**1,367**
Total gains or losses recognised in profit or loss	**(4)**	**136**	**–**	**649**	**21**	**–**	**268**
- trading income excluding net interest income	**–**	**136**	**–**	**649**	**21**	**–**	**268**
- gains less losses from financial investments	**(4)**	**–**	**–**	**–**	**–**	**–**	**–**
Total gains or losses recognised in other comprehensive income	**576**	**–**	**–**	**–**	**–**	**–**	**–**
- available-for-sale investments: fair value gains/(losses)	**572**	**–**	**–**	**–**	**–**	**–**	**–**
- exchange differences	**4**	**–**	**–**	**–**	**–**	**–**	**–**
Purchases	**208**	**74**	**–**	**–**	**–**	**–**	**–**
Issues	**–**	**–**	**–**	**–**	**432**	**–**	**–**
Sales	**(1,042)**	**(254)**	**–**	**–**	**–**	**–**	**–**
Settlements	**(7)**	**(19)**	**–**	**9**	**(305)**	**–**	**(127)**
Transfer out	**(126)**	**(58)**	**–**	**(202)**	**(202)**	**–**	**(197)**
Transfer in	**39**	**690**	**–**	**82**	**–**	**–**	**66**
At 31 December 2014	**2,361**	**2,132**	**–**	**1,621**	**1,236**	**–**	**1,377**
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	**(1)**	**11**	**–**	**542**	**(108)**	**–**	**147**
- trading income excluding net interest income	**–**	**11**	**–**	**542**	**(108)**	**–**	**147**
- loan impairment charges and other credit risk provisions	**(1)**	**–**	**–**	**–**	**–**	**–**	**–**
At 1 January 2013	2,635	1,370	–	1,233	1,469	–	1,400
Total gains or losses recognised in profit or loss	129	260	–	(230)	(230)	–	(41)
- trading income excluding net interest income	–	260	–	(230)	(230)	–	(41)
- gains less losses from financial investments	129	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income	32	–	–	–	–	–	–
- available-for-sale investments: fair value gains/(losses)	32	–	–	–	–	–	–
Purchases	37	89	–	–	–	–	–
Issues	–	–	–	–	631	–	–
Sales	(82)	(110)	–	–	–	–	–
Settlements	(25)	(41)	–	71	(573)	–	47
Transfer out	(3)	(43)	–	(17)	(8)	–	(68)
Transfer in	–	76	–	27	–	–	21
Exchange differences	(6)	(38)	–	(1)	1	–	8
At 31 December 2013	2,717	1,563	–	1,083	1,290	–	1,367
Unrealised gains/(losses) recognised in profit or loss relating to and liabilities held at 31 December	132	140	–	(76)	(264)	–	21
- trading income excluding net interest income	–	140	–	(76)	(264)	–	21
- loan impairment charges and other credit risk provisions	132	–	–	–	–	–	–

Notes on the Financial Statements (continued)

Effects of changes in significant unobservable assumptions to reasonably possible alternatives

The following table shows the sensitivity of Level 3 fair values to reasonably possible alternative assumptions:

The group

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
At 31 December 2014				
Derivatives/trading assets/trading liabilities[1]	**161**	**(140)**	**–**	**–**
Financial assets and liabilities designated at fair value	**–**	**(1)**	**–**	**–**
Financial investments: available-for-sale	**11**	**(7)**	**73**	**(95)**
At 31 December 2013				
Derivatives/trading assets/trading liabilities[1]	180	(133)	–	–
Financial assets and liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	89	(133)

The bank

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
At 31 December 2014				
Derivatives/trading assets/trading liabilities[1]	**162**	**(150)**	**–**	**–**
Financial assets and liabilities designated at fair value	**–**	**–**	**–**	**–**
Financial investments: available-for-sale	**–**	**–**	**76**	**(90)**
At 31 December 2013				
Derivatives/trading assets/trading liabilities[1]	209	(146)	–	–
Financial assets and liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	238	(276)

1 Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.

Sensitivity of Level 3 fair values to reasonably possible alternative assumptions by instrument type

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes £m	Unfavourable changes £m	Favourable changes £m	Unfavourable changes £m
At 31 December 2014				
Private equity investments	**6**	**(6)**	**38**	**(60)**
Asset-backed securities	**28**	**(11)**	**35**	**(35)**
Structured notes	**6**	**(6)**	**–**	**–**
Derivatives	**69**	**(75)**	**–**	**–**
Other portfolios	**63**	**(50)**	**–**	**–**
At 31 December 2013				
Private equity investments	–	(7)	24	(74)
Asset-backed securities	28	(8)	65	(59)
Structured notes	6	(6)	–	–
Derivatives	129	(93)	–	–
Other portfolios	17	(19)	–	–

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgemental. When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

Notes on the Financial Statements (continued)

Key unobservable inputs to Level 3 financial instruments

The table below lists key unobservable inputs to level 3 financial instruments, and provides the range of those inputs as at 31 December 2014. A further description of the categories of key unobservable inputs is given below.

	Fair value Assets £m	Fair value Liabilities £m	Valuation technique	Key unobservable inputs	Full range of inputs Lower	Full range of inputs Higher	Core range of inputs Lower	Core range of inputs Higher
At 31 December 2014								
Private equity including strategic investments	**691**	**28**	See notes below	See notes below	n/a	n/a	n/a	n/a
Asset-backed securities	**1,209**	–						
CLO/CDO[1]	**600**	–	Market proxy	Bid quotes	–	101	55	85
Other ABSs	**609**	–	Market proxy	Bid quotes	–	96	25	53
Structured notes	–	**1,265**						
Equity-linked notes	–	**601**	Model – Option model	Equity volatility	10%	66%	16%	43%
			Model – Option model	Equity correlation	38%	88%	44%	79%
Fund-linked notes	–	**362**	Model – Option model	Fund volatility	6%	8%	6%	8%
FX-linked notes	–	**182**	Model – Option model	FX volatility	3%	70%	3%	70%
Other	–	**120**						
Derivatives	**1,614**	**1,221**						
Interest rate derivatives:								
– securitisation swaps	**288**	**655**	Model – DCF[2]	Prepayment rate	0%	50%	6%	18%
– long-dated swaptions	**667**	**123**	Model – Option model	IR volatility	8%	59%	17%	38%
– other	**309**	**84**						
Foreign exchange derivatives:								
– foreign exchange options	**64**	**29**	Model – Option model	FX volatility	0%	70%	7%	26%
Equity derivatives:								
– long-dated single stock options	**87**	**112**	Model – Option model	Equity volatility	10%	66%	14%	38%
– other	**132**	**188**						
Credit derivatives:								
– other	**67**	**30**						
Other portfolios	**1,804**	**5**						
– structured certificates	**1,001**	**5**	Model – DCF[2]	Credit volatility	1%	3%	1%	3%
– other	**803**	–						
	5,318	**2,519**						

	Fair value Assets £m	Fair value Liabilities £m	Valuation technique	Key unobservable inputs	Full range of inputs Lower	Full range of inputs Higher	Core range of inputs Lower	Core range of inputs Higher
At 31 December 2013								
Private equity including strategic investments	698	-	See notes below	See notes below	n/a	n/a	n/a	n/a
Asset-backed securities	1,275	-						
CLO/CDO[1]	601	-	Market proxy	Bid quotes	-	102	46	95
Other ABSs	674	-			-	99	30	82
Structured notes	-	1,361						
Equity-linked notes	-	649	Model – Option model	Equity volatility	7%	67%	13%	39%
			Model – Option model	Equity correlation	54%	54%	54%	54%
Fund-linked notes	-	311	Model – Option model	Fund volatility	18%	22%	19%	21%
FX-linked notes	-	229	Model – Option model	FX volatility	0%	28%	0%	28%
Other	-	172						
Derivatives	1,072	1,297						
Interest rate derivatives:								
– securitisation swaps	166	681	Model – DCF[2]	Prepayment rate	0%	22%	2%	20%
– long-dated swaptions	384	111	Model – Option model	IR volatility	4%	78%	13%	40%
– other	99	77						
Foreign exchange derivatives:								
– Foreign exchange options	89	109	Model – Option model	FX volatility	0%	28%	5%	13%
Equity derivatives:								
– long-dated single stock options	226	228	Model – Option model	Equity volatility	7%	67%	13%	39%
– other	14	50						
Credit derivatives:								
– other	94	41						
Other portfolios	1,242	-						
	4,287	2,658						

1 *Collateralised loan obligation/collateralised debt obligation*
2 *Discounted cash flow*

Notes on the Financial Statements (continued)

Private equity including strategic investments

The group's private equity and strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. Given the bespoke nature of the analysis in respect of each holding, it is not practical to quote a range of key unobservable inputs.

Prepayment rates

Prepayment rates are a measure of the anticipated future speed at which a loan portfolio will be repaid in advance of the due date. Prepayment rates are an important input into modelled values of asset-backed securities. A modelled price may be used where insufficient observable market prices exist to enable a market price to be determined directly. Prepayment rates are also an important input into the valuation of derivatives linked to securitisations. For example, so-called securitisation swaps have a notional value that is linked to the size of the outstanding loan portfolio in a securitisation, which may fall as prepayments occur. Prepayment rates vary according to the nature of the loan portfolio, and expectations of future market conditions. For example, prepayment rates will generally be anticipated to increase as interest rates rise. Prepayment rates may be estimated using a variety of evidence, such as prepayment rates implied from proxy observable security prices, current or historic prepayment rates, macro-economic modelling.

Market proxy

Market proxy pricing may be used for an instrument for which specific market pricing is not available, but evidence is available in respect of instruments that have some characteristics in common. In some cases it might be possible to identify a specific proxy, but more generally evidence across a wider range of instruments will be used to understand the factors that influence current market pricing and the manner of that influence. For example, in the collateralised loan obligation market it may be possible to establish that A-rated securities exhibit prices in a range, and to isolate key factors that influence position within the range. Application of this to a specific A-rated security within HSBC's portfolio allows assignment of a price.

The range of prices used as inputs into a market proxy pricing methodology may therefore be wide. This range is not indicative of the uncertainty associated with the price derived for an individual security.

Volatility

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option, and the potentially higher costs that HSBC may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of HSBC's long option positions (i.e. the positions in which HSBC has purchased options), while HSBC's short option positions (i.e. the positions in which HSBC has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels. For example, while it is generally the case that foreign exchange volatilities are lower than equity volatilities, there may be examples in particular currency pairs or for particular equities where this is not the case.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data. For example, longer-dated volatilities may be extrapolated from shorter-dated volatilities.

The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference market price. For example, FX volatilities for a pegged currency may be very low, whereas for non-managed currencies the FX volatility may be higher. As a further example, volatilities for deep-in-the-money or deep-out-of-the-money equity options may be significantly higher than at-the-money options as a result of 'volatility skew'. For any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

Correlation

Correlation is a measure of the inter-relationship between two market prices. Correlation is a number between minus one and one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions.

Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. For example, an equity basket option has a payout that is dependent upon the performance of a basket of single stocks, and the correlation between the price movements of those stocks will be an input to the valuation. This is referred to as equity-equity correlation. There are a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations (e.g. equity-equity correlation) and cross-asset correlations (e.g. foreign exchange rate-interest rate correlation) used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Notes on the Financial Statements (continued)

Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, HSBC trade prices, proxy correlations and examination of historical price relationships. The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

Credit spread

Credit spread is the premium over a benchmark interest rate required by the market to accept a lower credit quality. In a discounted cash flow model, the credit spread increases the discount factors applied to future cash flows, thereby reducing the value of an asset. Credit spreads may be implied from market prices. Credit spreads may not be observable in more illiquid markets.

Inter-relationships between key unobservable inputs

Key unobservable inputs to level 3 financial instruments may not be independent of each other. As described above, market variables may be correlated. This correlation typically reflects the manner in which different markets tend to react to macro-economic or other events. For example, improving economic conditions may lead to a 'risk on' market, in which prices of risky assets such as equities and high yield bonds will rise, while 'safe haven' assets such as gold and US Treasuries decline. Furthermore, the impact of changing market variables upon the group's portfolio will depend upon the group's net risk position in respect of each variable. For example, increasing high-yield bond prices will benefit long high-yield bond positions, but the value of any credit derivative protection held against those bonds will fall.

13 Fair values of financial instruments not carried at fair value

The group

		Fair values			
			Valuation techniques		
	Carrying amount £m	Quoted market price Level 1 £m	Using observable inputs Level 2 £m	With significant unobserv-able inputs Level 3 £m	Total £m
Assets and liabilities not held for sale at 31 December 2014					
Assets					
Loans and advances to banks	**25,262**	**–**	**24,061**	**1,201**	**25,262**
Loans and advances to customers	**257,252**	**–**	**2,130**	**257,384**	**259,514**
Reverse repurchase agreements – non-trading	**41,945**	**–**	**39,055**	**2,890**	**41,945**
Liabilities					
Deposits by banks	**27,590**	**–**	**27,590**	**–**	**27,590**
Customer accounts	**346,507**	**–**	**345,721**	**824**	**346,545**
Repurchase agreements – non-trading	**23,353**	**–**	**23,353**	**–**	**23,353**
Debt securities in issue	**27,921**	**–**	**27,691**	**234**	**27,925**
Subordinated liabilities	**8,858**	**–**	**8,695**	**–**	**8,695**
Assets and liabilities not held for sale at 31 December 2013					
Assets					
Loans and advances to banks	23,013	–	20,209	2,804	23,013
Loans and advances to customers	273,722	–	2,388	269,777	272,165
Reverse repurchase agreements – non-trading	61,525	–	60,838	684	61,522
Liabilities					
Deposits by banks	28,769	–	28,769	–	28,769
Customer accounts	346,358	–	346,398	–	346,398
Repurchase agreements – non-trading	65,573	–	65,573	–	65,573
Debt securities in issue	32,895	–	32,499	430	32,929
Subordinated liabilities	10,785	–	10,487	–	10,487

Notes on the Financial Statements (continued)

The bank

		Fair values			
			Valuation techniques		
	Carrying amount £m	Quoted market price Level 1 £m	Using observable inputs Level 2 £m	With significant unobservable inputs Level 3 £m	Total £m
Assets and liabilities not held for sale at 31 December 2014					
Assets					
Loans and advances to banks	**18,776**	**–**	**18,536**	**240**	**18,776**
Loans and advances to customers	**201,671**	**–**	**1,513**	**202,632**	**204,145**
Reverse repurchase agreements – non-trading	**36,391**	**–**	**36,391**	**–**	**36,391**
Liabilities					
Deposits by banks	**31,383**	**–**	**31,383**	**–**	**31,383**
Customer accounts	**282,687**	**–**	**282,687**	**–**	**282,687**
Repurchase agreements – non-trading	**18,293**	**–**	**18,293**	**–**	**18,293**
Debt securities in issue	**14,950**	**–**	**14,950**	**–**	**14,950**
Subordinated liabilities	**7,854**	**–**	**7,654**	**–**	**7,654**
Assets and liabilities not held for sale at 31 December 2013					
Assets					
Loans and advances to banks	16,332	–	15,881	451	16,332
Loans and advances to customers	217,567	–	1,732	214,439	216,171
Reverse repurchase agreements – non-trading	47,847	–	47,163	684	47,847
Liabilities					
Deposits by banks	32,456	–	32,456	–	32,456
Customer accounts	280,940	–	280,940	–	280,940
Repurchase agreements – non-trading	51,198	–	51,198	–	51,198
Debt securities in issue	19,576	–	19,576	–	19,576
Subordinated liabilities	9,903	–	9,575	–	9,575

Fair values are determined according to the hierarchy set out in Note 12.

Other financial instruments not carried at fair value are typically short-term in nature and repriced to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value.

Valuation

The fair value measurement is the group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

Fair values of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third party brokers which reflect over-the-counter trading activity; forward looking discounted cash flow models using assumptions which HSBC believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value impact of repricing between origination and the balance sheet date.

Financial investments

Fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Notes on the Financial Statements (continued)

Deposits by banks and customer accounts

Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

Repurchase and reverse repurchase agreements – non-trading

Fair values are estimated using discounted cash flows, applying current rates. Fair values approximate carrying amounts as their balances are generally short dated.

14 Financial assets designated at fair value

Accounting policy

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated irrevocably at inception. The group may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments, or recognising gains and losses on different bases from related positions. Under this criterion, the main class of financial assets designated by the group are financial assets under unit-linked insurance and unit-linked investment contracts. Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds. If no fair value designation was made for the related assets, the assets would be classified as available for sale, with changes in fair value recorded in other comprehensive income. The related financial assets and liabilities are managed and reported to management on a fair value basis. Designation at fair value of the financial assets and related liabilities allows the changes in fair values to be recorded in the income statement and presented in the same line;
- applies to groups of financial instruments that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. For example, certain financial assets are held to meet liabilities under non-linked insurance contracts. The group has documented risk management and investment strategies designed to manage and monitor market risk of those assets on net basis, after considering non-linked liabilities. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for those insurance operations;
- relates to financial instruments containing one or more non-closely related embedded derivatives.

Designated financial assets are recognised at fair value when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when sold. Subsequent changes in fair values are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

Fair value of financial assets designated at fair value:

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Financial assets designated at fair value:				
– not subject to repledge or resale by counterparties	**6,899**	16,661	**9**	3,983
Treasury and other eligible bills	**3**	-	**–**	-
Debt securities	**987**	6,903	**9**	3,983
Equity securities	**5,855**	9,714	**–**	-
Securities designated at fair value	**6,845**	16,617	**9**	3,983
Loans and advances to banks	**54**	44	**–**	-
At 31 December	**6,899**	16,661	**9**	3,983

Notes on the Financial Statements (continued)

15 Derivatives

Accounting policy

Derivatives

Derivatives are initially recognised, and are subsequently remeasured, at fair value. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria presented in Note 30 are met.

Embedded derivatives are bifurcated from the last contract when their economic characteristics and risks are not clearly and closely related to those of the host non-derivative contract, their contractual terms would otherwise meet the definition of a stand-alone derivative and the combined contract is not held for trading or designated at fair value. The bifurcated embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income' except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value' together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities issued by HSBC and designated at fair value, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

When derivatives are designated as hedges, HSBC classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges').

Hedge accounting

At the inception of a hedging relationship, HSBC documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. HSBC requires documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group that contain the hedged risk. If a hedging relationship no longer meets the criteria for hedge accounting, the hedge accounting is discontinued: the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income; the ineffective portion of the change in fair value is recognised immediately in the income statement.

The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the periods in which the hedged item affects profit or loss. In hedges of forecasted transactions that result in recognition of a non-financial asset or liability, previous gains and losses recognised in other comprehensive income are included in the initial measurement of the asset or liability.

When a hedging relationship is discontinued, any cumulative gain or loss recognised in other comprehensive income remains in equity until the forecast transaction is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income; the residual change in fair value is recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal, or part disposal, of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, HSBC requires that at the inception of the hedge and throughout its life each hedge must be expected to be highly effective, both prospectively and retrospectively, on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy. For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, with the effectiveness range being defined as 80% to 125%. Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting was not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities.

Notes on the Financial Statements (continued)

Fair values of derivatives by product contract type held by

The group	Assets			Liabilities		
	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
Foreign exchange	**43,265**	**378**	**43,643**	**(44,754)**	**(53)**	**(44,807)**
Interest rate	**275,371**	**1,037**	**276,408**	**(271,602)**	**(2,068)**	**(273,670)**
Equities	**7,379**	**–**	**7,379**	**(8,916)**	**–**	**(8,916)**
Credit	**4,650**	**–**	**4,650**	**(5,214)**	**–**	**(5,214)**
Commodity and other	**1,826**	**–**	**1,826**	**(1,841)**	**–**	**(1,841)**
Gross total fair values	**332,491**	**1,415**	**333,906**	**(332,327)**	**(2,121)**	**(334,448)**
Offset			**(146,170)**			**146,170**
At 31 December 2014			**187,736**			**(188,278)**
Foreign exchange	32,851	245	33,096	(33,644)	(159)	(33,803)
Interest rate	244,392	997	245,389	(240,448)	(1,809)	(242,257)
Equities	10,296	–	10,296	(13,001)	–	(13,001)
Credit	3,713	–	3,713	(3,582)	–	(3,582)
Commodity and other	865	–	865	(829)	–	(829)
Gross total fair values	292,117	1,242	293,359	(291,504)	(1,968)	(293,472)
Offset			(156,120)			156,120
At 31 December 2013			137,239			(137,352)

The bank	Assets			Liabilities		
	Trading £m	Hedging £m	Total £m	Trading £m	Hedging £m	Total £m
Foreign exchange	**43,315**	**336**	**43,651**	**(44,865)**	**(43)**	**(44,908)**
Interest rate	**192,861**	**680**	**193,541**	**(189,841)**	**(1,402)**	**(191,243)**
Equities	**6,869**	**–**	**6,869**	**(8,545)**	**–**	**(8,545)**
Credit	**4,650**	**–**	**4,650**	**(5,209)**	**–**	**(5,209)**
Commodity and other	**1,843**	**–**	**1,843**	**(1,859)**	**–**	**(1,859)**
Gross total fair values	**249,538**	**1,016**	**250,554**	**(250,319)**	**(1,445)**	**(251,764)**
Offset			**(90,322)**			**90,322**
At 31 December 2014			**160,232**			**(161,442)**
Foreign exchange	33,260	192	33,452	(33,965)	(159)	(34,124)
Interest rate	163,636	746	164,382	(162,402)	(1,123)	(163,525)
Equities	10,137	–	10,137	(12,578)	–	(12,578)
Credit	3,713	–	3,713	(3,579)	–	(3,579)
Commodity and other	880	–	880	(845)	–	(845)
Gross total fair values	211,626	938	212,564	(213,369)	(1,282)	(214,651)
Offset			(99,941)			99,941
At 31 December 2013			112,623			(114,710)

Use of derivatives

The group transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge the group's own risks.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, the group employs the same credit risk management framework to assess and approve potential credit exposures that it uses for traditional lending.

Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities include market-making and risk management. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume. Risk management activity is undertaken to manage the risk arising from client transactions, with the principal purpose of retaining client margin.

Other derivatives classified as held for trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. Trading derivatives also include derivatives managed in conjunction with financial instruments designated at fair value.

Notes on the Financial Statements (continued)

Notional contract amounts of derivatives held for trading purposes by product type

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Foreign exchange	**2,520,473**	2,343,902	**2,539,975**	2,375,578
Interest rate	**11,609,407**	13,612,533	**9,024,790**	9,581,060
Equities	**362,678**	336,980	**358,081**	330,845
Credit	**269,376**	263,524	**269,366**	263,531
Commodity and other	**40,030**	34,233	**40,173**	35,414
At 31 December	**14,801,964**	16,591,172	**12,232,385**	12,586,428

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Unamortised balance of derivatives valued using models with significant unobservable inputs

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Unamortised balance at 1 January	**85**	90	**81**	86
Deferral on new transactions	**76**	113	**76**	111
Recognised in the income statement during the period:				
– amortisation	**(56)**	(55)	**(56)**	(54)
– subsequent to unobservable inputs becoming observable	**(8)**	(25)	**(8)**	(25)
– maturity, termination or offsetting derivative	**(45)**	(38)	**(44)**	(37)
Other	**7**	–	**7**	–
Unamortised balance at 31 December[1]	**59**	85	**56**	81

1 This amount is yet to be recognised in the consolidated income statement.

Hedge accounting derivatives

HSBC uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables HSBC to optimise the overall cost to the Group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The notional contract amounts of derivatives held for hedge accounting purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for hedge accounting purposes by product type

	The group			
	2014		2013	
	Cash flow hedge	**Fair value hedge**	Cash flow hedge	Fair value hedge
	£m	**£m**	£m	£m
Foreign exchange	**6,386**	**72**	7,491	137
Interest rate	**82,077**	**29,722**	94,586	30,122
At 31 December	**88,463**	**29,794**	102,077	30,259

	The bank			
	2014		2013	
	Cash flow hedge	**Fair value hedge**	Cash flow hedge	Fair value hedge
	£m	£m	£m	£m
Foreign exchange	**5,782**	**–**	7,071	–
Interest rate	**44,977**	**23,363**	45,070	23,031
At 31 December	**50,759**	**23,363**	52,141	23,031

Notes on the Financial Statements (continued)

Fair value hedges

HSBC's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

Fair value of derivatives designated as fair value hedges

	2014		2013	
	Assets	**Liabilities**	Assets	Liabilities
	£m	**£m**	£m	£m
The group				
Foreign exchange	**–**	**(1)**	3	–
Interest rate	**196**	**(1,841)**	453	(1,250)
At 31 December	**196**	**(1,842)**	456	(1,250)
The bank				
Interest rate	**272**	**(1,321)**	493	(995)
At 31 December	**272**	**(1,321)**	493	(995)

Gains or losses arising from fair value hedges

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Gains/(losses):				
– on hedging instruments	**(1,013)**	472	**(673)**	514
– on the hedged items attributable to the hedged risk	**1,033**	(439)	**687**	(480)
Year ended 31 December	**20**	33	**14**	34

The gains and losses on ineffective portions of fair value hedges are recognised immediately in 'Net trading income'.

Cash flow hedges

HSBC's cash flow hedges consist principally of interest rate swaps, futures and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions.

Fair value of derivatives designated as cash flow hedges

	2014		2013	
	Assets	**Liabilities**	Assets	Liabilities
	£m	**£m**	£m	£m
The group				
Foreign exchange	**378**	**(52)**	242	(159)
Interest rate	**841**	**(227)**	544	(559)
At 31 December	**1,219**	**(279)**	786	(718)
The bank				
Foreign exchange	**336**	**(43)**	192	(159)
Interest rate	**408**	**(81)**	253	(128)
At 31 December	**744**	**(124)**	445	(287)

Notes on the Financial Statements (continued)

Forecast principal balances on which interest cash flows are expected to arise

	3 months or less £m	More than 3 months but less than 1 year £m	5 years or less but more than 1 year £m	More than 5 years £m
The group				
Net cash inflows/(outflows) exposure				
Assets	**59,995**	**54,091**	**33,947**	**251**
Liabilities	**(17,824)**	**(13,609)**	**(10,388)**	**(3,380)**
At 31 December 2014	**42,171**	**40,482**	**23,559**	**(3,129)**
The bank				
Net cash inflows/(outflows) exposure				
Assets	**44,485**	**44,458**	**30,842**	**41**
Liabilities	**(5,315)**	**(5,226)**	**(4,741)**	**(1,235)**
At 31 December 2014	**39,170**	**39,232**	**26,101**	**(1,194)**
The group				
Net cash inflows/(outflows) exposure				
Assets	64,230	56,681	38,577	909
Liabilities	(19,893)	(12,262)	(10,481)	(4,807)
At 31 December 2013	44,337	44,419	28,096	(3,898)
The bank				
Net cash inflows/(outflows) exposure				
Assets	43,498	42,862	34,489	–
Liabilities	(6,343)	(6,223)	(4,539)	(322)
At 31 December 2013	37,155	36,639	29,950	(322)

This table reflects the interest rate repricing profile of the underlying hedged items.

The gains and losses on ineffective portions of derivatives designated as cash flow hedges are recognised immediately in 'Net trading income'. During the year to 31 December 2014 a gain of £8 million (2013: loss of £8 million) was recognised due to hedge ineffectiveness.

16 Non-trading reverse repurchase and repurchase agreement

Accounting policy

When securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to resale are not recognised on the balance sheet and the right to receive back the initial consideration paid is recorded in 'Loans and advances to banks', 'Loans and advances to customers' or 'Trading assets' as appropriate. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised in net interest income over the life of the agreement for loans and advances to banks and customers. Securities lending and borrowing transactions are generally secured against cash or non-cash collateral. Securities lent or borrowed do not normally result in derecognition or recognition on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively. Repos and reverse repos measured at amortised cost, or non-trading, are presented as separate lines in the balance sheet. This separate presentation was adopted with effect from 1 January 2014 and comparatives are re-presented accordingly. Previously, non-trading reverse repos were included within 'Loans and advances to banks' and 'Loans and advances to customers' and non-trading repos were included within 'Deposits by banks' and 'Customer accounts'.

The extent to which non-trading reverse repos and repos represent amounts with customers and banks is set out below.

	The group		The bank	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Assets				
Banks	**22,477**	30,215	**20,713**	25,234
Customers	**19,468**	31,310	**15,678**	22,613
At 31 December	**41,945**	61,525	**36,391**	47,847
Liabilities				
Banks	**9,793**	21,914	**6,302**	20,057
Customers	**13,560**	43,659	**11,991**	31,141
At 31 December	**23,353**	65,573	**18,293**	51,198

Notes on the Financial Statements (continued)

17 Financial investments

Accounting policy: financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available for sale or held to maturity. They are recognised on trade date when the group enters into contractual arrangements to purchase those instruments, and are normally derecognised when either the securities are sold or redeemed.

(i) Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income until they are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Interest income is recognised over the debt asset's expected life. Premiums and/or discounts arising on the purchase of dated debt securities are included in the interest recognised. Dividends from equity assets are recognised in the income statement when the right to receive payment is established.

(ii) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that HSBC positively intends and is able to hold to maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost, less any impairment losses.

The accounting policy relating to impairments of available-for-sale securities is presented in Note 1(j).

Financial investments:

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Financial investments:				
– which may be repledged or resold by counterparties	**14,831**	11,435	**13,552**	8,583
– not subject to repledge or resale by counterparties	**61,363**	63,595	**34,886**	36,465
At 31 December	**76,194**	75,030	**48,438**	45,048
Treasury and other eligible bills – available for sale	**2,849**	2,196	**2,081**	1,927
Debt securities – available for sale	**72,336**	71,828	**45,920**	42,667
Equity securities – available for sale	**1,009**	1,006	**437**	454
At 31 December	**76,194**	75,030	**48,438**	45,048

For the group, £6,172 million (2013: £2,936 million), and for the bank, £4,131 million (2013: £865 million), of the debt securities issued by banks and other financial institutions are guaranteed by various governments.

18 Assets transferred, assets charged as security for liabilities, and collateral accepted as security for assets

Accounting policy

Derecognition of financial assets

Financial assets are derecognised when the contractual rights to receive cash flows from the assets has expired; or when HSBC has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- the group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial assets not qualifying for full derecognition and associated financial liabilities

The group

	Carrying amount of assets before transfer	Carrying amount of transferred assets £m	Carrying amount of associated liabilities £m	Fair value of transferred assets £m	Fair value of associated liabilities £m	Net position £m
At 31 December 2014						
Repurchase agreements		**31,030**	**31,550**			
Securities lending agreements		**6,992**	**5,872**			
Other sales (recourse to transferred asset only)		**389**	**564**	**533**	**533**	**–**
Securitisations recognised to the extent of continuing involvement	**3,590**	**7**	**3**	**7**	**3**	**4**
At 31 December 2013						
Repurchase agreements		60,288	60,657			
Securities lending agreements		4,989	4,945			
Other sales (recourse to transferred asset only)		581	674	624	624	–
Securitisations recognised to the extent of continuing involvement	5,021	9	5	9	5	4

Notes on the Financial Statements (continued)

The bank

	Carrying amount of assets before transfer £m	Carrying amount of transferred assets £m	Carrying amount of associated liabilities £m	Fair value of transferred assets £m	Fair value of associated liabilities £m	Net position £m
At 31 December 2014						
Repurchase agreements		**16,073**	**16,674**			
Securities lending agreements		**6,963**	**5,863**			
Other sales (recourse to transferred asset only)		**389**	**564**	**533**	**533**	**–**
Securitisations recognised to the extent of continuing involvement	**3,590**	**7**	**3**	**7**	**3**	**4**
At 31 December 2013						
Repurchase agreements		34,869	35,676			
Securities lending agreements		4,945	4,945			
Other sales (recourse to transferred asset only)		581	674	624	624	–
Securitisations recognised to the extent of continuing involvement	5,021	9	5	9	5	4

Continuing involvement in financial assets and associated financial liabilities qualifying for full derecognition

The group and the bank

	At 31 December					For the year		
	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement					
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Maximum exposure to loss £m	Gain or loss recognised at transfer date £m	Income/ (expenses) recognised in reporting period £m	Income/ (expenses) recognised cumu-latively £m
Interest in SPEs								
31 December 2014	**98**	**–**	**98**	**–**	**98**	**–**	**–**	**43**
31 December 2013	184	–	186	–	184	6	5	41

The assets in the table above represent our continuing involvement in securitisations where HSBC has transferred assets to an unconsolidated SPE, but has retained some of the notes issued by the SPE. These notes are reported in loans and advances to customers. The maximum exposure to loss is the carrying amount of the notes.

Financial assets pledged to secure liabilities

	Group assets pledged at 31 December		Bank assets pledged at 31 December	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Treasury bills and other eligible securities	**160**	1,331	**–**	–
Loans and advances to banks	**9,608**	8,309	**6,240**	5,244
Loans and advances to customers	**35,972**	44,293	**15,061**	19,022
Debt securities	**53,978**	90,675	**27,694**	51,181
Equity shares	**7,051**	5,070	**6,963**	4,945
Other	**3,264**	72	**3,247**	–
Assets pledged at 31 December	**110,033**	149,750	**59,205**	80,392

The table above shows assets where a charge has been granted to secure liabilities on a legal and contractual basis. The amount of such assets may be greater than the book value of assets utilised as collateral for funding purposes or to cover liabilities. This is the case for securitisations and covered bonds where the amount of liabilities issued, plus any mandatory over-collateralisation, is less than the book value of financial assets available for funding or collateral purposes in the relevant pool of assets. This is also the case where financial assets are placed with a custodian or settlement agent which has a floating charge over all the financial assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreements.

The financial assets shown above include amounts transferred to third parties that do not qualify for derecognition, notably debt securities held by counterparties as collateral under repurchase agreements and equity securities lent under securities lending agreements. As the substance of these transactions is secured borrowings the asset collateral continues to be recognised in full and the related liability reflecting the Group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised on the balance sheet. As a result of these transactions, the Group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The Group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is £107,775 million (2013: £108,471 million) (the bank: 2014 £76,602 million; 2013 £63,862 million). The fair value of any such collateral that has been sold or repledged is £66,080 million (2013: £79,844 million) (the bank: 2014 £40,468 million; 2013 £36,445 million). The group is obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

Notes on the Financial Statements (continued)

19 Prepayments, accrued income and other assets

Accounting policy

Assets held for sale

Assets and liabilities of disposal groups and non-current assets are classified as held for sale ('HFS') when their carrying amounts will be recovered principally through sale rather than through continuing use. HFS assets are generally measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 1 'Non-current Assets Held for Sale and Discontinued Operations'.

Immediately before the initial classification as held for sale, the carrying amounts of the relevant assets and liabilities are measured in accordance with applicable IFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of IFRS 1, but are included in a disposal group classified as held for sale, shall be remeasured under applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less impairment losses and depreciation over their estimated useful lives, as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated at the greater of 1% per annum on a straight-line basis or over their remaining useful lives; and
- leasehold land and buildings are depreciated over the shorter of their unexpired terms of the leases or their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where the group is the lessor) are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 1 year and 11 years.

Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both, and those investment properties are included on balance sheet at fair value.

Prepayments, accrued income and other assets

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Prepayments and accrued income	**2,353**	2,584	**1,184**	1,185
Assets held for sale	**4,378**	33	**15**	20
Bullion	**2,736**	928	**2,733**	880
Reinsurers'share of liabilities under insurance contracts	**189**	492	**–**	–
Endorsements and acceptances	**591**	703	**364**	343
Employee benefit assets	**3,059**	1,234	**3,059**	1,234
Other accounts	**5,399**	4,465	**4,741**	3,315
Property, plant and equipment	**1,614**	2,004	**812**	1,224
At 31 December	**20,319**	12,443	**12,908**	8,201

Assets held for sale

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Non-current assets held for sale:				
- property, plant and equipment	**25**	32	**15**	20
- Assets of disposal groups held for sale	**4,353**	–	**–**	–
- other	**–**	1	**–**	–
Total assets classified as held for sale	**4,378**	33	**15**	20

Also included within property, plant and equipment classified as held for sale is repossessed property that had been pledged as collateral by customers. These repossessed assets are expected to be disposed of within 12 months of acquisition.

Property, plant and equipment – selected information

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Cost or fair value	**4,400**	4,937	**2,930**	3,452
Accumulated depreciation and impairment	**(2,786)**	(2,933)	**(2,118)**	(2,228)
Net carrying amount at 31 December	**1,614**	2,004	**812**	1,224
Additions - cost	**411**	322	**260**	227
Disposals - cost	**(148)**	(189)	**(100)**	(161)
Property plant and equipment includes				
Land and buildings	**913**	1,044	**390**	588
Freehold	**661**	794	**132**	339
Long leasehold	**101**	93	**105**	95
Short leasehold	**151**	157	**153**	154
Investment properties[1]	**344**	271	**–**	–

1 *Investment properties are valued on a market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of property.*

Notes on the Financial Statements (continued)

20 Interests in associates and joint ventures

Accounting policy

Investments in which the group, together with one or more parties, has joint control of an arrangement set up to undertake an economic activity are classified as joint ventures. The group classifies investments in entities over which it has significant influence, and that are neither subsidiaries (Note 22) nor joint ventures, as associates.

Investments in associates and interests in joint ventures are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the group's share of net assets. Goodwill arises on the acquisition of interests in joint ventures and associates when the cost of investment exceeds the group's share of the net fair value of the associate's or joint venture's identifiable assets and liabilities.

An investment in an associate is tested for impairment when there is an indication that the investment may be impaired. Goodwill on acquisitions of interests in joint ventures and associates is not tested separately for impairment.

Profits on transactions between the group and its associates and joint ventures are eliminated to the extent of the group's interest in the respective associates or joint ventures. Losses are also eliminated to the extent of the group's interest in the associates or joint ventures unless the transaction provides evidence of an impairment of the asset transferred.

Principal associates of the group and the bank

VocaLink Holdings Ltd ('VocaLink') is a principal associate of the bank and the group. VocaLink is incorporated in England and its principal activity is that of providing electronic payments and transaction services.

At 31 December 2014, the group had a 15.91% interest in the £133 million issued equity capital of VocaLink (2013: 15.91%). The carrying amount of the group's interest was £61 million at 31 December 2014 (2013: £59 million).

VocaLink is accounted for as an associate due to the group's involvement in the operational activities, policy-making decisions and representation on the board of directors.

Summarised financial information on associates

The group's share of:

	2014	2013
	£m	£m
Assets	**29**	100
Liabilities	**15**	52
Revenue	**21**	38
Profit after tax	**2**	–

Interests in significant joint ventures

Vaultex UK Limited is a significant joint venture of the bank and the group. Vaultex UK Limited is incorporated in England and its principal activity is that of cash management services. At 31 December 2014 and 31 December 2013, the group had a 50% interest in the £10 million issued equity capital.

Summarised financial information on joint ventures

The group's share of:

	2014	2013
	£m	£m
Current assets	**90**	103
Non-current assets	**18**	17
Current liabilities	**90**	103
Non-current liabilities	**10**	10
Income	**48**	48
Expense	**(47)**	(48)

Details of all associates and joint ventures, as required under S.409 Companies Act 2006, will be annexed to the next Annual Return of the bank filed with the UK Registrar of Companies.

21 Goodwill and intangible assets

	The group		**The bank**	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Goodwill	**6,140**	6,526	**342**	298
Present value of in-force long-term assurance business ('PVIF')	**456**	700	**–**	–
Other intangible assets	**698**	708	**606**	593
At 31 December	**7,294**	7,934	**948**	891

Notes on the Financial Statements (continued)

Goodwill

Accounting policy

Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquiree exceed the amount of the identifiable assets and liabilities acquired. If the amount of the identifiable assets and liabilities acquired is greater, the difference is recognised immediately in the income statement.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units ('CGUs) for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. The group's CGUs are based on global businesses. Impairment testing is performed at least annually, or whenever there is an indication of impairment, by comparing the recoverable amount of a CGU with its carrying amount. The carrying amount of a CGU is based on its assets and liabilities, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of the expected future CGU cash flows. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is carried on balance sheet at cost less accumulated impairment losses.

At the date of disposal of a business, attributable goodwill is included in the group's share of net assets in the calculation of the gain or loss on disposal.

Goodwill is included in a disposal group if the disposal group is a CGU to which goodwill has been allocated or it is an operation within such a CGU. The amount of goodwill included in a disposal group is measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained.

Critical accounting estimates and judgements

Goodwill impairment

The review of goodwill for impairment reflects management's best estimate of the future cash flows of the CGUs and the rates used to discount these cash flows, both of which are subject to uncertain factors as follows:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data, but they reflect management's view of future business prospects at the time of the assessment; and
- the rates used to discount future expected cash flows can have a significant effect on their valuation and are based on the costs of capital assigned to individual CGUs. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium for the risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions beyond management's control, are subject to uncertainty and require the exercise of significant judgment.

A decline in a CGU's expected cash flows and/or an increase in its cost of capital reduces the CGU's estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill is recognised in our income statement for the year.

The accuracy of forecasted cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management's best estimate of future business prospects.

During 2014, no impairment of goodwill was identified (2013: nil). In addition to the annual impairment test which was performed as at 1 July 2014, management reviewed the current and expected performance of the CGUs as at 31 December 2014 and determined that there was no indication of impairment of the goodwill allocated to them.

The group

	2014 **£m**	2013 £m
Gross amount and Carrying amount		
At 1 January	**6,526**	6,399
Acquisitions/(disposals)	**(5)**	14
Exchange differences	**(381)**	113
At 31 December	**6,140**	6,526

The bank

	2014 **£m**	2013 £m
At 1 January	**298**	298
Acquisitions/(disposals)	**49**	-
Other changes	**(5)**	-
At 31 December	**342**	298

Notes on the Financial Statements (continued)

Impairment testing

During 2014, no goodwill impairment was recognised (2013: nil).

Timing of impairment testing

Impairment testing in respect of goodwill is performed at least annually by comparing the recoverable amount of cash-generating units ('CGUs') determined as at 1 July 2014 based on a value in use calculation.

The value in use calculation uses cash flow estimates based on management's cash flow projections, extrapolated in perpetuity using a nominal long-term growth rate based on current market assessments of GDP and inflation for the countries within which the CGU operates. Cash flows are extrapolated in perpetuity due to the long-term perspective within the group of the business units making up the CGUs. The discount rate used is based on the cost of capital that the group allocates to investments in the countries within which the CGU operates.

The cost of capital assigned to an individual CGU and used to discount its future cash flows can have a significant effect on its valuation. The cost of capital percentage is generally derived from an appropriate capital asset pricing model, which itself depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium or discount to reflect the inherent risk of the business being evaluated. These variables are established on the basis of management judgement and current market assessments of economic variables.

The review of goodwill impairment represents management's best estimates of the factors set out above. These values are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term sustainable pattern of cash flows thereafter. While the acceptable range within which underlying assumptions can be applied is governed by the requirement for resulting forecasts to be compared with actual performance and verifiable economic data in future years, the cash flow forecasts necessarily and appropriately reflect management's view of future business prospects. The process of identifying and evaluating goodwill impairment is inherently uncertain because it requires significant management judgement in making a series of estimations, the results of which are highly sensitive to the assumptions used.

The following CGUs, include in their carrying value goodwill that is a significant proportion of total goodwill reported by the group at 31 December 2014. These CGUs do not carry on their balance sheet any intangible assets with indefinite useful lives, other than goodwill.

2014	**Goodwill at 1 July 2014 £m**	**Discount rate %**	**Nominal growth rate beyond initial cash flow projections %**
Global Banking and Markets	**4,409**	**11%**	**4.2%**
Retail Banking and Wealth Management	**1,260**	**9%**	**4.2%**
Total goodwill in the CGUs listed above	**5,669**		
2013	£m	%	%
Global Banking and Markets	4,682	10%	3.9%
Retail Banking and Wealth Management	1,338	8%	4.0%
Total goodwill in the CGUs listed above	6,020		

Additionally, as at 1 July 2014, aggregate goodwill of £630 million (2013: £668 million) had been allocated to other CGUs that were not considered individually significant.

Nominal long-term growth rate: external data that reflects the market's assessment of GDP and inflation for the countries within which the CGU operates. The rates used for 2014 and 2013 do not exceed the long-term growth rate for the countries within which the CGU operates.

Discount rate: the after tax discount rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a Capital Asset Pricing Model ('CAPM'). The CAPM depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. In addition, for the purposes of testing goodwill for impairment, management supplements this process by comparing the discount rates derived using the internally-generated CAPM with cost of capital rates produced by external sources. The group uses externally-sourced cost of capital rates where, in management's judgement, these rates reflect more accurately the current market and economic conditions. For 2014 and 2013, internal costs of capital rates were consistent with externally-sourced rates.

Notes on the Financial Statements (continued)

The present value of in-force long-term assurance business

Movement in PVIF

The group

	2014 £m	2013 £m
At 1 January	**700**	705
Addition from current year new business	**55**	65
Movement from in-force business (including investment return variances and changes in investment assumptions)	**(192)**	(76)
Transfer to assets classified as held for sale[1]	**(77)**	–
Exchange differences and other movements	**(30)**	6
At 31 December	**456**	700

1 *The transfer relates to the UK pensions business which was classified as held for sale in the first half of the year.*

The group's life insurance business is accounted for using the embedded value approach which, inter alia, provides a comprehensive risk and valuation framework. The PVIF asset represents the present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies.

PVIF-specific assumptions

The key assumptions used in the computation of PVIF for the group's main life insurance operations were:

	2014		2013	
	France[1]	**UK Life**	France[1]	UK Life
Weighted average risk free rate	**1.21%**	**1.65%**	2.38%	2.45%
Risk discount rate	**1.73%**	**2.15%**	4.69%	2.95%
Expenses inflation	**2.00%**	**4.67%**	2.00%	3.39%

1 *For 2014, the calculation of France's PVIF assumes a risk discount rate of 1.73% plus a risk margin of £38 million. For 2013, a composite rate of 4.69% was used. This was equivalent to a weighted average rate of 3.08% plus a risk margin of £41 million.*

The calculation of the PVIF is based upon assumptions that take into account risk and uncertainty. To project these cash flows, a variety of assumptions regarding future experience is made by each insurance operation which reflects local market conditions and management's judgement of local future trends.

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumption, risk-free rates, across all insurance manufacturing subsidiaries.

Sensitivity of PVIF to changes in economic assumptions

	PVIF	
	2014 £m	2013 £m
+ 100 basis points shift in risk-free rate	**84**	2
– 100 basis points shift in risk-free rate[1]	**(298)**	(51)

1 *Where a – 100 basis point shift in the risk free rate results in a negative rate, the effect on PVIF has been calculated using a minimum rate of 0%.*

Due to certain characteristics of the contracts, the relationships may be non-linear and the results of the sensitivity-testing should not be extrapolated to higher levels of stress. In calculating the scenario, the shift in the risk-free rate results in changes to investment returns, risk discount rates and bonus rates which are incorporated. The sensitivities shown are before actions that could be taken by management to mitigate impacts and before resultant changes in policyholder behaviour.

Non-economic assumptions

The group determines the policyholder liabilities for non-life manufacturers by reference to non-economic assumptions including claims costs and expense rates.

Policyholder liabilities and PVIF for life manufacturers are determined by reference to non-economic assumptions including mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit for 2014 and total equity at 31 December 2014 to reasonably possible changes in these non-economic assumptions at that date across all of the group's insurance manufacturing companies, with comparatives for 2013.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written.

Sensitivity to lapse rates is dependent on the type of contracts being written. For insurance contracts, the cost of claims is funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase in lapse rates typically has a negative effect on profit due to the loss of future premium income on the lapsed policies.

Expense rate risk is the exposure to a change in expense rates. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative impact on profits.

Notes on the Financial Statements (continued)

Sensitivity to changes in non-economic assumptions

	PVIF	
	2014	2013
	£m	£m
10% increase in mortality and/or morbidity rates	**(17)**	(20)
10% decrease in mortality and/or morbidity rates	**18**	20
10% increase in lapse rates	**(29)**	(34)
10% decrease in lapse rates	**31**	38
10% increase in expense rates	**(31)**	(30)
10% decrease in expense rates	**31**	30

Other intangible assets

The analysis of the movement of other intangible assets was as follows:

The group

	Internally generated software £m	Purchased Software £m	Customer/ merchant relationships £m	Other £m	Total £m
Cost					
At 1 January 2014	**1,367**	**170**	**220**	**15**	**1,772**
Additions[1]	**184**	**47**	**–**	**1**	**232**
Disposals	**(1)**	**(7)**	**–**	**–**	**(8)**
Amounts written off	**(1)**	**–**	**–**	**–**	**(1)**
Exchange differences	**(5)**	**(13)**	**–**	**–**	**(18)**
Other changes	**(4)**	**6**	**–**	**–**	**2**
At 31 December 2014	**1,540**	**203**	**220**	**16**	**1,979**
Accumulated amortisation and impairment					
At 1 January 2014	**(765)**	**(137)**	**(151)**	**(11)**	**(1,064)**
Amortisation charge for the year[2]	**(178)**	**(18)**	**(12)**	**(1)**	**(209)**
Impairment charge for the year[2]	**–**	**–**	**–**	**(2)**	**(2)**
Disposals	**–**	**6**	**–**	**–**	**6**
Amounts written off	**1**	**–**	**–**	**–**	**1**
Exchange differences	**3**	**11**	**–**	**–**	**14**
Other changes	**4**	**(33)**	**–**	**2**	**(27)**
At 31 December 2014	**(935)**	**(171)**	**(163)**	**(12)**	**(1,281)**
Net carrying amount at 31 December 2014	**605**	**32**	**57**	**4**	**698**
Cost					
At 1 January 2013	1,298	161	220	17	1,696
Additions[1]	184	14	–	1	199
Disposals	(1)	(2)	(1)	–	(4)
Amounts written off	(13)	–	–	–	(13)
Exchange differences	3	3	–	(3)	3
Other changes	(104)	(6)	1	–	(109)
At 31 December 2013	1,367	170	220	15	1,772
Accumulated amortisation and impairment					
At 1 January 2013	(697)	(124)	(139)	(14)	(974)
Amortisation charge for the year[2]	(177)	(17)	(11)	–	(205)
Impairment charge for the year[2]	(6)	–	–	–	(6)
Disposals	1	–	–	–	1
Amounts written off	13	–	–	–	13
Exchange differences	(3)	(2)	–	3	(2)
Other changes	104	6	(1)	–	109
At 31 December 2013	(765)	(137)	(151)	(11)	(1,064)
Net carrying amount at 31 December 2013	602	33	69	4	708

1 *At 31 December 2014, the group did not have any contractual commitments to acquire intangible assets (2013: nil).*
2 *The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets'.*

Notes on the Financial Statements (continued)

The bank

	Internally generated software £m	Other £m	Total £m
Cost			
At 1 January 2014	**1,269**	**30**	**1,299**
Additions[1]	**177**	**5**	**182**
Other changes	**–**	**2**	**2**
At 31 December 2014	**1,446**	**37**	**1,483**
Accumulated amortisation and impairment			
At 1 January 2014	**(700)**	**(6)**	**(706)**
Amortisation charge for the year[2]	**(165)**	**(5)**	**(170)**
Other changes	**1**	**(2)**	**(1)**
At 31 December 2014	**(864)**	**(13)**	**(877)**
Net carrying amount at 31 December 2014	**582**	**24**	**606**
Cost			
At 1 January 2013	1,103	24	1,127
Additions[1]	178	6	184
Disposals	–	–	–
Amounts written off	(12)	–	(12)
At 31 December 2013	1,269	30	1,299
At 1 January 2013	(544)	(2)	(546)
Amortisation charge for the year[2]	(162)	(4)	(166)
Impairment charge for the year[2]	(6)	–	(6)
Amounts written off	12	–	12
At 31 December 2013	(700)	(6)	(706)
Net carrying amount at 31 December 2013	569	24	593

1 *At 31 December 2014, the bank did not have any contractual commitments to acquire intangible assets (2013: nil).*
2 *The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets'.*

Notes on the Financial Statements (continued)

22 Investments in subsidiaries

Accounting policy

The group classifies investments in entities which it controls as subsidiaries. The group consolidation policy is described in Note 1(g). Subsidiaries which are structured entities are covered in Note (36).

The bank's investments in subsidiaries are stated at cost less impairment losses. Impairment losses recognised in prior periods are reversed through the income statement if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

Principal subsidiary undertakings of HSBC Bank plc

	Country of incorporation or registration	HSBC Bank plc's interest in equity capital %	Share class
HSBC France	France	99.99	Ordinary €5
HSBC Asset Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Bank A.S.	Turkey	100.00	A-Common TRL1 B-Common TRL1
HSBC Bank International Limited	Jersey	100.00	Ordinary £1
HSBC Bank Malta p.l.c.	Malta	70.03	Ordinary €0.30
HSBC Invoice Finance (UK) Limited	England	100.00	Ordinary £1
HSBC Life (UK) Limited	England	100.00	Ordinary £1
HSBC Private Bank (UK) Limited	England	100.00	Ordinary £10
HSBC Private Bank (C.I.) Limited	Guernsey	100.00	Ordinary US$1
HSBC Trinkaus & Burkhardt AG	Germany	80.65	Shares of no par value
HSBC Trust Company (UK) Limited	England	100.00	Ordinary £5
Marks and Spencer Retail Financial Services Holdings Limited	England	100.00	Ordinary £1

Special purpose entities ('SPEs') consolidated where the group owns less than 50 per cent of the voting rights:

	Carrying value of total consolidated assets £bn	Nature of SPE
Barion Funding Limited	1.3	Securities investment conduit
Malachite Funding Limited	0.9	Securities investment conduit
Mazarin Funding Limited	2.5	Securities investment conduit
Regency Assets Limited	7.0	Conduit
Solitaire Funding Limited	5.7	Securities investment conduit
Turquoise Receivables Trustee Limited	0.5	Securitisation vehicle

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

Details of all subsidiaries, as required under S.409 Companies Act 2006, will be annexed to the next Annual Return of the bank filed with the UK Registrar of Companies.

Disposals

In February 2014, the group sold SB JSC HSBC Bank Kazakhstan to JSC Halyk Bank for £112 million. The sale was completed on 28 November 2014.

23 Trading liabilities

Accounting policy

Trading liabilities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. They are recognised on trade date, when HSBC enters into contractual arrangements with counterparties, and are normally derecognised when extinguished. They are initially measured at fair value, with subsequent changes in fair value and interest paid recognised in the income statement in 'Net trading income'.

The sale of borrowed securities is classified as trading liabilities.

Trading liabilities

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Deposits by banks[1]	**29,444**	29,006	**24,518**	24,795
Customer accounts[1]	**14,127**	17,361	**10,335**	12,971
Other debt securities in issue	**14,390**	13,540	**10,801**	10,818
Other liabilities – net short positions	**24,639**	31,935	**13,385**	13,830
At 31 December	**82,600**	91,842	**59,039**	62,414

1 Deposits by banks and customer accounts include repos, settlement accounts, stock lending and other amounts.

Notes on the Financial Statements (continued)

24 Financial liabilities designated at fair value

Accounting policy

The criteria for designating instruments at fair value and their measurement are described in Note 14. The fair value designation, once made, is irrevocable. Designated financial liabilities are recognised when the group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when extinguished. This section provides examples of such designations:

- Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on certain interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, and this mismatch is eliminated through the fair value designation.
- Financial liabilities under unit-linked and non-linked investment contracts.

The group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts insignificant insurance risk from another party is not classified as an insurance contract, but is accounted for as a financial liability. See Note 26 for contracts where the group accepts significant insurance risk.

Customer liabilities under linked and certain non-linked investment contracts issued by insurance subsidiaries and the corresponding financial assets are designated at fair value. Liabilities are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts. The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

Financial liabilities designated at fair value

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Deposits by banks and customer accounts	**86**	4,145	**–**	3,972
Liabilities to customers under investment contracts	**1,017**	5,300	**–**	–
Debt securities in issue	**18,593**	21,823	**13,271**	15,253
Subordinated liabilities	**2,526**	2,445	**2,856**	2,781
Preference shares	**330**	323	**–**	–
At 31 December	**22,552**	34,036	**16,127**	22,006

The group

The carrying amount at 31 December 2014 of financial liabilities designated at fair value was £1,496 million higher (2013: £823 million higher) than the contractual amount at maturity. At 31 December 2014, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of £247 million (2013: £276 million loss).

The bank

The carrying amount at 31 December 2014 of financial liabilities designated at fair value was £1,082 million higher (2013: £699 million higher) than the contractual amount at maturity. At 31 December 2014, the accumulated amount of change in fair value attributable to changes in credit risk was a loss of £151 million (2013: £223 million loss).

25 Accruals, deferred income and other liabilities

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Liabilities of disposal groups held for sale	**4,356**	–	**–**	–
Accruals and deferred income	**2,531**	2,990	**1,518**	1,724
Amounts due to investors in funds consolidated by the group	**455**	550	**–**	–
Obligations under finance leases	**–**	88	**–**	–
Endorsements and acceptances	**582**	697	**364**	343
Share-based payment liability to HSBC Holdings	**191**	217	**148**	164
Employee benefit liabilities	**333**	318	**133**	144
Other liabilities	**3,969**	4,298	**3,126**	3,320
At 31 December	**12,417**	9,158	**5,289**	5,695

Notes on the Financial Statements (continued)

26 Liabilities under insurance contracts

Accounting policy

The group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

Future profit participation on insurance contracts with discretionary participation features

Where contracts provide discretionary profit participation benefits to policyholders, liabilities for these contracts include provisions for the future discretionary benefits to policyholders. These provisions reflect actual performance of the investment portfolio to date and management expectation on the future performance in connection with the assets backing the contracts, as well as other experience factors such as mortality, lapses and operational efficiency, where appropriate. This benefit may arise from the contractual terms, regulation, or past distribution policy.

Investment contracts with discretionary participation features

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4. The group therefore recognises the premiums for those contracts as revenue and recognises as an expense the resulting increase in the carrying amount of the liability.

In the case of net unrealised investment gains on these contracts, whose discretionary benefits principally reflect the actual performance of the investment portfolio, the corresponding increase in the liabilities is recognised in either the income statement or other comprehensive income, following the treatment of the unrealised gains on the relevant assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable. Movements in the liabilities arising from realised gains and losses on relevant assets are recognised in the income statement.

Liabilities under insurance contracts

	2014		
	Gross	Reinsurers' Share	Net
	£m	£m	£m
Non-linked insurance contracts[1]			
At 1 January	836	(448)	388
Claims and benefits paid	(140)	80	(60)
Movement in liabilities to policyholders	223	(117)	106
Transfer to liabilities of disposal groups held for sale	(338)	328	(10)
Exchange differences and other movements	(49)	15	(34)
At 31 December	532	(142)	390
Investment contracts with discretionary participation features			
At 1 January	15,987	–	15,987
Claims and benefits paid	(1,407)	–	(1,407)
Movement in liabilities to policyholders	1,933	–	1,933
Transfer to liabilities of disposal groups held for sale	–	–	–
Exchange differences and other movements[2]	(430)	–	(430)
At 31 December	16,083	–	16,083
Linked life insurance contracts			
At 1 January	2,405	(43)	2,362
Claims and benefits paid	(247)	3	(244)
Movement in liabilities to policyholders	284	(7)	277
Transfer to liabilities of disposal groups held for sale	(1,521)	–	(1,521)
Exchange differences and other movements[3]	(14)	–	(14)
At 31 December	907	(47)	860
Total liabilities to policyholders	17,522	(189)	17,333

Notes on the Financial Statements (continued)

	2013		
	Gross £m	Reinsurers' share £m	Net £m
Non-linked insurance contracts[1]			
At 1 January	825	(462)	363
Claims and benefits paid	(141)	76	(65)
Movement in liabilities to policyholders	189	(83)	106
Exchange differences and other movements	(37)	21	(16)
At 31 December	836	(448)	388
Investment contracts with discretionary participation features			
At 1 January	15,078	–	15,078
Claims and benefits paid	(1,473)	–	(1,473)
Movement in liabilities to policyholders	2,350	–	2,350
Exchange differences and other movements[2]	32	–	32
At 31 December	15,987	–	15,987
Linked life insurance contracts			
At 1 January	2,010	(34)	1,976
Claims and benefits paid	(197)	3	(194)
Movement in liabilities to policyholders	585	(13)	572
Exchange differences and other movements[3]	7	1	8
At 31 December	2,405	(43)	2,362
Total liabilities to policyholders	19,228	(491)	18,737

1 *Includes liabilities under non-life insurance contracts*

2 *Includes movement in liabilities relating to discretionary profit participation benefits due to policyholders arising from net unrealised investment gains recognised in other comprehensive income.*

3 *Includes amounts arising under reinsurance agreements.*

The increase in liabilities to policyholders represents the aggregate of all events giving rise to additional liabilities to policyholders in the year. The key factors contributing to the movement in liabilities to policyholders include death claims, surrenders, lapses, liabilities to policyholders created at the initial inception of the policies, the declaration of bonuses and other amounts attributable to policyholders.

27 Provisions

Accounting policy

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which has arisen as a result of past events, and for which a reliable estimate can be made.

Critical accounting estimates and judgements

Provisions

Judgement is involved in determining whether a present obligation exists and in estimating the probability, timing and amount of any outflows. Professional expert advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations.

Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous judgements and estimates as appropriate. At more advanced stages, it is typically easier to make judgements and estimates around a better defined set of possible outcomes. However, the amount provisioned can remain very sensitive to the assumptions used. There could be a wide range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result, it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved.

Provisions for customer remediation also require significant levels of estimation and judgement. The amounts of provisions recognised depend on a number of different assumptions, for example, the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint.

Notes on the Financial Statements (continued)

Provisions

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
At 1 January	**1,707**	1,641	**1,271**	1,250
Additional provisions/increase in provsions [1]	**1,631**	1,165	**1,457**	726
Provisions utilised	**(1,523)**	(1,079)	**(1,347)**	(746)
Amounts reversed	**(102)**	(125)	**(37)**	(61)
Acquisition/disposal of subsidiaries/businesses	**2**	104	**–**	99
Exchange and other movements	**(8)**	1	**1**	3
At 31 December	**1,707**	1,707	**1,345**	1,271

1 Includes unwinding of discounts of £4 million (2013: £5 million) in relation to vacant space provisions.

Provisions include £1,041 million (2013: £1,310 million) in respect of customer redress programmes. The most significant of these provisions are as follows and relate to both the group and bank, except where stated.

(i) £704 million (2013: £572 million) relating to the estimated liability for redress in respect of the possible mis-selling of Payment Protection Insurance ('PPI') policies in previous years (the bank: £585 million; 2013: £493 million). An increase in provisions of £583 million was recognised during the year primarily reflecting an increase in inbound complaints by Claims Management Companies compared to previous forecasts. The current projected trend of inbound complaint volumes implies that the redress programme will be complete by Q1 2018 (31 December 2013 assumption: Q4 2015). However, this timing is subject to uncertainty as the trend may change over time based on actual experience.

Cumulative provisions made since the Judicial Review ruling in the first half of 2011 amount to £2,578 million (the bank: £2,399 million) of which £1,936 million (the bank: £1,841 million) has been paid as at 31 December 2014.

The estimated liability for redress is calculated on the basis of total premiums paid by the customer plus simple interest of 8% per annum (or the rate inherent in the related loan product where higher). The basis for calculating the redress liability is the same for single premium and regular premium policies. Future estimated redress levels are based on historically observed redress per policy.

A total of approximately 5.4 million PPI policies have been sold by the group since 2000, generating estimated revenues of £2.6 billion at 2014. The gross written premiums on these polices was approximately £3.4 billion. At 31 December 2014, the estimated total complaints expected to be received was 1.9 million, representing 36% of total policies sold. It is estimated that contact will be made with regard to 2.3 million policies, representing 42% of total policies sold. This estimate includes inbound complaints as well as the group's proactive contact exercise on certain policies ('outbound contact').

The following table details the cumulative number of policies at 31 December 2014 and the number of claims expected in the future:

	Cumulative to 31 December 2014	Future expected
Inbound complaints[1] (000s of policies)	1,215	344
Outbound contact (000s of policies)	448	291
Response rate to outbound contact	51%	51%
Average uphold rate per claim[2]	77%	71%
Average redress per claim	£1,586	£1,892

1 Excludes invalid claims where complainant has not held a PPI policy.
2 Claims include inbound and responses to outbound contact.

The main assumptions involved in calculating the redress liability are the volume of inbound complaints, the projected period of inbound complaints, the decay rate of complaint volumes, the population identified as systemically mis-sold, the redress cost per policy and the number of policies per customer complaint. The main assumptions are likely to evolve over time as root cause analysis continues, more experience is available regarding customer initiated complaint volumes received, and we handle responses to our ongoing outbound contact.

A 100,000 increase/decrease in the total inbound complaints would increase/decrease the redress provision by approximately £135 million. Each 1% increase/decrease in the response rate to our outbound contact exercise would increase/decrease redress provision by approximately £8 million.

(ii) At 31 December 2014, a provision of £200 million (2013: £469 million) was held relating to the estimated liability for redress in respect of the possible mis-selling of interest rate derivatives in the UK. The provision relates to the estimated redress payable to customers in respect of historical payments under derivative contracts, the expected write-off by the bank of open derivative contract balances and estimated project costs. An increase in the provision of £175 million was recorded during the year, reflecting updated claims experience, the announcement by the FCA on 28 January 2015 of the extension of the scheme to 31 March 2015 and the expectation of an additional population who will opt into the scheme following communications to affected customers.

Notes on the Financial Statements (continued)

The extent to which the group is ultimately required to pay redress depends on the responses of contacted and other customers during the review period and analysis of the facts and circumstances of each individual case, including consequential loss claims received. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress related to this programme.

(iii) Provisions of £2 million (2013: £102 million) in respect of alleged failings in the sale of card and identity protection products.

(iv) Provisions of £80 million (2013: £96 million) for the estimated cost of redress in relation to the provision for possible mis-selling of wealth management products. The programme to redress customers is in an early stage. The main uncertainty arises from the time to finish this project and the associated project costs.

(v) Provisions of £24 million (2013: £55 million) for the estimated cost of redress in relation to the provision of services to a number of trusts by a subsidiary of the bank. The bank has undertaken to reimburse the subsidiary in respect of the initial estimated cost of redress. The total provision is based on a calculation extrapolated from a sample of cases. Uncertainties arise from factors affecting the timing of notifying and reimbursing those affected.

The group has undertaken a review of compliance with the fixed-sum unsecured loan agreement requirements of the UK Consumer Credit Act (CCA). £243 million has been recognised as at 31 December 2014 within 'Other liabilities' for the repayment of interest to customers primarily where annual statements did not remind them of their right to partially prepay the loan, notwithstanding that the customer loan documentation did include this right. The cumulative liability to date is £379 million, of which payments of £136 million have been made to customers. There is uncertainty as to whether other technical requirements of the CCA have been met, for which we have assessed the contingent liability at up to £0.6 billion.

Also included in the above table, for the bank and group, are provisions for onerous property contracts of £67 million (2013: £75 million) and £71 million (2013: £79 million) respectively, relating to the discounted future costs associated with leasehold properties that have become vacant. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared with rent payable, and the cost of refurbishing the buildings to attract tenants. Uncertainties arise from movements in market rents, delays in finding new tenants and the timing of rental reviews.

28 Subordinated liabilities

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Subordinated liabilities:				
– At amortised cost	**8,858**	10,785	**7,854**	9,903
Subordinated liabilities	**6,677**	8,502	**7,854**	9,903
Preference shares	**2,181**	2,283	**–**	–
– Designated at fair value	**2,856**	2,768	**2,856**	2,781
Subordinated liabilities	**2,526**	2,445	**2,856**	2,781
Preference shares	**330**	323	**–**	–
	11,714	13,553	**10,710**	12,684

Notes on the Financial Statements (continued)

Subordinated borrowings of the group

		Carrying amount 2014 £m	2013 £m
€1,000m	Floating Rate Subordinated Loan 2017	**779**	833
£500m	4.75% Callable Subordinated Notes 2020[1]	**514**	524
€500m	Callable Subordinated Floating Rate Notes 2020	**377**	396
US$1,450m	Floating Rate Subordinated Loan 2021	**930**	877
US$450m	Subordinated Floating Rate Notes 2021	**289**	272
US$275m	Floating Rate Subordinated Loan 2021	**176**	166
£350m	5% Callable Subordinated Notes 2023[2]	**388**	384
£300m	6.5% Subordinated Notes 2023	**299**	299
€650m	Floating Rate Subordinated Loan 2023	**507**	542
US$300m	7.65% Subordinated Notes 2025	**256**	230
€260m	Floating Rate Subordinated Loan 2029	**203**	-
£350m	5.375% Callable Subordinated Step-up Notes 2030[3]	**398**	364
£500m	5.375% Subordinated Notes 2033	**581**	535
€900m	7.75% Non-cumulative Subordinated Notes 2040	**701**	750
£225m	6.25% Subordinated Notes 2041	**224**	224
£600m	4.75% Subordinated Notes 2046	**593**	593
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities[4]	**700**	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities[5]	**330**	323
US$750m	Undated Floating Rate Primary Capital Notes	**481**	454
US$500m	Undated Floating Rate Primary Capital Notes	**321**	302
US$300m	Undated Floating Rate Primary Capital Notes (Series 3)	**192**	181
US$2,862m	Floating Rate Perpetual Subordinated Debt	**1,836**	1,732
US$1,000m	Floating Rate Subordinated Loan 2020[6]	**–**	605
€250m	Floating Rate Subordinated Loan 2021[6]	**–**	208
£350m	Floating Rate Subordinated Loan 2022[6]	**–**	350
£390m	6.9% Subordinated Loan 2033[6]	**–**	390
US$977m	Floating Rate Subordinated Loan 2040[6]	**–**	591
	Other subordinated liabilities less than £100m	**639**	728
		11,714	13,553

1 In September 2015 the interest rate changes to three month sterling LIBOR plus 0.82%.
2 In March 2018 the interest rate changes to become the rate per annum which is the sum of the gross redemption yield of the then prevailing five year UK gilt plus 1.80%.
3 In November 2025 the interest rate changes to three month sterling LIBOR plus 1.50%.
4 In November 2031 the distribution rate changes to six month sterling LIBOR plus 1.76%.
5 In April 2020 the distribution rate changes to six month sterling LIBOR plus 1.85%.
6 In December 2014 HSBC Bank plc repaid five existing subordinated loans provided by HSBC Holdings plc and issued two new GBP denominated Additional Tier 1 (AT1) capital instruments which are accounted for as "other equity instruments" in Note 32.

Footnotes 1 to 5 all relate to instruments that are redeemable at the option of the issuer on the date of the change in the interest or distribution rate, and on subsequent rate reset and payment dates in some cases, subject to prior consent of the Prudential Regulation Authority.

Subordinated liabilities rank behind senior obligations and generally count towards the capital base of the group. Where applicable, capital securities may be called and redeemed by the group subject to prior notification to the PRA and, where relevant, the consent of the local banking regulator. If not redeemed at the first call date, coupons payable may step-up or become floating rate based on interbank rates.

Interest rates on the floating rate capital securities are generally related to interbank offered rates. On the remaining capital securities, interest is payable at fixed rates of up to 7.75%.

Notes on the Financial Statements (continued)

29 Maturity analysis of assets and liabilities

The following table provides an analysis of consolidated total assets, liabilities and off-balance sheet commitments by residual contractual maturity at the balance sheet date. Asset and liability balances are included in the maturity analysis as follows:

- except for reverse repos, repos and debt securities in issue, trading assets and liabilities (including trading derivatives) are included in the 'Due not more than 1 month' time bucket, and not by contractual maturity because trading balances are typically held for short periods of time;
- financial assets and liabilities with no contractual maturity (such as equity securities) are included in the 'Due over 5 years' time bucket. Undated or perpetual instruments are classified based on the contractual notice period which the counterparty of the instrument is entitled to give. Where there is no contractual notice period, undated or perpetual contracts are included in the 'Due over 5 years' time bucket;
- non-financial assets and liabilities with no contractual maturity (such as property, plant and equipment, goodwill and intangible assets, current and deferred tax assets and liabilities and retirement benefit liabilities) are included in the 'Due over 5 years' time bucket;
- financial instruments included within assets and liabilities of disposal groups held for sale are classified on the basis of the contractual maturity of the underlying instruments and not on the basis of the disposal transaction; and liabilities under insurance contracts are included in the 'Due over 5 years' time bucket. Liabilities under investment contracts are classified in accordance with their contractual maturity. Undated investment contracts are classified based on the contractual notice period investors are entitled to give. Where there is no contractual notice period, undated contracts are included in the 'Due over 5 years' time bucket.

Loan and other credit-related commitments are classified on the basis of the earliest date they can be drawn down.

Cash flows payable under financial liabilities by remaining contractual maturities

The group

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
At 31 December 2014						
Deposits by banks	**18,890**	**6,217**	**1,062**	**1,352**	**109**	**27,630**
Customer accounts	**301,426**	**33,179**	**9,262**	**2,710**	**98**	**346,675**
Repurchase agreements	**110**	**19,492**	**3,781**	**–**	**–**	**23,383**
Trading liabilities	**82,600**	**–**	**–**	**–**	**–**	**82,600**
Financial liabilities designated at fair value	**218**	**1,257**	**3,419**	**10,204**	**8,651**	**23,749**
Derivatives	**186,160**	**183**	**683**	**2,248**	**268**	**189,542**
Debt securities in issue	**3**	**13,753**	**9,542**	**5,203**	**852**	**29,353**
Subordinated liabilities	**203**	**45**	**32**	**1,040**	**8,530**	**9,850**
Other financial liabilities	**4,454**	**1,782**	**875**	**200**	**482**	**7,793**
	594,064	**75,908**	**28,656**	**22,957**	**18,990**	**740,575**
Loan commitments	**134,306**	**707**	**380**	**124**	**5**	**135,522**
Financial guarantee contracts	**3,392**	**1,827**	**3,754**	**2,176**	**2,303**	**13,452**
At 31 December 2014	**731,762**	**78,442**	**32,790**	**25,257**	**21,298**	**889,549**
At 31 December 2013						
Deposits by banks	19,193	3,365	874	512	277	24,221
Customer accounts	303,886	32,870	10,290	4,059	85	351,190
Repurchase agreements	11,841	44,695	9,084	–	–	65,620
Trading liabilities	91,842	–	–	–	–	91,842
Financial liabilities designated at fair value	6,825	493	1,477	15,692	14,063	38,550
Derivatives	135,490	204	912	2,529	571	139,706
Debt securities in issue	2,364	13,682	12,392	5,695	714	34,847
Subordinated liabilities	33	62	144	783	12,734	13,756
Other financial liabilities	1,730	5,494	922	194	680	9,020
	573,204	100,865	36,095	29,464	29,124	768,752
Loan commitments	121,324	792	408	459	34	123,017
Financial guarantee contracts	3,328	1,066	3,591	1,842	2,019	11,846
At 31 December 2013	697,856	102,723	40,094	31,765	31,177	903,615

Notes on the Financial Statements (continued)

The bank

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
At 31 December 2014						
Deposits by banks	**20,529**	**7,661**	**897**	**386**	**3,155**	**32,628**
Customer accounts	**254,978**	**18,258**	**7,850**	**2,353**	**1**	**283,440**
Repurchase Agreements	**–**	**15,667**	**2,657**	**–**	**–**	**18,324**
Trading liabilities	**59,039**	**–**	**–**	**–**	**–**	**59,039**
Financial liabilities designated at fair value	**–**	**1,242**	**3,178**	**7,660**	**5,092**	**17,172**
Derivatives	**160,185**	**183**	**683**	**1,602**	**268**	**162,921**
Debt securities in issue	**–**	**4,195**	**7,461**	**2,768**	**842**	**15,266**
Subordinated liabilities	**–**	**44**	**25**	**1,562**	**7,149**	**8,780**
Other financial liabilities	**3,970**	**576**	**313**	**6**	**4**	**4,869**
	498,701	**47,826**	**23,064**	**16,337**	**16,511**	**602,439**
Loan commitments	**96,504**	**112**	**118**	**46**	**5**	**96,785**
Financial guarantee contracts	**473**	**2,575**	**3,531**	**2,130**	**2,259**	**10,968**
At 31 December 2014	**595,678**	**50,513**	**26,713**	**18,513**	**18,775**	**710,192**
At 31 December 2013						
Deposits by banks	17,962	5,948	833	544	4,449	29,736
Customer accounts	255,257	19,124	5,844	4,332	1	284,558
Repurchase agreements	7,852	42,181	1,193	–	–	51,226
Trading liabilities	62,414	–	–	–	–	62,414
Financial liabilities designated at fair value	–	493	1,460	12,761	10,100	24,814
Derivatives	113,683	203	912	1,717	571	117,086
Debt securities in issue	–	4,391	10,543	4,244	713	19,891
Subordinated liabilities	–	44	23	1,108	9,668	10,843
Other financial liabilities	827	4,149	148	–	–	5,124
	457,995	76,533	20,956	24,706	25,502	605,692
Loan commitments	79,605	111	259	409	33	80,417
Financial guarantee contracts	462	1,637	3,307	1,907	2,053	9,366
At 31 December 2013	538,062	78,281	24,522	27,022	27,588	695,475

Maturity analysis of assets and liabilities

The group

	At 31 December 2014		
	Due within one year £m	Due after more than one year £m	Total £m
Assets			
Financial assets designated at fair value	**202**	**6,697**	**6,899**
Loans and advances to banks	**21,359**	**3,903**	**25,262**
Loans and advances to customers	**98,613**	**158,639**	**257,252**
Reverse Repurchase agreements- non trading	**41,669**	**276**	**41,945**
Financial investments	**9,181**	**67,013**	**76,194**
Other financial assets	**5,772**	**72**	**5,844**
At 31 December 2014	**176,796**	**236,600**	**413,396**
Liabilities			
Deposits by banks	**26,191**	**1,399**	**27,590**
Customer accounts	**343,724**	**2,783**	**346,507**
Reverse repurchase agreements – non trading	**23,353**	**–**	**23,353**
Financial liabilities designated at fair value	**3,449**	**19,103**	**22,552**
Debt securities in issue	**22,106**	**5,815**	**27,921**
Other financial liabilities	**8,836**	**370**	**9,206**
Subordinated liabilities	**4**	**8,854**	**8,858**
At 31 December 2014	**427,663**	**38,324**	**465,987**

Notes on the Financial Statements (continued)

	At 31 December 2013		
	Due within one year £m	Due after more than one year £m	Total £m
Assets			
Financial assets designated at fair value	734	15,927	16,661
Loans and advances to banks	19,531	3,482	23,013
Loans and advances to customers	116,400	157,322	273,722
Reverse repurchase agreements – non trading	60,811	714	61,525
Financial investments	10,484	64,546	75,030
Other financial assets	4,899	128	5,027
At 31 December 2013	212,859	242,119	454,978
Liabilities			
Deposits by banks	27,998	771	28,769
Customer accounts	342,317	4,041	346,358
Reverse repurchase agreements – non trading	65,573	-	65,573
Financial liabilities designated at fair value	4,045	29,991	34,036
Debt securities in issue	26,394	6,501	32,895
Other financial liabilities	4,629	782	5,411
Subordinated liabilities	80	10,705	10,785
At 31 December 2013	471,036	52,791	523,827

The bank

	At 31 December 2014		
	Due within one year £m	**Due after more than one year £m**	**Total £m**
Assets			
Financial assets designated at fair value	**9**	**–**	**9**
Loans and advances to banks	**16,464**	**2,312**	**18,776**
Loans and advances to customers	**77,945**	**123,726**	**201,671**
Reverse repurchase agreements – non trading	**36,391**	**–**	**36,391**
Financial investments	**14,239**	**34,199**	**48,438**
Other financial assets	**5,093**	**12**	**5,105**
At 31 December 2014	**150,141**	**160,249**	**310,390**
Liabilities			
Deposits by banks	**27,843**	**3,540**	**31,383**
Customer accounts	**280,361**	**2,326**	**282,687**
Reverse repurchase agreements – non trading	**18,293**	**–**	**18,293**
Financial liabilities designated at fair value	**3,195**	**12,932**	**16,127**
Debt securities in issue	**11,578**	**3,372**	**14,950**
Other financial liabilities	**3,479**	**11**	**3,490**
Subordinated liabilities	**–**	**7,854**	**7,854**
At 31 December 2014	**344,749**	**30,035**	**374,784**
		At 31 December 2013	
Assets			
Financial assets designated at fair value	2	3,981	3,983
Loans and advances to banks	14,501	1,831	16,332
Loans and advances to customers	97,990	119,577	217,567
Reverse repurchase agreements – non trading	47,847	-	47,847
Financial investments	6,571	38,477	45,048
Other financial assets	3,637	20	3,657
At 31 December 2013	170,548	163,886	334,434
Liabilities			
Deposits by banks	27,479	4,977	32,456
Customer accounts	276,683	4,257	280,940
Reverse repurchase agreements – non trading	51,198	-	51,198
Financial liabilities designated at fair value	1,858	20,148	22,006
Debt securities in issue	14,885	4,691	19,576
Other financial liabilities	3,587	75	3,662
Subordinated liabilities	–	9,903	9,903
At 31 December 2013	375,690	44,051	419,741

Further discussion of the group's liquidity and funding management can be found in the Risk section of the Report of the Directors.

Notes on the Financial Statements (continued)

30 Offsetting of financial assets and financial liabilities

Accounting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously ('the offset criteria').

	Gross amounts of recognised financial instruments £m	Gross amounts offset in the balance sheet £m	Amounts presented in the balance sheet £m	Amounts not offset in the balance sheet: Financial instruments[1] £m	Amounts not offset in the balance sheet: Cash collateral received/ pledged £m	Net amount £m
Financial assets						
Derivatives[2]	**333,906**	**(146,170)**	**187,736**	**(150,460)**	**(23,672)**	**13,604**
Reverse repurchase, securities borrowing and similar agreements	**88,338**	**(40,812)**	**47,526**	**(47,368)**	**(158)**	**–**
Classified as:						
– trading assets	**5,831**	**(250)**	**5,581**	**(5,581)**	**–**	**–**
– non-trading assets	**82,507**	**(40,562)**	**41,945**	**(41,787)**	**(158)**	**–**
Loans and advances to customers at amortised cost	**61,912**	**(22,182)**	**39,730**	**(35,920)**	**–**	**3,810**
At 31 December 2014	**484,156**	**(209,164)**	**274,992**	**(233,748)**	**(23,830)**	**17,414**
Financial liabilities						
Derivatives[2]	**334,448**	**(146,170)**	**188,278**	**(151,340)**	**(23,581)**	**13,357**
Repurchase, securities lending and similar agreements	**78,121**	**(40,812)**	**37,309**	**(37,244)**	**(65)**	**–**
Classified as:						
– trading liabilities	**14,206**	**(250)**	**13,956**	**(13,956)**	**–**	**–**
– non-trading liabilities	**63,915**	**(40,562)**	**23,353**	**(23,288)**	**(65)**	**–**
Customer accounts at amortised cost	**66,217**	**(22,182)**	**44,035**	**(35,920)**	**–**	**8,115**
At 31 December 2014	**478,786**	**(209,164)**	**269,622**	**(224,504)**	**(23,646)**	**21,472**
Financial assets						
Derivatives[2]	293,359	(156,120)	137,239	(96,018)	(16,913)	24,308
Reverse repurchase, securities borrowing and similar agreements	115,261	(41,888)	73,373	(73,337)	(33)	3
Classified as:						
– trading assets	23,082	(11,234)	11,848	(11,848)	–	–
– non-trading assets	92,179	(30,654)	61,525	(61,489)	(33)	3
Loans and advances to customers at amortised cost	111,695	(54,236)	57,459	(54,076)	–	3,383
At 31 December 2013	520,315	(252,244)	268,071	(223,431)	(16,946)	27,694
Financial liabilities						
Derivatives[2]	293,472	(156,120)	137,352	(96,462)	(14,610)	26,280
Repurchase, securities lending and similar agreements	123,823	(41,888)	81,935	(81,886)	(49)	–
Classified as:						
– trading liabilities	27,596	(11,234)	16,362	(16,362)	–	–
– non-trading liabilities	96,227	(30,654)	65,573	(65,524)	(49)	–
Customer accounts at amortised cost	115,739	(54,236)	61,503	(54,076)	–	7,427
At 31 December 2013	533,034	(252,244)	280,790	(232,424)	(14,659)	33,707

1 *Including non-cash collateral.*
2 *Including amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

Notes on the Financial Statements (continued)

31 Foreign exchange exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiary undertakings, branches, joint ventures and associates.

The group's management of structural foreign currency exposures is discussed in the risk section in the Report of Directors.

Net structural foreign currency exposures

Currency of structural exposure

	2014 £m	2013 £m
Euro	**10,036**	10,126
US dollars	**792**	442
Turkish lira	**876**	927
Russian rouble	**104**	185
Others, each less than £150 million	**438**	426
Total	**12,246**	12,106

32 Called up share capital and other equity instruments

Accounting policy

Financial instruments issued are classified as equity when there is no contractual obligation to transfer cash, other financial assets or issue a variable number of own equity instruments. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Issued and fully paid capital

HSBC Bank plc £1.00 ordinary shares

	Number	**£m**
At 1 January 2014	**796,969,108**	**797**
Shares issued	**2**	**–**
At 31 December 2014	**796,969,110**	**797**
At 1 January 2013	796,969,107	797
Share issued	1	–
At 31 December 2013	796,969,108	797

HSBC Bank plc £1.00 preferred ordinary shares

	Number	**£'000**
At 1 January and 31 December 2014	**1**	**–**
At 1 January and 31 December 2013	1	–

The preferred ordinary share ranks pari passu in all respects with the ordinary shares and with all other shares expressed to rank pari passu therewith. It carries the same rights and is subject to the same limitations as the ordinary shares but in addition the preferred ordinary share confers:

(i) on each and any distribution of profits by the bank on any class of share (other than the ordinary shares), the right to receive, in priority to any other share, the first £100 of any amount so distributed; and

(ii) on any distribution on a winding-up of the bank (but not on any redemption, reduction or purchase of any share capital), the right to receive out of the assets of the bank available for distribution, in priority to any other share, a sum equal to the nominal amount of the preferred ordinary share and any premium paid on the issue thereof.

HSBC Bank plc US$0.01 non-cumulative third dollar preference shares

	Number	**£'000**
At 1 January and 31 December 2014	**35,000,000**	**172**
At 1 January and 31 December 2013	35,000,000	172

The bank has no obligation to redeem the preference shares but may redeem them in part or in whole at any time, subject to the prior consent of the Prudential Regulation Authority. Dividends on the preference shares in issue are paid annually at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the preference shares in issue if payment of the dividend would cause the bank not to meet the capital adequacy requirements of the Prudential Regulation Authority or the profit of the bank, available for distribution as dividends, is not sufficient to enable the bank to pay in full both dividends on the preference shares in issue and dividends on any other shares that are scheduled to be paid on the same date and have an equal right to dividends or if payment of the dividend is prohibited by the rights attached to any class of shares in the capital of the bank, excluding ordinary shares. The preference shares in issue carry no rights to conversion into ordinary shares of the bank. Holders of the preference shares in issue will be able to attend any general meetings of shareholders of the bank and to vote on any resolution proposed to vary or abrogate any of the rights attaching to the preference shares or any resolution proposed to reduce the paid up capital of the preference shares. If the dividend payable on the preference shares in issue has not been paid in full for the most recent dividend period or any resolution is proposed for the winding-up of the bank or the sale of its entire business then, in such circumstances, holders of preference shares will be entitled to vote on all matters put to general meetings. In the case of unpaid dividends the holders of preference shares in issue will be entitled to attend and vote at any general meetings until such time as dividends on the preference shares have been paid in full, or a sum set aside for such payment in full, in respect of one dividend period.

All shares in issue are fully paid.

Other equity instruments

HSBC Bank plc additional tier 1instruments

		2014 £m	2013 £m
£1,096m	Undated Subordinated Additional Tier 1 Instrument issued 2014 (Callable December 2019 onwards)	**1,096**	–
£1,100m	Undated Subordinated Additional Tier 1 Instrument issued 2014 (Callable December 2024 onwards)	**1,100**	–
At 31 December		**2,196**	–

During 2014, the bank issued new capital instruments that are included in the group's capital base as fully CRD IV compliant additional tier 1 capital.

Interest on these instruments will be due and payable only at the sole discretion of the bank, and the bank has sole and absolute discretion at all times and for any reason to cancel (in whole or in part) any interest payment that would otherwise be payable on any date. There are limitations on the payment of principal, interest or other amounts if such payments are prohibited under UK banking regulations, or other requirements, if the bank has insufficient distributable items or if the bank fails to satisfy the solvency condition as defined in the instruments' terms.

The instruments are undated and are repayable, at the option of the bank, in whole at the initial call date, or on any Interest Payment Date after the initial call date. In addition, the instruments are repayable at the option of the bank in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the Prudential Regulation Authority. These instruments rank pari passu with the bank's most senior class or classes of issued preference shares and therefore ahead of ordinary shares. These instruments will be written down in whole, together with any accrued but unpaid interest if either the group's solo or consolidated Common Equity Tier 1 Capital Ratio falls below 7.00%.

33 Notes on the cash flow statement

Non-cash items included in profit before tax

	The group		The bank	
	2014 **£m**	2013 £m	**2014** **£m**	2013 £m
Depreciation, amortisation and impairment	**532**	542	**412**	410
Share-based payment expense	**162**	147	**128**	119
Credit-related impairment losses	**833**	971	**498**	800
Provisions raised	**1,529**	1,055	**1,420**	665
Impairment of investments	**(203)**	36	**(2)**	7
Charge/(credit) for defined benefit plans	**123**	(170)	**79**	(191)
Accretion of discounts and amortisation of premiums	**(58)**	103	**(8)**	198
	2,918	2,684	**2,527**	2,008

Change in operating assets

	The group		The bank	
	2014 **£m**	2013 £m	**2014** **£m**	2013 £m
Change in prepayments and accrued income	**214**	23	**1**	–
Change in net trading securities and net derivatives	**(5,335)**	(9,234)	**(960)**	(9,177)
Change in loans and advances to banks	**(5,249)**	(3,482)	**(4,636)**	(14,759)
Change in loans and advances to customers	**15,543**	(8,042)	**15,381**	31
Change in reverse repurchase agreements – non-trading	**11,180**	(30,837)	**8,159**	(28,850)
Change in financial assets designated at fair value	**9,762**	(1,179)	**3,974**	397
Change in other assets	**(7,084)**	(255)	**(3,715)**	136
	19,031	(53,006)	**18,204**	(52,222)

Notes on the Financial Statements (continued)

Change in operating liabilities

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Change in accruals and deferred income	**(459)**	(288)	**(206)**	(51)
Change in deposits by banks	**(1,156)**	26,372	**(1,072)**	38,978
Change in customer accounts	**756**	89,342	**1,642**	77,827
Change in repurchase agreements – non-trading	**(42,220)**	(47,009)	**(32,905)**	(40,193)
Change in debt securities in issue	**(4,974)**	(7,670)	**(4,626)**	(5,394)
Change in financial liabilities designated at fair value	**(11,484)**	1,118	**(5,879)**	(1,507)
Change in other liabilities	**577**	(830)	**(515)**	(2,165)
	(58,960)	61,035	**(43,561)**	67,495

Cash and cash equivalents

Accounting policy

Cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition.

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Cash and balances at central banks	**42,853**	67,584	**41,424**	60,996
Items in the course of collection from other banks	**973**	1,948	**630**	1,374
Loans and advances to banks of one month or less	**15,558**	18,529	**12,089**	14,398
Reverse repurchase agreements with banks of one month or less	**12,299**	20,699	**7,816**	11,114
Treasury bills, other bills and certificates of deposit less than three months	**484**	969	**319**	557
Less: items in the course of transmission to other banks	**(667)**	(960)	**(336)**	(422)
Total cash and cash equivalents[1]	**71,500**	108,769	**61,942**	88,017

1 Total cash and cash equivalents include the following amounts that are not available for use by the group: Nil held by foreign subsidiaries and subject to foreign exchange control restrictions (2013: nil); and £4,065 million subject to other restrictions (2013: £3,543 million).

Total interest paid by the group during the year was £2,638 million (2013: £3,900 million). Total interest received by the group during the year was £9,604 million (2013: £10,767 million). Total dividends received by the group during the year were £451 million (2013: £454 million).

Notes on the Financial Statements (continued)

34 Contingent liabilities, contractual commitments and guarantees

Accounting policy

Contingent liabilities

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security as well as contingent liabilities related to legal proceedings or regulatory matters (see Note 37), are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or present value of the fee receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

The group has issued financial guarantees and similar contracts to other group entities. The group elects to account for certain guarantees as insurance contracts, in which case they are measured and recognised as insurance liabilities. This election is made on a contract by contract basis, and is irrevocable.

	The group		The bank	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Guarantees and other contingent liabilities				
Guarantees	**17,012**	15,529	**13,459**	11,606
Other contingent liabilities	**71**	40	**70**	39
	17,083	15,569	**13,529**	11,645
Commitments[1]				
Documentary credits and short-term trade-related transactions	**3,073**	2,814	**1,814**	1,475
Forward asset purchases and forward deposits placed	**335**	18	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend[2]	**132,114**	120,185	**94,971**	78,942
	135,522	123,017	**96,785**	80,417

1 Excluding capital commitments, which are separately disclosed below.
2 Based on original contractual maturity.

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

Contingent liabilities arising from litigation against the group are disclosed in Note 37.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury which at 31 December 2014 stood at approximately £16 billion.

In order to repay the loan principal that is not expected to be recovered, the FSCS levies participating financial institutions. In January 2015, the FSCS announced that the expected levy on participating financial institutions for Scheme Year 2015/2016 would be £347 million (2014/15: £399 million).

The bank could be liable to pay a further proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury.

The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

Guarantees

The group provides guarantees and similar undertakings on behalf of both third party customers and other entities within the group. These guarantees are generally provided in the normal course of the group's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which the group could be required to make at 31 December, were as follows:

Notes on the Financial Statements (continued)

The group

	At 31 December 2014		At 31 December 2013	
	Guarantees in favour of third parties £m	**Guarantees by the group in favour of other Group entities £m**	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m
Guarantee type				
Financial guarantee contracts[1]	**8,853**	**1,048**	7,944	875
Credit-related substitutes[2]	**3,467**	**84**	2,929	98
Other guarantees	**3,249**	**382**	3,427	296
Total	**15,569**	**1,514**	14,300	1,269

The bank

	At 31 December 2014		At 31 December 2013	
	Guarantees in favour of third parties £m	**Guarantees by the group in favour of other Group entities £m**	Guarantees in favour of third parties £m	Guarantees by the group in favour of other Group entities £m
Guarantee type				
Financial guarantee contracts[1]	**6,925**	**2,056**	6,231	1,804
Credit-related substitutes[2]	**1,911**	**76**	1,139	192
Other guarantees	**2,053**	**508**	1,912	367
Total	**10,889**	**2,640**	9,282	2,363

1 *Financial guarantees contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.*

2 *Credit related guarantees are contracts that have similar features to financial guarantee contracts but fail to meet the strict definition of a financial guarantee contract under IAS 39.*

The amounts disclosed in the above table reflect the group's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with the group's overall credit risk management policies and procedures. Guarantees with terms of more than one year are subject to the group's annual credit review process.

Other commitments

In addition to the commitments disclosed above, at 31 December 2014 the group had capital commitments to purchase, within one year, land and buildings and other fixed assets from a number of suppliers for a value of £8 million (2013: £14 million).

The group had no contingent liabilities or commitments in relation to joint ventures or associates, incurred jointly or otherwise.

Notes on the Financial Statements (continued)

35 Lease commitments

Accounting policy

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets are classified as finance leases.

As a lessor under finance leases, the group presents the amounts due under the leases, after deduction of unearned charges, in 'Loans and advances to banks' or 'Loans and advances to customers'. As a lessee under finance leases, the group presents the leased assets in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments.

All other leases are classified as operating leases. As a lessor, the group presents assets subject to operating leases in 'Property, plant and equipment'. Impairment losses are recognised to the extent that the carrying values are not fully recoverable. As a lessee, leased assets are not recognised on the balance sheet.

The finance income or charges on finance leases are recognised in 'Net interest income' over the lease periods so as to give a constant rate of return. Rentals payable or receivable under operating leases are spread on a straight-line basis over the lease periods and are recognised in 'General and administrative expenses' or in 'Other operating income'.

Finance lease commitments

The group leases land and buildings (including branches) and equipment from third parties under finance lease arrangements to support its operations.

	2014			2013		
	Total future Minimum payments £m	**Interest charges £m**	**Present value £m**	Total future Minimum payments £m	Interest charges £m	Present value £m
No later than one year	**–**	**–**	**–**	8	(8)	–
Later than one year and no later than five years	**–**	**–**	**–**	39	(39)	–
Later than five years	**–**	**–**	**–**	97	(9)	88
Total	**–**	**–**	**–**	144	(56)	88

At 31 December 2014 future minimum sublease payments of £nil million (2013: £144 million) were expected to be received under non-cancellable subleases at the balance sheet date.

Operating lease commitments

At 31 December 2014, the group was obligated under a number of non-cancellable operating leases for properties, plant and equipment for which the future minimum lease payments extend over a number of years.

	Land and buildings	
	2014 £m	2013 £m
Future minimum lease payments under non-cancellable operating leases expiring		
No later than one year	**211**	164
Later than one year and no later than five years	**598**	588
Later than five years	**786**	892
Total	**1,595**	1,644

In 2014, £174 million (2013: £186 million) was charged to 'General and administrative expenses' in respect of lease and sublease agreements.

Finance lease receivables

HSBC leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2014			2013		
	Total future Minimum payments £m	**Unearned finance income £m**	**Present value £m**	Total future Minimum payments £m	Unearned finance income £m	Present value £m
Lease receivables						
No later than one year	**1,312**	**(138)**	**1,174**	1,147	(117)	1,030
Later than one year and no later than five years	**3,350**	**(395)**	**2,955**	2,883	(366)	2,517
Later than five years	**1,583**	**(265)**	**1,318**	1,641	(342)	1,299
	6,245	**(798)**	**5,447**	5,671	(825)	4,846

Notes on the Financial Statements (continued)

At 31 December 2014, unguaranteed residual values of £102 million (2013: £124 million) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to £4 million (2013: £7 million).

In 2014, £27 million (2013: £26 million) was received as contingent rents and recognised in the income statement.

Operating lease receivables

The group leases a variety of different assets to third parties under operating lease arrangements, including property, aircraft and general plant and machinery.

	Equipment	
	2014	2013
	£m	£m
Future minimum lease payments under non-cancellable operating leases expiring		
No later than one year	**11**	12
Later than one year and no later than five years	**17**	25
	28	37

36 Structured entities

Accounting policy

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual arrangements. Structured entities often have restricted activities and a narrow and well defined objective.

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 1(g).

The group is involved with structured entities, mainly through securitisation of financial assets, conduits and investment funds.

The group's arrangements that involve structured entities are authorised centrally when they are established to ensure appropriate purpose and governance. The activities of structured entities administered by the group are closely monitored by senior management. The group has involvement with both consolidated and unconsolidated structured entities, which may be established by the group or by a third party, as detailed below.

Consolidated structured entities

Total assets of the group's consolidated structured entities, split by entity type

	Conduits £m	Securitisations £m	Other £m	Total £m
At 31 December 2014	**17,474**	**1,099**	**2,392**	**20,965**
At 31 December 2013	23,324	1,253	5,826	30,403

Conduits

The group has established and manages two types of conduits: securities investment conduits ('SIC's) and multi-seller conduits. These entities have been designed so that voting or similar rights are not the dominant factor in deciding who has control; in such cases, the relevant activities are directed by means of contractual arrangement. The conduits are consolidated where the group is exposed or has the right to variable returns from its involvement with the entity and has the ability to affect its returns through its power over the entity.

Securities investment conduits

Solitaire, the group's principal SIC, purchases highly rated ABSs to facilitate tailored investment opportunities. At 31 December 2014, Solitaire held £5.1 billion of ABSs (2013: £5.4 billion). These are included within the disclosures of ABS 'held through consolidated structured entities' on pages 58. The group's other SICs, Mazarin, Barion and Malachite, evolved from the restructuring of group's established structured investment vehicles ('SIV's) in 2008.

• Solitaire – Solitaire is currently funded entirely by Commercial Paper ('CP') issued to the group. Although the group continues to provide a liquidity facility, Solitaire has no need to draw on it so long as the group purchases the CP issued, which it intends to do for the foreseeable future. At 31 December 2014 HSBC held £6.1 billion of CP (2013: £6.7 billion).

• *Mazarin* – the group is exposed to the par value of Mazarin's assets through the provision of a liquidity facility equal to the lesser of the amortised cost of issued senior debt and the amortised cost of non-defaulted assets. At 31 December 2014, this amounted to £2.5 billion (2013: £4.5 billion). First loss protection is provided through the capital notes issued by Mazarin, which are substantially all held by third parties.

At 31 December 2014, the group held 1.2% of Mazarin's capital notes (2013: 1.3%) which have a par value of £6 million (2013: £10 million) and a carrying amount of £0.9 million (2013: £0.2 million).

• *Barion and Malachite* – the group's primary exposure to these SICs is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2014 this amounted to £1.9 billion (2013: £3.8 billion). First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

At 31 December 2014, the group held 9.9% of the capital notes (2013: 3.8%) issued by these vehicles which have a par value of £35 million (2013: £22 million) and a carrying amount of £6 million (2013: £2 million).

Multi-seller conduits

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for the group's clients.

The group bears risk equal to the transaction-specific liquidity facilities offered to the multi-seller conduits. First loss protection is provided by the originator of the assets, and not by the group, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by the group in the form of programme-wide enhancement facilities.

Securitisations

The group uses structured entities to securitise customer loans and advances that it has originated in order to diversify its sources of funding for asset origination and for capital efficiency purposes. The loans and advances are transferred by the group to the structured entities for cash or synthetically through credit default swaps, and the structured entities issue debt securities to investors.

Group managed funds

The group has established a number of money market, and non-money market funds. Where the group is deemed to be acting as principal rather than agent in its role as investment manager, the group will control and hence consolidate these funds.

Other

The group also enters into a number of transactions in the normal course of business, including asset and structured finance transactions where it has control of the structured entity.

Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities that are not controlled by the group. The group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities.

The table below shows the total assets of unconsolidated structured entities in which the group has an interest at the reporting date, and the group's maximum exposure to loss in relation to those interests.

The maximum exposure to loss from the group's interests in unconsolidated structured entities represents the maximum loss that the group could incur as a result of its involvement with unconsolidated structured entities regardless of the probability of the loss being incurred.

- For commitments and guarantees, and written credit default swaps, the maximum exposure to loss is the notional amount of potential future losses.
- For retained and purchased investments in and loans to unconsolidated structured entities, the maximum exposure to loss is the carrying value of these interests at the balance sheet reporting date.

The maximum exposure to loss is stated gross of the effects of hedging and collateral arrangements entered into to mitigate the group's exposure to loss.

Notes on the Financial Statements (continued)

Nature and risks associated with the group's interests in unconsolidated structured entities

	Group managed funds £m	Non-group managed funds £m	Other £m	Total £m
At 31 December 2014				
Total assets	**10,582**	**1,132,196**	**13,156**	**1,155,934**
Group interest – assets				
Cash	**–**	**–**	**–**	**–**
Trading assets	**27**	**85**	**1,057**	**1,169**
Financial assets designated at fair value	**878**	**3,453**	**–**	**4,331**
Derivatives	**–**	**–**	**797**	**797**
Loans and advances to banks	**–**	**84**	**35**	**119**
Loans and advances to customers	**55**	**–**	**171**	**226**
Financial investments	**40**	**416**	**94**	**550**
Other assets	**1**	**–**	**–**	**1**
Total assets in relation to the group's interests in the unconsolidated structured entities	**1,001**	**4,038**	**2,154**	**7,193**
Group interest – liabilities				
Customer accounts	**26**	**–**	**–**	**26**
Total liabilities in relation to the group's interests in the unconsolidated structured entities	**26**	**–**	**–**	**26**
The group's maximum exposure	**1,001**	**4,038**	**2,154**	**7,193**
Total income from the group interests[1]	**3**	**42**	**159**	**204**
At 31 December 2013				
Total assets	13,674	1,005,343	10,036	1,029,053
Group interest – assets				
Cash	—	—	—	—
Trading assets	44	149	985	1,178
Financial assets designated at fair value	1,151	3,055	3,972	8,178
Derivatives	—	23	714	737
Loans and advances to customers	60	—	253	313
Financial investments	74	302	80	456
Other assets	54	25	—-	79
Total assets in relation to the group's interests in the unconsolidated structured entities	1,383	3,554	6,004	10,941
Total liabilities in relation to the group's interests in the unconsolidated structured entities	78	—	—	78
The group's maximum exposure	1,383	3,554	6,004	10,941
Total income from the group interests[1]	2	14	358	374

1. *Income includes recurring and non-recurring fees, interest, dividends, gains or loss on the remeasurement or derecognition of interests in structured entities, any mark-to-market gains/losses on a net basis and gains or losses from the transfer of assets and liabilities to the structured entity.*

Group managed funds

The group has established and manages money market funds and non-money market investment funds to provide customers with investment opportunities. The group, as fund manager, may be entitled to receive a management and performance fee based on the assets under management.

Non-group managed funds

The group purchases and holds units of third party managed funds in order to facilitate both business and customer needs.

Other

The group has established structured entities in the normal course of business for example, structured credit transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions.

Group sponsored structured entities

Accounting policy

The group is considered to sponsor another entity if, in addition to ongoing involvement with the entity, it had a key role in establishing that entity or in bringing together the relevant counterparties to a structured transaction, so that the transaction, which is the purpose of the entity, could occur. The group is generally not considered a sponsor if the only involvement with the entity is merely administrative in nature.

The amount of assets transferred to and income received from such sponsored entities during 2014 and 2013 was not significant.

Notes on the Financial Statements (continued)

37 Legal proceedings and regulatory matters

The group is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the group considers that none of these matters are material. The recognition of provisions is determined in accordance with the accounting policies set out in Note 27. While the outcome of legal proceedings and regulatory matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of these matters as at 31 December 2014. Where an individual provision is material, the fact that a provision has been made is stated and quantified. Any provision recognised does not constitute an admission of wrongdoing or legal liability. It is not practicable to provide an aggregate estimate of the potential liability for our legal proceedings and regulatory matters as a class of contingent liabilities.

Bernard L. Madoff Investment Securities LLC

Bernard L. Madoff ('Madoff') was arrested in December 2008, and ultimately pleaded guilty to running a Ponzi scheme. He has acknowledged, in essence, that while purporting to invest his customers' money in securities, he in fact never invested in securities and used other customers' money to fulfil requests to return investments. His firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), is being liquidated by a trustee (the 'Trustee').

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities. Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US$8.4 billion, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC, we have estimated that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US$4 billion. Various HSBC companies have been named as defendants in lawsuits arising out of Madoff Securities' fraud.

US/UK Litigation: The Trustee has brought suits against various HSBC companies in the US Bankruptcy Court and in the English High Court. The Trustee's US actions included common law claims, alleging that HSBC aided and abetted Madoff's fraud and breach of fiduciary duty. Those claims were dismissed on grounds of lack of standing. The Trustee's remaining US claims seek recovery of prepetition transfers pursuant to US bankruptcy law. The amount of these remaining claims has not been pleaded or determined as against HSBC.

Alpha Prime Fund Ltd ('Alpha Prime') and Senator Fund SPC, co-defendants in the Trustee's US actions, have brought cross-claims against HSBC. These funds have also sued HSBC in Luxembourg (discussed below).

The Trustee's English action seeks recovery of unspecified transfers from Madoff Securities to or through HSBC. HSBC has not yet been served with the Trustee's English action. The Trustee's deadline for serving the claim has been extended through the third quarter of 2015.

Fairfield Sentry Limited, Fairfield Sigma Limited, and Fairfield Lambda Limited (collectively 'Fairfield'), funds whose assets were invested with Madoff Securities, commenced multiple suits in the US and the British Virgin Islands (the 'BVI') against fund shareholders, including various HSBC companies that acted as nominees for HSBC clients, seeking restitution of payments made in connection with share redemptions. The US actions brought by Fairfield are stayed pending the outcome of the Fairfield cases in the BVI (discussed below).

In September 2013, the US Court of Appeals for the Second Circuit affirmed the dismissal of purported class action claims against HSBC and others brought by investors in three Madoff-invested funds on grounds of *forum non conveniens*. The plaintiffs' petitions for certiorari to the US Supreme Court were filed in December 2014. The Supreme Court's decision on whether to grant certiorari review is expected in the first half of 2015.

In December 2014, three new Madoff-related actions were filed. The first is a purported class action brought by direct investors in Madoff Securities who were holding their investments as of December 2008, asserting various common law claims and seeking to recover damages lost to Madoff Securities' fraud on account of HSBC's purported knowledge and alleged furtherance of the fraud. The other two actions were filed by SPV Optimal SUS Ltd ('SPV Optimal'), the purported assignee of the Madoff Securities-invested company, Optimal Strategic US Equity Ltd. One of these actions was filed in New York state court and the other in US federal district court. In January 2015, SPV Optimal dismissed its federal lawsuit against HSBC. The state court action against HSBC remains pending.

BVI Litigation: Beginning in October 2009, the Fairfield funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the BVI against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield funds are seeking restitution of redemption payments made by the funds to defendants on the grounds that they were mistakenly based on inflated net asset values. In April 2014, the UK Privy Council issued a ruling on two preliminary issues in favour of other defendants in the BVI actions, and issued its order in October 2014. There is also a pending motion brought by other defendants before the BVI court challenging the Fairfield liquidator's authorisation to pursue its claims in the US. The BVI court has adjourned the hearing on that pending motion until March 2015.

Bermuda Litigation: Thema Fund Limited ('Thema') and Hermes International Fund Limited ('Hermes'), funds invested with Madoff Securities, each also brought three actions in Bermuda in 2009. The first set of actions were brought against

HSBC Institutional Trust Services (Bermuda) Limited and seek recovery of funds in frozen accounts held at HSBC. The second set of actions asserts liability against HSBC Institutional Trust Services (Bermuda) Limited in relation to claims for mistake, recovery of fees, and damages for breach of contract. The third set of actions seeks return of fees from HSBC Bank Bermuda Limited and HSBC Securities Services (Bermuda). There has been little progress in these actions for several years, although in January 2015, Thema and Hermes served notice of intent to proceed in respect of the second set of actions referred to above.

Cayman Islands Litigation: In February 2013, Primeo Fund, a Cayman Islands-based fund invested in Madoff Securities, brought an action against the fund administrator, Bank of Bermuda (Cayman), and the fund custodian, HSBC Securities Services (Luxembourg) ('HSSL'), alleging breaches of contract. Primeo Fund claims damages from defendants to compensate it for alleged losses, including loss of profit and any liability to the Trustee. Trial has been postponed to January 2016.

Luxembourg Litigation: In April 2009, Herald Fund SPC ('Herald') (in official liquidation since July 2013) commenced action against HSSL before the Luxembourg District Court seeking restitution of all cash and securities Herald purportedly lost because of Madoff Securities' fraud, or in the alternative, damages in the same amount. In March 2013, the Luxembourg District Court dismissed Herald's restitution claim for the return of the securities. Herald's restitution claim for return of the cash and claim for damages were reserved. Herald appealed this judgement in May 2013. Judgement on the issue of a judicial bond is expected to be rendered in May 2015**.** Proceedings on the reserved restitution claim were suspended pending resolution of the appeal.

In October 2009, Alpha Prime sued HSSL before the Luxembourg District Court, alleging breach of contract and negligence in the appointment of Madoff Securities as a sub-custodian of Alpha Prime's assets. Alpha Prime was ordered to provide a judicial bond. Alpha Prime requested a stay of the proceedings pending its negotiations with the Trustee in the US proceedings. The matter has been temporarily suspended.

In March 2010, Herald (Lux) SICAV ('Herald (Lux)') (in official liquidation since April 2009) brought an action against HSSL before the Luxembourg District Court seeking restitution of securities, or the cash equivalent, or damages in the alternative. Herald (Lux) also requested the restitution of fees paid to HSSL as custodian and service agent of the fund. The last preliminary hearing is scheduled to take place in March 2015.

In December 2014, Senator Fund SPC commenced an action against HSSL before the Luxembourg District Court, seeking the restitution of securities held as of the latest net asset value statement from November 2008, or, in the alternative, damages. The first preliminary hearing is scheduled to take place in February 2015.

HSSL has been sued in various actions by the shareholders in the Primeo Select Fund, Herald, Herald (Lux), and Hermes funds. These actions are in different stages, most of which are dismissed suspended or postponed.

Ireland Litigation: In November 2013, Defender Limited, a fund invested with Madoff securities, commenced an action against HSBC Institutional Trust Services (Ireland) Limited ('HTIE'), alleging breach of the custodian agreement and claiming damages and indemnification for claims against it for fund losses. The action also includes four non-HSBC parties, who served as directors and investment managers to Defender Limited.

In July 2013 and December 2013, settlements were reached in respect of claims filed against HTIE in the Irish High Court by Thema International Fund plc ('Thema International') and Alternative Advantage Plc ('AA'),respectively. Five actions by individual Thema International shareholders remain.

In December 2014, a new proceeding against HTIE and HSBC Securities Services (Ireland) Limited was brought by SPV Optimal alleging breach of the custodian agreement and claiming damages and indemnification for fund losses.

There are many factors that may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings described above, including but not limited to the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. For these reasons, amongst others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities, or ranges of liabilities, that might arise as a result of all claims in the various Madoff-related proceedings, but they could be significant.

Anti-money laundering and sanctions-related investigations

In October 2010, HSBC Bank USA ('HSBC Bank USA') entered into a consent cease-and-desist order with the Office of the Comptroller of the Currency ('OCC'), and HSBC North America Holdings ('HNAH') entered into a consent cease-and-desist order with the Federal Reserve Bureau ('FRB') (the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across HSBC's US businesses, including risk management related to US Bank Secrecy Act (the 'BSA') and anti-money laundering ('AML') compliance. Steps continue to be taken to address the requirements of the Orders.

In December 2012, HSBC Holdings plc ('HSBC Holdings'), HNAH and HSBC Bank USA entered into agreements with US and UK government agencies regarding past inadequate compliance with the BSA, AML and sanctions laws. Among those agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement with the US Department of Justice ('DoJ'), the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia (the 'US DPA'); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney (the 'DANY DPA'); and HSBC Holdings consented to a cease and desist order and HSBC Holdings and HNAH consented to a civil money penalty order with the FRB. In addition, HSBC Bank USA entered into a civil money penalty order with FinCEN and a separate civil money penalty order with the OCC. HSBC Holdings also entered into an agreement with the Office of Foreign Assets Control ('OFAC') regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the UK Financial Conduct Authority (the 'FCA'), to comply with certain forward-looking AML and sanctions-related obligations.

Under these agreements, HSBC Holdings and HSBC Bank USA made payments totalling US$1.9 billion to US authorities and are continuing to comply with ongoing obligations. In July 2013, the US District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of that agreement. Under the agreements with the DoJ, FCA, and FRB, an independent monitor (who is, for FCA purposes, a 'skilled person' under Section 166 of the Financial Services and Markets Act) is evaluating and regularly assessing the effectiveness of HSBC's AML and sanctions compliance function and HSBC's progress in implementing its remedial obligations under the agreements.

HSBC Holdings has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two year period of that agreement in December 2014. If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DoJ charges against those entities will be dismissed at the end of the five-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to any matters that are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA.

HSBC Bank USA entered into a separate consent order with the OCC requiring it to correct the circumstances and conditions as noted in the OCC's then most recent report of examination, and imposing certain restrictions on HSBC Bank USA directly or indirectly acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, unless it receives prior approval from the OCC. HSBC Bank USA also entered into a separate consent order with the OCC requiring it to adopt an enterprise-wide compliance programme.

The settlement with US and UK authorities has resulted in private litigation, and does not preclude further private litigation relating to HSBC's compliance with applicable AML, BSA and sanctions laws or other regulatory or law enforcement actions for AML, BSA or sanctions matters not covered by the various agreements.

In November 2014, a complaint was filed in the US District Court for the Eastern District of New York on behalf of representatives of US persons killed or injured in Iraq between April 2004 and November 2011. The complaint was filed against HSBC Holdings, HSBC Bank plc, HSBC Bank USA and HSBC Bank Middle East, as well as other non-HSBC banks and the Islamic Republic of Iran (together, the 'Defendants'). The plaintiffs allege that defendants conspired to violate the US Anti-Terrorism Act, by altering or falsifying payment messages involving Iran, Iranian parties and Iranian banks for transactions processed through the US. Defendants' motion to dismiss is due to be filed in March 2015.

These private lawsuits are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing or any possible impact on HSBC.

London interbank offered rates, European interbank offered rates and other benchmark interest rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world including in the UK, the US, the EU, Switzerland and elsewhere, are conducting investigations and reviews related to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest rates. As certain HSBC companies are members of such panels, HSBC has been the subject of regulatory demands for information and is cooperating with those investigations and reviews.

In December 2013, the European Commission (the 'Commission') announced that it had imposed fines on eight financial institutions under its cartel settlement procedure for their participation in illegal activity related to euro interest rate derivatives and/or yen interest rate derivatives. Although HSBC was not one of the financial institutions fined, the Commission announced that it had opened proceedings against HSBC in connection with its Euribor-related investigation of euro interest rate derivatives only. This investigation will continue under the standard Commission cartel procedure. In May 2014, HSBC received a Statement of Objections from the Commission alleging anti-competitive practices in connection with the pricing of euro interest rate derivatives. The Statement of Objections sets out the Commission's preliminary views and does not prejudge the final outcome of its investigation. HSBC responded partially to the Commission's Statement of Objections in November 2014, and will have the opportunity to complete its response on a date to be decided by the Commission, once various procedural issues are resolved.

Based on the facts currently known, with respect to each of these ongoing investigations, there is a high degree of uncertainty as to the terms on which they will be resolved and the timing of such resolution, including the amounts of fines and/or penalties, which could be significant.

In addition, HSBC and other US dollar Libor panel banks have been named as defendants in a number of private lawsuits filed in the US with respect to the setting of US dollar Libor. The complaints assert claims under various US laws, including US antitrust and racketeering laws, the US Commodity Exchange Act ('CEA'), and state law. The lawsuits include individual and putative class actions, most of which have been transferred and/or consolidated for pre-trial purposes before the New York District Court.

Notes on the Financial Statements (continued)

In March 2013, the New York District Court overseeing the consolidated proceedings related to US dollar Libor issued a decision in the six oldest actions, dismissing the plaintiffs' federal and state antitrust claims, racketeering claims and unjust enrichment claims in their entirety, but allowing certain of their CEA claims that were not barred by the applicable statute of limitations to proceed. Some of those plaintiffs appealed the New York District Court's decision to the US Court of Appeals for the Second Circuit, which later dismissed those appeals. In January 2015, the US Supreme Court reversed the Court of Appeals' decision and remanded the case to the Court of Appeals for consideration of the merits of the plaintiffs' appeal.

Other plaintiffs sought to file amended complaints in the New York District Court to assert additional allegations. In June 2014, the New York District Court issued a decision that, amongst other things, denied the plaintiffs' request for leave to amend their complaints to assert additional theories of Libor manipulation against HSBC and certain non-HSBC banks, but granted leave to assert such manipulation claims against two other banks; and granted defendants' motion to dismiss certain additional claims under the CEA as barred by the applicable statute of limitations. Proceedings with respect to all other actions in the consolidated proceedings were stayed pending this decision. The stay was lifted in September 2014. Amended complaints were filed in previously stayed non-class actions in October 2014; and amended complaints were filed in several of the previously stayed class actions in November 2014. Motions to dismiss were filed in November 2014 and January 2015, respectively, and remain pending.

Separately, HSBC and other panel banks have also been named as defendants in a putative class action filed in the New York District Court on behalf of persons who transacted in euroyen futures and options contracts related to the euroyen Tokyo interbank offered rate ('Tibor'). The complaint alleges, amongst other things, misconduct related to euroyen Tibor, although HSBC is not a member of the Japanese Bankers Association's euroyen Tibor panel, as well as Japanese yen Libor, in violation of US antitrust laws, the CEA, and state law. In March 2014, the New York District Court issued an opinion dismissing the plaintiffs' claims under US antitrust law and state law, but sustaining their claims under the CEA. In June 2014, the plaintiffs moved for leave to file a third amended complaint. HSBC has opposed that motion which remains pending.

In November 2013, HSBC and other panel banks were also named as defendants in a putative class action filed in the New York District Court on behalf of persons who transacted in euro futures contracts and other financial instruments related to Euribor. The complaint alleges, amongst other things, misconduct related to Euribor in violation of US antitrust laws, the CEA, and state law. The plaintiffs filed a second and later third amended complaint in May 2014 and October 2014, respectively. HSBC intends to respond to the third amended complaint once a court ordered stay expires, currently set for May 2015.

In September and October 2014, HSBC Bank plc and other panel banks were named as defendants in a number of putative class actions that were filed and consolidated in the New York District Court on behalf of persons who transacted in interest rate derivative transactions or purchased or sold financial instruments that were either tied to USD ISDAfix rates or were executed shortly before, during, or after the time of the daily ISDAfix setting window. The complaint alleges, amongst other things, misconduct related to these activities in violation of US antitrust laws, the CEA, and state law. In October 2014 the plaintiffs filed a consolidated amended complaint. A motion to dismiss that complaint was filed in December 2014 and remains pending. In February 2015, plaintiffs filed a second consolidated amended complaint, replacing HSBC Bank plc with HSBC Bank USA.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing or any possible impact on HSBC.

Foreign exchange rate investigations and litigation

Various regulators and competition and law enforcement authorities around the world including in the UK, the US, the EU and elsewhere, are conducting investigations and reviews into a number of firms, including HSBC, related to trading on the foreign exchange markets.

In November 2014, HSBC Bank plc entered into regulatory settlements with the FCA and the US Commodity Futures Trading Commission ('CFTC') in connection with their respective investigations of HSBC's trading and other conduct involving foreign exchange benchmark rates. Under the terms of those settlements, HSBC Bank plc agreed to pay a financial penalty of £216 million to the FCA and a civil monetary penalty of £176 million to the CFTC, and to undertake various remedial actions.

The remaining investigations and reviews in the UK, the US and elsewhere are ongoing. Based on the facts currently known there is a high degree of uncertainty as to the terms on which they will be resolved and the timing of such resolutions, including the amounts of fines and/or penalties, which could be significant. As at 31 December 2014, HSBC has recognised a provision in the amount of £353 million in respect of these matters.

In addition, in late 2013 and early 2014, HSBC Holdings, HSBC Bank plc, HNAH and HSBC Bank USA were named as defendants, among other banks, in various putative class actions filed in the New York District Court. In March 2014, the plaintiffs filed a consolidated amended complaint alleging, among other things, that defendants conspired to manipulate the WM/Reuters foreign exchange benchmark rates by sharing customers' confidential order flow information, thereby injuring plaintiffs and others by forcing them to pay artificial and non-competitive prices for products based on these foreign currency rates ('the Consolidated Action'). Separate putative class actions were also brought on behalf of non-US plaintiffs (the 'Foreign Actions'). Defendants moved to dismiss all actions. In January 2015, the court denied defendants' motion to dismiss as to the Consolidated Action, but granted the defendants' motion to dismiss as to the Foreign Actions.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing or any possible impact on HSBC.

Precious metals fix-related litigation

Since March 2014, numerous putative class actions have been filed in the US District Courts for the Southern District of New York, the District of New Jersey and the Northern District of California naming HSBC Bank USA, HSBC Bank plc, HSBC Securities (USA) Inc. ('HSI') and other members of The London Gold Market Fixing Limited as defendants. The complaints allege that, from January 2004 to the present, the defendants conspired to manipulate the price of gold and gold derivatives during the afternoon London gold fix in order to reap profits on proprietary trades. These actions have been assigned to and consolidated in the New York District Court. An amended consolidated class action complaint was filed in December 2014, and HSBC's response was filed in February 2015.

Since July 2014, putative class actions were filed in the US District Court for the Southern District of New York and the Eastern District of New York naming HSBC Holdings, HNAH, HSBC Bank USA, HSBC USA Inc. and other members of The London Silver Market Fixing Ltd as defendants. The complaints allege that, from January 2007 to the present, defendants conspired to manipulate the price of physical silver and silver derivatives for their collective benefit in violation of US antitrust laws and the CEA. These actions have been assigned to and consolidated in the New York District Court. An amended consolidated class action complaint was filed in January 2015, and HSBC's response is due in March 2015.

Between late 2014 and early 2015, numerous putative class actions were filed in the New York District Court naming HSBC Bank USA and other members of The London Platinum and Palladium Fixing Company Limited as defendants. The complaints allege that, from January 2007 to the present, defendants conspired to manipulate the price of physical Platinum Group Metals ('PGM') and PGM-based financial products for their collective benefit in violation of the US antitrust laws and the CEA.

In November 2014, the DoJ issued a document request to HSBC Holdings seeking a voluntary production of documents relating to a criminal antitrust investigation which the DoJ is conducting in relation to precious metals. In January 2015, the CFTC issued a subpoena to HSBC Bank USA seeking production of documents related to HSBC Bank USA's precious metals trading operations. HSBC is cooperating with the US authorities in their respective investigations.

These matters are at an early stage. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these matters, including the timing or any possible impact on HSBC.

Credit default swap regulatory investigation and litigation

In July 2013, HSBC received a Statement of Objections from the Commission relating to its ongoing investigation of alleged anti-competitive activity by a number of market participants in the credit derivatives market between 2006 and 2009. The Statement of Objections sets out the Commission's preliminary views and does not prejudge the final outcome of its investigation. HSBC has submitted a response and attended an oral hearing in May 2014. Following the oral hearing the Commission decided to conduct a further investigation phase before deciding whether or how to proceed with the case. HSBC is cooperating with this further investigation. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of this matter, including the timing or any possible impact on HSBC.

In addition, HSBC Bank USA, HSBC Holdings and HSBC Bank plc have been named as defendants, amongst others, in numerous putative class actions filed in the New York District Court and the Illinois District Court. These class actions allege that the defendants, which include ISDA, Markit and several other financial institutions, conspired to restrain trade in violation of US antitrust laws by, amongst other things, restricting access to credit default swap pricing exchanges and blocking new entrants into the exchange market, with the purpose and effect of artificially inflating the bid/ask spread paid to buy and sell credit default swaps in the US. The plaintiffs in these suits purport to represent a class of all persons who purchased credit default swaps from or sold credit default swaps to defendants primarily in the US.

In October 2013 these cases were consolidated in the New York District Court. An amended consolidated complaint was filed in January 2014 naming HSBC Bank USA and HSBC Bank plc as defendants, amongst other non-HSBC defendants. Following the filing of defendants' initial motions to dismiss in March 2014, plaintiffs filed a second amended consolidated complaint, which defendants also moved to dismiss. In September 2014, the court granted in part and denied in part the defendants' motion to dismiss. Discovery is in process.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing or any possible impact on HSBC.

Notes on the Financial Statements (continued)

38 Related party transactions

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

Copies of the Group financial statements may be obtained from the following address:

HSBC Holdings plc
8 Canada Square
London
E14 5HQ

The group's related parties include the parent, fellow subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled or jointly controlled or significantly influenced by Key Management Personnel or their close family members.

(a) Transactions with Directors and other Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank plc and the group and includes members of the Boards of Directors of HSBC Bank plc and HSBC Holdings plc and Group Managing Directors of HSBC Holdings plc.

Compensation of Key Management Personnel

The following represents the compensation for Directors and other Key Management Personnel of the bank in exchange for services rendered to the bank for the period they served during the year. This reflects a number of changes at Board level during the last quarter of 2013 and during 2014.

	2014 £000	2013 £000
Short-term employee benefits	**3,937**	3,284
Post-employment benefits	**49**	159
Other long-term benefits	**808**	341
Share-based payments	**4,223**	1,709
	9,017	5,493

Shareholdings and options of Directors and other Key Management Personnel

	Balance at 31 December 2014	Balance at 31 December 2013
Number of options over HSBC Holdings plc ordinary shares held by Directors and other key management personnel under employee share plans [1]	**28,288**	224,916
Number of HSBC Holdings plc shares held by Directors and other key management personnel beneficially	**17,817,226**	14,999,933

Includes the holdings of Key Management Personnel of both the bank and its parent company, HSBC Holdings plc and their close family members

Transactions, arrangements and agreements including Directors and other Key Management Personnel

The table below sets out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the group and Key Management Personnel.

	2014		2013	
	Highest balance during the year[1] £000	**Balance at 31 December[1] £000**	Highest balance during the year[1] £000	Balance at 31 December[1] £000
Key Management Personnel[2]				
Loans	**149,645**	**137,396**	109,567	89,354
Credit cards	**1,587**	**589**	662	269
Guarantees	**–**	**–**	4,911	–

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

2 *Includes the Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, close family members of Key Management Personnel, and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.*

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Transactions with Directors: Advances, Credits and Guarantees (Companies Act 2006)

In addition to the requirements of IAS 24, particulars of advances (loans and quasi-loans), credits and guarantees entered into by HSBC Bank plc and its subsidiaries with Directors of HSBC Bank plc are required to be disclosed pursuant to section

Notes on the Financial Statements (continued)

413 of the Companies Act 2006. Under the Companies Act there is no requirement to disclose transactions with the Key Management Personnel of the bank's parent company, HSBC Holdings plc.

The table below sets out transactions which fall to be disclosed under section 413 of Companies Act 2006.

The group

	Balance at 31 December 2014 £000	Balance at 31 December 2013 £000
Directors		
Loans	**12,975**	3,493
Credit cards	**61**	57

No guarantees were issued in favour of Directors during 2014 (2013: nil).

(b) Transactions with other related parties

Associates and joint ventures

The group

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Amounts due from joint ventures – unsubordinated	**132**	**132**	182	182
Amounts due to joint ventures	**–**	**–**	4	4

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

The *bank*

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Amounts due from joint ventures – unsubordinated	**132**	**132**	182	182
Amounts due to joint ventures	**–**	**–**	4	4

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Transactions of the group with HSBC Holdings plc and fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Holdings plc.

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**1,824**	**1,319**	1,982	1,574
Financial assets designated at fair value	**23**	**23**	23	22
Loans and advances to customers	**3,966**	**513**	4,580	3,582
Financial investments	**99**	**94**	103	100
Liabilities				
Trading liabilities	**–**	**–**	2	–
Customer accounts	**10,993**	**8,689**	10,033	10,033
Subordinated amounts due	**6,025**	**4,035**	5,827	5,827
Guarantees	**–**	**–**	–	–

Notes on the Financial Statements (continued)

	2014 £m	2013 £m
Income Statement		
Interest income	**47**	71
Interest expense	**189**	177
Fee income	**1**	1
Dividend income	**1**	1
Trading income	**1**	10
Other operating income	**66**	20
General and administrative expenses	**37**	76

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

Transactions detailed below include amounts due to/from fellow subsidiaries of HSBC Holdings plc

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**8,093**	**1,489**	9,765	1,801
Derivatives	**19,767**	**19,767**	21,175	15,698
Financial assets designated at fair value	**25**	**21**	62	18
Loans and advances to banks	**12,106**	**12,106**	10,542	9,301
Loans and advances to customers	**5,624**	**4,643**	4,161	3,969
Financial investments	**246**	**77**	270	114
Liabilities				
Trading liabilities	**12,954**	**7,269**	20,165	7,163
Financial liabilities designated at fair value	**–**	**–**	–	–
Deposits by banks	**11,124**	**9,040**	15,225	9,230
Customer accounts	**8,574**	**1,453**	9,017	6,878
Derivatives	**19,289**	**19,289**	19,664	15,745
Subordinated amount due	**1,818**	**1,694**	2,220	1,826
Guarantees	**1,791**	**1,102**	2,016	889

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2014 £m	2013 £m
Income Statement		
Interest income	**31**	24
Interest expense	**114**	137
Fee income	**95**	102
Fee expense	**220**	296
Trading income	**38**	82
Other operating income	**123**	70
General and administrative expenses	**317**	273

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Notes on the Financial Statements (continued)

Transactions between HSBC Bank plc and its subsidiaries and HSBC Holdings plc and the other fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Bank plc and its subsidiaries.

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**10,462**	**3,659**	27,817	7,677
Derivatives	**15,114**	**14,836**	18,734	12,971
Financial assets designated at fair value	**–**	**–**	–	–
Loans and advances to banks	**11,223**	**8,568**	14,010	11,928
Loans and advances to customers	**11,610**	**10,830**	18,880	11,495
Financial investments	**8,878**	**7,866**	9,069	8,895
Liabilities				
Trading liabilities	**6,179**	**1,458**	21,397	2,928
Deposits by banks	**15,320**	**11,359**	16,573	11,877
Customer accounts	**3,524**	**3,224**	3,573	3,573
Derivatives	**14,907**	**14,907**	16,476	12,415
Subordinated amounts due	**2,276**	**2,181**	2,928	2,283
Guarantees	**1,177**	**1,177**	1,795	957

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

Transactions detailed below include amounts due to/from HSBC Bank plc and HSBC Holdings plc.

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**1,691**	**954**	1,884	1,220
Loans and advances to customers	**3,965**	**511**	4,579	3,581
Liabilities				
Trading liabilities	**–**	**–**	2	–
Customer accounts	**10,961**	**8,669**	10,011	10,011
Subordinated amounts due	**5,756**	**3,562**	5,567	5,567
Guarantees	**–**	**–**	–	–

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

In December 2010, the bank received two guarantees from HSBC Holdings plc in respect of monies owing to the bank by its structured investment conduits ('SICs'). The first guarantee covers due but unpaid monies owed by the bank's principal SIC, Solitaire, up to a maximum amount of US$16 billion, to the extent that unpaid liabilities exceed US$1 billion. A second guarantee covers due but unpaid monies owed by the bank's other SICs, Mazarin, Barion and Malachite, up to a maximum amount of US$22 billion, to the extent that unpaid liabilities exceed US$200 million. In December 2012, the bank received a third guarantee from HSBC Holdings plc that covers due but unpaid monies owed to the bank by its multi-seller conduit, Regency, up to a maximum amount of US$17 billion, to the extent that unpaid liabilities exceed US$2 billion.
The bank pays no fee to its parent company for the provision of these guarantees.

Transactions detailed below include amounts due to/from HSBC Bank plc and fellow subsidiaries of HSBC

	2014		2013	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**7,940**	**1,390**	9,594	1,734
Derivatives	**33,412**	**33,412**	37,701	27,618
Loans and advances to banks	**8,229**	**8,126**	6,533	5,897
Loans and advances to customers	**4,941**	**4,203**	3,943	3,787
Liabilities				
Trading liabilities	**12,848**	**7,129**	19,997	7,117
Deposits by banks	**8,808**	**8,118**	8,624	6,219
Customer accounts	**8,355**	**1,339**	8,893	6,755
Derivatives	**35,806**	**35,806**	36,465	30,027
Subordinated amount due	**–**	**–**	297	–
Guarantees	**1,683**	**988**	1,877	752

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

Notes on the Financial Statements (continued)

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Pension funds

At 31 December 2014, fees of £5 million (2013: £9 million) were earned by group companies for management services related to the group's pension funds held under management. The group's pension funds had placed deposits of £121 million (2013: £347 million) with its banking subsidiaries.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The HSBC Bank (UK) Pension Scheme (the 'Scheme') entered into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 31 December 2014, the gross notional value of the swaps was £15,177 million (2013: £26,144 million), the swaps had a negative fair value of £597 million to the bank (2013: negative fair value of £1,710 million) and the bank had delivered collateral of £1,268 million (2013: £2,348 million) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

39 Events after the balance sheet date

A second interim dividend for 2014 of £315 million to shareholders of the parent company was declared by the Directors after 31 December 2014.

HSBC Bank plc
Incorporated in England with limited liability. Registered in England: number 14259

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HSBC Bank plc

Additional Information 2014

HSBC

Additional Information 2014

Presentation of Information

This document, which should be read in conjunction with the HSBC Bank plc Annual Report and Accounts 2014, contains certain additional information, including commentary on the group's results for 2013 compared to 2012 and certain statistical and other information not required to be included in the group's Annual Report and Accounts by either the UK Companies Act 2006 or by International Financial Reporting Standards.

In November 2012, the group sold HSBC Private Banking Holdings (Suisse) SA to HSBC Holdings plc, with the exception of HSBC Private Bank (UK) Limited which remains as part of the group. The 2012 results include 10 months of HSBC Private Banking Holdings (Suisse) SA prior to its sale.

With effect from 1 January 2013, the group's operating segments were revised to reflect internal changes made to the management structure. The revised segments are consistent with those reported to the bank's Executive Committee, the identified Chief Operating Decision Maker under IFRS 8. The 2012 segmental information comparatives have been adjusted to the new basis.

'Prior period information', business commentary is provided on a reported basis. To enable consistent comparison to the adjusted basis referenced in the HSBC Bank plc's Annual Report and Accounts 2014 a reconciliation between the reported and adjusted performance has been provided in the Appendix setting out comparative figures for each of the adjusting items reported for 2014.

'Prior period information' is reported as published in the HSBC Bank plc Annual Report and Account 2013 and does not reflect the new balance sheet representation of reverse repurchase agreements and repurchase agreement as applied by HSBC Bank plc from 1 January 2014. "Other information" for 2014 along with related comparatives is aligned to the 2014 reported balance sheet reflecting this revised presentation.

Contents

Prior period information

Financial highlights of the group 2013 and 2012

	2013	2012
For the year (£m)		
Profit on ordinary activities before tax [1]	3,294	1,004
Total operating income	15,868	15,407
Net operating income before loan impairment charges and other credit risk provisions	12,840	12,488
Profit attributable to shareholders of the parent company	2,495	2,384
At year-end (£m)		
Total equity attributable to shareholders of the parent company	32,370	31,675
Risk weighted assets	185,879	193,402
Loans and advances to customers (net of impairment allowances)	305,032	282,685
Customer accounts	390,017	324,886
Capital ratios (%)		
Core Tier 1 ratio	12.1	11.4
Tier 1 ratio	13.0	12.4
Total capital ratio	18.0	17.3
Performance ratios (%)		
Return on average invested capital (on underlying basis) [2]	8.4	6.2
Return on average invested capital (on reported basis)	7.9	3.2
Return on average shareholders' funds (equity) of the parent company [3]	7.9	3.5
Post-tax return on average total assets	0.3	0.1
Pre-tax return on average risk-weighted assets	1.7	0.5
Dividend payout ratio [4]	80.2	118.4
Credit coverage ratios (%)		
Loan impairment charges as a percentage of total operating income	6.1	8.1
Loan impairment charges as a percentage of average gross customer advances	0.4	0.5
Efficiency and revenue mix ratios (%)		
Cost efficiency ratio [5]	66.8	82.0
As a percentage of total operating income:		
- net interest income	43.9	44.8
- net fee income	21.0	24.5
- net trading income	15.0	11.9
Financial ratios (%)		
Ratio of customer advances to customer accounts	78.2	87.0
Average total shareholders' equity to average total assets	3.8	3.4

1 *Excludes 2012 gain on sale of £1,265 million of HSBC Private Banking Holdings (Suisse) SA to HSBC Holdings plc.*

2 *The return on average invested capital measures the return made in the business, enabling management to benchmark the group against competitors. This ratio is defined as profit attributable to shareholders of the bank divided by average invested capital. Average invested capital is measured as average total shareholders' equity after deducting the average of the group's:*
- *revaluation surplus relating to property held for own use. This reserve was generated when determining the deemed carrying cost of such properties on transition to IFRSs and will run down over time as the properties are sold;*
- *preference shares and other equity instruments issued by HSBC Bank plc (as defined in Note 32 'Called up share capital and other equity instruments'); and*
- *average reserves for unrealised gains/ (losses) on effective cash flow hedges and available-for-sale securities.*

3 *The return on average total shareholders' equity is defined as profit attributable to shareholders of the bank divided by the average total shareholders' equity.*

4 *Dividends per ordinary share expressed as a percentage of basic earnings per share. Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year.*

5 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

The financial highlights are influenced by changes in the group structure over the two years.

Prior period information (continued)

Key Performance Indicators

The Board of Directors monitors the group's progress against its strategic objectives on a regular basis. Progress is assessed by comparison with the group strategy, operating plan targets and historical performance. Further information on the key performance indicators is given on page 11 of the *Annual Report and Accounts 2014*.

Financial KPIs

	2013	2012
	%	%
Risk adjusted revenue growth	5.6	(9.3)
Cost efficiency ratio	66.8	82.0
Pre-tax return on average risk-weighted assets ratio	1.7	0.5
Core tier 1 capital ratio	12.1	11.4

Financial summary

Summary consolidated income statement

	2013	2012 Continuing operations	2012
	£m	£m	£m
Net interest income	6,961	6,519	6,904
Net fee income	3,336	3,309	3,781
Trading income	2,373	1,587	1,834
Net income from financial instruments designated at fair value	900	118	118
Gains less losses from financial investments	100	335	336
Net earned insurance premiums	2,022	2,286	2,286
Other operating income	176	144	148
Total operating income	15,868	14,298	15,407
Net insurance claims incurred and movement in liabilities to policyholders	(3,028)	(2,919)	(2,919)
Net operating income before impairments and provisions	12,840	11,379	12,488
Loan impairment charges and other credit risk provisions	(971)	(1,246)	(1,245)
Net operating income	11,869	10,133	11,243
Total operating expenses[1]	(8,575)	(9,506)	(10,236)
Operating profit	3,294	627	1,007
Share of profit in associates and joint ventures	-	(3)	(3)
Profit before tax	3,294	624	1,004
Tax (expense)/ credit	(754)	220	156
Profit for the year before discontinued operations	2,540	844	1,160
Gain on sale of discontinued operations[2]	–	–	1,265
Profit for the year	2,540	844	2,425
Profit attributable to shareholders of the parent company	2,495	803	2,384
Profit attributable to non-controlling interests	45	41	41

1 *Total operating expenses include notable items as detailed on page 7.*

2 *On the sale of HSBC Private Banking Holdings (Suisse) SA, the associated foreign exchange revaluation reserve of £1,258 million was recycled through the income statement, together with a gain on disposal of £7 million.*

Prior period information (continued)

Review of business performance

The following commentaries reflect reported performance including significant items excluded from the "adjusted performance" measures as described further on pages 18 and 19 of the bank's *Annual Report and Accounts 2014*. The appendix provides a reconciliation of reported to adjusted comparatives for each of the adjusting items reported for 2014 profit before tax, revenue and operating expenses for the group, and each business (on a total as well as a continuing basis).

For comparison, adjusted profit before tax would have been £4,210 million and £3,562 million for 2013 and 2012 respectively as compared to reported profit before tax of £3,294 million and £1,004 million for 2013 and 2012 respectively.

2013 compared with 2012

HSBC Bank plc and its subsidiary undertakings reported profit before tax of £3,294 million, £2,290 million or 228 per cent higher than 2012.

On a continuing operations basis, adjusting the 2012 results to exclude the contribution made by HSBC Private Banking Holdings (Suisse) SA, profit before tax increased by £2,670 million or 428 per cent compared with 2012. This was primarily due to lower adverse fair value movements on own debt attributable to credit spreads of £167 million (£1,055 million in 2012) and significantly lower operating expenses from a decrease in charges relating to UK customer redress programmes, an accounting gain of £280 million relating to changes in delivering ill-health benefits to certain employees in the UK and sustainable cost savings in 2013.

Progress continues to be made in aligning the in-country businesses to the respective global business operating models. This is designed to reduce complexity and lower costs in a sustainable way. Total restructuring costs of £96 million were incurred as a result of streamlining the businesses and other initiatives which delivered sustainable cost savings of approximately £370 million.

RBWM continued to make progress in delivering against its strategy. In addition, the business implemented the Global Wealth Incentive Plan to better align customer and business interests. In Turkey, unsecured lending continued to grow, notably in personal lending and cards, while in France there was strong growth in both mortgage and deposit balances.

CMB repositioned its Business Banking segment towards international and internationally aspirant customers, while streamlining and re-engineering core processes to deliver efficiencies, which supported continued investment in corporate banking and Global Trade and Receivables Finance. Following the success of the 2012 International SME Fund, the business launched a further fund in the UK in 2013 and similar SME funds in France and Turkey targeted at international trade customers.

In GB&M, debt capital markets activity in the Credit and Capital Financing businesses was successful in capturing growth in issuance demand which has resulted in leading market positions and an increase in sterling markets share. The business was ranked first by Bloomberg for primary debt capital market issuances in 2013. In France, the business acted as joint book runner of a £5.17 billion hybrid bond for a premier corporate client, demonstrating HSBC's ability to deliver large and complex transactions, connecting customers to opportunities.

GPB continued to reposition its business model and target its client base to focus on selected priority markets. In November 2013 the legal ownership of HSBC's Channel Islands Private Banking group was transferred to HSBC Private Bank (UK) Limited from HSBC Private Banking Holdings (Suisse) SA.

The business continued to implement Global Standards and reposition itself through the adoption of new compliance and tax transparency standards.

Items which are significant in a comparison of 2013's results to 2012 have been summarised on page 7. The following commentary is on a continuing operations basis.

Net interest income increased by £442 million or 7 per cent. The income increase in RBWM was from growth in lending balances and margins, notably residential mortgages in the UK and, to a lesser extent, home loans in France. In GB&M, Balance Sheet Management net interest income was higher largely due to interest rate management and net deployment of funds at enhanced levels during the year. In addition, net interest income rose from higher lending spreads in Capital Financing and lower interest paid resulting from legacy portfolio maturities. In CMB, net interest income was also higher, primarily in the UK, from growth in term lending revenues from higher spreads on new and renewed business resulting in increased portfolio margins overall as well as deposit growth in Payments and Cash Management.

Net fee income increased by £27 million or 1 per cent. In CMB the growth in fee income reflected a rise in lending fees in the UK and Germany. In GB&M, net fee income decreased primarily due to higher fees paid to HSBC entities in other regions relating to increased foreign exchange trading activities undertaken for their clients. This was partly offset by increased issuance demand in debt capital markets and event-driven fee income in equity underwriting from increased deal volumes. In RBWM the growth in credit card revenue in Turkey was more than offset by a higher level of fees payable under partnership arrangements and lower creditor insurance fees in the UK.

Trading income increased by £786 million or 50 per cent. Of this increase £344 million was due to lower adverse foreign exchange movements on trading assets held as economic hedges against issued foreign currency debt designated at fair value, compared to 2012. These offset lower favourable foreign exchange movements on the foreign currency debt reported in *"Net (expenses) income from financial instruments designated at fair value"*.

In Markets, revenues were higher than 2012 which included a charge of £387 million as a result of a change in estimation methodology in respect of credit valuation adjustments on derivative assets. This was partially offset by lower favourable debit valuation adjustments from the change in estimation methodology in 2012 for

Prior period information (continued)

derivative liabilities of £45 million compared to £191 million in 2012.

Foreign exchange income benefited from increased client activity in part offset by margin compression and reduced market volatility in the second half of 2013. Equities benefited from increased deal volumes and revaluations gains. Rates revenue decreased, despite new client mandates and improved market share, particularly in European government bonds, as 2012 benefited from tightening spreads following the ECB liquidity intervention. In addition, revenue was also favourable from lower adverse fair value movements from own credit spreads on structured liabilities.

Net income from financial instruments designated at fair value increased by £782 million compared to 2012. This included favourable credit spread-related movements in the fair value of the group's own long-term debt of £888 million as adverse fair value movements were less extensive in 2013 compared to 2012. In addition, net income arising from financial assets held to meet liabilities under insurance and investment contracts increased reflecting higher net investment returns in 2013 than in 2012. These returns reflected favourable equity market movements in the UK and France.

Investment gains or losses arising from equity markets result in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back insurance contracts or investment contracts with discretionary participation features ('DPFs'), the corresponding movement in liabilities to customers is recorded under '*Net insurance claims incurred and movement in liabilities to policyholders'*.

Other changes in fair value reflected lower favourable foreign exchange movements of £344 million in 2013 compared to 2012 on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset from assets held as economic hedges in '*Trading income'*), and higher adverse movements due to hedging ineffectiveness in 2013.

Gains less losses from financial investments were £235 million or 70 per cent lower than in 2012. Net gains on the disposal of debt securities fell as 2012 included significant gains on the sale of available-for-sale government debt securities, notably in the UK, arising from the structural interest rate risk management of the balance sheet.

Net earned insurance premiums decreased by £264 million or 12 per cent. This was mainly as a result of lower sales of investment contracts with DPFs in France. In addition, 2012 benefited from a number of large sales through independent financial adviser channels which are now in run off.

Other operating income was broadly in line with the prior year.

Net insurance claims incurred and movement in liabilities to policyholders increased by £109 million or 4 per cent. This reflected higher investment returns on the assets held to support policyholder contracts where the policyholder bears investment risk from favourable equity market movements in the UK and France. This was partly offset by a decrease in new business written, notably in France, as explained under '*Net earned insurance premiums'*.

Loan impairment charges and other credit risk provisions decreased by £275 million or 22 per cent. In the UK, GB&M reported net releases of credit risk provisions on available-for-sale asset backed securities, compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, there were lower loan impairment charges in CMB due to lower collectively and individually assessed provisions and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales. In other European countries, lower individually assessed impairment provisions for CMB in Greece, were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM, and in the Spanish GB&M and CMB businesses as challenging economic conditions continued to affect the market.

Total operating expenses decreased by £931 million or 10 per cent, primarily due to lower customer redress provisions and a reduction of restructuring costs of £71 million.

These included:

- a charge for additional estimated redress for possible mis-selling in previous years of payment protection insurance ('PPI') policies of £483 million (£938 million in 2012);
- £166 million in respect of interest rate protection products (£375 million in 2012); and
- £96 million in respect of wealth management products.

In addition litigation-related expenses increased primarily due to Madoff litigation costs in GB&M following settlements reached in Ireland.

Following a consultation process on several employee benefit proposals, the group announced to UK employees that the future service accrual for defined benefit pension members would cease from 1 July 2015. As part of these amendments, the group is changing the basis of delivering ill-health benefits to certain employees, resulting in the recognition of an accounting gain of £280 million. This gain together with lower performance costs in GB&M reduced the level of staff costs compared to 2012.

During 2013 the group maintained its strict cost control discipline and benefited from the delivery of the organisational effectiveness programmes. The number of employees, expressed in fulltime equivalent numbers at the end of 2013 was 3 per cent lower compared to 2012.

Tax expense totalled £754 million in 2013, compared to tax income of £156 million (on a reported basis) in 2012. The effective tax rate for 2013 was 22.9 per cent, compared to a credit of 6.9 per cent (on a reported basis) in 2012. The effective tax rate in 2012 was lower primarily due to a non-taxable intragroup disposal of HSBC Private Banking Holdings (Suisse) SA and losses claimed from HSBC Holdings plc for nil consideration.

Prior period information (continued)

Review of business position

Summary consolidated balance sheet

	2013	2012
	£m	£m
Total assets	811,695	815,481
Cash and balances at central banks	67,584	51,613
Trading assets	134,097	161,516
- reverse repos	5,607	35,951
- other trading assets	128,490	125,565
Financial assets designated at fair value	16,661	15,387
Derivative assets	137,239	177,808
Loans and advances to banks	53,228	32,286
- reverse repos	30,023	13,798
- loans and other receivables	23,205	18,488
Loans and advances to customers	305,032	282,685
- reverse repos	29,091	16,890
- loans and other receivables	275,941	265,795
Financial investments	75,030	71,265
Other	22,824	22,921
Total liabilities	778,776	783,281
Deposits by banks	50,683	39,571
- repos	20,863	6,357
- cash deposits and other accounts	29,820	33,214
Customer accounts	390,017	324,886
- repos	38,039	12,207
- cash deposits and other accounts	351,978	312,679
Trading liabilities	91,842	122,896
- repos	9,426	40,742
- other	82,416	82,154
Financial liabilities designated at fair value	34,036	32,918
Derivative liabilities	137,352	181,095
Debt securities in issue	32,895	40,358
Liabilities under insurance contracts issued	19,228	17,913
Other	22,723	23,644
Total equity	32,919	32,200
Total shareholders' equity	32,370	31,675
Non-controlling interests	549	525

Prior period information (continued)

Movements in 2013

Total assets were £812 billion, in line with prior year.

The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts at 78.2 per cent (2012: 87.0 per cent).

The group's core tier 1 ratio stood at 12.1 per cent (2012: 11.4 per cent).

In 2013, GB&M changed the way it manages repo and reverse repo activities in the Credit and Rates businesses which were previously being managed in a trading environment. During the year, the repo and reverse repo business activities were organised into trading and non-trading portfolios, with separate risk management procedures. This resulted in an increase in the amount of reverse repos classified as *'Loans and advances to customers'* and *'Loans and advances to banks*', and a decline in the amount classified as *'Trading assets'* by 31 December 2013, compared to previous period-ends. Similarly, by 31 December 2013 there was an increase in the amount of repos classified as *'Customer accounts'* and *'Deposits by banks'*, with a decline in the amount classified as *'Trading liabilities'*, compared to previous period-ends. The increase in amortised cost balances and the decrease in trading balances primarily occurred in the UK.

Assets

Cash and balances at central banks rose by 31 per cent as a greater portion of the surplus liquidity was placed with central banks, reflecting growth in deposits in excess of lending opportunities.

Trading assets decreased by 17 per cent. Excluding the change in GB&M's management approach, trading assets were broadly in line with December 2012 levels.

Financial assets designated at fair value increased by 8 per cent due to favourable market movements in insurance operations and the investment of premium income received during the year in the insurance businesses.

Derivative assets decreased by 23 per cent. Upward movements in yield curves in major currencies led to a decline in the fair value of interest rate contracts, although this was partly offset by a reduction in netting.

Loans and advances to banks increased by 65 per cent predominantly due to GB&M's change in the management approach for reverse repos. Excluding this, there was a £5 billion increase driven by higher placements with financial institutions.

Loans and advances to customers increased by 8 per cent, including a £12 billion increase in reverse repo balances. Excluding these, customer lending balances grew by £10 billion as the group continued to grow its mortgage and home loan portfolios in the UK and France, reflecting the banks competitive offering. In addition, there was an increase in corporate overdraft balances that did not meet the criteria for netting.

Financial investments increased by 5 per cent as part of the group's redeployment of liquidity, mainly into UK government debt securities.

Liabilities

Deposits by banks increased by 28 per cent. Excluding the increase in repo balances there was a fall in balances mainly due to redemptions.

Customer accounts increased by 20 per cent of which 8 per cent related to the change in GB&M's management approach to repo funding. Excluding this impact, customer accounts increased by £39 billion as in the UK RBWM customers' continued to have a preference for holding higher balances in readily accessible current and savings accounts. In addition there was higher Payments and Cash Management business in GB&M and CMB. Current accounts also grew in GB&M due to higher balances that did not meet the netting criteria.

Trading liabilities decreased by 25 per cent, again largely due to the change in the management approach for repo trade activities.

The derivative businesses are managed within market risk limits and, as a consequence, the decrease in the value of '*Derivative liabilities'* broadly matched that of *'Derivative assets'.*

Debt securities in issue fell by 18 per cent. This was due to net redemptions of debt securities in issue.

Liabilities under insurance contracts increased by 7 per cent. The increase was mainly driven by liabilities to policyholders established for new business together with the impact of an increase in equity markets of unit-linked insurance contracts.

Equity

Total shareholders' equity rose by 2 per cent.

Prior period information (continued)

Performance and Business Review

Profit on ordinary activities before tax

	2013 £m	2012 Continuing operations £m	2012 Total £m
Retail Banking and Wealth Management	**1,177**	411	411
Commercial Banking	**1,333**	766	766
Global Banking and Markets	**1,023**	642	642
Global Private Banking	**140**	100	480
Other/Intersegment	**(379)**	(1,295)	(1,295)
	3,294	624	1,004

Notable items by business segment

The following items are significant in a comparison of 2013's results against 2012:

	Retail Banking and Wealth Management £m	Commercial Banking £m	Global Banking and Markets £m	Global Private Banking £m	Other £m	Total £m
2013						
UK customer redress programmes	**610**	**91**	**84**	**2**	**–**	**787**
Restructuring and other related costs	**41**	**18**	**6**	**1**	**30**	**96**
Operational losses	**–**	**(10)**	**–**	**–**	**–**	**(10)**
Gain in change of delivering ill-health benefit	**(123)**	**(104)**	**(53)**	**–**	**–**	**(280)**
2012 (continuing operations)						
UK customer redress programmes	982	162	207	–	–	1,351
Restructuring and other related costs	47	22	36	5	57	167
Operational losses	–	65	–	–	–	65
Other provisions	–	–	–	–	84	84

HSBC Bank plc and its subsidiaries reported a profit before tax of £3,294 million, £2,290 million or 228 per cent higher than 2012. On a continuing operations basis profit before tax was £2,670 million or 328 per cent higher than 2012.

On a continuing operations basis all business segments reported significantly higher profits in 2013, with RBWM, CMB and GB&M all reporting profits in excess of £1 billion.

GPB reported lower levels of reported profit than 2012. This reflected the sale of HSBC Private Banking Holdings (Suisse) SA in November 2012.

Retail Banking and Wealth Management

	2013 £m	2012 £m
Net interest income	**3,569**	3,394
Net fee income	**1,502**	1,532
Trading income	**147**	32
Other income	**(147)**	(52)
Net operating income before impairments and provisions	**5,071**	4,906
Loan impairment charges and other credit risk provisions	**(223)**	(248)
Net operating income	**4,848**	4,658
Total operating expenses	**(3,673)**	(4,248)
Operating profit	**1,175**	410
Share of profit in associates and joint ventures	**2**	1
Profit before tax	**1,177**	411

Profit before tax – by country

	2013 £m	2012 £m
United Kingdom	**995**	309
France	**182**	85
Germany	**19**	18
Turkey	**(47)**	(20)
Malta	**22**	25
Other	**6**	(6)
Profit before tax	**1,177**	411

Overview

RBWM reported a profit before tax of £1,177 million, £766 million or 186 per cent higher than 2012. This was primarily due to a decrease in operating expenses resulting from lower provisions of £372 million relating to customer redress programmes, an accounting gain on changes to staff benefits of £123 million and growth in revenues.

RBWM continued to fulfil the hopes and ambitions of customers by supporting the UK housing market, approving £14.4 billion of new mortgage lending to over 135,000 customers during 2013. This included £3.8 billion to over 30,000 first time buyers. The loan to value ratio on new lending was 59.5 per cent compared with the ratio of the average mortgage portfolio 48.3 per cent. In France, the business increased the market share in home loans confirming the ability to grow the mortgage business in a highly competitive market. In Turkey, unsecured lending continued to grow notably in

Prior period information (continued)

the credit card business through new product features and channel capabilities including mobile banking.

In addition, the business implemented the Global Wealth Incentive Plan to better align customer and business interests.

Financial performance

Net interest income increased by £175 million or 5 per cent, primarily due to higher lending balances and margins, principally in residential mortgages in the UK and home loans in France, with the UK also experiencing growth in customer accounts. This was partially offset by deposit spread compression in 2013.

Net fee income decreased by £30 million or 2 per cent predominantly in the UK due to a higher level of fees payable under partnership arrangements and lower creditor insurance fees. This was partially offset by growth in card revenue in Turkey from business expansion.

Trading income increased by £115 million, mainly due to favourable fair value adjustments on non-qualifying hedges on the French home loans portfolio, as long-term interest rates rose. In addition, there were favourable market movements on derivatives used as economic hedges in the insurance business in France.

Other income decreased by £95 million. Lower levels of net earned premiums and higher levels of claims on credit protection and term-lending policies more than offset the increase in net income from financial assets designated at fair value. In addition, the offset of the net trading gain on economic hedges noted in *'Trading income'* also contributed to lower *'Other income'*.

Loan impairment charges and other credit risk provisions decreased by £25 million or 10 per cent. A fall in loan impairment charges in the UK as a result of improved delinquency rates and recoveries of previously written off debt were in part offset by an increase in Turkey, reflecting growth in credit card volumes.

Total operating expenses decreased by £575 million or 14 per cent. Excluding the £123 million accounting gain relating to the change of ill-health benefits in 2013 and customer redress provisions of £610 million compared to £982 million in 2012, operating expenses were 2 per cent lower. This reflected the benefits being delivered through re-engineering and streamlining of business processes and were achieved despite the additional cost incurred in respect of new regulation and implementation of the Group's Global Standards. The customer redress provision related primarily to the possible mis-selling of PPI policies and wealth management products.

Adjusted performance

For comparison:

- adjusted profit before tax would have been £1,672 million and £1,442 million for 2013 and 2012, respectively;
- adjusted revenue would have been £5,038 million and £4,908 million for 2013 and 2012, respectively; and
- adjusted operating expenses would have been £3,145 million and £3,219 million for 2013 and 2012, respectively.

Please refer to the appendix for a reconciliation of reported to adjusted figures.

Commercial Banking

	2013 £m	2012 £m
Net interest income	**2,144**	2,037
Net fee income	**1,143**	1,047
Trading income	**23**	26
Other income	**60**	70
Net operating income before impairments and provisions	**3,370**	3,180
Loan impairment charges and other credit risk provisions	**(601)**	(699)
Net operating income	**2,769**	2,481
Total operating expenses	**(1,437)**	(1,715)
Operating profit	**1,332**	766
Share of profit in associates and joint ventures	**1**	–
Profit before tax	**1,333**	766

Profit before tax – by country

	2013 £m	2012 £m
United Kingdom	**1,075**	529
France	**163**	128
Germany	**45**	41
Turkey	**24**	45
Malta	**33**	33
Other	**(7)**	(10)
Profit before tax	**1,333**	766

Overview

CMB reported a profit before tax of £1,333 million, £567 million or 74 per cent higher than 2012. Overall revenues rose by 6 per cent primarily due to growth term lending in the UK and higher fee income earned in both the UK and Germany.

CMB continued to help businesses thrive and prosper by further repositioning its Business Banking segment towards international and internationally aspirant customers. The streamlining and re-engineering of core processes delivered efficiencies in a number of areas and supported continued investment in corporate banking and Global Trade and Receivables Finance.

Following the success of the 2012 International SME fund the business launched a further fund in 2013, continuing to support UK businesses that trade or aspire to trade internationally with approved lending of £4.8 billion. This included the renewal of overdraft and other lending facilities. Similarly, the business launched SME funds in France and Turkey, targeted at international trade customers, with approved lending of £1.3 billion in France and £303 million in Turkey.

In addition, the business continued to support the programme of renminbi internationalisation during the year with flagship client events taking place in the UK, France and Germany.

Prior period information (continued)

Financial Performance

Net interest income increased by £107 million or 5 per cent mainly in the UK due to growth in term lending revenues from higher spreads on new and renewal business and deposit growth in Payments and Cash Management.

Net fee income increased by £96 million or 9 per cent, due to an increase in lending fees in the UK and higher fee income from credit and lending business in Germany.

Loan impairment charges and other credit risk provisions decreased by £98 million or 14 per cent primarily due to lower individually and collectively assessed provisions in the UK and Greece. There were higher levels of individually assessed provisions in Spain.

Total operating expenses decreased by £278 million or 16 per cent compared to 2012. Excluding the £104 million accounting gain relating to the change of ill-health benefits in 2013 and customer redress and operational loss provisions of £81 million compared to £227 million in 2012, operating expenses were 2 per cent lower. This reflected the benefits being delivered through re-engineering and streamlining of business processes. The customer redress and operational losses related to the possible mis-selling of interest rate protection products and closed account balances of dissolved companies respectively.

Adjusted performance

For comparison:

- adjusted profit before tax would have been £1,328 million and £1,015 million for 2013 and 2012, respectively;
- adjusted revenue would have been £3,370 million and £3,180 million for 2013 and 2012, respectively; and
- adjusted operating expenses would have been £1,442 million and £1,466 million for 2013 and 2012, respectively.

Please refer to the appendix for a reconciliation of reported to adjusted figures.

Global Banking and Markets

	2013	2012
	£m	£m
Net interest income[1]	**1,101**	876
Net fee income	**588**	616
Trading income[1]	**2,192**	1,554
Other income	**400**	973
Net operating income before impairments and provisions	**4,281**	4,019
Loan impairment charges and other credit risk provisions	**(133)**	(280)
Net operating income	**4,148**	3,739
Total operating expenses	**(3,122)**	(3,093)
Operating profit	**1,026**	646
Share of profit in associates and joint ventures	**(3)**	(4)
Profit before tax	**1,023**	642

1 The bank's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M 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 (refer to Note 13).

Profit before tax – by country

	2013	2012
	£m	£m
United Kingdom	**667**	(55)
France	**227**	326
Germany	**115**	178
Turkey	**70**	66
Malta	**22**	20
Other	**(78)**	107
Profit before tax	**1,023**	642

Overview

GB&M reported a profit before tax of £1,023 million in the period compared with a profit before tax of £642 million in 2012, an increase of £381 million or 59 per cent.

Overall, revenues rose by 7 per cent, primarily due to higher revenues in Capital Financing. These movements were partially offset by lower revenues in Rates and lower disposal gains on available-for-sale debt securities in Balance Sheet Management.

Financial performance

Net interest income increased by £225 million or 26 per cent compared to 2012, mainly in Balance Sheet Management largely due to interest rate management and net deployment of funds at enhanced levels during the year. In addition, net interest income was higher due to higher lending margins in Capital Financing and lower levels of interest paid on a reduced legacy portfolio.

Net fee income decreased by £28 million or 5 per cent compared to 2012 primarily due to higher levels of fees paid to other HSBC entities in respect to higher volumes of foreign exchange trading activities in other geographical regions. This was partly offset by higher fees earned on increased customer demand in debt capital markets and increase deal volumes in the equity underwriting businesses.

Trading income was £638 million or 41 per cent higher than 2012, of which £344 million was due to foreign exchange movements on trading assets held as economic hedges of foreign debt designated at fair value. A corresponding offset is reported within *"Other Income"*.

In Markets, revenues were higher than 2012 which included a charge of £387 million as a result of a change in estimation methodology in respect of credit valuation adjustments on derivative assets to reflect evolving market practices. This was partially offset by lower favourable debit valuation adjustments on derivative liabilities of £45 million in 2013 (2012: £191 million) also reflecting a refinement in estimation methodology in 2012.

Foreign exchange income benefited from higher client activity and volumes, although this rise was offset in part by margin compression. Equities benefited from increased deal volumes and revaluations gains. Rates revenue decreased despite new mandates and improved market share, particularly in European government bonds as the benefits from tightening spreads following the ECB liquidity intervention in 2012 were not repeated. In addition, revenues benefited from lower adverse fair value movements from own credit spreads on structured liabilities.

Prior period information (continued)

Other income decreased by £573 million or 59 per cent primarily reflecting £344 million lower favourable foreign exchange movements on debt designated at fair value offset in *'Trading income'* above. In addition lower gains on the disposal of available-for sale debt securities in Balance Sheet Management contributed to the decrease.

Loan impairment charges and other credit risk provisions decreased by £147 million or 53 per cent, primarily due to lower net impairments on available-for-sale asset-backed securities. This resulted from an improvement in underlying asset prices; partly offset by higher loan impairment charges in the UK and Spain.

Total operating expenses were in line with 2012 increasing by £29 million. Excluding the £53 million accounting gain relating to the change of ill-health benefits recognised in 2013, provisions of £84 million compared to £207 million in 2012 in relation to the possible mis-selling of interest rate protection products and a decrease in restructuring costs of £30 million, operating expenses were 8 per cent higher. This reflected higher litigation costs relating to the agreed settlements reached in respect to Madoff related claims in Ireland.

Adjusted performance

For comparison,

- adjusted profit before tax would have been £1,249 million and £694 million for 2013 and 2012, respectively;
- adjusted revenue would have been £4,277 million and £3,828 million for 2013 and 2012, respectively; and
- adjusted operating expenses would have been £2,892 million and £2,850 million for 2013 and 2012, respectively.

Please refer to the appendix for a reconciliation of reported to adjusted figures.

Global Private Banking

	2013	2012 Continuing operations	2012[1] Total
	£m	£m	£m
Net interest income	**224**	212	597
Net fee income	**100**	111	583
Trading income	**10**	7	254
Other income	**(4)**	3	8
Net operating income before impairments and provisions	**330**	333	1,442
Loan impairment charges and other credit risk provisions	**(14)**	(19)	(18)
Net operating income	**316**	314	1,424
Total operating expenses	**(176)**	(213)	(943)
Operating profit	**140**	101	481
Share of profit in associates and joint ventures	**–**	(1)	(1)
Profit before tax	**140**	100	480

Profit before tax – by country

	2013	2012 Continuing operations	2012[1] Total
	£m	£m	£m
United Kingdom	**99**	87	134
France	**13**	(7)	(7)
Germany	**28**	25	25
Turkey	**–**	–	–
Malta	**–**	–	–
Other	**–**	(5)	328
Profit before tax	**140**	100	480

1 *The reported results for 2012 include only 10 months of HSBC Private Banking Holdings (Suisse) SA, prior to its sale.*

Overview

GPB reported profit before tax of £140 million in 2013 compared to £480 million in 2012, a decrease of 71 per cent.

On a continuing operations basis, GPB reported a profit before tax of £140 million in 2013 compared with £100 million in 2012, an increase of 40 per cent.

Financial performance

The commentary that follows is on a continuing operations basis.

Net interest income was £12 million or 6 per cent higher, due to improved margins in the UK and additional net interest income as a result of the acquisition of HSBC Private Banking (C.I.) Limited in November 2013.

Net fee income was £11 million or 10 per cent lower primarily due to the non-recurrence of fee income following the disposal of Property Vision in 2012, and lower client demand.

Trading income was broadly in line with prior year.

Other income decreased by £7 million in part due to lower net premium income in France.

Total operating expenses decreased by £37 million or 17 per cent compared to 2012. This was due to lower staff costs reflecting a reduction in staff numbers and related costs, reduced performance costs and the recovery of losses arising on a 2001 litigation in France.

Adjusted performance

For comparison:

- adjusted profit before tax would have been £143 million and £510 million for 2013 and 2012, respectively;
- adjusted profit before tax on a continuing basis would have been £143 million and £105 million for 2013 and 2012, respectively;
- adjusted revenue would have been £330 million and £1,442 million for 2013 and 2012, respectively; and
- adjusted operating expenses would have been £173 million and £913 million for 2013 and 2012, respectively.

Please refer to the appendix for a reconciliation of reported to adjusted figures.

Prior period information (continued)

Other

	2013 £m	2012 £m
Net interest income	**(73)**	(43)
Net fee income	**3**	3
Trading income	**(22)**	(9)
Change in credit spread on long-term debt	**(167)**	(1,055)
Other income	**102**	118
Net operating income before impairments and provisions	**(157)**	(986)
Loan impairment charges and other credit risk provisions	**–**	–
Net operating expense	**(157)**	(986)
Total operating expenses	**(222)**	(310)
Operating loss	**(379)**	(1,296)
Share of profit in associates and joint ventures	**–**	1
Loss profit before tax	**(379)**	(1,295)

‘Other contains the movements in fair value of own debt, financing operations, central support and functional costs with associated recoveries.

The reported loss before tax in ‘Other’ was £379 million, compared to a loss before tax of £1,295 million in 2012. This was primarily due to the change in own credit spreads on long-term debt which resulted in a loss of £167 million in 2013 compared with a loss of £1,055 million in 2012.

Adjusted performance

For comparison,

- adjusted loss before tax would have been £182 million and £99 million for 2013 and 2012, respectively;
- adjusted revenue would have been £10 million and £69 million for 2013 and 2012, respectively; and
- adjusted operating expenses would have been £192 million and £169 million for 2013 and 2012, respectively.

Please refer to the appendix for a reconciliation of reported to adjusted figures.

Other information

Average balance sheet and net interest income

Average balances are based on daily averages of the group's banking activities with monthly or less frequent averages used elsewhere. Net interest margin numbers are calculated by dividing net interest income as reported in the income statement by the average interest-earning assets from which interest income is reported within the *'Net interest income'* line of the income statement. Interest income and interest expense arising from trading assets and liabilities and the funding thereof is included within *'Net trading income'* in the income statement.

Assets

	2014			2013			2012		
Summary	**Average balance £m**	**Interest income £m**	**Yield %**	Average balance £m	Interest income £m	Yield %	Average balance £m	Interest income £m	Yield %
Interest-earning assets measured at amortised cost (itemised below)	**426,150**	**9,249**	**2.17%**	405,671	10,000	2.47%	465,594	10,674	2.29%
Trading assets and financial assets designated at fair value	**92,827**	**1,725**	**1.86%**	133,406	2,122	1.59%	134,841	2,463	1.83%
Impairment provisions	**(3,042)**	**–**	**–**	(3,499)	–	–	(3,488)	–	–
Non-interest-earning assets	**264,712**	**–**	**–**	283,677	–	–	341,851	–	–
Total assets and interest income	**780,647**	**10,974**	**1.41%**	819,255	12,122	1.48%	938,798	13,137	1.40%
Short-term funds and loans and advances to banks									
HSBC Bank	**58,080**	**550**	**0.95%**	56,311	536	0.95%	64,103	609	0.95%
HSBC France	**4,526**	**40**	**0.88%**	6,557	60	0.92%	8,169	74	0.91%
HSBC Private Bank Holdings	**–**	**–**	**–**	–	–	–	3,925	26	0.66%
Other	**5,242**	**65**	**1.24%**	2,957	45	1.52%	15,805	103	0.65%
	67,848	**655**	**0.97%**	65,825	641	0.97%	92,002	812	0.88%
Loans and advances to customers									
HSBC Bank	**155,288**	**4,876**	**3.14%**	155,915	5,271	3.38%	152,616	5,242	3.43%
HSBC France	**28,060**	**843**	**3.00%**	28,679	1,060	3.70%	27,860	1,042	3.74%
HSBC Private Bank Holdings	–	–	–	–	–	–	18,299	374	2.04%
Other	**38,834**	**1,531**	**3.94%**	37,998	1,652	4.35%	54,646	1,519	2.78%
	222,182	**7,250**	**3.26%**	222,592	7,983	3.59%	253,421	8,177	3.23%
Reverse repurchase agreements									
HSBC Bank	**40,910**	**146**	**0.36%**	17,290	58	0.34%	7,626	26	0.34%
HSBC France	**19,397**	**37**	**0.19%**	27,784	30	0.11%	27,214	78	0.29%
Other	**1,390**	**127**	**9.14%**	705	14	1.99%	339	20	5.90%
	61,697	**310**	**0.50%**	45,779	102	0.22%	35,179	124	0.35%
Financial investments									
HSBC Bank	**38,122**	**414**	**1.09%**	33,443	415	1.24%	33,990	498	1.47%
HSBC France	**8,006**	**69**	**0.86%**	7,623	32	0.42%	6,934	82	1.18%
HSBC Private Bank Holdings	**–**	**–**	**–**	**–**	**–**	**–**	14,098	204	1.45%
HSBC Assurance Vie	**10,567**	**389**	**3.68%**	10,737	402	3.74%	9,967	387	3.88%
Other	**16,816**	**147**	**0.88%**	19,261	405	2.10%	19,432	386	1.99%
	73,511	**1,019**	**1.39%**	71,064	1,254	1.76%	84,421	1,557	1.84%
Other interest-earning assets									
HSBC Bank	**26**	**5**	**19.23%**	23	2	8.70%	12	**–**	**–**
HSBC France	**146**	**8**	**5.48%**	240	13	5.42%	**–**	**–**	**–**
HSBC Private Bank Holdings	**–**	**–**	**–**	**–**	**–**	**–**	5	**–**	**–**
Other	**740**	**2**	**0.27%**	148	5	**–**	554	4	**–**
	912	**15**	**1.64%**	411	20	4.87%	571	4	0.70%
Total interest-earning assets									
HSBC Bank	**292,426**	**5,991**	**2.05%**	262,982	6,282	2.39%	258,347	6,375	2.47%
HSBC France	**60,135**	**997**	**1.66%**	70,883	1,195	1.69%	70,177	1,276	1.82%
HSBC Private Bank Holdings	**–**	**–**	**–**	**–**	**–**	**–**	36,327	604	1.66%
Other	**73,589**	**2,261**	**3.07%**	71,806	2,523	**–**	100,743	2,419	**–**
	426,150	**9,249**	**2.17%**	405,671	10,000	2.47%	465,594	10,674	2.29%

In November 2012, the group sold HSBC Private Banking Holdings (Suisse) SA to HSBC Holdings plc, with the exception of HSBC Private Bank (UK) Limited which remains part of the group.

Other information (continued)

Total equity and liabilities

	2014			2013			2012		
Summary	**Average balance £m**	**Interest expense £m**	**Cost %**	Average balance £m	Interest expense £m	Cost %	Average balance £m	Interest expense £m	Cost %
Interest-bearing liabilities measured at amortised cost (itemised below)	**411,406**	**2,810**	**0.68%**	382,582	3,039	0.79%	418,280	3,770	0.90%
Trading liabilities and financial liabilities designated at fair value (excluding own debt)	**81,652**	**1,177**	**1.44%**	128,368	1,366	1.06%	105,563	1,512	1.43%
Non–interest bearing current accounts	**32,832**	**–**	**–**	31,243	–	–	40,045	–	–
Total equity and other non–interest bearing liabilities	**254,757**	**–**	**–**	277,062	–	–	374,910	–	–
Total equity and liabilities	**780,647**	**3,987**	**0.51%**	819,255	4,405	0.54%	938,798	5,282	0.56%
Deposits by banks									
HSBC Bank	**15,410**	**118**	**0.77%**	17,246	167	0.97%	26,500	329	1.24%
HSBC France	**4,026**	**32**	**0.79%**	5,710	45	0.79%	9,177	91	0.99%
HSBC Private Bank Holdings	**–**	**–**	**–**	–	–	–	1,056	2	0.19%
Other	**2,189**	**27**	**1.23%**	485	37	7.63%	15,226	31	0.20%
	21,625	**177**	**0.82%**	23,441	249	1.06%	51,959	453	0.87%
Financial liabilities designated at fair value – own debt issued									
HSBC Bank	**16,503**	**243**	**1.47%**	18,229	271	1.49%	17,399	329	1.89%
HSBC France	**5,281**	**40**	**0.76%**	5,549	43	0.77%	4,422	74	1.67%
Other	**349**	**13**	**3.72%**	290	13	4.48%	256	22	8.59%
	22,133	**296**	**1.34%**	24,068	327	1.36%	22,077	425	1.93%
Customer accounts									
HSBC Bank	**211,906**	**878**	**0.41%**	188,525	1,058	0.56%	177,537	1,128	0.64%
HSBC France	**13,465**	**114**	**0.85%**	14,838	152	1.02%	14,794	203	1.37%
HSBC Private Bank Holdings	**–**	**–**	**–**	–	–	–	30,474	154	0.51%
Other	**39,110**	**685**	**1.75%**	40,879	523	1.28%	43,592	623	1.43%
	264,481	**1,677**	**0.63%**	244,242	1,733	0.71%	266,397	2,108	0.79%
Repurchase agreements									
HSBC Bank	**45,359**	**116**	**0.26%**	18,223	55	0.30%	4,539	17	0.37%
HSBC France	**18,951**	**35**	**0.18%**	22,718	22	0.10%	21,812	70	0.32%
Other	**50**	**13**	**26.00%**	338	15	4.44%	303	19	6.46%
	64,360	**164**	**0.26%**	41,279	92	0.22%	26,654	106	0.40%
Debt securities in issue									
HSBC Bank	**22,448**	**234**	**1.04%**	30,889	265	0.86%	31,159	405	1.30%
HSBC France	**6,958**	**31**	**0.45%**	8,085	35	0.43%	9,157	75	0.82%
Regency Assets Limited	**5,770**	**21**	**0.37%**	6,678	27	0.40%	4,564	20	0.44%
Other (includes intercompany	**1,902**	**148**	**7.75%**	2,234	237	-	5,087	138	-
	37,078	**434**	**1.17%**	47,886	564	1.18%	49,967	638	1.28%
Other interest–bearing liabilities									
HSBC Bank	**44**	**5**	**11.36%**	76	5	6.58%	–	–	–
HSBC France	**348**	**13**	**3.74%**	502	26	5.18%	–	–	–
HSBC Private Bank Holdings	**–**	**–**	**–**	–	–	–	10	–	–
Other	**1,337**	**44**	**3.29%**	1,088	43	–	1,216	40	–
	1,729	**62**	**3.59%**	1,666	74	4.44%	1,226	40	3.26%
Total interest–bearing liabilities									
HSBC Bank	**311,670**	**1,594**	**0.51%**	273,188	1,821	0.67%	257,134	2,208	0.86%
HSBC France	**49,029**	**265**	**0.54%**	57,402	323	0.56%	59,362	513	0.86%
HSBC Private Bank Holdings	**–**	**–**	**–**	–	–	–	31,549	156	0.49%
Other	**50,707**	**951**	**1.88%**	51,992	895	–	70,235	893	–
	411,406	**2,810**	**0.68%**	382,582	3,039	0.79%	418,280	3,770	0.90%

Distribution of average total assets

	2014	2013	2012
	%	%	%
HSBC Bank	**73.4**	72.4	65.2
HSBC France	**18.9**	20.8	19.0
HSBC Private Bank Holdings (Suisse)	**–**	–	4.8
Other	**7.7**	6.8	11.0
	100.0	100.0	100.0

Other information (continued)

Analysis of changes in net interest income

The following table allocates changes in net interest income between volume and rate for 2014 compared to 2013, and for 2013 compared to 2012.

		Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012		
	2014 £m	**Volume £m**	**Rate £m**	2013 £m	Volume £m	Rate £m	2012 £m
Interest income							
Short-term funds and loans and advances to banks							
HSBC Bank	550	34	(20)	536	(74)	1	609
HSBC France	40	(19)	(1)	60	(15)	1	74
HSBC Private Bank Holdings (Suisse)	–	–	–	–	(26)	–	26
Other	65	22	(2)	45	(84)	26	103
	655	29	(15)	641	(231)	60	812
Loans and advances to customers							
HSBC Bank	4,876	(15)	(380)	5,271	113	(84)	5,242
HSBC France	843	(23)	(194)	1,060	31	(13)	1,042
HSBC Private Bank Holdings (Suisse)	–-	–	–	–	(374)	–	374
Other	1,531	86	(207)	1,652	(463)	596	1,519
	7,250	33	(766)	7,983	(995)	801	8,177
Reverse repurchase agreements							
HSBC Bank	146	–	88	58	33	25	-
HSBC France	37	–	7	30	2	2	26
HSBC Private Bank Holdings (Suisse)	–-	–	–	–	–	(78)	78
Other	127	–	113	14	-	(6)	20
	310	14	194	102	22	(44)	124
Financial investments							
HSBC Bank	414	58	(59)	415	(8)	(75)	498
HSBC France	69	2	35	32	8	(58)	82
HSBC Private Bank Holdings (Suisse)	–	–	–	–	(204)	–	204
HSBC Assurance Vie	389	(6)	(6)	402	30	(16)	387
Other	147	(51)	(207)	405	(3)	23	386
	1,019	43	(278)	1,254	(246)	(57)	1,557
Interest expense							
Deposits by banks							
HSBC Bank	118	37	(86)	167	(115)	(47)	329
HSBC France	32	(13)	–	45	(34)	(12)	91
HSBC Private Bank Holdings (Suisse)	–	–	–	–-	(2)	–	2
Other	27	(278)	268	37	(30)	36	31
	177	(16)	(56)	249	(249)	45	453
Customer accounts							
HSBC Bank	878	107	(287)	1,058	16	(86)	1,128
HSBC France	114	(14)	(24)	152	19	(70)	203
HSBC Private Bank Holdings (Suisse)	–	–	–	–	–	(154)	154
Other	685	46	116	523	(39)	(61)	623
	1,677	151	(207)	1,733	(175)	(200)	2,108
Financial liabilities designated at fair value–own debt issued							
HSBC Bank	243	(26)	(2)	271	16	(74)	329
HSBC France	40	(2)	(1)	43	19	(50)	74
HSBC Private Bank Holdings (Suisse)	–	–	–	–	–	–	-
Other	13	3	(3)	13	3	(12)	22
	296	(26)	(5)	327	38	(136)	425
Repurchase agreements							
HSBC Bank	116	–	61	55	70	(32)	17
HSBC France	35	–	13	22	1	(49)	70
HSBC Private Bank Holdings (Suisse)	–	–	–	–	(154)	154	–
Other	13	–	(2)	15	-	(4)	19
	164	(13)	85	92	3	(17)	106
Debt securities in issue							
HSBC Bank	234	(72)	41	265	(4)	(136)	405
HSBC France	31	(5)	1	35	(9)	(31)	75
Regency Assets Limited	21	(4)	(2)	27	9	(2)	20
Other	148	–	(89)	237	(77)	176	138
	434	(127)	(3)	564	(27)	(47)	638

Other information (continued)

Net interest margin

	2014	2013	2012
	%	%	%
Net interest margin	**1.51**	1.72	1.48
HSBC Bank	**1.50**	1.70	1.61
HSBC France	**1.22**	1.23	1.09
HSBC Private Bank Holdings (Suisse)	–	–	1.23
Other	**1.78**	2.27	1.51

In-country foreign currency and cross-border amounts outstanding

The following table summarises the aggregate of the in-country foreign currency and cross-border outstandings by type of borrower to countries which individually represent in excess of 0.75% of total assets. The classification is based on the country of residence of the borrower but also recognises the transfer of country risk in respect of third-party guarantees, eligible collateral held and residence of the head office when the borrower is a branch. In accordance with the Bank of England Country Exposure Report ('Form CE') guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit ('CD's) and debt and equity securities (net of short positions), and exclude accrued interest and intra-group exposures.

	Banks £m	Government and official institutions £m	Other £m	Total £m
At 31 December 2014				
US	**8,821**	**7,810**	**23,981**	**40,612**
UK	**7,268**	**956**	**22,015**	**30,239**
France	**2,250**	**1,169**	**4,876**	**8,295**
Germany	**7,518**	**11,077**	**3,559**	**22,154**
Turkey	**1,889**	**1,797**	**3,911**	**8,304**
Cayman Islands	**22**	**–**	**7,539**	**7,561**
Netherlands	**1,708**	**1,845**	**7,657**	**11,210**
Japan	**469**	**2,125**	**8,269**	**10,863**
Ireland	**800**	**121**	**5,057**	**5,978**
At 31 December 2013				
US	7,117	10,989	16,960	35,066
UK	6,949	600	28,031	35,580
France	2,964	3,179	3,925	10,068
Germany	7,198	8,942	4,000	20,140
Turkey	1,889	1,797	3,911	7,597
Cayman Islands	10	–	12,308	12,318
Ireland	406	50	4,379	4,835
At 31 December 2012				
US	5,499	12,962	12,961	31,422
UK	10,672	1,244	24,276	36,192
France	6,045	4,250	6,340	16,635
Germany	6,144	6,045	6,216	18,405
Turkey	2,341	3,975	4,029	10,345
Cayman Islands	1	–	14,050	14,051
Ireland	1,049	71	7,302	8,422

Contractual obligations

The table below provides details of selected known contractual obligations of the group.

	At 31 December 2014 Payments due by period			
	Total £m	Less than 1 year £m	1 to 5 years £m	More than 5 years £m
Long-term debt obligations	**57,362**	**18,610**	**20,932**	**17,820**
Term deposits and certificates of deposit	**76,655**	**73,760**	**2,741**	**154**
Capital (finance) lease obligations	**–**	**–**	**–**	**–**
Operating lease obligations	**1,595**	**211**	**598**	**786**
Purchase obligations	**8**	**8**	**–**	**–**
Short positions in debt securities and equity shares	**24,639**	**14,035**	**4,939**	**5,665**
Current tax liability	**255**	**255**	**–**	**–**
Pension/health care obligation	**502**	**150**	**192**	**160**
	161,016	**107,029**	**29,402**	**24,585**

Other information (continued)

Loan maturity and interest rate sensitivity analysis

At 31 December 2014 the analysis of loan maturity and interest rate sensitivity by loan type on a contractual repayment basis was as follows:

	At 31 December 2014 £m
Maturity of 1 year or less	
Loans and advances to banks	21,379
	21,379
Commercial loans to customers	
Manufacturing and international trade and services	48,893
Real estate and other property related	6,685
Non-bank financial institutions	11,558
Governments	710
Other commercial	20,177
	88,023
Maturity after 1 year but within 5 years	
Loans and advances to banks	3,567
	3,567
Commercial loans to customers	
Manufacturing and international trade and services	18,946
Real estate and other property related	10,986
Non-bank financial institutions	4,568
Governments	150
Other commercial	11,879
	46,529
Interest rate sensitivity of loans and advances to banks and commercial loans to customers	
Fixed interest rate	9,722
Variable interest rate	40,374
	50,096
Maturity after 5 years	
Loans and advances to banks	336
	336
Commercial loans to customers	
Manufacturing and international trade and services	6,164
Real estate and other property related	4,800
Non-bank financial institutions	604
Governments	592
Other commercial	5,950
	18,110
Interest rate sensitivity of loans and advances to banks and commercial loans to customers	
Fixed interest rate	4,854
Variable interest rate	13,592
	18,446

Other information (continued)

Deposits

The following table summarises the average amount of bank deposits, customer deposits and certificates of deposit ('CDs') and other money market instruments (which are included within *Debt securities in issue* in the balance sheet), together with the average interest rates paid thereon for each of the past three years. The Other category includes securities sold under agreements to repurchase.

	2014		2013		2012	
	Average balance £m	**Average rate %**	Average balance £m	Average rate %	Average balance £m	Average rate %
Deposits by banks	**31,616**		46,729		64,896	
Demand and other–non-interest bearing	**9,650**	**-**	10,604	–	4,427	–
Demand–interest bearing	**3,531**	**0.4**	3,259	0.5	5,637	0.4
Time	**8,644**	**1.0**	10,725	1.2	15,381	1.5
Other	**9,791**	**3.2**	22,141	1.6	39,451	1.1
Customer accounts	**301,478**		308,711		330,182	
Demand and other–non-interest bearing	**35,952**	**-**	35,874	–	45,641	–
Demand–interest bearing	**189,915**	**0.4**	170,962	0.4	160,147	0.4
Savings	**33,873**	**1.5**	37,502	1.5	38,807	1.8
Time	**24,383**	**1.1**	27,466	1.2	44,376	1.3
Other	**17,355**	**1.3**	36,907	1.1	41,211	1.0
CDs and other money market instruments	**12,949**	**0.4**	18,155	0.5	20,972	0.5

Certificates of deposit and other time deposits

At 31 December 2014, the maturity analysis of CDs and other wholesale time deposits, by remaining maturity, was as follows:

	At 31 December 2014				
	3 months or less £m	**After 3 months but within 6 months £m**	**After 6 months but within 12 months £m**	**After 12 months £m**	**Total £m**
Certificates of deposit	**5,333**	**3,924**	**645**	**–**	**9,902**
Time deposits					
-banks	**24,059**	**912**	**205**	**1,389**	**26,565**
-customers	**29,426**	**6,849**	**2,407**	**1,506**	**40,188**

Short-term borrowings

Short-term borrowings are included within customer accounts, deposits by banks and debt securities in issue and are not shown separately on the balance sheet. Short-term borrowings are defined by the US Securities and Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

The only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue.

For securities sold under agreements to repurchase, the group runs matched repo and reverse repo trading books. The group generally observes lower year-end demand in the reverse repo lending business which results in lower repo balances at the balance sheet date. Additional information on these is provided in the table below.

Other information (continued)

Repos and short-term bonds

	2014 £m	2013 £m	2012 £m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**25,692**	75,019	66,156
Average amount outstanding during the year	**75,492**	86,502	81,812
Maximum quarter-end balance outstanding during the year	**84,740**	90,361	74,673
Weighted average interest rate during the year	**0.2%**	0.2%	0.3%
Weighted average interest rate at the year-end	**0.6%**	0.6%	0.4%
Short-term bonds			
Outstanding at 31 December	**12,917**	17,775	18,876
Average amount outstanding during the year	**15,247**	19,184	16,462
Maximum quarter-end balance outstanding during the year	**15,608**	22,342	18,876
Weighted average interest rate during the year	**0.1%**	0.1%	0.1%
Weighted average interest rate at the year-end	**0.7%**	0.3%	0.2%

Financial investments

Carrying amounts of financial investments

	2014 £m	2013 £m	2012 £m
Financial investments:			
– which may be repledged or resold by counterparties	**14,831**	11,435	7,979
– not subject to repledge or resale by counterparties	**61,363**	63,595	63,286
	76,194	75,030	71,265
Fair value of financial investments			
Treasury and other eligible bills - available-for-sale	**2,849**	2,196	5,203
Debt securities	**72,336**	71,828	65,034
– available-for-sale	**72,336**	71,828	65,034
– held-to-maturity	**–**	–	–
Equity securities - available-for-sale	**1,009**	1,006	1,028
Total financial investments at 31 December	**76,194**	75,030	71,265

£6,172 million (2013: £2,936 million, 2012: £1,953 million) of the debt securities issued by banks and other financial institutions are guaranteed by various governments. The fair value of the held to maturity financial investments reported in 2011 was £4,204 million.

Financial investments at fair value

	2014 £m	2013 £m	2012 £m
At 31 December			
US Treasury	**4,304**	5,551	7,881
US Government agencies	**–**	–	–
US Government sponsored entities	**–**	–	–
UK Government	**16,627**	13,729	10,392
Hong Kong Government	**–**	–	–
Other government	**25,254**	23,615	21,487
Asset-back securities	**12,025**	14,069	15,392
Corporate debt and other securities	**16,976**	17,060	15,085
Equities	**1,008**	1,006	1,028
	76,194	75,030	71,265

Other information (continued)

Contractual maturities and weighted average yields of investment debt securities at 31 December 2014

	Within one year		After one year but within five years		After five years but within ten years		After ten years	
	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %
Available for sale								
US Treasury	1,026	1.2	1,321	0.4	1,619	1.9	–	–
UK Government	180	2.2	7,676	0.9	8,046	1.7	–	–
Other government	3,007	2.5	13,149	1.6	3,971	0.9	1,102	0.1
Asset-back securities	441	0.1	716	1.3	2,558	0.9	9,406	1.0
Corporate debt and other securities	2,125	0.8	9,646	0.9	3,223	1.1	1,263	0.5
Total amortised cost	6,779		32,508		19,417		11,771	
Total fair value	6,400		33,303		21,097		11,536	

The maturity distributions of asset-backed securities are presented in the above table on the basis of contractual maturity dates. The weighted average yield for each range of maturities is calculated by dividing the annualised interest income for the year ended 31 December 2013 by the carrying amount of available-for-sale debt securities at that date. The yields do not include the effect of related derivatives.

Further analysis of credit risk

Gross loans and advances by industry sector

	2014 Amount £m	%	2013 Amount £m	%	2012 Amount £m	%	2011 Amount £m	%	2010 Amount £m	%
Personal										
Residential mortgages	83,009	29.09%	83,882	27.95%	82,544	28.71%	77,871	26.71%	72,327	25.44%
Other personal[1]	24,381	8.55%	25,257	8.42%	23,222	8.08%	33,571	11.52%	35,008	12.31%
	107,390	37.64%	109,139	36.37%	105,766	36.79%	111,442	38.23%	107,335	37.75%
Commercial										
Commercial, industrial and international trade	74,003	25.94%	79,576	26.52%	78,176	27.19%	71,098	24.39%	72,006	25.33%
Commercial real estate	17,899	6.27%	18,755	6.25%	20,504	7.13%	21,034	7.22%	19,970	7.02%
Other property-related	4,572	1.60%	4,421	1.47%	4,580	1.59%	4,908	1.68%	4,125	1.45%
Government	1,452	0.51%	2,020	0.67%	1,481	0.52%	1,977	0.68%	1,452	0.51%
Other commercial[2]	38,006	13.32%	40,610	13.53%	34,569	12.02%	36,583	12.55%	37,161	13.07%
	135,932	47.64%	145,382	48.44%	139,310	48.44%	135,600	46.52%	134,714	47.38%
Financial										
Non-bank financial institutions	16,085	5.64%	21,602	7.20%	23,649	8.22%	19,667	6.75%	15,142	5.32%
Settlement accounts	645	0.22%	935	0.31%	316	0.11%	440	0.15%	612	0.22%
	16,730	5.86%	22,537	7.51%	23,965	8.33%	20,107	6.90%	15,754	5.54%
Total gross loans and advances to customers	260,052	91.14%	277,058	92.32%	269,041	93.56%	267,149	91.64%	257,803	90.67%
Gross loans and advances to banks	25,282	8.86%	23,035	7.68%	18,512	6.44%	24,357	8.35%	26,520	9.33%
Total gross loans and advances	285,334	100.00%	300,093	100.00%	287,553	100.00%	291,506	100.00%	284,323	100.00%
Impaired loans and advances to customers	6,398		7,869		6,778		7,467		7,155	
as a percentage of total gross loans and advances to customers		2.46%		2.84%		2.52%		2.80%		2.78%
Loan impairment charge	647		1,102		2,639		2,624		2,698	
new allowance net of allowance releases	828		1,508		2,424		2,327		2,539	
recoveries	(181)		(406)		215		297		159	

1 *'Other personal loans and advances' include second lien mortgages and other property-related lending.*
2 *'Other commercial loans and advances' include advances in respect of agriculture, transport, energy and utilities.*

Other information (continued)

Charge for impairment losses as a percentage of average gross loans and advances to customers

(Unaudited)

	2014	2013	2012	2011	2010
	%	%	%	%	%
Net allowances net of allowances releases	**0.36**	0.67	0.53	0.53	0.72
Recoveries	**(0.08)**	(0.18)	(0.08)	(0.10)	(0.06)
Total charge for impairment losses	**0.28**	0.49	0.45	0.43	0.66
Amount written off net of recoveries	**0.49**	0.43	0.46	0.46	0.67

Loan impairment charges by industry sector over 5 years

(Unaudited)

	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Loan impairment charge					
Personal	**148**	215	250	415	803
– residential mortgages	**(45)**	(9)	(34)	60	99
– other personal[1]	**193**	224	284	355	704
Corporate and commercial	**472**	921	974	798	709
– manufacturing and international trade and services	**306**	518	420	261	322
– commercial real estate and other property-related	**50**	276	279	310	232
– other commercial	**116**	127	275	227	155
Financial	**27**	(34)	(11)	9	121
Year ended 31 December	**647**	1,102	1,213	1,222	1,633
Loan loss rates					
Personal	**0.14%**	0.20%	0.24%	0.37%	0.75%
Corporate and commercial	**0.35%**	0.63%	0.70%	0.59%	0.53%
Financial	**0.16%**	(0.15%)	(0.05%)	0.04%	0.77%

Movement in impairment allowances over 5 years

(Unaudited)

	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Impairment allowances at 1 January	**3,357**	3,270	3,381	3,580	3,649
Amounts written off	**(1,285)**	(1,386)	(1,475)	(1,627)	(1,824)
Personal	**(435)**	(559)	(499)	(996)	(834)
– residential mortgages	**(13)**	(53)	(17)	(15)	(31)
– other personal[1]	**(422)**	(506)	(482)	(981)	(803)
Corporate and commercial	**(728)**	(801)	(902)	(612)	(980)
– manufacturing and international trade and services	**(443)**	(430)	(416)	(345)	(247)
– commercial real estate and other property-related	**(208)**	(184)	(238)	(165)	(648)
– other commercial[10]	**(77)**	(187)	(248)	(102)	(85)
Financial[1]	**(122)**	(26)	(74)	(19)	(10)
Recoveries of amounts written off in previous years	**181**	406	214	297	159
Personal	**162**	374	180	268	136
– residential mortgages	**1**	16	21	13	19
– other personal[1]	**161**	358	159	255	117
Corporate and commercial	**17**	32	32	27	22
– manufacturing and international trade and services	**12**	11	11	11	11
– commercial real estate and other property-related	**6**	4	6	5	4
– other commercial[10]	**(1)**	17	15	11	7
Financial[1]	**2**	–	2	2	1
Charge to the income statement	**647**	1,102	1,213	1,222	1,633
Exchange and other movements	**(80)**	(35)	(63)	(91)	(37)
Impairment allowances at 31 December	**2,820**	3,357	3,270	3,381	3,580
Impairment allowances - banks:					
– individually assessed	**20**	21	24	32	50
Impairment allowances - customers					
– individually assessed	**1,874**	2,402	2,327	2,429	2,248
– collectively assessed	**926**	934	919	920	1,282
Impairment allowances at 31 December	**2,820**	3,357	3,270	3,381	3,580

1 *Includes movements in impairment allowances against banks.*

Other information (continued)

Risk elements in the loan portfolio

	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Impaired loans	**6,415**	7,893	6,818	7,514	6,783
Unimpaired loans contractually past 90 days or more as to principal or interest	**3**	14	23	27	41
Troubled debt restructuring (not included in the classification above)	**1,059**	863	789	458	165

The interest that would have been recognised under the original terms of impaired and restructured loans amounted to approximately £132 million in 2014 (2013: £137 million). Interest income from such loans of approximately £70 million was recorded in 2014 (2013: £66 million).

Reconciliation of reported to adjusted basis

	Total Global Businesses			**RBWM**		**CMB**		**GB&M**		**GPB**			**Other**	
	2013	**2012** Continuing	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012** Continuing	**2012**	**2013**	**2012**
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Revenue														
Reported[1]	**12,840**	**11,379**	**12,488**	**5,071**	**4,906**	**3,370**	**3,180**	**4,281**	**4,019**	**330**	**333**	**1,442**	**(157)**	**(986)**
Less significant items:														
Change in credit spread on long-term debt	(167)	(1,055)	(1,055)	–	–	–	–	–	–	–	–	–	(167)	(1,055)
Fair value movement on non-qualifying hedges	(8)	(2)	(2)	33	(2)	–	–	(41)	–	–	–	–	–	–
Debit valuation adjustment on derivative contracts	45	191	191	–	–	–	–	45	191	–	–	–	–	–
Provisions arising from the on-going review of compliance with the Consumer Credit Act in the UK	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Revenue excluding significant items:	**12,970**	**12,245**	**13,354**	**5,038**	**4,908**	**3,370**	**3,180**	**4,277**	**3,828**	**330**	**333**	**1,442**	**10**	**69**
Loan impairment charges and other credit risk provisions	**(971)**	**(1,246)**	**(1,245)**	**(223)**	**(248)**	**(601)**	**(699)**	**(133)**	**(280)**	**(14)**	**(19)**	**(18)**	–	–
Total operating expenses														
Reported[1]	**(8,575)**	**(9,506)**	**(10,236)**	**(3,673)**	**(4,248)**	**(1,437)**	**(1,715)**	**(3,122)**	**(3,093)**	**(176)**	**(213)**	**(943)**	**(222)**	**(310)**
Less significant items:														
UK customer redress programme	(787)	(1,351)	(1,351)	(610)	(982)	(91)	(162)	(84)	(207)	(2)	–	–	–	–
Restructuring and other related costs	(96)	(167)	(162)	(41)	(47)	(18)	(22)	(6)	(36)	(1)	(5)	–	(30)	(57)
Operational losses (dissolved company)	10	(65)	(65)	–	–	10	(65)	–	–	–	–	–	–	–
Gains in change of delivering ill-health benefits	280	–	–	123	–	104	–	53	–	–	–	–	–	–
Madoff related litigation costs	(193)	–	–	–	–	–	–	(193)	–	–	–	–	–	–
Settlements and provisions in connection with foreign exchange investigations	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Other provisions	–	(84)	(114)	–	–	–	–	–	–	–	–	(30)	–	(84)
Total operating expenses excluding significant items:	**(7,789)**	**(7,839)**	**(8,544)**	**(3,145)**	**(3,219)**	**(1,442)**	**(1,466)**	**(2,892)**	**(2,850)**	**(173)**	**(208)**	**(913)**	**(192)**	**(169)**

[1] Includes intersegment eliminations of £(55) million for 2013 and £(73) million for 2012 respectively.

	Total Global Business			RBWM		CMB		GB&M		GPB			Other	
	2013	2012 Continuing	2012	2013	2012	2013	2012	2013	2012	2013	2012 Continuing	2012	2013	2012
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Share of profit in associates and joint ventures	**–**	**(3)**	**(3)**	**2**	**1**	**1**	**–**	**(3)**	**(4)**	**–**	**(1)**	**(1)**	**–**	**1**
Profit before tax														
Reported	**3,294**	**624**	**1,004**	**1,177**	**411**	**1,333**	**766**	**1,023**	**642**	**140**	**100**	**480**	**(379)**	**(1,295)**
Less significant items:														
Change in credit spread on long-term debt	(167)	(1,055)	(1,055)	–	–	–	–	–	–	–	–	–	(167)	(1,055)
Fair value movement on non-qualifying hedges	(8)	(2)	(2)	33	(2)	–	–	(41)	–	–	–	–	–	–
Debit valuation adjustment on derivative contracts	45	191	191	–	–	–	–	45	191	–	–	–	–	–
Provisions arising from the on-going review of compliance with the Consumer Credit Act in the UK	–	–	–	–	–	–	–	–	–	–	–	–	–	–
UK customer redress programme	(787)	(1,351)	(1,351)	(610)	(982)	(91)	(162)	(84)	(207)	(2)	–	–	–	–
Restructuring and other related costs	(96)	(167)	(162)	(41)	(47)	(18)	(22)	(6)	(36)	(1)	(5)	–	(30)	(57)
Operational losses (dissolved company)	10	(65)	(65)	–	–	10	(65)	–	–	–	–	–	–	–
Gains in change of delivering ill-health benefits	280	–	–	123	–	104	–	53	–	–	–	–	–	–
Madoff related litigation costs	(193)	–	–	–	–	–	–	(193)	–	–	–	–	–	–
Settlements and provisions in connection with foreign exchange investigations	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Other provisions	–	(84)	(114)	–	–	–	–	–	–	–	–	(30)	–	(84)
Profit before tax excluding significant items:	**4,210**	**3,157**	**3,562**	**1,672**	**1,442**	**1,328**	**1,015**	**1,249**	**694**	**143**	**105**	**510**	**(182)**	**(99)**

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