HSBC HOLDINGS PLC
Form 20-F
March 20, 2006

As filed with the Securities and Exchange Commission on March 20, 2006.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

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

or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2005

or

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

or

SHELL COMPANY REPORT PURSUANT TO SECTION 14 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from N/A to N/A

Commission file number: 1-14930

HSBC Holdings plc

(Exact name of Registrant as specified in its charter)

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

8 Canada Square
London E14 5HQ
United Kingdom
(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value US$0.50 each.	London Stock Exchange Hong Kong Stock Exchange Euronext Paris Bermuda Stock Exchange New York Stock Exchange*

American Depository Shares, each representing 5 Ordinary Shares of nominal value US$0.50 each.	New York Stock Exchange
6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange*
American Depository Shares, each representing one-fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange

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

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

---

The number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2005 was:

Ordinary Shares, nominal value US$0.50 each	11,172,075,550

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

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934:

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statements Item the registrant has elected to follow:

Item 17 Item 18

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes No

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

HSBC HOLDINGS PLC

Table of Contents

Certain Defined Terms

Unless the context requires otherwise, HSBC Holdings means HSBC Holdings plc and HSBC or the Group means HSBC Holdings together with its subsidiaries and associates. Within this document the Hong Kong Special Administrative Region of the People s Republic of China is referred to as Hong Kong . When used in the terms shareholders equity and total shareholders equity , shareholders means holders of HSBC Holdings ordinary and preference shares.

Back to Contents

Financial Highlights

HSBC s Financial Statements and Notes thereon, as set out on pages 236 to 402, are prepared in accordance with International Financial Reporting Standards (IFRSs) as endorsed by the EU and effective for HSBC s reporting for the year ended 31 December 2005. There is no difference between IFRSs currently in effect and EU-endorsed IFRSs as they apply to the Group. This is the first time HSBC s annual financial statements have been prepared under IFRSs. Moving to IFRSs has necessarily involved the application of a number of available transition exemptions which means that prior year figures are not fully comparable with those presented in respect of 2005. Details of HSBC s transition to IFRSs are set out on page 332. HSBC previously reported under United Kingdom Generally Accepted Accounting Principles (UK GAAP).

In July 2005, HSBC published *2004 IFRS Comparative Financial Information*, summarising the principal effects of IFRSs on the financial information previously reported in respect of 2004 and including a reconciliation between data previously reported in respect of 2004 under UK GAAP and under IFRSs. HSBC s opening balance sheet at 1 January 2005 differs from the closing balance sheet at 31 December 2004 as the former reflects first-time adoption of International Accounting Standard 32 Financial Instruments: Presentation (IAS 32), IAS 39 Financial Instruments: Recognition and Measurement (IAS 39) and IFRS 4 Insurance Contracts (IFRS 4).

Certain information for years prior to 2004 has been prepared under UK GAAP, which is not comparable with IFRSs.

HSBC uses the US dollar as its presentation currency because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts its business. Unless otherwise stated, the accounting information presented in this document has been prepared in accordance with IFRSs.

	2005	2004
	US$m	US$m
For the year		
Total operating income	**61,704**	55,988
Profit before tax	**20,966**	18,943
Profit attributable to shareholders of the parent company	**15,081**	12,918
Dividends	**7,750**	6,932
At the year-end		
Total equity	**98,226**	99,197
Total shareholders equity	**92,432**	85,522
Capital resources	**105,449**	90,780
Customer accounts and deposits by banks	**809,146**	777,127
Total assets	**1,501,970**	1,279,974
Risk-weighted assets	**827,164**	759,210
	US$	US$
Per ordinary share		
Basic earnings	**1.36**	1.18
Diluted earnings	**1.35**	1.17
Dividends	**0.69**	0.63
Net asset value at the year-end	**8.16**	7.66

	At	At

	31 December 2005	31 December 2004
Share information		
US$0.50 ordinary shares in issue (million)	**11,334**	11,172
Market capitalisation (billion)	**US$ 182**	US$190
Closing market price per ordinary share:		
London	**£ 9.33**	£8.79
Hong Kong	**HK$ 124.50**	HK$133.00
Closing market price per American Depositary Share (ADS[1])	**US$ 80.47**	US$ 85.14

	Over 1 year	Over 3 years	Over 5 years
HSBC total shareholder return (TSR) to 31 December 2005[2]	**111.3**	**158.8**	**121.2**
Benchmarks:			
FTSE 100[3]	120.8	158.4	105.9
MSCI World[4]	123.1	159.1	99.1

For footnotes, see page 4.

Back to Contents

Financial Highlights (continued)

Capital and performance ratios

	2005	2004
	%	%
Capital ratios		
Tier 1 capital	**9.0**	8.9
Total capital	**12.8**	12.0
Performance ratios		
Return on average invested capital[5]	**15.9**	15.0
Return on average total shareholders equity[6]	**16.8**	16.3
Post-tax return on average total assets	**1.06**	1.14
Post-tax return on average risk-weighted assets	**2.01**	2.13
Credit coverage ratios		
Loan impairment charges as a percentage of total operating income	**12.74**	11.06
Loan impairment charges as a percentage of average gross customer advances	**1.16**	1.04
Total outstanding allowances against loan impairment as a percentage of non-performing loans at the year end	**99.1**	100.9
Efficiency and revenue mix ratios		
Cost efficiency ratio[7]	**51.2**	51.6
constant currency basis	**51.2**	52.4
As a percentage of total operating income:		
net interest income	**50.8**	55.5
net fee income	**23.4**	23.1
trading income	**9.5**	5.0

Constant currency

Constant currency comparatives in respect of 2004 used in the 2005 commentaries are computed by retranslating into US dollars:

- the income statements for 2004 of non-US dollar branches, subsidiaries, joint ventures and associates at the average rates of exchange for 2005; and
- the balance sheets at 31 December 2004 for non-US dollar branches, subsidiaries, joint ventures and associates at the prevailing rates of exchange on 31 December 2005.

No adjustment is made to the exchange rates used to translate foreign currency denominated assets and liabilities into the functional currency of any HSBC branch, subsidiary, joint venture or associate.

2005 compared with 2004

	As reported %	Constant currency on an underlying basis %
Operating income and cost growth		
Total operating income	**10**	**10**
Net operating income before loan impairment charges and other credit risk provisions	**12**	**12**
Total operating expenses	**11**	**9**

For details of the underlying constant currency basis, see Comparison of financial information on page 4.

For footnotes, see page 4.

Back to Contents

Five-year comparison

2005	2004		2003	2002	2001
US$m	US$m		US$m	US$m	US$m
		For the year			
31,334	31,099	Net interest income	25,598	15,460	14,725
30,370	24,889	Other operating income	15,474	11,135	11,163
(7,801)	(6,191)	Loan impairment charges and other credit risk provisions			
		Provisions for bad and doubtful debts	(6,093)	(1,321)	(2,037)
(29,514)	(26,487)	Total operating expenses	(22,532)	(15,808)	(15,404)
20,966	18,943	Profit before tax	12,816	9,650	8,000
15,081	12,918	Profit attributable to shareholders of the parent company	8,774	6,239	4,992
7,750	6,932	Dividends	6,532	5,001	4,467
		At the year-end			
5,667	5,587	Called up share capital	5,481	4,741	4,678
92,432	85,522	Total shareholders equity			
		Shareholders funds	74,473	51,765	45,688
105,449	90,780	Capital resources[10]	74,042	57,430	50,854
739,419	693,072	Customer accounts	573,130	495,438	449,991
3,474	3,686	Undated subordinated loan capital	3,617	3,540	3,479
35,856	32,914	Dated subordinated loan capital	17,580	14,831	12,001
740,002	672,891	Loans and advances to customers[11,12]	528,977	352,344	308,649
1,501,970	1,279,974	Total assets	1,034,216	758,605	695,545
US$	US$		US$	US$	US$
		Per ordinary share			
1.36	1.18	Basic earnings	0.84	0.67	0.54
1.35	1.17	Diluted earnings	0.83	0.66	0.53
0.69	0.63	Dividends	0.60	0.53	0.48
8.16	7.66	Net asset value at year-end	6.79	5.46	4.88
		Share information			
11,334	11,172	US$0.50 ordinary shares in issue (millions)	10,960	9,481	9,355
%	%		%	%	%
		Financial ratios			
50.7	53.4	Dividend payout ratio[13]	60.6	69.7	76.2
1.06	1.14	Post-tax return on average total assets	1.01	0.97	0.86
16.8	16.3	Return on average total shareholders equity			
		Return on average shareholders funds	13.0	12.4	10.6
5.96	6.35	Average total shareholders equity to average total assets			
		Average shareholders funds to average total assets	7.06	6.91	6.87
		Capital ratios			
9.0	8.9	Tier 1 capital	8.9	9.0	9.0
12.8	12.0	Total capital	12.0	13.3	13.0
		Foreign exchange translation rates to US$			
0.581	0.517	Closing £:US$1	0.560	0.620	0.690
0.847	0.733	:US$1	0.793	0.953	1.130
0.550	0.546	Average £:US$1	0.612	0.666	0.695
0.805	0.805	:US$1	0.885	1.061	1.117

For footnotes, see page 4.

Back to Contents

Financial Highlights (continued)

Five-year comparison *(continued)*

Amounts in accordance with US GAAP

	2005	2004	2003	2002	2001
	US$m	US$m	US$m	US$m	US$m
Income statement for the year					
Net income available for ordinary shareholders	**14,703**	12,506	7,231	4,900	4,911
Other comprehensive income	**(7,271)**	983	7,401	5,502	(1,439)
Dividends	**7,750**	6,932	6,974	4,632	4,394
Balance sheet at 31 December					
Total assets	**1,406,944**	1,266,365	1,012,023	763,565	698,312
Shareholders funds	**93,524**	90,082	80,251	55,831	48,444
	US$	US$	US$	US$	US$
Per ordinary share					
Basic earnings	**1.33**	1.15	0.69	0.52	0.53
Diluted earnings	**1.32**	1.13	0.69	0.52	0.53
Dividends	**0.69**	0.63	0.685	0.495	0.48
Net asset value at year end	**8.25**	8.06	7.32	5.89	5.18

Comparison of financial information

When reference to constant currency or constant exchange rates is made, comparative data reported in the functional currencies of HSBC s operations have been translated at the appropriate exchange rates applied in the current period in respect of the income statement or the balance sheet. When reference to underlying basis is made, comparative information has been expressed at constant currency and adjusted for the effect of acquisitions and the change in presentation of non-equity minority issues.

As the transition to IFRSs affects the comparability of the financial information presented in this document (see Note 1 on the Financial Statements), the commentary that follows specifies the impact when this is material to a reader s understanding of the underlying business trends.

Footnotes to Financial Highlights

1 *Each ADS represents five ordinary shares.*
2 *Total shareholder return (TSR) is defined on page 220.*
3 *The Financial Times-Stock Exchange 100 Index.*
4 *The Morgan Stanley Capital International World Index.*
5 *The definition of return on average invested capital and a reconciliation to the equivalent GAAP measures are set out on page 43.*
6 *The return on average total shareholders equity is defined as profit attributable to shareholders of the parent company divided by average total shareholders equity.*
7 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*
8 *Comparative data for 2004 excludes the provisions of IAS 32, IAS 39 and IFRS 4, which were adopted for the first time with effect from 1 January 2005.*
9 *The periods 2001-2003 were prepared in accordance with UK GAAP. The principal adjustments necessary to conform these periods with IFRSs are described in Note 46 on the Financial Statements on page 332. HSBC s accounting policies under UK GAAP are stated in Note 2 on the Financial Statements in the* 2004 Annual Report and Accounts.

10 *Capital resources are defined on page 173. A detailed computation for 2005 and 2004 is provided on page 176.*
11 *Net of suspended interest and provisions for bad and doubtful debts (UKGAAP).*
12 *Net of impairment allowances against customers (IFRSs).*
13 *Dividends per share expressed as a percentage of earnings per share (2001 to 2003: excluding goodwill amortisation).*

Back to Contents

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 HSBC.

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

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

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

- changes in general economic conditions in the markets in which HSBC operates, such as:
  - changes in foreign exchange rates, in both market exchange rates (for example, between the US dollar and the pound sterling) and government-established exchange rates (for example, between the Hong Kong dollar and the US dollar);
  - volatility in interest rates;
  - volatility in equity markets, including in the smaller and less liquid trading markets in Asia and South America;
  - lack of liquidity in wholesale funding markets in periods of economic or political crisis;
  - illiquidity and downward price pressure in national real estate markets, particularly consumer-owned real estate markets;
  - the impact of lower than expected investment returns on the burden of funding private and public sector defined benefit pensions;
  - the effect of unexpected changes in actuarial assumptions on longevity which would influence the funding of private and public sector defined benefit pensions;
  - continuing or deepening recessions and employment fluctuations; and
  - consumer perception as to the continuing availability of credit, and price competition in the market segments served by HSBC.
- changes in governmental policy and regulation, including:
  - the monetary, interest rate and other policies of central banks and bank and other regulatory authorities, including the United Kingdom Financial Services Authority, the Bank of England, the Hong Kong Monetary Authority, the United States Federal Reserve, the US Office of the Comptroller of the Currency, the European Central Bank, the People s Bank of China and the

central banks of other leading economies and markets where HSBC operates;

- expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership;
- initiatives by local, state and national regulatory agencies or legislative bodies to revise the practices, pricing or responsibilities of financial institutions serving their consumer markets;
- changes in bankruptcy legislation in the principal markets in which HSBC operates and the consequences thereof;
- general changes in governmental policy that may significantly influence investor decisions in particular markets in which HSBC operates;
- other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for HSBC s products and services;
- the costs, effects and outcomes of regulatory reviews, actions or litigation, including any additional compliance requirements; and

Back to Contents

Cautionary Statement regarding Forward-Looking Statements (continued)

  - the effects of competition in the markets where HSBC operates including increased competition from non-bank financial services companies, including securities firms.

- factors specific to HSBC:

  - the success of HSBC in adequately identifying the risks it faces, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, HSBC s ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses.

Information about the Enforceability of Judgements made in the United States

HSBC Holdings is a public limited company incorporated in England and Wales. Most of HSBC Holdings Directors and executive officers live outside the US. As a result, it may not be possible to serve process on such persons or HSBC Holdings in the US or to enforce judgements obtained in US courts against them or HSBC Holdings based on civil liability provisions of the securities laws of the US. There is doubt as to whether English courts would enforce:

- certain civil liabilities under US securities laws in original actions; or

- judgements of US courts based upon these civil liability provisions.

In addition, awards of punitive damages in actions brought in the US or elsewhere may be unenforceable in the UK. The enforceability of any judgement in the UK will depend on the particular facts of the case as well as the laws and treaties in effect at the time

Exchange Controls and Other Limitations affecting Equity Security Holders

There are currently no UK laws, decrees or regulations which would prevent the import or export of capital or remittance of distributable profits by way of dividends and other payments to holders of HSBC Holdings equity securities who are not residents of the UK. There are also no

restrictions under the laws of the UK or the terms of the Memorandum and Articles of Association of HSBC Holdings concerning the right of non-resident or foreign owners to hold HSBC Holdings equity securities or, when entitled to vote, to do so.

Back to Contents

Description of Business

Introduction

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$182 billion at 31 December 2005.

Headquartered in London, HSBC operates through long-established businesses and has an international network of over 9,800 properties in 76 countries and territories in five geographical regions: Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and South America. Within these regions, a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit bases, and consumer finance operations.

HSBC manages its business through four customer groups: Personal Financial Services; Commercial Banking; Corporate, Investment Banking and Markets; and Private Banking. Personal Financial Services incorporates the Group s consumer finance businesses, reflecting their increasing integration within mainstream financial services around the world. The largest of these is HSBC Finance Corporation, one of the leading consumer finance companies in the US.

The establishment in 1999 of HSBC as a uniform, international brand name ensured that the Group s hexagon corporate symbol has become an increasingly familiar sight across the world.

History and development

The founding member of HSBC, The Hongkong and Shanghai Banking Corporation Limited (The Hongkong and Shanghai Banking Corporation), was established in both Hong Kong and Shanghai in 1865. The bank expanded rapidly, with an emphasis on building up representation in mainland China and throughout the rest of Asia, while also establishing a presence in the major financial and trading centres in Europe and America.

In the mid-1950s, The Hongkong and Shanghai Banking Corporation embarked on a strategy of pursuing profitable growth through acquisition as well as organic development a combination that has remained a key feature of HSBC s approach ever since.

With each acquisition, HSBC focused on integrating its newly acquired operations with its existing businesses with the aim of maximising the

synergy between the various components. Key to this integration process is the blending of local and international expertise.

The most significant developments are described below. Other acquisitions in 2005 are discussed in the Financial Review on pages 26 to 177.

The Hongkong and Shanghai Banking Corporation purchased The Mercantile Bank of India Limited and The British Bank of the Middle East, now HSBC Bank Middle East Limited (HSBC Bank Middle East) in 1959. In 1965, it acquired a 51 per cent interest (subsequently increased to 62.14 per cent) in Hang Seng Bank Limited (Hang Seng Bank), consolidating its leadership position in Hong Kong. Hang Seng Bank is the third-largest listed bank in Hong Kong by market capitalisation.

The Hongkong and Shanghai Banking Corporation entered the US market in 1980 by acquiring a 51 per cent interest in Marine Midland Banks, Inc., now HSBC USA, Inc. The remaining interest was acquired in 1987.

In 1981, The Hongkong and Shanghai Banking Corporation incorporated its then existing Canadian operations. HSBC Bank Canada has since made numerous acquisitions, expanding rapidly to become the largest foreign-owned bank in Canada and the seventh-largest overall at 31 December 2005.

From the early 1980s, The Hongkong and Shanghai Banking Corporation began to focus its acquisition strategy on the UK. In 1987, it purchased a 14.9 per cent interest in Midland Bank plc, now HSBC Bank plc (HSBC Bank), one of the UK s principal clearing banks. In 1991, HSBC Holdings plc was established as the parent company of the HSBC Group and, in 1992, it purchased the remaining interest in HSBC Bank. As a consequence of this acquisition, HSBC s head office was transferred from Hong Kong to London in January 1993.

In 1997, HSBC assumed selected assets, liabilities and subsidiaries of Banco Bamerindus do Brasil S.A., now HSBC Bank Brasil S.A.-Banco Múltiplo (HSBC Bank Brazil), following the intervention of the Central Bank of Brazil, and in Argentina completed the acquisition of Grupo Roberts, now part of HSBC Bank Argentina S.A. (HSBC Bank Argentina).

In December 1999, HSBC acquired Republic New York Corporation, subsequently merged with HSBC USA, Inc., and Safra Republic Holdings S.A. In July 2004, HSBC Bank USA, Inc. merged with

Back to Contents

Description of Business (continued)

HSBC Bank & Trust (Delaware) N.A. to form HSBC Bank USA, N.A. (HSBC Bank USA).

To expand its base in the euro zone, in 2000 HSBC completed its acquisition of 99.99 per cent of the issued share capital of Crédit Commercial de France S.A., subsequently CCF S.A. (CCF) and now HSBC France, a major French banking group.

In 2002, HSBC took further steps in expanding its presence in the Americas, completing the acquisition of 99.59 per cent of Grupo Financiero Bital, S.A. de C.V., the holding company of what is now HSBC México, S.A. (HSBC Mexico), the fourth-largest banking group in Mexico measured by assets and the third by customer deposits.

Mainland China remains a key long-term growth area for the Group. In 2002, HSBC completed the acquisition of a 10 per cent equity stake in Ping An Insurance Company of China Limited (Ping An Insurance), reducing its holding to 9.99 per cent following an initial public offering (IPO) in 2004. In August 2005, HSBC acquired a further 9.91 per cent of Ping An Insurance at a cost of US$1,039 million, increasing its investment to 19.9 per cent. Ping An Insurance is the second-largest life insurer and the third-largest property and casualty insurer in mainland China.

In 2003, HSBC acquired Household International, Inc., now HSBC Finance Corporation (HSBC Finance). HSBC Finance brought to the Group national coverage in the US for consumer lending, credit cards and credit insurance through multiple distribution channels, as well as expertise in consumer finance for HSBC to roll out internationally.

Also in 2003, HSBC expanded in Brazil, acquiring Banco Lloyds TSB S.A.-Banco Múltiplo and the country s leading consumer finance company, Losango Promotora de Vendas Limitada (Losango).

In 2004, the acquisition of The Bank of Bermuda Limited (Bank of Bermuda) was completed.

In the same year, HSBC acquired Marks and Spencer Retail Financial Services Holdings Limited, which trades as Marks and Spencer Money (M&S Money) in the UK.

In mainland China in 2004, HSBC acquired 19.9 per cent of Bank of Communications Limited (Bank of Communications), mainland China s fifth largest bank by total assets. In the same year, Hang Seng Bank acquired 15.98 per cent of Industrial Bank Co.

Limited (Industrial Bank), one of only 13 national joint-stock banks.

In December 2005, HSBC Finance completed the acquisition of Metris Companies Inc. (Metris) for US$1.6 billion. HSBC is now the 5th largest issuer of MasterCard® and Visa® cards1 in the US.

Outlook

In the near term, the outlook is encouraging. The world economy continues to grow steadily. The US economy is strong, the UK resilient, Japan and Germany are recovering and the emerging markets are buoyant.

Longer term prospects are more uncertain. Apart from the possibility, albeit remote, of a sudden shock to the world s financial system, HSBC remains concerned about the unprecedented level of trade imbalances. Similarly, the implications of demographic change and of ageing populations for financial markets and businesses will be profound. It is inevitable that at some stage a process of adjustment will begin, but the timing is open to question. So far, the financial markets are taking a benign view of these potential sources of instability.

Progressively, globalisation is forcing countries and businesses operating within them to re-evaluate their comparative advantages and to adjust to a world in which emerging markets compete not only in terms of cost but also in skills and technology. The globalisation of the services industry, spurred on by new technologies and the rapid fall in communication costs, will afford huge opportunities but also pose significant challenges to many areas of economic activity, including financial services. Incipient protectionism, resulting from a reluctance to face up to the new competitive realities, remains a threat to the continuing growth of the world economy.

In certain mature markets, under-funded pension schemes threaten to become a drain on companies resources. Combined with the rising cost of long-term health care, they pose a considerable challenge to policy makers. Continuing productivity growth is, therefore, increasingly important. Only if it is achieved will financial markets be able to offer returns with a meaningful premium to the risk-free rate embodied in government debt. Without such productivity gains and associated financial returns, the affordability of pension and health care promises

1 *Visa is a registered trademark of VISA USA, Inc.and MasterCard is a registered trademark of MasterCard International, Incorporated.*

Back to Contents

will become increasingly burdensome. The challenge to society of managing the equitable distribution of wealth created between competing generations may well become one of the most pressing of the next decade.

In this environment HSBC, with its unique international footprint, is determined to continue to deliver profitable growth and value to its various constituencies. Success ensures that the Group can offer good employment prospects to an ever more diverse workforce. It means that HSBC can afford to continue to invest in expanding the platforms by which it delivers services to its customers. It enables the Group to contribute to the savings and retirement needs of those who invest in HSBC directly, or indirectly through pension plans and investment funds.

Building on its achievements, HSBC s priority for the rest of 2006 is to continue to implement its Managing for Growth strategy. It will achieve this by being distinctive, reinforcing its brand values of trust and integrity in all its dealings with customers. The Group will make itself even more relevant by broadening the product, channel and geographical coverage it offers. Furthermore, HSBC will ensure that the scale and complexity needed to compete successfully will be seamless from the perspective of its customers and manageable from that of its employees.

HSBC s businesses in Asia, Turkey, Mexico, Brazil and the Middle East see strong opportunities for growth on the back of investments already made. The Group also sees opportunities to strengthen its position in its franchises in the UK, Hong Kong, North America and France. HSBC believes there is growing momentum from the development of its new business streams within Corporate, Investment Banking and Markets businesses. Overall, HSBC is well positioned for further growth.

Strategy

At the end of 2003, HSBC launched Managing for Growth , a strategic plan that provides HSBC with a blueprint for growth and development during the period to 2008. The strategy is evolutionary, not revolutionary. It builds on HSBC s strengths and it addresses the areas where further improvement is considered both desirable and attainable.

Management s vision for the Group remains consistent: HSBC aims to be the world s leading financial services company. In this context, leading means preferred, admired and dynamic, and being recognised for giving the customer a fair deal. HSBC

will strive to secure and maintain a leading position within each of its customer groups in selected markets.

HSBC will concentrate on growing earnings over the long term at a rate which will place it favourably when compared with its peer group. It will also focus on investing in its delivery platforms, its technology, its people and its brand to support the future value of HSBC as reflected in its comparative stock market rating and TSR. HSBC remains committed to benchmarking its performance both absolutely and by comparison with a peer group. For full details of the peer group benchmark, see page 220.

HSBC s core values are integral to its strategy, and communicating them to customers, shareholders and employees is intrinsic to the plan. These values comprise an emphasis on long-term, ethical client relationships; high productivity through teamwork; a confident and ambitious sense of excellence; being international in outlook and character; prudence; creativity and customer-focused marketing.

The plan also reaffirms HSBC s recognition of its corporate social responsibility (CSR). HSBC has always aspired to the highest standards of conduct, recognises its wider obligations to society and believes there is a strong link between CSR, long-term success and value creation. Moreover, changing public expectations across a wide spectrum of social, ethical and environmental issues require continuing attention to this area. The strategy therefore calls for a renewed emphasis on CSR and for increased external communication of the Group s CSR policies and performance, particularly on education and the environment, which will remain the principal beneficiaries of HSBC s philanthropic activities.

HSBC s growth ambitions centre on its four customer groups: Personal Financial Services; Commercial Banking; Corporate, Investment Banking and Markets; and Private Banking; and specific strategies are being implemented for each of them. HSBC believes that by organising its internal and external reporting around customer groups, it reinforces to all its employees the Group s customer focus.

Within Personal Financial Services, the increasing integration, skills sharing and transfer of technology with the consumer finance business has augmented and enhanced existing activities. In addition, the introduction of skills and practices from the world s leading retailing businesses is shaping HSBC s competitive positioning.

Back to Contents

Description of Business (continued)

Key elements in achieving HSBC s objectives for its customer groups will be accelerating the rate of growth of revenue; developing the brand strategy further; improving productivity; and maintaining the Group s prudent risk management and strong financial position. Developing the skills of HSBC s staff will also be critical and it will be necessary to ensure that all employees understand how they can contribute to the successful achievement of the Group s objectives. Employees who do make such a contribution will be rewarded accordingly.

Operational management will continue to be organised geographically under four regional intermediate head offices, with business activities concentrated in locations where growth and critical mass are to be found.

The plan contains eight strategic imperatives:

- Brand: make HSBC and its hexagon symbol one of the world s leading brands for customer experience and corporate social responsibility;
- Personal Financial Services: drive growth in key markets and through appropriate channels to make HSBC the strongest global player in personal financial services;
- Consumer Finance: extend the reach of this business to existing customers through a wider product range and penetrate new markets;
- Commercial Banking: make the most of HSBC s international customer base through effective relationship management and improved product offerings in all the Group s markets;
- Corporate, Investment Banking and Markets: accelerate growth by enhancing capital markets and advisory capabilities focused on client service in defined sectors where HSBC has critical relevance and strength;
- Private Banking: serve the Group s highest value personal clients around the world;
- People: attract, develop and motivate HSBC s people, rewarding success and rejecting mediocrity; and
- TSR: fulfil HSBC s TSR target by achieving strong competitive performances in earnings per share growth and efficiency.

Employees and management

At 31 December 2005, HSBC s customers were served by 284,000 employees (including part-time employees) worldwide, compared with 253,000 at 31 December 2004 and 232,000 at 31 December 2003. The main centres of employment are the UK

with 55,000 employees, the US 49,000, Brazil 28,000, Hong Kong 26,000, Mexico 22,000, India 20,000 and France 14,000. HSBC negotiates with recognised unions, and estimates that approximately 40 per cent of its employees are unionised. The highest concentrations of union membership are in Brazil, France, India, Malaysia, Malta, Mexico, the Philippines, Singapore and the UK. As a result of well-developed communications and consultation programmes, HSBC has not experienced any material disruptions to its operations from labour disputes during the past five years.

In support of its strategy, HSBC focuses on attracting, developing and motivating the very best individuals and on encouraging talent internally. Emphasis is placed on performance management; differentiated rewards; succession planning; diversity; and learning and development, with priority accorded to enhancing sales and relationship management skills. HSBC continues to endeavour to ensure that employees engagement with the business is maximised as this is beneficial to shareholders, colleagues and customers alike.

HSBC recruits from a broad cross-section of society and encourages the sharing of individual perspectives and ideas through collective training and global secondments. HSBC s diverse workforce represents a significant competitive advantage. The broad cultural mix and increasing cross-border mobility of its employees enables HSBC to resource operations with individuals who have detailed knowledge of local markets and of HSBC globally. This strengthens international networks and facilitates the sharing of best practices. In addition, a continuing focus on policies that encourage an inclusive working environment and the availability of career opportunities for all is critical to HSBC being an employer of choice. HSBC seeks to maintain an employee profile that reflects its customer base.

HSBC operates in a highly competitive and international business environment. Through its network of international operations, it has the advantage of being able to respond to the availability of talented employees wherever they are, in order to enhance customer service and improve productivity. As education levels improve globally and as investments in technology and telecommunications facilitate access at competitive cost to hitherto untapped resources, the balance of employment continues to change, resulting in global resource centres of excellence. Job losses may arise in some countries, but HSBC has a good record of communicating openly and sensitively in these circumstances, and of reassigning employees and

Back to Contents

minimising compulsory redundancies wherever possible.

HSBC seeks to promote and recruit the most able people and attaches great importance to cultivating its own talent. Resources have been set aside to ensure a supply of talented individuals to meet business succession needs, with support provided for these employees in the form of career enhancement and personal development programmes. In addition, HSBC recognises that there are lessons to be learned from other successful businesses, and will recruit from non-banking industries where appropriate.

Customer groups

Profit before tax by customer group

Year ended 31 December 2005

Total assets1 by customer group

As at 31 December 2005

1 *Excluding Hong Kong Government certificates of indebtedness.*

Personal Financial Services

Personal Financial Services provides some 120 million individual and self-employed customers with a wide range of banking and related financial services. The precise nature of the products and services provided is, to some extent, driven by local regulations, market practices and the market positioning of HSBC s local businesses. Typically, products provided include

current and savings accounts, mortgages and personal loans, credit cards, and local and international payments services.

Personal customers prefer to conduct their financial business at times convenient to them, using a range of delivery channels. This demand for flexibility is met through the increased provision of direct channels such as the internet and self-service terminals, in addition to traditional and automated branches and service centres accessed by telephone.

Delivering the right products and services for particular target markets is a fundamental requirement in any retail service business, and market research and customer analysis is key to developing an in-depth understanding of significant customer segments and their needs. This understanding of the customer ensures that Customer Relationship Management (CRM) systems are effectively used to identify and fulfil sales opportunities, and to manage the sales process.

HSBC *Premier* is a premium banking service providing personalised relationship management, 24-hour priority telephone access, global travel assistance and cheque encashment facilities. There are now over 1.3 million HSBC *Premier* customers, who can use more than 250 specially designated *Premier* branches and centres in 35 countries and territories, either when visiting, or on a more permanent basis if they require a banking relationship in more than one country.

Insurance and investment products play an important part in meeting the needs of customers. Insurance products sold and distributed by HSBC through its direct channels and branch networks include loan protection, life, property and health insurance, and pensions. Acting as both broker and underwriter, HSBC sees continuing opportunities to deliver insurance products to its personal customer base.

HSBC also makes available a wide range of investment products. A choice of third party and proprietary funds is offered, including traditional long only equity and bond funds; structured funds that provide capital security and opportunities for an enhanced return; and fund of funds products which offer customers the ability to diversify their investments across a range of best-in-class fund managers chosen after a rigorous and objective selection process. Comprehensive financial planning services covering customers investment, retirement, personal and asset protection needs are offered through specialist financial planning managers.

Back to Contents

Description of Business (continued)

High net worth individuals and their families who choose the differentiated services offered within Private Banking are not included in this customer group.

Consumer Finance

Within Personal Financial Services, HSBC Finance s operations in the US, the UK and Canada make credit available to customer groups not well catered for by traditional banking operations, facilitate point-of-sale credit in support of retail purchases and support major affiliate credit card programmes. At 31 December 2005 HSBC Finance had over 60 million customers with total gross advances of US$142.1 billion. Consumer Finance products are offered through the following businesses of HSBC Finance:

The **consumer lending** business is one of the largest sub-prime home equity originators in the US, marketed under the HFC and Beneficial brand names through a network of nearly 1,400 branches in 45 states, direct mail, telemarketing, strategic alliances and the internet. Consumer lending also acquires sub-prime loans on the secondary market. Sub-prime is a category used in the US which describes customers who have limited credit histories, modest incomes, high debt-to-income ratios, high loan-to-value ratios (for real estate secured products) or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions. Consumer lending products include secured and unsecured loans such as first and second lien closed-end mortgages, open-ended home equity loans, personal loans, loans secured on motor vehicles and retail finance contracts. Consumer lending also offers a near-prime mortgage product which was first introduced in 2003 to broaden the range of customers to which its products are relevant.

The **mortgage services** business purchases first and second lien residential mortgage loans, including open-end home equity loans, from a network of over 280 unaffiliated third-party lenders in the US. Purchases are primarily of pools of loans (bulk acquisitions), but also include individual loan portfolios (flow acquisitions), made under predetermined underwriting guidelines. Forward commitments are offered to selected correspondents to strengthen relationships and create a sustainable growth channel for this business. HSBC Finance, through its subsidiary, Decision One Mortgage Company (Decision One), also originates mortgage loans referred by mortgage brokers.

The **retail services** business is one of the

largest providers of third party private label credit cards (or store cards) in the US based on receivables outstanding, with over 70 merchant relationships and 15.8 million active customer accounts.

In addition to originating and refinancing motor vehicle loans, HSBC Finance s **motor vehicle finance** business purchases retail instalment contracts of US customers who do not have access to traditional prime-based lending sources. The loans are largely sourced from a network of approximately 10,000 motor dealers.

The **credit card services** business is the fifth largest issuer of MasterCard® and Visa® credit cards in the US, and also includes affiliation programmes such as the GM Card® and the AFL-CIO Union Plus® credit card. Also, credit cards issued in the name of Household Bank, Orchard Bank and Direct Merchants Bank brands are offered to customers under-served by traditional providers, or are marketed primarily through merchant relationships established by the retail services business.

A wide range of **insurance services** is offered by HSBC Finance to customers in the US, the UK and Canada who are typically not well-served by traditional sources.

The **taxpayer financial services** business accelerates access to funds for US taxpayers who are entitled to tax refunds and offers financial services through more than 25,000 tax return preparers in the US. The business is seasonal with most revenues generated in the first three months of the year.

HSBC Finance s business in the UK (HFC Bank) provides mid-market consumers with mortgages, secured and unsecured loans, insurance products, credit cards and retail finance products. It concentrates on customer service through its 187 HFC Bank and Beneficial branches, and finances consumer electronic goods through its retail finance operations. Its credit card business was sold to HSBC Bank in December 2005. In Canada, similar products are offered through trust operations of HSBC Finance s subsidiary there.

Commercial Banking

HSBC is one of the world s leading, and most international, banks in the provision of financial services and products to small, medium-sized and middle market businesses, with over 2.5 million customers including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly quoted companies.

Back to Contents

At 31 December 2005, HSBC had total commercial customer account balances of US$148.1 billion and total commercial customer loans and advances, net of loan impairment allowances, of US$142.0 billion.

Commercial Banking places particular emphasis on multi-disciplinary and geographical collaboration in meeting its commercial customers needs, thereby differentiating, broadening and enhancing its offering. The range of products includes:

Payments and cash management: HSBC is a leading provider of payments, collections, liquidity management and account services worldwide, enabling commercial customers to manage their cash efficiently on a global basis. HSBC s extensive network of offices and strong domestic capabilities in many countries, including direct access to local clearing systems, enhances its ability to provide high-quality competitive cash management services.

Treasury and capital markets: Commercial Banking customers have long been volume users of the Group s foreign exchange capabilities. These are now being supplemented with more sophisticated currency and interest rate options.

Investment banking: A small number of Commercial Banking customers need occasional investment banking advisory support. Co-operation with Corporate, Investment Banking and Markets ensures that in most key markets such requirements are serviced internally.

Wealth management services: These include advice and products related to savings and investments. They are provided to Commercial Banking customers and their employees through HSBC s worldwide network of branches and business banking centres.

Insurance: HSBC offers insurance protection, employee benefits programmes and pension schemes designed to meet the needs of businesses and their employees, and to help fulfil the applicable statutory obligations of client companies. These products are provided by HSBC either as an intermediary (broker, agent or consultant) or as a supplier of in-house or third party offerings. Products and services include a full range of commercial insurance, including pension schemes; healthcare schemes; key man life insurance; car fleet; goods in transit; trade credit protection; risk management and insurance due diligence reviews; and actuarial/employee benefit consultancy.

Trade services: HSBC has more than 140 years of experience in trade services. A complete range of traditional documentary credit, collections and

financing products is offered, as well as specialised services such as insured export finance, international factoring and forfaiting. HSBC s expertise is supported by highly automated systems.

Leasing, finance and factoring: HSBC has established specialised divisions to provide leasing and instalment finance for vehicles, plant and equipment, machinery and materials handling, and large complex leases. HSBC also provides domestic and international factoring and receivables finance services through a network of 11 businesses worldwide.

Credit cards: HSBC offers commercial credit card services in 18 countries. Commercial card issuing provides small to middle market businesses with services, including corporate and purchasing cards, which variously enhance cash management, improve cost control and streamline purchasing processes. Commercial card acquiring enables merchants to accept credit card payments either in-store or on the internet.

Corporate, Investment Banking and Markets

HSBC s Corporate, Investment Banking and Markets business provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business, this customer group operates a long-term relationship management approach to build a full understanding of clients financial requirements. Sectoral client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With dedicated offices in over 60 countries and with access to HSBC s worldwide presence and capabilities, this business serves subsidiaries and offices of its clients on a global basis.

Products and services offered include:

Global Markets

HSBC s operations in Global Markets consist of treasury and capital markets services for supranationals, central banks, corporations, institutional and private investors, financial institutions and other market participants. Products include:

- foreign exchange;
- currency, interest rate, bond, credit, equity and other specialised derivatives;
- government and non-government fixed income and money market instruments;
- precious metals and exchange traded futures;

Back to Contents

Description of Business (continued)

- equity services, including research, sales and trading for institutional, corporate and private clients and asset management services, including global investment advisory and fund management services; and
- distribution of capital markets instruments, including debt, equity and structured products, utilising links with HSBC s global networks.

Corporate and Investment Banking

Global Investment Banking comprises:

- capital raising, both publicly and privately, including debt and equity capital, structured finance and syndicated finance;
- corporate finance and advisory services for mergers and acquisitions, asset disposals, stock exchange listings, privatisations and capital restructurings; and
- project and export finance services providing non-recourse finance to exporters, importers and financial institutions, and working closely with all major export credit agencies.

Corporate and Institutional Banking includes:

- direct lending, including structured finance for complex investment facilities;
- leasing finance with an emphasis on large-ticket transactions; and
- deposit-taking.

Global Transaction Banking includes international, regional and in-country payments and cash management services; trade services, particularly the specialised supply chain product; and securities services, where HSBC is one of the world s leading custodians providing custody and clearing services and funds administration to both domestic and cross-border investors. Factoring and banknotes services are also provided by specialist units.

Private Equity comprises HSBC s captive private equity fund management activities, strategic relationships with certain third party private equity managers together with direct listed and unlisted equity investments and fund commitments.

Group Investment Businesses

These comprise asset management products and services for institutional investors, intermediaries and individual investors and their advisers.

Management structure

During February 2006, the management structure of Global Markets and Corporate and Investment Banking was restructured. Under the new structure, there are three principal business lines: Global Banking, Global Markets and Global Transaction Banking. This new structure will allow Corporate, Investment Banking and Markets to focus on the relationships and sectors that best fit the Group s footprint and ensure seamless delivery of HSBC s enhanced product capabilities to clients.

Private Banking

HSBC s presence in all the major wealth-creating regions has enabled it to build one of the world s leading private banking groups, providing financial services to high net worth individuals and their families in 74 locations in 35 countries, with total assets under management of US$282 billion at 31 December 2005. HSBC Private Bank is the principal marketing name of the HSBC Group s international private banking business which, together with HSBC Guyerzeller and HSBC Trinkaus & Burkhardt, provides private banking services.

Utilising the most suitable products from the marketplace, Private Banking works with its clients to offer both traditional and innovative ways to manage and preserve wealth whilst optimising returns. Products and services offered include:

Investment services: These comprise both advisory and discretionary investment services. A wide range of investment vehicles is covered, including bonds, equities, derivatives, options, futures, structured products and alternative products, mutual funds, hedge funds and fund of funds. Supported by six major advisory centres in Hong Kong, Singapore, Geneva, New York, Paris and London, Private Banking seeks to select the most suitable investments for clients needs and investment strategies.

Global wealth solutions: These comprise inheritance planning, trustee and other fiduciary services designed to protect existing wealth and create tailored structures to preserve wealth for future generations. Areas of expertise include trusts, foundation and company administration, charitable trusts and foundations, insurance and offshore structures.

Specialist advisory services: Private Banking offers expertise in several specialist areas of wealth management including tax advisory and financial planning, family office advisory, corporate finance,

Back to Contents

consolidated reporting, industry services such as charities and foundations, media, shipping, diamond and jewellery, and real estate planning. Specialist advisers are available to deliver products and services that are tailored to meet the full range of high net worth clients individual financial needs.

General banking services: These comprise treasury and foreign exchange, offshore and onshore deposits, credit and specialised lending, tailor-made loans and internet banking. Private Banking works to ensure its clients have full access to relevant skills and products available throughout HSBC, such as corporate banking, investment banking and insurance.

Geographical regions

Profit before tax split by geographical region

Year ended 31 December 2005

Total assets1 split by geographical region

As at 31 December 2005

1 *Excluding Hong Kong Government certificates of indebtedness.*

Additional information regarding business developments in 2005 may be found in the Financial Review on pages 26 to 177.

Europe

HSBC s principal banking operations in Europe are HSBC Bank in the UK, HSBC France, HSBC Bank

A.S. in Turkey, HSBC Bank Malta, HSBC Private Bank (Suisse), HSBC Trinkaus & Burkhardt KGaA and HSBC Guyerzeller Bank AG. Through these operations HSBC provides a wide range of banking, treasury and financial services to personal, commercial and corporate customers across Europe.

Hong Kong

HSBC s principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation and Hang Seng Bank. The former is the largest bank incorporated in Hong Kong and is HSBC s flagship bank in the Asia-Pacific region. It is one of Hong Kong s three note-issuing banks, accounting for more than 65 per cent by value of banknotes in circulation in 2005.

Rest of Asia-Pacific (including the Middle East)

The Hongkong and Shanghai Banking Corporation offers personal, commercial, corporate and investment banking and markets services in mainland China. The bank s network spans 12 major cities, comprising 12 branches and eight sub-branches. Hang Seng Bank offers personal and commercial banking services and operates six branches, four sub-branches, and two representative offices in eight cities in mainland China. HSBC also participates indirectly in mainland China through its three associates, Bank of Communications (19.9 per cent owned), Ping An Insurance (19.9 per cent) and Industrial Bank (15.98 per cent).

Outside Hong Kong and mainland China, the HSBC Group conducts business in the Asia-Pacific region primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation in 22 countries, with particularly strong coverage in India, Indonesia, South Korea, Singapore and Taiwan. HSBC s presence in the Middle East is led by HSBC Bank Middle East in a network of branches and subsidiaries with the widest coverage in the region; in Australia by HSBC Bank Australia Limited; and in Malaysia by HSBC Bank Malaysia Berhad, which has the second largest presence of any foreign-owned bank in the country. HSBC s associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom s sixth largest bank.

North America

HSBC s North American businesses cover the US, Canada, Mexico, Bermuda and Panama. Operations in the US are primarily conducted through HSBC Bank USA, N.A. which is concentrated in New York State, and HSBC Finance, a national consumer

Back to Contents

Description of Business (continued)

finance company based in Chicago. HSBC s businesses in Mexico and Panama are run through HSBC Mexico, with HSBC Bank Canada and Bank of Bermuda responsible for operations in their respective countries.

South America

HSBC s operations in South America principally comprise HSBC Bank Brazil and HSBC Bank Argentina, although HSBC is also represented in Venezuela, Chile and Uruguay. In addition to banking services, HSBC operates large insurance businesses in Argentina and Brazil. In Argentina, HSBC s main insurance business is HSBC La Buenos Aires and, through Máxima and HSBC New York Life, HSBC offers pensions and life assurance products. In Brazil, HSBC also offers consumer finance products through its subsidiary, Losango.

Competitive environment

HSBC believes that open and competitive markets are good for both local economies and their participants, and the Group faces very strong competition in the markets it serves. In personal and commercial banking, it competes with a wide range of institutions including commercial banks, consumer finance companies, retail financial service companies, savings and loan associations, credit unions, general retailers, brokerage firms and investment companies. In investment banking, HSBC faces competition from specialist providers and the investment banking operations of other commercial banks.

Regulators routinely monitor and investigate the competitiveness of the financial services industry (of which HSBC is a part) in a number of areas, particularly in the UK and Europe.

Global factors

Consolidation in the banking industry

Over the past few decades there has been a trend towards consolidation in banking and financial services, both nationally and internationally. This development has created a large and growing number of institutions which are capable of competing with HSBC across a wide range of services.

Limited market growth

The majority of HSBC s business is conducted in the US, the UK and Hong Kong. Penetration of standard banking services in these markets is nearing saturation, with little scope for further market

growth. Greater potential for expansion lies in the provision of a wider range of financial services, including consumer finance, to new and existing customers. HSBC has also identified emerging economies in Asia-Pacific, Mexico, the Middle East, Turkey and Latin America as a source of current and future growth.

Advances in technology

Over the last decade, new technologies such as the internet and related innovations have matured, and financial institutions have not been alone in recognising the potential of these developments. Financial services and other market participants can now deliver a large and expanding range of products and services through these channels and competition is, as a result, fierce. However, with competition come opportunities. HSBC will continue to offer a full range of services via the channels preferred by its customers. These currently include the internet, interactive TV, mobile phone, WAP and telephone banking as well as the traditional branch network.

Regional factors

Europe

The European Commission has commenced inquiries into retail banking and business insurance across all member states. All HSBC entities affected have responded to the initial questionnaires.

The 65 member banks of the European Payments Council have signed an agreement to create a Single European Payments Area by 2008 which aims to harmonise transfers, banker s orders and cards transactions. This should offer strong growth opportunities for some banks but will also lead to more competition.

UK

After several very positive years, UK growth slowed in 2005. Although corporate earnings rose and the UK stock market was healthy, strong commodity and oil prices adversely affected several sectors. Retailers are suffering from declining levels of consumer confidence and disposable income, mainly caused by high levels of indebtedness and rising tax and utility burdens.

A stable interest rate environment, strong employment levels and a solid housing market helped to keep demand for consumer finance strong but could not prevent a rise in default and arrears rates in all forms of unsecured personal lending.

Back to Contents

Despite these developments, competition in the retail banking sector for the best customers remained intense, with pressure on credit products, interest margins and, in particular, deposit rates.

The high level of personal indebtedness and strong competition within the retail banking and consumer finance sectors led regulatory authorities to continue to monitor closely the financial services sector.

In December, the UK Competition Commission released its provisional remedies to improve competition following its investigation into the US$8.3 billion store card industry. HSBC continues to co-operate with the Commission as the inquiry draws to a conclusion.

Also in 2005, the Office of Fair Trading (OFT) continued with its inquiry into credit card terms under the Unfair Terms in Consumer Contracts regulations. HSBC has made various submissions to the OFT and discussions continue.

The OFT also published its decision on the multilateral interchange agreement between MasterCard members in October. MasterCard has appealed against the decision to the Competition Appeals Tribunal. Visa is also subject to investigation but the case is suspended pending resolution of the MasterCard case.

In November, the Financial Services Authority published the results of its themed review of the sale of Payment Protection Insurance. It has expressed concerns regarding some practices which were common within the industry. HSBC has not received a negative response in respect of its own procedures, but will be considering its products and sales practices in the light of the findings. The OFT will be undertaking a market investigation into Payment Protection Insurance following a super-complaint from the Citizens Advice Bureau.

Throughout 2005, a Payments Task Force chaired by the OFT has brought together representatives of the banking industry, consumer bodies and business with the Bank of England and HM Treasury to look at various aspects of the payments system. Its first report recommended that the payment industry implement a faster means of making low cost electronic payments. HSBC agrees that this is in the consumer s interest and favours its early implementation.

The Consumer Credit Bill, currently in its second reading in Parliament, updates existing consumer legislation in order to provide better consumer protection, and is likely to come into force during 2006.

HSBC s policy is to co-operate and work positively with all its regulators, inputting data and perspective on those issues which affect all financial service providers via industry bodies.

France

Stable interest rates in the euro zone contributed to a strong growth in real estate investment in France. Competition between French banks was concentrated on the promotion of real estate mortgage loans, which are the principal means by which new customers in France are acquired. Market activity increased and consumers enjoyed improved pricing to the detriment of bank margins throughout 2005.

The payment of interest on sight deposits, which has only been permitted since the beginning of 2005, was introduced by one major mutual French bank. This move did not provoke a widespread reaction in the domestic market and, to date, no other leading French bank has followed suit.

In December 2005, Banque Postale (a subsidiary of the French Postal service) received the necessary regulatory approvals and with effect from January 2006 will be able to offer real estate mortgages and financial services, including the sale of investment products manufactured by third party providers. Given the scale of Banque Postale s geographical coverage, this will increase competition in an already competitive market.

The French government has reformed tax law for 2006/2007 with two measures which will increase disposable income for high income individuals: a tax exemption on capital gains on equities held for more than eight years, which brings the French taxation regime into line with practices in many other European countries, and a cap on total household taxes at 60 per cent of income. This will boost one of the market segments on which HSBC France focuses.

At the end of December, French banks were granted approval, as in the UK, to provide equity release mortgages. This will assist customers to invest in real estate and finance consumption.

Hong Kong

While fierce competition in traditional core banking products remained evident in Hong Kong, the rising cost of funds in the second half of 2005 from increasing interbank rates made banks with smaller deposit bases more cautious in price competition. A decline in property loan demand also added pressure on banks to look for new outlets for lending. Personal loans, including credit card advances, attracted

Back to Contents

Description of Business (continued)

banks attention as consumer spending revived strongly.

The Chinese currency regime was reformed in July 2005 and the second phase of Hong Kong s renminbi business introduced late in the year. While developments in these areas remain at an early stage, they are expected, along with the benefits flowing from the liberalisation of China s financial sector under the World Trade Organisation agreement, to be a continued source of growth in the future.

Rest of Asia-Pacific (including the Middle East)

The competitive environment in the Rest of Asia-Pacific continues to intensify as international banks focus on targeted sectors in emerging markets in pursuit of higher returns. Local banks are also actively expanding their reach and business, both within countries and across borders. Competition remains intense throughout the region in all the customer groups served by HSBC. However, in many countries the growing sophistication of the relatively young population and increasing affluence of the middle class continue to provide HSBC with further opportunities for growth.

Banks and non-banks, both local and international, are rapidly building consumer finance and direct banking businesses in a number of countries in the region.

North America

In an already highly competitive US financial services industry, institutions involved in a broad range of financial products and services continued to consolidate. Within the banking sector, consolidation continued into 2006, with a greater focus on national networks and retail branch banking.

The Group s principal US subsidiaries, HSBC Bank USA and HSBC Finance, face vigorous competition from a wide array of financial institutions. These include banks, thrifts, insurance companies, credit unions, mortgage lenders and brokers, and non-bank suppliers of consumer credit and other financial services. Many of these institutions are not subject to US banking industry regulation, unlike HSBC. This gives some of them cost and product advantages and will further increase competitive pressures. HSBC competes by expanding its customer base through portfolio acquisitions or alliances, co-branding opportunities and direct sales channels, by offering a very wide variety of consumer loan products and by maintaining a strong service orientation.

The five largest banks in Canada dominate the country s financial services industry. Despite this, the market remains very competitive with comparable financial products and services offered by other banks, insurance companies and other institutions. Merger activity among the largest banks in Canada remains possible, but without such consolidation major financial institutions will continue to look elsewhere for growth.

Mexico s banking industry is highly concentrated. Five large foreign-owned banks, including HSBC, control 75 per cent of banking assets and 78 per cent of deposits through their local subsidiaries. The majority of Mexico s 105 million people neither have access to nor use the banking system. Thus there are favourable growth opportunities for retail banking over the medium to long term. HSBC is well placed in this environment, with an extensive branch network and an expanding base of young customers from which to develop growth opportunities. Currently, there is strong regulatory and consumer pressure to reduce banking and pension management fees and commissions as volumes increase, constraining growth in non-funds income. Mexico s economy is very closely linked to the US and 88 per cent of its exports are sent there.

South America

The composition of the Brazilian financial system saw relatively little change in 2005. The top ten banking groups, which account for 68 per cent of assets and 86 per cent of branches, remained dominated by a combination of large state-owned banks, privately-owned local banks and subsidiaries of foreign banks such as HSBC. In 2005, HSBC was the sixth largest non-state owned bank in the country, ranked by assets.

Notwithstanding the persistence of high interest rates in Brazil and an uncertain outlook for the economy, 2005 saw strong growth in lending to individuals. Central Bank statistics indicate that personal lending increased by an estimated 37 per cent during the year, following growth of 28.6 per cent in 2004. However, total lending as a percentage of GDP remained low in international terms at 31.3 per cent. This, together with the fact that within the economically active population an estimated 40 million people have limited access to financial services, indicates that the outlook for further growth is positive.

Against this background, banks continued to develop their consumer finance businesses, with particular emphasis on partnerships with large retailers and green field ventures. In the retail

Back to Contents

segment, payroll and pension-linked advances emerged in 2005 as a significant source of lending. Banks also developed virtual banking networks known as *correspondentes bancários.* These are typically small retail establishments offering basic payment and banking services on behalf of established banks on a commission basis. By the end of 2005, HSBC had developed a network of 1,824 *correspondentes* generating close to one million monthly transactions.

In Argentina, HSBC s competition comes from international financial groups which, in most cases, provide an equivalent range of banking, insurance, pension and annuity products and services.

The completion of Argentina s international debt swap negotiation eliminated a major concern that had overshadowed the country and the financial system. This had a significantly favourable impact

upon the pensions and life insurance business, which also benefited from increasing contributions as more people returned to employment in the formal economy.

Consequently, the banking industry showed improved profitability with many of the larger foreign-owned banks re-capitalising their domestic operations. Continued growth and increased confidence in the economy were reflected in increased deposit levels and a 38 per cent growth in demand for loan products compared with 2004.

HSBC sees the return to a more normal business environment continuing and intends to monitor opportunities within the financial services industry in Argentina with a view to growing core retail and commercial banking franchises.

Governance, Regulation and Supervision

Governance

With listings of its ordinary shares in London, Hong Kong, New York, Paris and Bermuda, HSBC Holdings complies with the relevant requirements for listing and trading on each of these exchanges. In the UK, these are the Listing Rules of the Financial Services Authority; in Hong Kong, The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited; in the US, where the shares are traded in the form of ADSs, HSBC Holdings shares are registered with the US Securities and Exchange Commission. As a consequence of its US listing, HSBC Holdings is also subject to the reporting and other requirements of the US Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the New York Stock Exchange s Listed Company Manual, in each case as applied to foreign private issuers. In France and Bermuda, HSBC Holdings is subject to the listing rules of Euronext, Paris and the Bermuda Stock Exchange applicable to companies with secondary listings.

A statement of HSBC s compliance with the code provisions of the Combined Code on Corporate Governance issued by the Financial Reporting Council and with the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited is set out in the Report of the Directors .

Regulation and supervision

HSBC s operations throughout the world are regulated and supervised by approximately 490 different central banks and regulatory authorities in those jurisdictions in which HSBC has offices, branches or subsidiaries. HSBC estimates the cost of this regulation and supervision to be approximately US$635 million in 2005. These authorities impose a variety of requirements and controls covering, *inter alia*, capital adequacy, depositor protection, market liquidity, governance standards, customer protection (for example, fair lending practices, product design, and marketing and documentation standards), and social responsibility obligations (for example, anti-money laundering and anti-terrorist financing measures). In addition, a number of countries in which HSBC operates impose rules that affect, or place limitations on, foreign or foreign-owned or controlled banks and financial institutions. The rules include restrictions on the opening of local offices, branches or subsidiaries and the types of banking and non-banking activities that may be conducted by those local offices, branches or subsidiaries; restrictions on the acquisition of local banks or regulations requiring a specified percentage of local ownership; and restrictions on investment and other financial flows entering or leaving the country. The supervisory and regulatory regimes of the countries where HSBC operates will determine to some degree HSBC s ability to expand into new markets, the services and products that HSBC will be able to offer in those markets and how HSBC structures specific operations.

The Financial Services Authority (FSA) supervises HSBC on a consolidated basis. In addition, each operating bank, finance company or insurance operation within HSBC is regulated by local supervisors. The primary regulatory authorities are those in the UK, Hong Kong and the US, the Group s principal areas of operation.

In June 2004, the Basel Committee on Banking Supervision introduced a new capital adequacy framework to replace the 1988 Basel Capital Accord in the form of a final Accord (commonly known as Basel II). Details of the European Union s implementation of Basel II and how this will affect HSBC are set out on page 174.

United Kingdom regulation and supervision

UK banking and financial services institutions are subject to multiple regulations. The primary UK statute is the Financial Services and Markets Act 2000 (FSMA). Other UK primary and secondary banking legislation is derived from European Union (EU) directives relating to banking, securities, investment and sales of personal financial services.

The FSA is responsible for authorising and supervising UK financial services institutions and regulates all HSBC s businesses in the UK which require authorisation under the FSMA. These include retail banking, life and general insurance, pensions, mortgages, custody and branch share-dealing businesses, and treasury and capital markets activity. HSBC Bank is HSBC s principal authorised institution in the UK.

FSA rules establish the minimum criteria for authorisation for banks and financial services businesses in the UK. They also set out reporting (and, as applicable, consent) requirements with regard to large individual exposures and large exposures to related borrowers. In its capacity as supervisor of HSBC on a consolidated basis, the FSA receives information on the capital adequacy of, and sets requirements for, HSBC as a whole. Further details on capital measurement are included in Capital Management on pages 176 to 177. The FSA has the right to object, on prudential grounds, to

Back to Contents

persons who hold, or intend to hold, 10 per cent or more of the voting power of a financial institution.

The regulatory framework of the UK financial services system has traditionally been based on co-operation between the FSA and authorised institutions. The FSA monitors authorised institutions through ongoing supervision and the review of routine and *ad hoc* reports relating to financial and prudential matters. The FSA may periodically obtain independent reports, usually from the auditors of the authorised institution, as to the adequacy of internal control procedures and systems as well as procedures and systems governing records and accounting. The FSA meets regularly with HSBC s senior executives to discuss HSBC s adherence to the FSA s prudential guidelines. They also regularly discuss fundamental matters relating to HSBC s business in the UK and internationally, including areas such as strategic and operating plans, risk control, loan portfolio composition and organisational changes, including succession planning.

UK depositors and investors are covered by the Financial Services Compensation Scheme which deals with deposits with authorised institutions in the UK, investment business and contracts of insurance. Institutions authorised to accept deposits and conduct investment business are required to contribute to the funding of the scheme. In the event of the insolvency of an authorised institution, depositors are entitled to receive 100 per cent of the first £2,000 (US$3,442) of a claim plus 90 per cent of any further amount up to £33,000 (US$56,798) (the maximum amount payable being £31,700 (US$54,560)). Payments under the scheme in respect of investment business compensation are limited to 100 per cent of the first £30,000 (US$51,634) of a claim plus 90 per cent of any further amount up to £20,000 (US$34,423) (the maximum amount payable being £48,000 (US$82,615)). In addition, the Financial Services Compensation Scheme has been extended to cover mortgage advice and arranging, certain long term and general insurance products, and the provision of general advice and arranging services. Differing levels of compensation limits apply to each of these additional areas.

The EU Savings Directive took effect on 1 July 2005. Under the directive, each member state other than Austria, Belgium, and Luxembourg is required to provide the tax authorities of each other member state with details of payments of interest or other similar income paid by a person within its jurisdiction to individuals resident in such other member state. For a transitional period beginning on the same date, Austria, Belgium, and Luxembourg

have imposed a withholding tax on such income. The withholding tax rate is 15 per cent, increasing to 20 per cent from 2008 and 35 per cent from 2011. Subject to future conditions being met, Austria, Belgium, and Luxembourg may cease to apply the withholding tax and instead comply with the automatic exchange of information rules applicable to the other member states. These future conditions will depend on other key financial centres Switzerland, Liechtenstein, San Marino, Andorra and the US not exchanging information. These financial centres and several other European countries and related offshore territories have also entered into similar agreements to the Savings Directive with the EU states.

Hong Kong regulation and supervision

Banking in Hong Kong is subject to the provisions of the Banking Ordinance of Hong Kong (Chapter 155) (the Banking Ordinance), and to the powers, functions and duties ascribed by the Banking Ordinance to the Hong Kong Monetary Authority (the HKMA). The principal function of the HKMA is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA is responsible for supervising compliance with the provisions of the Banking Ordinance. The Banking Ordinance gives power to the Chief Executive of Hong Kong to give directions to the HKMA and the Financial Secretary with respect to the exercise of their respective functions under the Banking Ordinance.

The HKMA has responsibility for authorising banks, and has discretion to attach conditions to its authorisation. The HKMA requires that banks or their holding companies file regular prudential returns, and holds regular discussions with the management of the banks to review their operations. The HKMA may also conduct on site examinations of banks, and in the case of banks incorporated in Hong Kong, of any local and overseas branches and subsidiaries. The HKMA requires all authorised institutions to have adequate systems of internal control and requires the institutions external auditors, upon request, to report on those systems and other matters such as the accuracy of information provided to the HKMA. In addition, the HKMA may from time to time conduct tripartite discussions with banks and their external auditors.

The HKMA, which may deny the acquisition of voting power of over 10 per cent in a bank, and may attach conditions to its approval thereof, can effectively control changes in the ownership and control of Hong Kong-incorporated financial institutions. In addition, the HKMA has the power to

21

Governance, Regulation and Supervision (continued)

divest controlling interests in a bank from persons if they are no longer deemed to be fit and proper, if they may otherwise threaten the interests of depositors or potential depositors, or if they have contravened any conditions specified by the HKMA.

The HKMA may revoke authorisation in the event of an institution s non-compliance with the provisions of the Banking Ordinance. These provisions require, among other things, the furnishing of accurate reports.

The Banking Ordinance requires that banks submit to the HKMA certain returns and other information and establishes certain minimum standards and ratios relating to capital adequacy (see below), liquidity, capitalisation, limitations on shareholdings, exposure to any one customer, unsecured advances to persons affiliated with the bank and holdings of interests in land, with which banks must comply.

Hong Kong fully implemented the capital adequacy standards established by the 1988 Basel Capital Accord. The Banking Ordinance currently provides that banks incorporated in Hong Kong maintain a capital adequacy ratio (calculated as the ratio, expressed as a percentage, of the bank's capital base to its risk-weighted exposure) of at least 8 per cent. For banks with subsidiaries, the HKMA is empowered to require that the ratio be calculated on a consolidated basis, or on both consolidated and unconsolidated bases. If circumstances require, the HKMA is empowered to increase the minimum capital adequacy ratio (to up to 16 per cent), after consultation with the bank.

The HKMA is in the process of establishing a Deposit Protection Scheme for banks in Hong Kong. It is expected that this will be launched in 2006.

The marketing of, dealing in and provision of advice and asset management services in relation to securities in Hong Kong are subject to the provisions of the Securities and Futures Ordinance of Hong Kong (Chapter 571) (the Securities and Futures Ordinance). Entities engaging in activities regulated by the Securities and Futures Ordinance are required to be licensed. The HKMA is the primary regulator for banks involved in the securities business, while the Securities and Futures Commission is the regulator for non-banking entities.

US regulation and supervision

HSBC is subject to extensive federal and state supervision and regulation in the US. Banking laws and regulations of the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC) and

the Office of the Comptroller of the Currency (OCC) govern many aspects of HSBC s US business.

HSBC and its US operations are subject to supervision, regulation and examination by the Federal Reserve Board because HSBC is a bank holding company under the US Bank Holding Company Act of 1956 (the BHCA) as a result of its ownership of HSBC Bank USA. HSBC Bank USA is a nationally chartered commercial bank and a member of the Federal Reserve System. HSBC Bank USA is the surviving institution of the 1 July 2004 merger of HSBC Bank USA and HSBC Bank & Trust (Delaware) N.A. HSBC also owns HSBC Bank Nevada, N.A. (HSBC Bank Nevada), a nationally chartered credit card bank and HSBC Trust Company (Delaware) NA (HSBC Bank Delaware), a nationally chartered bank limited to trust activities, each of which is also a member of the Federal Reserve System. Each of HSBC Bank USA, HSBC Bank Nevada and HSBC Bank Delaware is subject to regulation, supervision and examination by the OCC. The deposits of HSBC Bank USA and HSBC Bank Nevada are insured by the FDIC and both banks are subject to relevant FDIC regulation. On 1 January 2004, HSBC formed a new company to hold all of its North American operations, including these two banks. This company, called HSBC North America Holdings Inc. (HNAH) is also a bank holding company under the BHCA, by virtue of its ownership and control of HSBC Bank USA.

The BHCA and the International Banking Act of 1978 impose certain limits and requirements on the US activities and investments of HSBC, HNAH, and certain companies in which they hold direct or indirect investments. HSBC is also a qualifying foreign banking organisation under Federal Reserve Board regulations and, as such, may engage within the United States in certain limited non-banking activities and hold certain investments that would otherwise not be permissible under US law. Prior to 13 March 2000, the BHCA generally prohibited HSBC from acquiring, directly or indirectly, ownership or control of more than 5 per cent of the voting shares of any company engaged in the US in activities other than banking and certain activities closely related to banking. On that date HSBC became a financial holding company (FHC) under the Gramm-Leach-Bliley Act amendments to the BHCA, enabling it to offer a more complete line of financial products and services. Upon its formation, HNAH also registered as an FHC. HSBC and HNAH s ability to engage in expanded financial activities as FHCs depend upon HSBC and HNAH continuing to meet certain criteria set forth in the

Back to Contents

BHCA, including requirements that its US depository institution subsidiaries, HSBC Bank USA, HSBC Bank Nevada and HSBC Bank Delaware, be well-capitalised and well-managed , and that such institutions have achieved at least a satisfactory record in meeting community credit needs during their most recent examinations pursuant to the Community Reinvestment Act. These requirements also apply to Wells Fargo HSBC Trade Bank, N.A., in which HSBC and HNAH have a 20 per cent voting interest in equity capital and a 40 per cent economic interest. Each of these depository institutions achieved at least the required rating during their most recent examinations. At 31 December 2005, HSBC Bank USA, HSBC Bank Nevada, HSBC Bank Delaware and Wells Fargo HSBC Trade Bank, N.A. were each well capitalised and well managed under Federal Reserve Board regulations.

In general under the BHCA, an FHC would be required, upon notice by the Federal Reserve Board, to enter into an agreement with the Federal Reserve Board to correct any failure to comply with the requirements to maintain FHC status. Until such deficiencies are corrected, the Federal Reserve Board may impose limitations on the US activities of an FHC and depository institutions under its control. If such deficiencies are not corrected, the Federal Reserve Board may require an FHC to divest its control of any subsidiary depository institution or to desist from certain financial activities in the US.

HSBC and HNAH are generally prohibited under the BHCA from acquiring, directly or indirectly, ownership or control of more than 5 per cent of any class of voting shares of, or substantially all the assets of, or exercising control over, any US bank or bank holding company without the prior approval of the Federal Reserve Board.

The US is party to the 1988 Basel Capital Accord and US banking regulatory authorities have adopted risk-based capital requirements for US banks and bank holding companies that are generally consistent with the Accord. In addition, US regulatory authorities have adopted leverage capital requirements that generally require US banks and bank holding companies to maintain a minimum amount of capital in relation to their balance sheet assets (measured on a non-risk-weighted basis).

The Federal Deposit Insurance Corporation Improvement Act of 1991 provides for extensive regulation of insured depository institutions (such as HSBC Bank USA, HSBC Bank Nevada and Wells Fargo HSBC Trade Bank, N.A.), including requiring federal banking regulators to take prompt corrective

action with respect to FDIC-insured banks that do not meet minimum capital requirements.

HSBC Bank USA, HSBC Bank Nevada and Wells Fargo HSBC Trade Bank, N.A., like other FDIC-insured banks, may be required to pay assessments to the FDIC for deposit insurance under the FDIC s Bank Insurance Fund. Under the FDIC s risk-based system for setting deposit insurance assessments, an institution s assessments vary according to the level of capital an institution holds, its deposit levels and other factors.

The USA Patriot Act (Patriot Act) imposes significant record keeping and customer identity requirements, expands the US federal government s powers to freeze or confiscate assets and increases the available penalties that may be assessed against financial institutions for failure to comply with obligations imposed on such institutions to detect, prevent and report money laundering and terrorist financing. Among other things, the Patriot Act requires the US Treasury Secretary to develop and adopt final regulations with regard to the anti-money laundering compliance obligations of financial institutions (a term which, for this purpose, includes insured US depository institutions, US branches and agencies of foreign banks, US broker-dealers and numerous other entities). The US Treasury Secretary delegated certain authority to a bureau of the US Treasury Department known as the Financial Crimes Enforcement Network (FinCEN).

Many of the anti-money laundering compliance requirements of the Patriot Act, as implemented by FinCEN, are generally consistent with the anti-money laundering compliance obligations previously imposed on the then HSBC Bank USA and Household Bank (now HSBC Bank Nevada) under the Bank Secrecy Act (which was amended in certain respects by the Patriot Act) and applicable regulations. These include requirements to adopt and implement an anti-money laundering programme, report suspicious transactions and implement due diligence procedures for certain correspondent and private banking accounts. Certain other specific requirements under the Patriot Act involve new compliance obligations. The passage of the Patriot Act and other recent events have resulted in heightened scrutiny of the Bank Secrecy Act and anti-money laundering compliance by federal and state bank examiners. On 30 April 2003 the then HSBC Bank USA entered into a written agreement with the Federal Reserve Bank of New York and the New York State Banking Department to enhance its compliance with anti-money laundering requirements. HSBC Bank USA implemented certain improvements in its compliance, reporting, and review systems and procedures to

23

Back to Contents

Governance, Regulation and Supervision (continued)

comply with this agreement. When HSBC Bank USA merged with HSBC Bank & Trust (Delaware) N.A. on 1 July 2004, the OCC made the merger conditional on HSBC Bank USA s continuing compliance with the requirements of the written agreement. On 6 February 2006, the OCC determined that HSBC Bank USA had satisfied the requirements of the written agreement, and it terminated the agreement.

HSBC s US consumer finance operations are subject to extensive state-by-state regulation in the US, and to laws relating to consumer protection; (both in general, and in respect of sub-prime lending operations, which have been subject to enhanced regulatory scrutiny); discrimination in extending credit; use of credit reports; privacy matters; disclosure of credit terms; and correction of billing errors. They also are subject to regulations and legislation that limit operations in certain jurisdictions. For example, limitations may be placed on the amount of interest or fees that a loan may bear, the amount that may be borrowed, the types of actions that may be taken to collect or foreclose upon delinquent loans or the information about a customer that may be shared. HSBC s US consumer finance branch lending offices are generally licensed

in those jurisdictions in which they operate. Such licences have limited terms but are renewable, and are revocable for cause. Failure to comply with applicable laws and regulations may limit the ability of these licensed lenders to collect or enforce loan agreements made with consumers and may cause the consumer finance lending subsidiary to be liable for damages and penalties.

HSBC s US credit insurance operations are subject to regulatory supervision under the laws of the states in which they operate. Regulations vary from state to state but generally cover licensing of insurance companies; premiums and loss rates; dividend restrictions; types of insurance that may be sold; permissible investments; policy reserve requirements; and insurance marketing practices.

Certain US source payments to foreign persons may be subject to US withholding tax unless the foreign person is a qualified intermediary. A qualified intermediary is a financial intermediary which is qualified under the Internal Revenue Code and has completed the Qualified Intermediary Withholding Agreement with the Internal Revenue Service. Various HSBC operations outside the US are qualified intermediaries.

Back to Contents

Description of Property

At 31 December 2005, HSBC operated from some 9,800 operational properties worldwide, of which approximately 3,300 were located in Europe, 600 in Hong Kong and the Rest of Asia-Pacific, 4,000 in North America (including 1,600 in Mexico) and 1,900 in South America. These properties had an area of approximately 63.8 million square feet (2004: 62.2 million square feet).

In addition, properties with a net book value of US$2,170 million were held for investment purposes. Of the total net book value of HSBC properties, more than 80 per cent were owned or held under long-term leases. Further details are included in Note 23 on the Financial Statements.

HSBC s properties are stated at cost, being historical cost or fair value at the date of transition to IFRSs (their deemed cost) less any impairment losses, and are depreciated on a basis calculated to write off the assets over their estimated useful lives.

Legal Proceedings

HSBC is named in and is defending legal actions in various jurisdictions arising out of its normal business operations. None of the above proceedings is regarded as material litigation.

Back to Contents

Financial Review

Summary

	Year ended 31 December	
	2005	2004
	US$m	US$m
Interest income	**60,094**	50,471
Interest expense	**(28,760)**	(19,372)
Net interest income	**31,334**	31,099
Fee income	**17,486**	15,902
Fee expense	**(3,030)**	(2,954)
Net fee income	**14,456**	12,948
Trading income excluding net interest income	**3,656**	2,786
Net interest income on trading activities	**2,208**	
Net trading income[1]	**5,864**	2,786
Net income from financial instruments designated at fair value	**1,034**	
Net investment income on assets backing policyholders liabilities		1,012
Gains less losses from financial investments	**692**	540
Dividend income	**155**	622
Net earned insurance premiums	**5,436**	5,368
Other operating income	**2,733**	1,613
Total operating income	**61,704**	55,988
Net insurance claims incurred and movement in policyholders liabilities	**(4,067)**	(4,635)
Net operating income before loan impairment charges and other credit risk provisions	**57,637**	51,353
Loan impairment charges and other credit risk provisions	**(7,801)**	(6,191)
Net operating income	**49,836**	45,162
Employee compensation and benefits	**(16,145)**	(14,523)
General and administrative expenses	**(11,183)**	(9,739)
Depreciation of property, plant and equipment	**(1,632)**	(1,731)
Amortisation of intangible assets	**(554)**	(494)
Total operating expenses	**(29,514)**	(26,487)
Operating profit	**20,322**	18,675
Share of profit in associates and joint ventures	**644**	268
Profit before tax	**20,966**	18,943
Tax expense	**(5,093)**	(4,685)
Profit for the year	**15,873**	14,258

Profit attributable to shareholders of the parent company	**15,081**	12,918
Profit attributable to minority interests	**792**	1,340

1 *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 related external interest income, interest expense and dividend income. The 2004 comparative figure does not include interest income and interest expense on trading assets and liabilities except for trading derivatives, nor does it include dividend income on trading assets.*

HSBC made a profit before tax of US$20,966 million, a rise of US$2,023 million or 11 per cent compared with 2004. Of this increase, US$267 million was attributable to additional contributions of ten and two months from M&S Money and Bank of Bermuda respectively, one month s contribution from Metris, and the first full year effect of HSBC s investments in Bank of Communications and Industrial Bank.

As a result of the transition to full IFRSs, the format of the income statement has changed. In

particular, US$685 million of what would, in the past, have been included in non-equity minority interest, has moved within the income statement and is classified as Interest expense in 2005, rather than Profit attributable to minority interests . As the applicable IFRSs requiring these changes only came into effect from 1 January 2005, the comparative 2004 figures are presented on the previous basis.

On an underlying basis, which is described on page 4, profit before tax increased by 13 per cent.

Back to Contents

Total operating income of US$61,704 million was US$5,716 million or 10 per cent higher than in 2004. On an underlying basis, total operating income also rose by 10 per cent. This reflected organic lending growth in all regions and expansion in transactional banking revenues from increased trade, funds under management, administration and custody activities. Strong growth was also seen in fixed income and credit trading. Operating income performance was well spread geographically with particularly strong growth in HSBC s operations in South America, the Middle East and the Rest of Asia-Pacific.

Loan impairment and other credit risk provisions as a percentage of gross average advances to customers was moderately higher in 2005 at 1.16 per cent than in 2004, 0.99 per cent. There was also a small rise in the percentage ratio of new loan impairment charges to gross average advances to customers from 1.41 in 2004 to 1.50 in 2005. The charge of US$7,801 million was US$1,610 million or 26 per cent higher than in 2004 and on an underlying basis 23 per cent higher. Of this increase, approximately half was driven by growth in lending, with the remainder attributable to the higher rate of new provisions and the non-recurrence of general provision releases benefiting 2004. Underlying credit conditions in the UK were adversely affected by slower economic growth and changes in bankruptcy legislation. This was offset by improved credit experience in the US, notwithstanding the impact of Hurricane Katrina and an acceleration of bankruptcy filings ahead of legislative changes in the fourth quarter of 2005. In Brazil, HSBC also experienced higher charges as increased credit availability, particularly in the consumer segment, led to over-indebtedness.

Total operating expenses of US$29,514 million were US$3,027 million or 11 per cent higher than in 2004, 9 per cent higher on an underlying basis. Much of the growth reflected investment to expand the Group s geographic presence and adding product expertise and sales support. This expansion was most marked in Personal Financial Services in the Rest of Asia-Pacific and in Corporate, Investment Banking and Markets, where investment spend peaked during 2005. In addition, business expansion in Mexico, the Middle East and South America contributed to cost growth.

Productivity improvements achieved in the UK and Hong Kong allowed the Group to continue building its Personal Financial Services and Commercial Banking businesses in the Rest of Asia-Pacific, and expanding its capabilities in Corporate, Investment Banking and Markets, without deterioration in the Group s cost efficiency ratio. In the UK, the focus on improving utilisation of the existing infrastructure led to broadly flat costs in Personal Financial Services and Commercial Banking compared with underlying combined revenue growth of 10 per cent.

HSBC s cost efficiency ratio, which is calculated as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions, improved slightly to 51.2 per cent in 2005 from 51.6 per cent in 2004.

HSBC s share of profit in associates and joint ventures increased by US$376 million, boosted by full year contributions from Bank of Communications and Industrial Bank in mainland China, and increased income from The Saudi British Bank, which reported a record performance on the back of a vibrant economy and a strong oil price.

Back to Contents

Financial Review (continued)

Net interest income

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**8,221**	**26.2**	9,098	29.3
Hong Kong	**4,064**	**13.0**	3,638	11.7
Rest of Asia-Pacific	**2,412**	**7.7**	2,060	6.6
North America	**14,887**	**47.5**	14,993	48.2
South America	**1,750**	**5.6**	1,310	4.2
Net interest income[1]	**31,334**	**100.0**	31,099	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest income[1]	**31,334**	31,099
Average interest-earning assets	**999,421**	976,387
Gross interest yield (per cent)[2]	**6.01**	5.17
Net interest spread (per cent)[3]	**2.84**	2.97
Net interest margin (per cent)[4]	**3.14**	3.19

1 *Net interest income in 2005 comprises interest income less interest expense on financial assets and liabilities which is not recognised as part of Net trading income or Net income earned from financial instruments designated at fair value . In 2004, all interest income and expense was included within Net interest income so these figures are not strictly comparable.*
2 *Gross interest yield is the average annualised interest rate earned on average interest-earning assets (AIEA).*
3 *Net interest spread is the difference between the average annualised interest rate earned on AIEA, net of amortised premiums and loan fees, and the average annualised interest rate paid on average interest-bearing funds.*
4 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*

Net interest income of US$31,334 million was US$235 million, or 1 per cent, higher than in 2004.

Under IFRSs, HSBC s presentation of net interest income in 2005 was particularly affected by:

- the reclassification of certain preference dividends within non-equity minority interests as interest expense;
- the inclusion of certain loan origination fees and expenses as part of an effective interest rate calculation instead of being recognised in full on inception of the loan; and
- external interest income and expense on trading assets and liabilities now included within Netrading income .

Adjusting for these changes and on an underlying basis, net interest income increased by 12 per cent. The commentary that follows is on this basis.

The benefit of strong growth in interest-earning assets globally more than offset the effect of spread compression from flattening yield curves in the major currencies. This latter phenomenon reduced opportunities for HSBC s treasury operations to enhance margin by placing the Group s surplus liquidity longer term than the behaviouralised deposit funding base. In addition, short-term interest rate rises in the US reduced spreads on consumer finance loans.

In Europe, higher personal and commercial lending and increased deposit balances led to a 12 per cent increase in net interest income. UK Personal Financial Services balances grew strongly in mortgages, unsecured lending and cards, mainly funded by a 12 per cent increase in deposit and savings balances. In Turkey, card balances grew from increased marketing and working with HSBC s retail partners. Spreads tightened on UK personal lending, reflecting the introduction of preferential pricing for lower-risk and higher-value customers, and on savings, due to better pricing for customers. In Commercial Banking in the UK, lending and overdraft balances increased by 23 per cent, with growth particularly strong in the property, distribution and services sectors. Deposit balances grew by 11 per cent, partly from keen pricing, though this reduced deposit spreads. Yields on UK corporate lending, which were lower largely as a result of competitive pressure, were only partly offset by higher loan balances, while lower treasury income reflected the effect of rising short-term rates and flattening yield curves on balance sheet management revenues.

In North America, net interest income increased by 6 per cent. Growth in mortgage, card and unsecured personal lending balances was strong, offsetting spread contraction as the cost of funds rose with progressive interest rate rises. Core deposit growth benefited from expansion of the branch

Back to Contents

network and the launch of new savings products, including an online savings product which attracted a significant number of new customers. Treasury income from balance sheet management within Corporate, Investment Banking and Markets diminished as the rise in short-term interest rates limited opportunities to profit from placing the liquidity generated from core banking operations over extended periods.

In Hong Kong, net interest income rose by 17 per cent. Rising interest rates reinvigorated demand for traditional savings products, driving increases in personal and commercial savings balances. Coupled with the rise in deposit spreads, which increased in line with interest rates, this led to a sharp rise in net interest income. Mortgage spreads, however, contracted, as the gradual increase in yields during the year, in line with higher rates, was more than offset by rising funding costs. There was little net new lending for residential mortgages as interest rate rises cooled the residential property market in the second half of 2005. Economic growth in mainland China boosted commercial lending to the trade and manufacturing sectors, and property lending also increased. Treasury income remained under pressure, with rising short-term interest rates and a flat yield curve providing limited opportunities to profitably deploy surplus liquidity and increasing funding costs.

In the Rest of Asia-Pacific, net interest income increased by 24 per cent, reflecting business expansion and favourable economic conditions throughout the region. In the Middle East, buoyant oil-based economies stimulated demand for credit for property and infrastructure projects. Increasing personal and corporate wealth contributed to growth in deposit balances, while interest rate rises led to higher deposit spreads. General economic expansion created demand for consumption credit which boosted credit card lending. For the reasons noted above, treasury income from balance sheet management was weaker.

In South America, the positive economic environment encouraged growth in personal and commercial lending, particularly in credit cards and vehicle finance, which led to a 35 per cent increase in net interest income. A significant rise in customer acquisition and the development of the Losango customer base in Brazil also contributed.

Average interest-earning assets increased by US$23 billion, or 2 per cent, compared with 2004. At constant exchange rates, and excluding the US$84.7 billion of trading assets in 2004, average interest-earning assets increased by 11 per cent, reflecting strong growth in mortgages, personal lending and cards globally, and increased lending in Commercial Banking.

HSBC s net interest margin was 3.14 per cent in 2005 compared with 3.19 in 2004. For the reasons set out in the opening paragraphs, these figures are not strictly comparable as a result of presentation changes under IFRSs from 1 January 2005.

Back to Contents

Financial Review (continued)

Net fee income

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**6,299**	**43.6**	5,980	46.2
Hong Kong	**1,674**	**11.6**	1,703	13.2
Rest of Asia-Pacific	**1,340**	**9.2**	1,041	8.0
North America	**4,606**	**31.9**	3,765	29.1
South America	**537**	**3.7**	459	3.5
Net fee income	**14,456**	**100.0**	12,948	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Account services	**3,132**	2,779
Credit facilities[1]	**880**	1,179
Remittances	**396**	353
Cards	**4,699**	3,987
Imports/exports	**722**	692
Underwriting	**274**	234
Insurance	**1,082**	1,001
Mortgage servicing	**76**	80
Trust income	**199**	203
Broking income	**1,104**	943
Global custody	**656**	564
Maintenance income on operating leases	**180**	190
Funds under management	**1,831**	1,479
Unit trusts	**388**	498
Corporate finance	**211**	193
Other	**1,656**	1,527
Total fee income	**17,486**	15,902
Less: fee expense	**(3,030)**	(2,954)
Net fee income	**14,456**	12,948

1 *Under IFRSs from 2005, a higher proportion of fees on credit facilities is dealt with as part of an effective interest rate calculation than previously. This change in accounting affects both the timing of fee income recognition and its presentation in the accounts. In accordance with the transition arrangements to IFRSs, the 2004 comparative figure is presented on the old accounting basis.*

Net fee income of US$14,456 million was US$1,508 million or 12 per cent higher than in 2004. Under IFRSs, a greater proportion of fees related to the provision of credit facilities is now amortised and accounted for in net interest income as part of an effective interest rate calculation than was the case before 1 January 2005. This resulted in a reduction in reported net fee income of approximately 4 per cent. Excluding this effect and on an underlying basis, growth in net fee income was 14 per cent and the comments that follow are presented on this basis. The principal drivers of this growth were:

- the increase in card fee income, reflecting strong growth in personal credit card sales across the Group and increased transaction volumes;
- increased customer numbers, higher transaction volumes, an increase in packaged accounts and the selective management of tariffs led to an 11 per cent increase in account services fees;
- in Private Banking, the introduction of a wider range of alternative investment products and services generated higher fee income;
- increased demand for credit among personal and commercial customers drove mortgage and lending fees up by 11 per cent; and
- rising equity markets and renewed interest in emerging markets led to higher global custody, broking and asset management fees.

Offsetting these positive trends, after a strong run of growth, fee income from unit trust sales in Hong Kong fell as rising interest rates made traditional deposit products more attractive.

In Europe, fee income increased by 9 per cent. Higher personal and commercial lending volumes led to a 19 per cent increase in credit fees. Card fee

Back to Contents

income rose by 22 per cent, principally in the UK which benefited from higher customer numbers and greater card utilisation. Account service fees increased by 9 per cent, reflecting increased customer numbers, the launch of a new packaged product in the UK and the introduction of a Small Business Tariff in Commercial Banking. Buoyant equity markets benefited custody fees, which grew as a result of both increased asset values and strong new business volumes. Private Banking fee income was 12 per cent higher than in 2004 following increases in client assets under management and transaction volumes.

In Hong Kong, net fee income was in line with 2004. Unit trust fees decreased by 42 per cent as Personal Financial Services customers switched to traditional deposit savings and shorter-term investment products. The launch of 173 new open-ended funds established HSBC as the leading investment service provider in Hong Kong. This, together with the successful attraction of client assets in Private Banking, contributed to a rise in income from funds under management. Credit card fee income increased by 18 per cent, reflecting growth in cardholder spending as HSBC strengthened its position as the largest credit card issuer in Hong Kong. In Commercial Banking, net fees increased as trade services, insurance and lending income rose. However, lower Structured Finance revenues led to reduced Corporate, Investment Banking and Markets fees.

Net fee income in the Rest of Asia-Pacific rose by 28 per cent from higher card transaction volumes and increased account service fees in response to the expansion of the Personal Financial Services

business in the region. Rising equity markets, buoyant regional economies and an increase in personal wealth combined with the launch of new products to increase sales of investment products to personal customers. Client assets in Private Banking also grew. Global Transaction Banking revenues increased in line with transaction volumes following investment in 2004 to expand capabilities. Custody fees grew by 29 per cent as a result of improved investor sentiment and rising local equity markets. Trade services income rose by 13 per cent, reflecting strong trade flows.

In North America, net fee income grew by 21 per cent. Card fee income grew as a result of higher transactions, increased receivables and improvements in the interchange rate, while US mortgage lending fees benefited from lower refinancing prepayments and the consequent release of impairment provisions on mortgage servicing rights. In Mexico, strong growth in the cards base drove higher net fee income and increased transaction volumes delivered higher ATM fees and increased remittance income. Investment banking fees increased in response to HSBC s success in attracting customers with an expanded range of products.

Net fee income in South America increased by 23 per cent, principally due to higher card, lending and current account servicing fees. Current account fees benefited from increased customer numbers and tariff increases, while lending fee growth was principally related to higher lending volumes. Card fees increased as a result of higher spending in both Brazil and Argentina.

Back to Contents

Financial Review (continued)

Net trading income

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**3,036**	**51.7**	997	35.8
Hong Kong	**546**	**9.3**	659	23.7
Rest of Asia-Pacific	**860**	**14.7**	494	17.7
North America	**1,013**	**17.3**	582	20.9
South America	**409**	**7.0**	54	1.9
Net trading income	**5,864**	**100.0**	2,786	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Trading activities	**3,884**	2,786
Net interest income on trading activities	**2,208**	
Other trading income		
Hedge ineffectiveness:		
on cash flow hedges	**(96)**	
on fair value hedges	**14**	
Non-qualifying hedges	**(146)**	
Net trading income	**5,864**	2,786

Net trading income of US$5,864 million rose by 110 per cent against 2004. Under IFRSs, HSBC s presentation of trading income for 2005 reclassified into trading income external interest income and dividend income on trading assets and interest expense on trading liabilities.

The external funding of long trading positions is reported separately within Net interest income on trading activities ; in the 2004 comparatives this was included within Interest expense . The net effect of these adjustments added approximately US$2.9 billion to net trading income.

In the segmental analysis, both net internal funding and net external interest income on trading activities are reported as Net interest income on trading activities . The offset on the net internal funding is reported as Net interest income within the lending customer group. The resulting Net trading income line comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, together with related external interest income and interest expense and dividends received.

Income from trading activities rose, reflecting positive revenue trends on core products within Global Markets following the investment made in client-facing trading capabilities. In Europe, revenues were boosted from higher volumes through electronic trading platforms and from the expansion of primary dealing activity in European government bond markets. In the US, the benefit of favourable movements on credit spreads was compounded by

the non-recurrence of losses experienced in the industrial sector in 2004.

In Asia, volatility in the value of the Korean won against the US dollar, the introduction of a managed float for Malaysian ringgit and the enhancement of capabilities coupled with greater focus on trading regional currencies in the Middle East all contributed to higher foreign exchange revenues. In Europe, the weakening euro and market volatility following the general election in the UK and the French referendum on the EU constitutional treaty afforded opportunities to increase foreign exchange revenues.

Derivatives activity grew strongly as structured product capabilities were added in the credit, equity, and interest rate and foreign exchange areas. Further benefit was derived from the greater focus put on client-driven risk management and the investment made in sales and execution expertise in previous years. In accordance with IFRSs, the inception profits on certain derivative transactions are deferred as described in Note 17 on the Financial Statements.

Further analysis on the trading performance of the Global Markets business is provided in the regional business commentaries on Corporate, Investment Banking and Markets.

Back to Contents

Net income from financial instruments designated at fair value

	Year ended 31 December 2005		At 31 December 2005	
	Net income US$m	%	Assets US$m	Liabilities US$m
By geographical region				
Europe	**362**	**35.0**	**9,077**	**27,442**
Hong Kong	**(6)**	**(0.6)**	**3,909**	**3,999**
Rest of Asia-Pacific	**58**	**5.6**	**872**	**300**
North America	**434**	**42.0**		**29,934**
South America	**186**	**18.0**	**1,188**	**154**
Net income from financial instruments designated at fair value	**1,034**	**100.0**	**15,046**	**61,829**

	2005 US$m
Income from assets held to meet liabilities under insurance and investment contracts	**1,760**
Change in fair value of liabilities to customers under investment contracts	**(1,126)**
Movement in fair value of HSBC s long-term debt issued and related derivatives	**403**
change in own credit spread on long-term debt	**(70)**
other changes in fair value	**473**
Income from other instruments designated at fair value	**(3)**
Net income from financial instruments designated at fair value	**1,034**

HSBC has utilised the Amendment to IAS 39 Financial Instruments: Recognition and Measurement: the Fair Value Option with effect from 1 January 2005. HSBC may designate financial instruments at fair value under the option in order to remove or reduce accounting mismatches in measurement or presentation, or where financial instruments are managed and their performance is evaluated on a fair value basis. All income and expense on financial instruments for which the fair value option has been taken is included in this line except for debt securities in issue and related derivatives, where the interest components are shown in interest income.

HSBC has principally used the fair value designation in the following cases:

- for certain fixed rate long-term debt issues whose interest rate characteristic has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. Approximately US$51 billion of the Group s debt issues have been accounted for using the option. The movement in fair value of these debt issues includes the effect of changes in own credit spread and any ineffectiveness in the economic relationship between the related swaps and own debt. Such ineffectiveness arises from the different credit characteristics of the swap and own debt coupled with the sensitivity of the floating leg of the swap to changes in short-term interest rates. In addition, the economic relationship between the swap and own debt can be affected by relative movements in market factors, such as bond and swap rates, and the relative bond and swap rates at inception. The size and direction of the accounting consequences of changes in own credit spread and ineffectiveness can be volatile from period to period, but do not alter the cash flows envisaged as part of the documented interest rate management strategy;

- certain financial assets held by insurance operations and managed at fair value to meet liabilities under insurance contracts (approximately US$4 billion of assets); and

- financial liabilities under investment contracts and the related financial assets, when the change in value of the assets is correlated with the change in value of the liabilities to policyholders (approximately US$8 billion of liabilities and related assets).

The introduction of the new categories of financial instruments under IAS 39 on 1 January 2005 has led to a change in income statement presentation for the results of HSBC s life insurance business. In 2005, income from assets designated at fair value and held to meet liabilities under insurance and investment contracts of US$1,760 million is reported under Net income from financial instruments designated at fair value . In 2004, the corresponding amounts were reported within Net investment income on assets backing policyholders liabilities .

Back to Contents

Financial Review (continued)

Income from assets designated at fair value and held to meet liabilities under insurance and investment contracts during 2005 is correlated with increases in liabilities under the related investment and insurance contracts. Under IFRSs, only investment contracts can be designated as financial instruments. Changes in the liability under these contracts, therefore, like the related assets, are included within the heading Net income from financial instruments designated at fair value . The

element of the increase in liabilities under insurance contracts that reflects investment performance is reported separately within Net insurance claims incurred and movements in policyholders liabilities . In 2004, investment income on assets backing policyholder liabilities was offset against the movement in policyholders liabilities without distinction between insurance and investment contracts.

Gains less losses from financial investments

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**439**	**63.4**	154	28.5
Hong Kong	**108**	**15.6**	175	32.4
Rest of Asia-Pacific	**18**	**2.6**	17	3.1
North America	**88**	**12.8**	160	29.7
South America	**39**	**5.6**	34	6.3
Gains less losses from financial investments	**692**	**100.0**	540	100.0

	2005	2004
	US$m	US$m
Net gain from disposal of:		
debt securities	**138**	202
equity securities	**505**	296
other financial investments	**7**	42
	650	540
Recovery of impairment losses	**42**	
Total gains from financial investments	**692**	540

The net gain of US$692 million from the disposal of available-for-sale financial investments was 28 per cent higher than in 2004. Lower income from the disposal of debt securities was more than

compensated for by an increase in gains from the disposal of private equity investments, particularly in HSBC s European operations.

Back to Contents

Net earned insurance premiums

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**1,599**	**29.4**	1,875	34.9
Hong Kong	**2,334**	**42.9**	2,247	41.9
Rest of Asia-Pacific	**155**	**2.9**	97	1.8
North America	**602**	**11.1**	553	10.3
South America	**746**	**13.7**	596	11.1
Net earned insurance premiums	**5,436**	**100.0**	5,368	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Gross insurance premium income	**6,152**	6,022
Reinsurance premiums	**(716)**	(654)
Net earned insurance premiums	**5,436**	5,368

Net earned insurance premiums of US$5,436 million increased by US$68 million compared with 2004. On an underlying basis, net earned insurance premiums were in line with 2004.

Under IFRSs, in 2005 there were changes in the presentation of certain aspects of HSBC s insurance business, which are now treated as liabilities under investment contracts. Investment income from these products is now reported as Net income from financial investments designated at fair value . Income that was previously reported as Net earned insurance premiums is now taken directly to the balance sheet as customer liabilities, with a corresponding movement in net insurance claims. Net insurance claims have fallen to a greater extent than premium income, due to the additional impact of the reclassification of the fair value movement in respect of liabilities under investment contracts.

The commentary that follows excludes the presentational changes discussed above, and is on an underlying basis.

Higher premium income in Europe was due to an increased uptake of creditor protection products in the UK.

The increase in premiums in Hong Kong reflected HSBC s continued emphasis on the growth and development

of its insurance proposition. Higher volumes of life assurance new business were directly driven by the launch of new endowment products, augmented by HSBC s leading position in online personal insurance provision. In addition, greater demand for private medical insurance products was driven by the public response to government deliberation over reforms to healthcare financing. Investment in HSBC s insurance business included the establishment of a new Commercial Banking insurance division in October, which positively contributed to higher volumes of new business.

In the Rest of Asia-Pacific, the increase in premiums was mainly attributable to growth in the number of personal insurance policies, resulting from an expansion of HSBC s insurance operations in the region.

In North America, increased cross-sales of insurance products through the branch network, combined with strong sales of other personal insurance-related products, resulted in an increase in net earned insurance premiums.

On an underlying basis, net earned insurance premiums in South America were broadly in line with 2004.

Back to Contents

Financial Review (continued)

Other operating income

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**1,603**	**43.7**	1,175	52.4
Hong Kong	**805**	**21.9**	536	23.9
Rest of Asia-Pacific	**335**	**9.1**	146	6.5
North America	**740**	**20.2**	359	16.0
South America	**188**	**5.1**	28	1.2
	3,671	**100.0**	2,244	100.0
Intra-HSBC elimination	**(938)**		(631)	
Other operating income	**2,733**		1,613	

	Year ended 31 December	
	2005	2004
	US$m	US$m
Rent received	**859**	793
Gain/(loss) on disposal of assets held for resale	**11**	(93)
Valuation gains on investment properties	**201**	99
Gain on disposal of property, plant and equipment, and non-financial investments	**703**	267
Gain on disposal of operating leases	**26**	
Change in present value of in-force long-term insurance business	**40**	71
Other	**893**	476
Other operating income	**2,733**	1,613

Other operating income of US$2,733 million was US$1,120 million higher than in 2004. On an underlying basis, other operating income grew by 69 per cent.

The commentary that follows is on an underlying basis.

In Europe, the increase in other operating income was largely driven by increased rental income on the leasing of train rolling stock, higher disposals of assets and a number of private equity realisations.

In Hong Kong, higher other operating income was driven mainly by an increase in market value of the investment property portfolio and the disposal of a leasehold residential property. HSBC s investment properties are located principally in Hong Kong. Under IFRSs, valuation movements on investment properties are reflected in the income statement rather than through revaluation reserves. Within Hong Kong, the commercial property sector enjoyed good growth as the economy grew and vacant space fell markedly with a corresponding rise in rents.

The increase in other operating income in the Rest of Asia-Pacific was, in part, due to gains realised on the sale of the Group s asset management operations in Australia.

Other operating income in North America doubled, in part due to improved revenues from the sale of consumer real estate owned assets, higher rental income and disposals of property, plant and equipment.

In South America, other operating income increased by US$160 million, primarily as a result of the sale of the insurance underwriter HSBC Seguros de Automoveis e Bens Limitada in Brazil, and the receipt of compensation and coverage bonds in Argentina.

HSBC s rental income mainly arose from leasing in the UK. Europe accounted for 80 per cent of total rental income; the remainder was attributable to North America and Hong Kong.

The increase in the Other caption was partly due to the receipt of non-core income in Mexico from the distribution of third-party products through the HSBC network. Higher Other income in South America reflected the receipt of compensation and coverage bonds in Argentina and increased revenues from capitalisation products in Brazil.

Back to Contents

Net insurance claims incurred and movement in policyholders liabilities

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**818**	**20.1**	1,628	35.1
Hong Kong	**2,059**	**50.6**	2,154	46.5
Rest of Asia-Pacific	**166**	**4.1**	82	1.8
North America	**333**	**8.2**	312	6.7
South America	**691**	**17.0**	459	9.9
Net insurance claims incurred and movement in policyholders liabilities	**4,067**	**100.0**	4,635	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Gross insurance claims and movement in policyholders liabilities	**4,153**	5,220
Reinsurers share of claims incurred and movement in policyholders liabilities	**(86)**	(585)
Net insurance claims incurred and movement in policyholders liabilities	**4,067**	4,635

Net insurance claims incurred and movement in policyholders liabilities of US$4,067 million decreased by 12 per cent compared with 2004. On an underlying basis, net insurance claims incurred decreased by 13 per cent.

As with net earned insurance premiums, the primary reason for the reduction was the required reclassification under IFRSs in 2005 of policyholders liabilities in respect of long term insurance contracts which were reclassified as Liabilities to customers under investment contracts . As a consequence, reported net insurance claims incurred and movement in policyholders liabilities have reduced.

The majority of HSBC s non-life insurance business largely relates to the provision of personal insurance products. Minimal impact from hurricane damage in the US and a lack of significant claims events during 2005 resulted in a relatively stable

claims experience, augmented by negligible prior-year reserve development in respect of 2004.

Excluding the effect of the above reclassification, the most significant reduction in net claims occurred in Europe, due to the effect of revised actuarial valuations of existing life insurance policies in the UK life operation.

The reinsurers share of claims incurred and movement in policyholder liabilities in 2004 included the renegotiation of a reinsurance treaty in the UK life operation, in which a greater proportion of risk was transferred to the reinsurer. The subsequent implementation of a revised liability valuation system in 2005 reduced the amount of reserves held for liabilities in respect of income protection products, bringing additional benefits in terms of capital efficiency of the UK life operation.

Back to Contents

Financial Review (continued)

Loan impairment charges and other credit risk provisions

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**1,929**	**24.7**	1,033	16.8
Hong Kong	**146**	**1.9**	(220)	(3.6)
Rest of Asia-Pacific	**134**	**1.7**	89	1.4
North America	**5,038**	**64.6**	5,022	81.1
South America	**554**	**7.1**	267	4.3
Total loan impairment charges and other credit risk provisions	**7,801**	**100.0**	6,191	100.0

	Year ended 31 December	
	2005	2004
	US$m	US$m
Loan impairment charges[1]		
New allowances	**10,140**	8,873
Reversal of allowances no longer required	**(1,786)**	(1,267)
Recoveries of amounts previously written off	**(494)**	(913)
	7,860	6,693
Individually assessed allowances	**518**	
Collectively assessed allowances	**7,342**	
General provisions		(498)
Other credit risk provisions	**(59)**	(4)
Total loan impairment charges and other credit risk provisions	**7,801**	6,191
Customer impaired loans	**11,446**	12,427
Customer loan impairment allowances	**11,357**	12,542

1 *Loan impairment charges in 2004 refer to specific provisions.*

During 2005, the underlying growth in customer lending excluding loans to the financial sector and the impact of grossing adjustments required from 1 January 2005 under IFRSs, was 12 per cent. Personal lending accounted for 63 per cent of this increase, principally in mortgages, credit cards and other personal lending products. At 31 December 2005, personal lending accounted for 56 per cent of the customer loan portfolio, in line with 2004. The proportion of the portfolio attributable to corporate and commercial lending was augmented by the IFRSs adjustment noted above. Residential mortgages comprised 56 per cent of the personal lending portfolio.

The charge for loan impairment adjusts the balance sheet allowance for loan impairment to the level that management deems adequate to absorb actual and inherent losses in the Group s loan portfolios. The majority of the Group s loan impairment charges are determined on a portfolio basis, employing statistical calculations using roll rate methodologies. The total charge for loan impairment and other credit risk provisions in 2005 was US$7,801 million compared with a total charge of US$6,191 million in 2004, a rise of 26 per cent. This reflected:

- underlying growth in lending of 12 per cent;

- a weakening credit environment in the UK and Brazil but an improved credit experience in the US; and

- the non-recurrence of the 2004 net release of general provision of US$498 million.

In the US, the underlying trend in loan impairment charges was favourable compared with 2004, notwithstanding the negative effect on loan impairment charges of Hurricane Katrina and a surge in personal bankruptcies in October ahead of new legislation making such declarations more onerous. This was due to a change in portfolio mix towards higher quality lending and a positive economic environment.

In the UK, credit costs rose following an expansion in personal lending, which was accompanied by an increase in delinquencies as the economy slowed during 2005. This was evidenced by rising personal bankruptcy, caused in part by legislative changes which facilitated debt reconstruction procedures, an increase in unemployment and higher levels of personal debt. In Hong Kong, the credit environment remained benign, with falling bankruptcies contributing to a modest reduction in loan impairment allowances in the personal sector. A fall in releases in the corporate

Back to Contents

sector, however, contributed to a modest charge for loan impairment as compared with a net release in 2004. In the Rest of Asia-Pacific, continuing releases and recoveries partly offset the impact of lending growth in the region. Higher charges in the personal sector in Brazil followed intense competitive pressure in the consumer segment, where significant increases in the availability of credit led to customers becoming over-indebted.

The aggregate customer loan impairment allowances at 31 December 2005 of US$11,357 million represented 1.5 per cent of gross customer advances (net of reverse repos, settlement accounts and netting) compared with 2.0 per cent at

31 December 2004. As in 2004, HSBC s cross-border exposures did not necessitate significant allowances.

Impaired loans to customers were US$11,446 million at 31 December 2005 compared with US$12,427 million at 31 December 2004, largely reflecting the write-off of impaired loans against the provisions held in respect of these loans. At constant exchange rates, impaired loans were 3 per cent lower than 2004 compared with underlying lending growth (excluding lending to the financial sector and settlement accounts) of 12 per cent.

Operating expenses

	Year ended 31 December			
	2005		2004	
	US$m	**%**	US$m	%
By geographical region				
Europe	**12,639**	**41.4**	12,028	44.4
Hong Kong	**2,867**	**9.4**	2,558	9.4
Rest of Asia-Pacific	**2,762**	**9.1**	2,087	7.7
North America	**10,217**	**33.6**	9,032	33.3
South America	**1,967**	**6.5**	1,413	5.2
	30,452	**100.0**	27,118	100.0
Intra-HSBC elimination	**(938)**		(631)	
Total operating expenses	**29,514**		26,487	

	Year ended 31 December	
	2005	2004
	US$m	US$m
By expense category		
Employee compensation and benefits	**16,145**	14,523
Premises and equipment (excluding depreciation)	**2,977**	2,615
General and administrative expenses	**8,206**	7,124
Administrative expenses	**27,328**	24,262
Depreciation of property, plant and equipment	**1,632**	1,731
Amortisation of intangible assets[1]	**554**	494
Total operating expenses	**29,514**	26,487

	At 31 December	
	2005	2004
Staff numbers (full-time equivalent)		
Europe	**77,755**	74,861
Hong Kong	**25,931**	25,552
Rest of Asia-Pacific	**55,577**	41,031
North America	**75,926**	69,781
South America	**33,282**	32,108
Total staff numbers	**268,471**	243,333

1 *Intangible asset amortisation comprises the expensing through the income statement of purchased intangibles such as mortgage servicing rights and customer/merchant relationships and amounts allocated to intangible assets on the fair valuation of assets within acquired business combinations. This latter category principally includes customer relationships.*

Operating expenses of US$29,514 million were US$3,027 million, or 11 per cent, higher than in 2004. On an underlying basis, cost growth was 9 per cent, trailing net operating income growth before

Back to Contents

impairment charges by 3 percentage points. This resulted in a slight improvement in the cost efficiency ratio to 51 per cent. The three main drivers of cost growth were as follows:

- volume expansion in many markets drove both revenue and costs. In Personal Financial Services and Commercial Banking, business expansion drove cost growth of 6 per cent and 4 per cent respectively, though this was exceeded by growth in net operating income before loan impairment charges of 11 per cent and 15 per cent respectively. In Mexico, Turkey and Brazil, cost increases contributed over half of the overall increase, but were significantly exceeded by income growth;

- HSBC continued to improve productivity in mature markets. In the UK, reorganisations in Personal Financial Services and Commercial Banking in 2004 resulted, in aggregate, in broadly flat costs compared with growth of 10 per cent in net operating income before loan impairment charges. This was delivered through greater utilisation of direct channels, improved training and increased incentives. In Hong Kong, the promotion of cost-efficient delivery channels and greater utilisation of the Group Service Centres contributed to a 6 percentage point improvement in the cost efficiency ratios in Personal Financial Services and Commercial Banking; and

- following a number of senior hires in 2004 in Corporate, Investment Banking and Markets, subsequent investment was focused on operations and technology, to support revenue growth. Non-staff costs increased by 23 per cent in 2005, with staff costs growing by 14 per cent.The rate of cost growth peaked during the year and the cost efficiency ratio was 2 percentage points better in the second half of the year than the first half, as net operating income before loan impairment charges grew faster than costs.

The following points are also of note. In Europe, costs included the rebranding of the Group s operations in France, the refurbishment of 60 UK branches and increased marketing costs. These increases were offset by lower costs in Commercial Banking in the UK following restructuring activity

in 2004. Costs in Corporate, Investment Banking and Markets increased by 9 per cent, reflecting increased staff numbers and investments in technology and infrastructure.

In Hong Kong, higher operating expenses reflected business expansion in Corporate, Investment Banking and Markets, supported by increased staff in the investment banking division and the recruitment of senior relationship managers. This was partly offset by the effect of branch restructuring and increased utilisation of the Group Service Centres in Personal Financial Services, which led to a 4 per cent fall in branch headcount.

Underlying operating expenses in the Rest of Asia-Pacific increased by 31 per cent, reflecting investment in broadening the customer base and the distribution platform. HSBC s branch network was extended in mainland China, South Korea, and India and additional sales and support staff were recruited in Personal Financial Services and Commercial Banking. Staff numbers also increased in response to the migration of call centre activities to the Group Service Centres in the region. Growth initiatives required investment in infrastructure and technology, and accordingly non-staff costs increased by 39 per cent.

In North America, costs bore a particularly large share of the investment in Corporate, Investment Banking and Markets, reflecting HSBC s commitment to growing its presence in the region. Costs also reflected the expansion of the network, with the opening of 27 new branches in 2005 and the launch of HSBC s on-line savings account in the US.

HSBC s South American operations reported a 17 per cent increase in operating expenses on an underlying basis, partly as a result of higher average staff numbers following the acquisition of consumer finance businesses in 2004. Marketing costs rose following a number of high profile campaigns in 2005, while transactional taxes and incentive payments grew as a direct consequence of higher income.

Productivity improvements and strong disposal gains allowed HSBC to substantially complete its investment in Corporate, Investment Banking and Markets without any deterioration in the Group s cost efficiency ratio.

Back to Contents

Cost efficiency ratios

	Year ended 31 December	
	2005	2004
	%	%
HSBC	**51.2**	51.6
Personal Financial Services	**48.7**	50.1
Europe	**58.2**	65.7
Hong Kong	**33.3**	39.2
Rest of Asia-Pacific	**72.3**	70.8
North America	**42.8**	41.9
South America	**66.6**	72.5
Commercial Banking	**45.5**	50.0
Europe	**49.9**	55.2
Hong Kong	**27.2**	33.7
Rest of Asia-Pacific	**43.8**	42.7
North America	**45.9**	48.3
South America	**60.5**	62.9

HSBC s cost efficiency ratio on an underlying basis improved from 52.4 per cent to 51.2 per cent. This was mainly attributable to improvements in productivity in Personal Financial Services and Commercial Banking, as illustrated in the

tables set out above. The deterioration in cost efficiency ratios in the Rest of Asia-Pacific reflected continuing investment to expand HSBC s presence within the region.

Asset deployment

	At 31 December			
	2005		2004	
	US$m	**%**	US$m	%
Loans and advances to customers	**740,002**	**49.7**	672,891	53.2
Loans and advances to banks	**125,965**	**8.5**	143,449	11.3
Trading assets	**232,909**	**15.6**	122,160	9.6
Financial investments	**182,342**	**12.2**	185,332	14.6
Derivatives	**73,928**	**5.0**	32,190	2.5
Goodwill and intangible assets	**33,200**	**2.2**	34,495	2.7
Other	**101,070**	**6.8**	77,579	6.1
	1,489,416	**100.0**	1,268,096	100.0
Hong Kong Government certificates of indebtedness	**12,554**		11,878	
	1,501,970		1,279,974	

Loans and advances to customers include:		
reverse repos	**14,610**	29,346
settlement accounts	**2,142**	13,819
Loans and advances to banks include:		
reverse repos	**24,754**	36,543
settlement accounts	**2,669**	6,086

HSBC s total assets (excluding Hong Kong Government certificates of indebtedness) at 31 December 2005 were US$1,489.4 billion, an increase of US$221.3 billion or 17 per cent since 31 December 2004. Acquisitions, including Metris in the US, added just over US$6 billion to total assets. The accounting effect of the adjustments required under IFRSs from 1 January 2005 added a further US$89.8 billion, to which the largest single contributor was the grossing up of certain customer

lending and current account relationships in the UK, mainly in Corporate, Investment Banking and Markets, which would previously have been offset in reported loans and advances and customer accounts. At 31 December 2005, this grossing change resulted in a US$44.2 billion increase in customer loans and advances. At constant exchange rates and excluding these changes, total assets grew by 17 per cent.

At 31 December 2005, HSBC s balance sheet remained highly liquid. The proportion of assets

Back to Contents

deployed in customer advances fell to 50 per cent, largely due to expansion of the fixed income business and the reclassification of certain financial instruments to Trading assets . Customer advances increased by 10 per cent, driven by lending to finance consumer spending, mortgage financing and cards. These were areas in which HSBC grew market share, particularly through competitive pricing and marketing initiatives in parts of Asia-Pacific, the UK and the US. Growth in corporate lending was concentrated in Commercial Banking, and largely reflected trade financing, project finance in the Middle East and expansion of the customer base in the UK, particularly in the property, distribution and services sectors. At constant exchange rates and excluding the grossing change mentioned above, net loans and advances to customers grew by 10 per cent in 2005, of which acquisitions represented 1 per cent, or US$5.3 billion.

At 31 December 2005, assets held by HSBC as custodian amounted to US$3,242 billion, 15 per cent higher than the US$2,819 billion held at 31 December 2004. At constant exchange rates, growth was 22 per cent. Custody is the safekeeping and administration of securities and financial instruments on behalf of others.

Complementing this is HSBC s funds under administration business. At 31 December 2005, the value of funds held under administration by the Group amounted to US$779 billion, 28 per cent higher than the US$610 billion held at 31 December 2004. At constant exchange rates, growth was 37 per cent.

Trading assets and financial investments

Trading assets principally consist of debt and equity instruments acquired for the purpose of benefiting from short-term price movements. Securities classified as held-for-trading are carried in the balance sheet at fair value with movements in fair value reflected within the income statement.

Trading assets of US$232.9 billion were 91 per cent higher than at 31 December 2004. This increase was primarily driven by the reclassification of certain financial instruments from loans and advances to Trading assets , coupled with the expansion of the fixed income platform in Global Markets.

Financial investments include debt and equity instruments that are classified as available-for-sale or, to a very small extent, held to maturity. The available-for-sale investments essentially represent the deployment of the Group s surplus deposits and

may be disposed of either to manage liquidity or in response to reinvestment opportunities arising from favourable movements in economic indicators, such as interest rates, foreign exchange rates and equity prices. They are carried at fair value with unrealised gains and losses from movements thereon reported in equity until disposal. On disposal, the accumulated unrealised gain or loss is recognised through the income statement and reported as Gains less losses from financial investments .

Financial investments of US$182.3 billion were broadly in line with the balance at 31 December 2004. Unrealised gains included in the valuation of equities amounted to US$1.1 billion.

Funds under management

Funds under management of US$561 billion were US$85 billion, or 18 per cent, higher than at 31 December 2004. Growth reflected strong inflows of net new money and good investment performances in both Group Investment Businesses and Private Banking, partly offset by the translation effect of the strengthening US dollar on sterling and euro-denominated funds.

In Group Investment Businesses, net new money trebled to US$33 billion compared with the previous year. Included in this, HSBC s Sinopia subsidiary in France grew funds under management by 35 per cent, particularly in alternative funds. HSBC continues to manage some of the world s largest active equity funds investing in India and China with US$4.7 billion and US$1.9 billion of assets, respectively, at the end of 2005. In Private Banking, increased recognition of HSBC in the private banking sector and an expanded product range contributed to strong funds inflows.

At 31 December 2005, HSBC s Group Investment Businesses, including affiliates, reported funds under management of US$272 billion, and Private Banking reported funds under management of US$202 billion. Other funds under management, of which the main constituent was a corporate trust business in Asia, comprised US$87 billion.

Client assets, which are a measure of overall Private Banking volumes and include funds under management, cash deposits and fiduciary deposits, rose by 13 per cent to US$282 billion.

Back to Contents

	2005	2004
	US$bn	US$bn
Funds under management		
At 1 January	**476**	386
Net new money	**63**	64
Bank of Bermuda		22
Other	**63**	42
Value change	**45**	19
Exchange and other	**(23)**	7
At 31 December	**561**	476

Economic profit

HSBC s internal performance measures include economic profit, a calculation which compares the return on financial capital invested in HSBC by its shareholders with the cost of that capital. HSBC prices its cost of capital internally and the difference between that cost and post-tax profit attributable to ordinary shareholders represents the amount of economic profit generated. Economic profit is used by management as a means to decide where to allocate resources so that they will be most productive. In order to concentrate on external factors rather than measurement bases, HSBC emphasises the trend in economic profit within business units rather than absolute amounts. In light of the current levels of world interest rates, and taking into account its geographical and customer group diversification, HSBC believes that its true cost of capital on a consolidated basis is 10 per cent. HSBC plans to continue using this rate until the end of the current five-year strategic plan in 2008 in order to ensure consistency and comparability.

The effect of adopting IFRSs on the Group s financial results has been reflected in the derivation of economic profit shown below. Under IFRSs, there is no periodic amortisation charge for goodwill arising on acquisitions. This removes the need for adjustments to post-tax profit for economic profit purposes. In addition, the Group has modified its calculation of economic profit for the following:

- Unrealised gains and losses on effective cash flow hedges. Gains and losses on the effective hedging of future cash flows essentially reflect the opportunity profit or loss on decisions taken to fix in monetary terms the yield on assets or the cost of liabilities when measured against current market rates. Given that these amounts are ultimately reflected in profit for the period, they are excluded from average invested capital upon which the capital charge is based.

- Unrealised gains and losses on available-for-sale securities. These are excluded from the measure of average invested capital for the purpose of computing economic profit because (i) the gains or losses represent unrealised profit which may be offset or reversed in the future, and (ii) there is accounting asymmetry in that the offsetting profit or loss on the liabilities taken out to fund these assets is not reflected.

On this basis, economic profit increased by US$1,318 million or 31 per cent compared with 2004, reflecting improved underlying profitability.

Economic profit

	Year ended 31 December			
	2005		2004	
	US$m	%1	US$m	%1
Average total shareholders equity	**89,589**		79,391	
Add: Goodwill previously amortised or written off	**8,172**		8,172	
Less: Property revaluation reserves	**(1,092)**		(1,092)	
Reserves for unrealised gains on effective hedges	**(315)**			
Reserves for unrealised gains on available-for-sale securities	**(1,294)**			

Preference shares	**(351)**			
Average invested capital[2]	**94,709**		86,471	
Return on invested capital[3]	**15,060**	**15.9**	12,918	15.0
Benchmark cost of capital	**(9,471)**	**(10.0)**	(8,647)	(10.0)
Economic profit/spread	**5,589**	**5.9**	4,271	5.0

1 *Expressed as a percentage of average invested capital.*

2 *Average invested capital is measured as average total shareholders equity after adding back goodwill previously written-off directly to reserves, deducting preference shares issued by HSBC Holdings and deducting average reserves for unrealised gains/(losses) on effective hedges and available-for-sale securities. This measure reflects capital initially invested and subsequent profit.*

3 *Return on invested capital is based on the profit attributable to ordinary shareholders of the parent company.*

Back to Contents

Analysis by customer group and by geographical region

By customer group

Profit before tax

	Year ended 31 December 2005						
Total	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Corporate, Investment Banking & Markets US$m**	**Private Banking US$m**	**Other[6] US$m**	**Inter-segment elimination US$m**	**Total US$m**
Net interest income/(expense)	23,351	6,310	3,001	848	(472)	(1,704)	31,334
Net fee income	7,313	2,876	2,967	1,080	220		14,456
Trading income/(expense) excluding net interest income	360	150	2,919	317	(90)		3,656
Net interest income/ (expense) on trading activities	214	(3)	306		(13)	1,704	2,208
Net trading income/(expense)[1]	574	147	3,225	317	(103)	1,704	5,864
Net income/(expense) from financial instruments designated at fair value .	574	(12)	67	(1)	406		1,034
Gains less losses from financial investments	19	9	475	45	144		692
Dividend income	16	9	79	9	42		155
Net earned insurance premiums	4,864	236	76		260		5,436
Other operating income	729	327	1,621	68	2,634	(2,646)	2,733
Total operating income	37,440	9,902	11,511	2,366	3,131	(2,646)	61,704
Net insurance claims[2]	(3,716)	(118)	(54)		(179)		(4,067)
Net operating income before loan impairment charges and other credit risk provisions	33,724	9,784	11,457	2,366	2,952	(2,646)	57,637
Loan impairment charges and other credit risk provisions	(7,537)	(547)	272	12	(1)		(7,801)
Net operating income	26,187	9,237	11,729	2,378	2,951	(2,646)	49,836
Total operating expenses	(16,427)	(4,453)	(6,838)	(1,466)	(2,976)	2,646	(29,514)

Operating profit	**9,760**	**4,784**	**4,891**	**912**	**(25)**		**20,322**
Share of profit in associates and joint ventures	**144**	**177**	**272**		**51**		**644**
Profit before tax	**9,904**	**4,961**	**5,163**	**912**	**26**		**20,966**
	%	%	%	%	%		%
Share of HSBC s profit before tax	**47.2**	**23.7**	**24.6**	**4.4**	**0.1**		**100.0**
Cost efficiency ratio	**48.7**	**45.5**	**59.7**	**62.0**	**100.8**		**51.2**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Selected balance sheet data[3]							
Loans and advances to customers (net)	**398,884**	**142,041**	**169,435**	**27,749**	**1,893**		**740,002**
Total assets[4]	**471,760**	**175,120**	**755,056**	**59,827**	**27,653**		**1,489,416**
Customer accounts	**321,240**	**148,106**	**202,361**	**67,205**	**507**		**739,419**
Loans and advances to banks (net)[5]			**106,123**				
Trading assets, financial assets designated at fair value, and financial investments[5]			**373,787**				
Deposits by banks[5]			**65,853**				

For footnotes, see page 55.

44

Back to Contents

	Year ended 31 December 2004						
Total	Personal Financial Services US$m	Commercial Banking US$m	Corporate, Investment Banking & Markets US$m	Private Banking US$m	Other [6] US$m	Inter-segment elimination US$m	Total US$m
Net interest income	21,422	4,875	3,994	718	90		31,099
Net fee income	6,406	2,645	2,764	962	171		12,948
Trading income	320	234	1,935	257	40		2,786
Net investment income on assets backing policy-holders liabilities	635	324	9		44		1,012
Gains less losses from financial investments	79	6	197	39	219		540
Dividend income	16	37	548	5	16		622
Net earned insurance premiums	3,652	1,072	86		558		5,368
Other operating income	360	513	1,029	24	2,050	(2,363)	1,613
Total operating income	32,890	9,706	10,562	2,005	3,188	(2,363)	55,988
Net insurance claims[2]	(2,953)	(1,264)	(59)		(359)		(4,635)
Net operating income before loan impairment charges and other credit risk provisions	29,937	8,442	10,503	2,005	2,829	(2,363)	51,353
Loan impairment charges and other credit risk provisions	(6,500)	(200)	499	11	(1)		(6,191)
Net operating income	23,437	8,242	11,002	2,016	2,828	(2,363)	45,162
Total operating expenses	(15,009)	(4,220)	(5,809)	(1,319)	(2,493)	2,363	(26,487)
Operating profit	8,428	4,022	5,193	697	335		18,675
Share of profit in associates and joint ventures	69	35	95		69		268
Profit before tax	8,497	4,057	5,288	697	404		18,943
	%	%	%	%	%		%
Share of HSBC s profit before tax	44.9	21.4	27.9	3.7	2.1		100.0
Cost efficiency ratio	50.1	50.0	55.3	65.8	88.1		51.6
	US$m	US$m	US$m	US$m	US$m		US$m
Selected balance sheet data[3]							
Loans and advances to customers (net)	370,576	130,160	145,353	24,463	2,339		672,891
Total assets[4]	441,114	159,251	584,779	56,751	26,201		1,268,096
Customer accounts	319,485	137,801	177,449	57,780	557		693,072
The following assets and liabilities were significant to Corporate, Investment Banking and Markets:							
Loans and advances to banks (net)			128,032				
Trading assets, financial assets designated at fair							

value, and financial investments	252,459
Deposits by banks	80,443

For footnotes, see page 55.

Back to Contents

Financial Review (continued)

Personal Financial Services

Profit before tax

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest income	**23,351**	21,422
Net fee income	**7,313**	6,406
Trading income excluding net interest income	**360**	320
Net interest income on trading activities	**214**	
Net trading income[1]	**574**	320
Net income from financial instruments designated at fair value	**574**	
Net investment income on assets backing policyholders liabilities		635
Gains less losses from financial investments	**19**	79
Dividend income	**16**	16
Net earned insurance premiums	**4,864**	3,652
Other operating income	**729**	360
Total operating income	**37,440**	32,890
Net insurance claims[2]	**(3,716)**	(2,953)
Net operating income before loan impairment charges and other credit risk provisions	**33,724**	29,937
Loan impairment charges and other credit risk provisions	**(7,537)**	(6,500)
Net operating income	**26,187**	23,437
Total operating expenses	**(16,427)**	(15,009)
Operating profit	**9,760**	8,428
Share of profit in associates and joint ventures	**144**	69
Profit before tax	**9,904**	8,497
By geographical region		
Europe	**1,932**	1,621
Hong Kong	**2,628**	2,063
Rest of Asia-Pacific	**377**	336
North America	**4,761**	4,384
South America	**206**	93

Profit before tax	**9,904**	8,497
	%	%
Share of HSBC s profit before tax	**47.2**	44.9
Cost efficiency ratio	**48.7**	50.1
	US$m	US$m
Selected balance sheet data[3]		
Loans and advances to customers (net)	**398,884**	370,576
Total assets[4]	**471,760**	441,114
Customer accounts	**321,240**	319,485

For footnotes, see page 55.

Business highlights

- Pre-tax profits from Personal Financial Services grew by 17 per cent to US$9,904 million, driven by improved performances in the core operations in the UK, North America and Hong Kong. On an underlying basis, growth in profit before tax was 15 per cent, and markedly strong rates of growth were achieved in Turkey, Canada, the Middle East and Brazil.

- The importance of direct sales channels continued to increase globally. HSBC conducted 183 million transactions online in 2005, an increase of 17 per cent on 2004. Online sales to personal customers rose by 65 per cent and online revenues by 71 per cent.

- The number of customers using HSBC *Premier* grew for the sixth consecutive year, to 1.3 million, an increase of 17 per cent compared with 2004. HSBC *Premier* was launched in Bangladesh and South Korea during the year, and is now available in 35 countries.

Europe

- In the UK, investment in marketing and a range of campaigns, including the first ever January sale for a UK bank, heightened brand awareness and increased market share in most product lines. In France, marketing campaigns accompanying the rebranding to HSBC by CCF and four subsidiary banks generated sales growth in mortgages, current accounts and savings products. In Turkey, marketing helped increase customer numbers by 7 per cent to 2.2 million.

- HSBC s mortgage products in the UK were highly rated: HSBC was named Best Value National Bank for mortgage borrowing over two, five and ten years by *What Mortgage* magazine for the fourth year running, and Best Bank for mortgages by *Mortgage* magazine. First Direct was also named Best Direct Lender over two and ten years by *What Mortgage* magazine, and Best Offset Mortgage by *Mortgage* magazine.

- The UK business was further streamlined, with the product range simplified and strengthened and the rollout of a branch refurbishment programme initially covering 60 major branches. In the UK, the credit card operations of HFC Bank and HSBC Bank were merged. Good progress was made with the integration and expansion of M&S Money.

Back to Contents

- HSBC s UK current account offering was relaunched in 2005, providing a range of simplified propositions tailored to customer segments, including HSBC s first packaged bank account in the UK market. *Personal Finance Magazine* awarded HSBC Best Current Account provider during the year.

Hong Kong

- HSBC built on its leading position with the rollout of 25 new Financial Management Centres, providing investment planning services to non-*Premier* customers.

- HSBC was named by the *Asian Banker* as the Best Retail Bank in Hong Kong and Asia in 2004, and its web site was rated by *Global Finance* as the Best Consumer Internet Bank in Hong Kong in 2005.

- HSBC maintained its position as the largest credit card issuer in Hong Kong, increasing the number of cards in circulation by 15 per cent and its market share of spending from 50.5 per cent to 52.1 per cent.

- A new innovative retirement planning solution was launched to meet the retirement planning needs of customers of all ages. HSBC was one of the first banks in Hong Kong to offer such a comprehensive service.

Rest of Asia-Pacific

- Customer acquisition was a core focus again in 2005, with customer numbers growing by 22 per cent to 7.0 million. HSBC continued to enhance distribution channels with a 43 per cent increase in the sales force. Seven new branches were opened in South Korea, Vietnam and India.

- Customer loans grew by 20 per cent, driven by the new customer acquisition programmes. In particular, the number of credit cards in circulation grew by 34 per cent, or 1.6 million cards, to 6.3 million.

- In mainland China, HSBC maintains the largest branch network amongst foreign banks, and opened ten new branches and sub-branches in 2005. Average deposit balances grew by 80 per cent and income by 61 per cent.

North America

- HSBC continued to expand its banking presence in the US by opening 27 new branches. The introduction of the HSBC *Premier* Savings account and the Online Savings Account, HSBC s first nationwide savings product, generated total new deposit balances of US$2.5 billion and added over 30,000 new customers to HSBC.

- Other niche marketing initiatives introduced by HSBC in the US included the launch of deposit generation programmes focused on the Chinese and Hispanic communities. Together these garnered US$589 million of new deposits.

- An agreement was reached for HSBC to offer American Express branded credit cards in the US. This will allow HSBC to expand its product range and offer broader choice, value and convenience to customers.

- HSBC completed its acquisition of Metris on 1 December 2005, and is now the 5th largest issuer of MasterCard and Visa cards in the US. This will strengthen HSBC s capabilities to serve the full spectrum of credit card customers.

- HSBC acquired Invis Inc, the largest independent mortgage broker in Canada.

- In Mexico, strong asset and liability growth continued. Average deposit balances grew by 15 per cent, due in part to the success of the 'Tu Cuenta' product, the only integrated financial services product of its kind in the country. Since its launch in February, over 600,000 new accounts have been opened. Product innovation, improved customer service and competitive pricing led to strong growth in mortgages, vehicle financing and payroll loans.

- HSBC Mexico s cards in circulation grew by 80 per cent to over one million, following an active marketing campaign, and strong sales to the existing customer base.

South America

- In Brazil, the integration of two consumer finance businesses purchased in 2004 into the Losango operating model was completed during 2005.

- A number of new products were introduced in 2005. In Brazil, HSBC launched Consórcio de Imóveis, a lending product aimed at funding property purchases, and a new credit card, Cartão Solidariedade, which enables donations to be made to a children s charity in lieu of an annual fee. In Argentina, a co-branded C&A credit card was launched in November, with over 25,000 cards issued in the following month.

Back to Contents

Financial Review (continued)

Commercial Banking

Profit before tax

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest income	**6,310**	4,875
Net fee income	**2,876**	2,645
Trading income excluding net interest income	**150**	234
Net interest expense on trading activities	**(3)**	
Net trading income[1]	**147**	234
Net expense from financial instruments designated at fair value	**(12)**	
Net investment income on assets backing policyholders liabilities		324
Gains less losses from financial investments	**9**	6
Dividend income	**9**	37
Net earned insurance premiums	**236**	1,072
Other operating income	**327**	513
Total operating income	**9,902**	9,706
Net insurance claims[2]	**(118)**	(1,264)
Net operating income before loan impairment charges and other credit risk provisions	**9,784**	8,442
Loan impairment charges and other credit risk provisions	**(547)**	(200)
Net operating income	**9,237**	8,242
Total operating expenses	**(4,453)**	(4,220)
Operating profit	**4,784**	4,022
Share of profit in associates and joint ventures	**177**	35
Profit before tax	**4,961**	4,057
By geographical region		
Europe	**1,939**	1,663
Hong Kong	**955**	904
Rest of Asia-Pacific	**818**	483
North America	**1,064**	848

South America	**185**	159
Profit before tax	**4,961**	4,057
	%	%
Share of HSBC s profit before tax	**23.7**	21.4
Cost efficiency ratio	**45.5**	50.0
	US$m	US$m
Selected balance sheet data[3]		
Loans and advances to customers (net)	**142,041**	130,160
Total assets[4]	**175,120**	159,251
Customer accounts	**148,106**	137,801

For footnotes, see page 55.

Business highlights

- Pre-tax profit was 22 per cent higher than last year, driven by strong growth in net operating income before loan impairment, which more than compensated for the non-recurrence of the loan provision releases that benefited results in 2004. On an underlying basis, profits increased by 19 per cent.
- Customer numbers rose by 10 per cent to 2.5 million as customers were attracted by HSBC s competitive positioning. Loans and advances to customers and customer account balances increased by 9 per cent and 7 per cent respectively, with significant expansion in the UK and Hong Kong. Interest spreads increased in Hong Kong, North America and the Rest of Asia-Pacific following interest rate rises.
- The commercial customer base was refined and now comprises four categories: Corporate, Mid-Market (together, MME), Small and Micro businesses (collectively, SME), building upon the successful business segmentation model in existence in Hong Kong and the UK.
- Cross-border sales were strengthened by the launch of new cross-border referral programmes and the global implementation of online cross-border account opening and referral tools.
- HSBC s competitiveness in meeting the needs of SMEs was enhanced through the introduction of pre- approved loans and lines of credit in Hong Kong, the launch of scored lending in India, the introduction of small business accounts in Singapore and the expansion of business banking centres in Malaysia.
- Customers responded favourably to enhanced online banking services, with numbers registered for internet banking increasing by 24 per cent and online transaction volumes during the year up by 116 per cent.
- Business insurance and wealth management sales continued to advance, supported by two new dedicated insurance sales teams in Hong Kong. A worksite marketing programme launched in Mexico, and a programme across the Rest of Asia-Pacific to increase the sale of structured investment products, were also notable successes.
- Having enhanced its systems, HSBC retained its position as Best in Cash Management in Asia and the Middle East , its number two ranking in the world and its top five ranking for Europe, North America, Latin America and Africa in *Euromoney* s 2005 Cash Management Survey.

Back to Contents

- *Finance Asia* named HSBC Best Trade Bank in Asia for the ninth successive year, reflecting HSBC s continuing development of new products and services.

Europe

- In the UK, HSBC continued to focus on business start-ups and customers switching from other banks to grow its customer base. As a result, more customers moved their banking relationships from other financial institutions to HSBC than to any other established high street bank.

- Investment in customer service as a differentiating factor continued, with the recruitment of further relationship managers, the improved deployment and training of over 600 dedicated small business specialists and a substantial investment in mobile working technology.

- Recognising lack of scale, HSBC outsourced the processing of its UK vehicle finance contract hire product to a third party provider, Lex Vehicle Leasing. As well as releasing capital, this provided HSBC with access to Lex s IT systems and expertise to enable a greater range of services to be offered to customers.

- In France, the most experienced relationship managers focused on the largest 350 MME customers in 2004, resulting in income growth from this segment of 17 per cent in 2005. In addition, a centralised and specialised franchising team was established to increase penetration of this significant and expanding market.

- A substantial investment was made to grow the Commercial Banking franchise in Turkey with the launch of SME banking, invoice discounting and commercial cards.

Hong Kong

- Loan balances increased as HSBC added relationship managers and launched two new pre-approved lending products, the Pre-approved Small Business Loan and the Pre-approved Business Revolving Credit account.

- The first ever Commercial Banking brand awareness campaign was launched in 2005. SME sales outlets were also rebranded as SME Centres to strengthen the brand identity and more closely align HSBC with this market segment.
- Supporting customer service, a new SME call centre, employing 100 staff and incorporating a dedicated sales hotline, took over four million calls in 2005.

Rest of Asia-Pacific

- Regional relationship management offering a single point of contact across several countries was implemented in the Middle East. A similar approach was adopted in Hong Kong, mainland China and Taiwan.

- The sales distribution network was expanded in key growth markets. In mainland China, three new branches and an additional sub-branch, with commercial banking presence, were opened. In South Korea, four commercial banking centres were established to extend HSBC s presence in the MME market.

- Across the region, several liability products were tailored for individual markets. HSBC in Bangladesh designed an innovative deposit scheme, Double Your Money , and in Taiwan HSBC launched a Cash Marketing Campaign .

North America

- HSBC s market share of small business customers in New York City increased, supported by the success of the BusinessSmart Value package which added 41,000 new accounts in 2005. HSBC Bank USA was voted the No. 1 Small Business Administration lender in New York State.

- The MME and commercial real estate businesses continued to expand in Boston, Miami, Los Angeles, San Francisco and Seattle, with new offices established in Washington DC, Philadelphia and New Jersey.

- HSBC Mexico was awarded The best initiative in support of small and medium business owners in Mexico by the Mexican Minister of Economy for Estimulo, a tailor-made financial services package.

South America

- 40 commercial centres with 100 specialised staff were established to expand sales activity and address the banking needs of over 12,500 larger SMEs in Brazil.

- In Argentina, customer service was improved through the launch of an in-house internet banking solution, PC Banking Empresas, and a dedicated inbound call centre.

Back to Contents

Financial Review (continued)

Corporate, Investment Banking and Markets

Profit before tax

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest income	**3,001**	3,994
Net fee income	**2,967**	2,764
Trading income excluding net interest income	**2,919**	1,935
Net interest income on trading activities	**306**	
Net trading income[1]	**3,225**	1,935
Net income from financial instruments designated at fair value	**67**	
Net investment income on assets backing policyholders liabilities		9
Gains less losses from financial investments	**475**	197
Dividend income	**79**	548
Net earned insurance premiums	**76**	86
Other operating income	**1,621**	1,029
Total operating income	**11,511**	10,562
Net insurance claims[2]	**(54)**	(59)
Net operating income before loan impairment charges and other credit risk provisions	**11,457**	10,503
Net recovery of loan impairment charges and other credit risk provisions	**272**	499
Net operating income	**11,729**	11,002
Total operating expenses	**(6,838)**	(5,809)
Operating profit	**4,891**	5,193
Share of profit in associates and joint ventures	**272**	95
Profit before tax	**5,163**	5,288
By geographical region		
Europe	**2,114**	1,668

Hong Kong	**922**	1,603
Rest of Asia-Pacific	**1,207**	942
North America	**774**	966
South America	**146**	109
Profit before tax	**5,163**	5,288
	%	%
Share of HSBC s profit before tax	**24.6**	27.9
Cost efficiency ratio	**59.7**	55.3

For footnotes, see page 55.

Business highlights

- Increased revenues marginally failed to cover increased costs arising from continuing investment to expand product capabilities and customer penetration. Notwithstanding a decline in balance sheet management revenues of US$1 billion and a US$1 billion increase in costs, pre-tax profit only fell by 2 per cent to US$5,163 million. On an underlying basis, pre-tax profits fell by 4 per cent. Earnings grew in key product areas and client sectors where HSBC has invested, particularly in foreign-exchange options, project and export finance, and securities services, demonstrating the success of the strategy to diversify revenue streams. Operating expenses increased by 18 per cent. The rate of cost growth peaked during the year as the investment phase of the Corporate, Investment Banking and Markets development plan neared completion. Some 3,600 additional people were recruited during 2005 and 2,220 people departed. The cost efficiency ratio was 2 percentage points better in the second half of the year than in the first half as net operating income before loan impairment charges grew faster than costs.

- As the investment-led phase of the development strategy moved to implementation, the competitive advantage of HSBC s geographic network and emerging market capabilities was underscored by client demand for cross-border services. HSBC advised on several cross-border acquisitions, notably outward investment by clients in the Middle East and inward investment into mainland China. The parallel development of primary debt finance and secondary debt trading capabilities allowed HSBC, acting as bookrunner, to help 792 clients in 65 countries to raise US$867.8 billion in bond and loan financing in the public markets. In Global Transaction Banking, HSBC won several new multi-country mandates. Foreign exchange trading benefited from strong income streams from emerging markets.

- In Global Markets, client revenues and market share rose in response to new investment. Money market and balance sheet management income fell due to rising short-term US dollar and Hong Kong dollar interest rates, together with the flattening and in some cases inversion of yield curves in the US, Hong Kong, the UK, eurozone, Mexico and Brazil.

  Credit and rates revenue rose. HSBC is now a primary dealer in 10 European government bond markets compared with eight at the end of 2004. Cash equities commission revenue rose, reversing a four- year declining trend.

Back to Contents

Management view of total operating income

	Year ended 31 December	
	2005	2004
	US$m	US$m
Global Markets		
Money market and balance sheet	**1,238**	2,376
Foreign exchange	**1,200**	1,125
Credit and rates	**931**	655
Structured derivatives	**387**	386
Equities	**324**	256
	4,080	4,798
Corporate and Investment Banking		
Global Investment Banking	**1,022**	877
Corporate and Institutional Banking and Global Transaction Banking	**3,433**	2,937
Private Equity	**648**	207
	5,103	4,021
Other[1]	**2,328**	1,743
Total operating income	**11,511**	10,562
Selected balance sheet data[3]		
Loans and advances to:		
customers (net)	**169,435**	145,353
banks (net)	**106,123**	128,032
Total assets[4]	**755,056**	584,779
Customer accounts	**202,361**	177,449
Trading assets, financial instruments designated at fair value, and financial investments	**373,787**	252,459
Deposits by banks	**65,853**	80,443

1 *Other includes the Corporate, Investment Banking and Markets business of HSBC Trinkaus & Burkhardt, Group Investment Businesses, and net interest earned on free capital held in Corporate, Investment Banking and Markets not assigned to products.*

For other footnotes, see page 55.

Structured derivatives activity rose strongly as a significant upgrade and expansion of the quantitative skill base and investment in systems allowed HSBC to complete higher volumes of derivatives transactions in 2005. In accordance with IFRSs, the inception profits on certain types of these transactions are deferred as described in Note 17 on the Financial Statements.

The strong momentum in client revenue was confirmed by industry surveys. In the Euromoney foreign exchange survey, HSBC ranked second in FX options in 2005, up from fourth in 2004 and eighth in 2003. In addition, HSBC was ranked fourth in foreign exchange trading market share, retained the premier ranking in Hong Kong and was voted, for the first time, the best foreign exchange bank in London.

- In Corporate and Institutional Banking, which includes relationship management and lending activities, market conditions and competitive pressures resulted in spread contraction in all regions. This was mitigated by a continued focus on fee-generating business, cost management and a favourable credit environment. HSBC introduced a number of balance sheet management initiatives including the implementation of a detailed review of HSBC s portfolio and a balance sheet securitisation programme to enhance return on capital employed.

- In Global Investment Banking, an increase in market share reflected HSBC s success in developing customer relationships. In debt capital markets, HSBC was ranked fifth in the international bond league table, up from seventh in 2004. In project and export finance, *Dealogic* ranked HSBC first in the Global Financial Adviser, Project Finance category.

  In the advisory business, there was continued momentum in both developed and emerging markets. Notable transactions included advising Dubai International Capital on its US$1.5 billion acquisition of Tussauds Group and acting as adviser to Autoroutes Paris-Rhin-Rhone on its privatisation.

  Significant equity-related transactions, in which HSBC acted as joint global coordinator, were the US$2.8 billion Link Real Estate Investment Trust (REIT) IPO, the largest ever real estate offering and REIT IPO in the world, and the US$2.2 billion IPO by the Bank of Communications.

- In Global Transaction Banking, a move to offering a wider range of integrated solutions to clients played a large part in winning Unilever s first Asian pan- regional cash management mandate, covering 17 countries and territories.

- At the end of December 2005, Group Investment Businesses managed US$272 billion of assets, a 33 per cent increase on 2004, driven mainly by US$33 billion of net flows from clients. Assets in money market products exceeded US$60 billion. HSBC manages two of the world's largest active equity funds investing in India and China with US$4.7 billion and US$1.9 billion assets, respectively. HSBC s presence in mainland China was strengthened with an asset management joint venture with Shanxi Trust and Investment Corporation Limited.

Back to Contents

Financial Review (continued)

Private Banking

Profit before tax

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest income	**848**	718
Net fee income	**1,080**	962
Net trading income[1]	**317**	257
Net expenses from financial instruments designated at fair value	**(1)**	
Gains less losses from financial investments	**45**	39
Dividend income	**9**	5
Other operating income	**68**	24
Total operating income	**2,366**	2,005
Net insurance claims[2]		
Net operating income before loan impairment charges and other credit risk provisions	**2,366**	2,005
Net recovery of loan impairment charges and other credit risk provisions	**12**	11
Net operating income	**2,378**	2,016
Total operating expenses	**(1,466)**	(1,319)
Operating profit	**912**	697
Share of profit in associates and joint ventures		
Profit before tax	**912**	697
By geographical region		
Europe	**539**	438
Hong Kong	**190**	131
Rest of Asia-Pacific	**78**	60
North America	**104**	68
South America	**1**	
Profit before tax	**912**	697
	%	%
Share of HSBC s profit before tax	**4.4**	3.7
Cost efficiency ratio	**62.0**	65.8
	US$m	US$m

Selected balance sheet data[3]		
Loans and advances to customers (net)	**27,749**	24,463
Total assets[4]	**59,827**	56,751
Customer accounts	**67,205**	57,780

For footnotes, see page 55.

Business highlights

- Pre-tax profit grew by 31 per cent compared with 2004, supported by strong growth in client assets and lending. On an underlying basis, growth was also 31 per cent. Operational efficiency was increased by greater utilisation of Group Service Centres and the cost efficiency ratio was reduced by 4 percentage points to 62 per cent.

- HSBC won a number of awards in the *Euromoney* third annual private banking survey. In the global private banking awards, notable wins included 1st Private Bank for Trust Services for the second year running, 1st Private Bank for Islamic Services and 1st Private Bank for Inheritance and Succession Planning . Overall, HSBC improved one place to 3rd best Private Bank .

- Client assets increased by 13 per cent to US$282 billion, benefiting from net new money of US$35.7 billion in 2005. On an underlying basis, growth was 20 per cent. Discretionary and advisory asset growth benefited from the establishment of dedicated investment advisory resources in all major regions, and also from growth in the Strategic Investment Solutions product, in which invested assets increased by US$1.9 billion to US$2.9 billion during the year.

- HSBC also continued to develop alternative investment products. Total client investment in hedge funds reached US$29.5 billion, and HSBC Private Bank was named the third largest global provider of hedge funds by capital invested by *Institutional Investor* magazine.

- Dedicated teams working with Commercial Banking, Personal Financial Services and Corporate, Investment Banking and Markets produced a significant increase in intra-Group referrals in 2005. A closer alignment with the latter was also reflected in the manufacture of tailored structured products for private banking clients. Bank of Bermuda s private banking operations were fully integrated during the year.

- The lending book grew strongly, as clients sought to leverage their investments in the low interest rate environments in North America, Europe and Asia. In the UK and US, lending book growth was also buoyed by strong growth in higher value mortgages.

Back to Contents

Europe

- In France, HSBC Private Bank s subsidiary, Louvre Gestion, was awarded second and fourth places for overall performance over five and three years respectively by *La Tribune* Standard & Poor s. A number of HSBC s individual funds also won awards in the Lipper Fund Awards France.

- Private Banking expanded its onshore business through the launch of regional offices in the UK and France, bringing HSBC closer to customers and strengthening referrals with the retail bank. Regional offices were also launched in Russia, and preparations were made for further expansion in 2006.

- Client assets increased by 12 per cent, or 22 per cent on an underlying basis, with net new money reaching US$23.4 billion.

- *Euromoney* awarded HSBC Best Private Bank Monaco for Ultra High Net Worth Clients .

Asia

- Client assets increased by 17 per cent, or 19 per cent on an underlying basis. Investment in Taiwan and Japan continued and HSBC expanded its support of clients from mainland China. Onshore operations were launched in Dubai and India during the year, and the expansion of the discretionary managed team aided growth of 47 per cent in this asset class.

- HSBC won awards from *Euromoney* as 1st for Inheritance and Succession Planning , 1st for Tax Guidance and Services and 1st for Trust Services in Asia.

North America

- HSBC extended its Private Banking capabilities through front office recruitment in New York, California and Florida, and expanded its Wealth and Tax advisory business in Philadelphia through recruitment and a small acquisition.

- The business was streamlined through restructuring, delivering front office synergies with Corporate, Investment Banking and Markets, cross-selling with Commercial Banking was enhanced, and a single management structure was put in place to cover the Hispanic customer base.

Back to Contents

Financial Review (continued)

Other6

Profit before tax

	Year ended 31 December	
	2005	2004
	US$m	US$m
Net interest (expense)/income	**(472)**	90
Net fee income	**220**	171
Trading (expense)/income excluding net interest income	**(90)**	40
Net interest expense on trading activities	**(13)**	
Net trading income[1]	**(103)**	40
Net income from financial instruments designated at fair value	**406**	
Net investment income on assets backing policyholders liabilities		44
Gains less losses from financial investments	**144**	219
Dividend income	**42**	16
Net earned insurance premiums	**260**	558
Other operating income	**2,634**	2,050
Total operating income	**3,131**	3,188
Net insurance claims[2]	**(179)**	(359)
Net operating income before loan impairment charges and other credit risk provisions	**2,952**	2,829
Loan impairment charges and other credit risk provisions	**(1)**	(1)
Net operating income	**2,951**	2,828
Total operating expenses	**(2,976)**	(2,493)
Operating profit/(loss)	**(25)**	335
Share of profit in associates and joint ventures	**51**	69
Profit before tax	**26**	404
By geographical region		
Europe	**(168)**	366
Hong Kong	**(178)**	129
Rest of Asia-Pacific	**94**	26
North America	**169**	(196)
South America	**109**	79

Profit before tax	**26**	404
	%	%
Share of HSBC s profit before tax	**0.1**	2.1
Cost efficiency ratio	**100.8**	88.1
	US$m	US$m
Selected balance sheet data[3]		
Loans and advances to customers (net)	**1,893**	2,339
Total assets[4]	**27,653**	26,201
Customer accounts	**507**	557

For footnotes, see page 55.

Notes

- For a description of the main items reported under Other , see footnote 6 on page 55.

- Under IFRSs, from 1 January 2005 dividends payable on preference securities classified as liabilities have been recognised as an interest expense within Other in 2005. In 2004, these dividends were shown as non- equity minority interests. This change decreased net interest income by US$653 million compared with 2004. It also affected inter-regional dividends and this increased net interest income in Europe by US$387 million, which was offset at a Group level by an equivalent reduction in net interest income in Hong Kong.

- The US Technology Centre incurred and recharged US$1,100 million of expense, 18 per cent higher than 2004 as a result of increased activity in support of both increased global IT requirements and the development of new capabilities in Corporate, Investment Banking and Markets.

- Costs incurred in the Group Service Centres outside the US increased by 75 per cent to US$302 million, reflecting the ongoing migration of processing and call centre activities.

- Gains on the sale and revaluation of property and investments in Hong Kong were US$65 million lower than in 2004, at US$263 million.

- Increases in US interest rates led to higher net interest income earnings on centrally held US dollar denominated investments in Hong Kong and the Rest of Asia-Pacific.

- The reclassification of the Brazilian insurance business from Other to Personal Financial Services led to a US$16 million reduction in profit before tax, though significant variances were observed on operating income and operating expenses lines.

- In Argentina, HSBC received compensation bonds in 2005 related to the pesification in 2002. This, together with reduced Amparos provisions and other items related to the sovereign debt default, led to a US$17 million increase in profit before tax.

- Movement in the fair value of own debt designated at fair value was US$386 million, arising in North America and Europe. No movement was reported in 2004.

Back to Contents

By geographical region

In the analysis of profit by geographical region that follows, operating income and operating expenses include intra-HSBC items of US$938 million (2004: US$631 million).

Profit before tax

	Year ended 31 December			
	2005 **US$m**	**%**	2004 US$m	%
Europe	**6,356**	**30.3**	5,756	30.4
Hong Kong	**4,517**	**21.5**	4,830	25.5
Rest of Asia-Pacific	**2,574**	**12.3**	1,847	9.8
North America	**6,872**	**32.8**	6,070	32.0
South America	**647**	**3.1**	440	2.3
	20,966	**100.0**	18,943	100.0

Total assets[3,4]

	At 31 December			
	2005 **US$m**	**%**	2004 US$m	%
Europe	**636,703**	**42.7**	545,557	43.0
Hong Kong[4]	**222,822**	**15.0**	213,458	16.8
Rest of Asia-Pacific	**142,014**	**9.5**	120,530	9.5
North America	**463,143**	**31.1**	371,183	29.3
South America	**24,734**	**1.7**	17,368	1.4
	1,489,416	**100.0**	1,268,096	100.0

Basis of preparation

The results are presented in accordance with the accounting policies used in the preparation of HSBC s consolidated financial statements. HSBC s operations are closely integrated and, accordingly, the presentation of customer group data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and head office functions, to

the extent that these can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity.

Where relevant, income and expense amounts presented include the results of inter-segment funding as well as inter-company and inter-business line transactions. All such transactions are undertaken on arm s length terms.

Footnotes to Analysis by customer group and by geographical region

1 *Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, together with related external and internal interest income and interest expense, and dividends received.*
2 *Net insurance claims incurred and movement in policyholders liabilities.*
3 *Third party only.*
4 *Excluding Hong Kong Government certificates of indebtedness.*
5 *Assets and liabilities recorded here were significant to Corporate, Investment Banking and Markets.*
6 *The main items reported under Other are the income and expenses of wholesale insurance operations, certain property activities, unallocated investment activities including hsbc.com, centrally held investment companies, movements in the fair value of own debt designated at fair value, and HSBC s holding company and financing operations. The results include net interest earned on free capital held centrally and operating costs incurred by the head office operations in providing stewardship and central management services to HSBC. Net operating income of the Group s wholesale insurance operations amounted to US$460 million in 2005 (2004: US$511 million). Other also includes the costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries.*

Back to Contents

Financial Review (continued)

Europe

Profit/(loss) before tax by country within customer group

	Year ended 31 December	
	2005	2004
	US$m	US$m
Personal Financial Services	**1,932**	1,621
United Kingdom[1]	**1,475**	1,340
France[2]	**223**	205
Turkey	**134**	29
Other	**100**	47
Commercial Banking	**1,939**	1,663
United Kingdom	**1,495**	1,258
France[2]	**278**	272
Turkey	**39**	25
Other	**127**	108
Corporate, Investment Banking and Markets	**2,114**	1,668
United Kingdom	**1,186**	1,021
France[2]	**472**	337
Turkey	**92**	88
Other	**364**	222
Private Banking	**539**	438
United Kingdom	**171**	135
France[2]	**7**	(22)
Switzerland	**254**	203
Other	**107**	122
Other	**(168)**	366
United Kingdom	**(47)**	477
France[2]	**(147)**	(123)
Other	**26**	12
Total	**6,356**	5,756
United Kingdom	**4,280**	4,231
France[2]	**833**	669
Turkey	**265**	142
Switzerland	**254**	203
Other	**724**	511

1 *In the UK, the Personal Financial Services business primarily comprises HSBC Bank and the UK subsidiary of HSBC Finance. The latter s results included within UK Personal Financial Services in 2005 were a loss of US$76 million (2004: profit US$97 million).*

2 *France primarily comprises the domestic operations of HSBC France and the Paris branch of HSBC Bank.*

Back to Contents

Profit before tax

Europe	Year ended 31 December 2005 US$m	2004 US$m
Net interest income	**8,221**	9,098
Net fee income	**6,299**	5,980
Net trading income	**3,036**	997
Net income from financial instruments designated at fair value	**362**	
Net investment income on assets backing policyholders liabilities		571
Gains less losses from financial investments	**439**	154
Dividend income	**63**	558
Net earned insurance premiums	**1,599**	1,875
Other operating income	**1,603**	1,175
Total operating income	**21,622**	20,408
Net insurance claims incurred and movement in policyholders liabilities	**(818)**	(1,628)
Net operating income before loan impairment charges and other credit risk provisions	**20,804**	18,780
Loan impairment charges and other credit risk provisions	**(1,929)**	(1,033)
Net operating income	**18,875**	17,747
Total operating expenses	**(12,639)**	(12,028)
Operating profit	**6,236**	5,719
Share of profit in associates and joint ventures	**120**	37
Profit before tax	**6,356**	5,756
	%	%
Share of HSBC s profit before tax	**30.3**	30.4
Cost efficiency ratio	**60.8**	64.0
Year-end staff numbers (full-time equivalent)	**77,755**	74,861
	US$m	US$m
Selected balance sheet data[1]		
Loans and advances to customers (net)	**312,537**	277,560
Loans and advances to banks (net)	**44,360**	56,049
Financial investments, trading assets, and financial instruments designated at fair value	**146,777**	139,183
Total assets	**636,703**	545,557
Deposits by banks	**47,202**	55,720
Customer accounts	**334,200**	292,568

1 *Third party only*.

Growth in the **UK** economy remained subdued during 2005 at 1.8 per cent, the lowest rate since 1992. Consumer spending and housing activity slowed sharply during the first nine months of the year, staging a minor recovery in the final quarter. Doubts remained over the strength of consumer spending, given the rise in unemployment in ten consecutive months and reduced confidence in the housing market. The boost to the economy from government spending in recent years was also not expected to be as significant. The recovery in exports was maintained, helped in large part by the strength of the global economy, though the industrial sector continued to struggle. Industrial output contracted in 2005 for the fourth time in the past five years. Companies remained reluctant to invest despite a general profit recovery, stronger balance

sheets and an impressive equity market performance. Although commodity prices rose sharply, inflation remained well contained at around 2 per cent and wage growth eased. In response to weaker economic activity, the Bank of England cut interest rates in August to 4.5 per cent.

The **eurozone** experienced lacklustre economic growth in 2005 of 1.4 per cent, although momentum accelerated during the course of the year. With consumer spending growth remaining subdued, the strongest areas were exports and fixed investment. There was, as usual, considerable divergence between countries: Italy and Portugal saw hardly any economic growth while Spain, Greece and Ireland grew by over 3 per cent. Growth in France slowed from 2.1 per cent in 2004 to 1.4 per cent in 2005 but both investment and consumer spending revived a

Back to Contents

little in the second half of the year. Weak domestic demand continued to constrain German gross domestic product (GDP) growth, which slowed from 1.1 per cent in 2004 to 0.9 per cent in 2005, despite a strong increase in exports, particularly capital goods. Eurozone inflation averaged a little over 2 per cent in 2005, with higher energy prices boosting inflation by around 0.5 per cent. The European Central Bank raised interest rates from 2.0 per cent to 2.25 per cent in early December, the first increase for almost five years.

The performance of the Turkish economy in 2005 remained very positive. GDP grew by approximately 5.5 per cent, while inflation continued to fall, to 7.7 per cent in December from 9.7 per cent a year earlier. Economic policy remained anchored by the government s agreement with the IMF. Turkey s current account deficit, which reached US$23.1 billion, or approximately 6.3 per cent of GDP in 2005, is increasingly being financed by longer-term foreign direct investment into the country, which should help reduce Turkey s vulnerability to a sudden reversal in short-term capital flows.

European operations reported a pre-tax profit of US$6,356 million compared with US$5,756 million in 2004, an increase of 10 per cent. IFRSs changes to the treatment of preference share dividends led to a US$275 million reduction in pre-tax profits. On an underlying basis, pre-tax profits grew by 25 per cent and represented around 30 per cent of HSBC s equivalent total profits. In the UK, strong revenue growth in Personal Financial Services and good cost discipline were partially tempered by a weaker credit experience. A quadrupling of pre-tax profits in Turkey reflected the strong growth in customer acquisition and retention achieved in the country. In Commercial Banking, HSBC s strong service proposition attracted a 5 per cent growth in customers with consequent growth in deposits, receivables and service revenues. Corporate, Investment Banking and Markets delivered strong revenue growth in Europe, notably in client related trading activities, Global Transaction Banking and securities services. In aggregate, European Corporate, Investment Banking and Markets revenues grew by 15 per cent against a 9 per cent increase in operating expenses.

The commentary that follows is on an underlying basis.

Personal Financial Services reported a pre-tax profit of US$1,932 million, an increase of 16 per cent compared with 2004, driven by revenue growth and productivity improvements in the UK and

expansion in Turkey, where pre-tax profit more than quadrupled to US$134 million. In France, revenue growth benefited from the rebranding of CCF and four subsidiary banks to HSBC France , with a notable increase in international products, particularly mortgage lending to overseas customers.

Continued emphasis was placed on streamlining the business to improve productivity, and on sales and channel management, particularly in the UK, where one third of sales were made through direct channels in 2005. Attention was also paid to further simplifying HSBC s product range in the UK, and on integrating the M&S Money business in its first full year since acquisition. A number of innovative marketing campaigns and promotions during 2005 heightened brand awareness, leading to greater customer consideration of HSBC products. This was evidenced in strong balance growth and market share gains across most major product lines. In Turkey, an emphasis on business expansion and customer acquisition delivered increased card sales and utilisation combined with higher mortgage sales. In France, marketing campaigns in conjunction with the rebranding exercise boosted mortgage lending and sales of insurance and investment products.

Net interest income increased by 10 per cent to US$5,309 million. This arose substantially in the UK through increases in mortgage and credit card lending, and in Turkey, mainly in credit cards. Increased net interest income from balance sheet growth in France was offset by spread compression.

Despite a more subdued housing market, net interest income from UK mortgages increased by 37 per cent, driven by balance growth of 22 per cent and improvements in customer retention. Spreads also increased, reflecting the inclusion from 1 January 2005 of fee income within the effective interest rate calculation under IFRSs. New lending was strongest in the first time buyer market, where successful pricing and marketing strategies helped gain market share of new sales in a market which contracted overall.

Net interest income from UK credit cards increased by 24 per cent, driven by balance growth and the IFRSs impact noted above. Increased card utilisation by existing customers, as well as new customers attracted by competitive pricing, marketing and cross-sales, contributed to an increase of 16 per cent in average balances. HSBC-branded cards increased market share of new cards issued; sales of the John Lewis branded credit card also increased. Income benefited from the roll-off of balance transfers introduced in the 0 per cent campaign at the end of 2004, while more

Back to Contents

sophisticated risk-based pricing enabled customer rates to be differentiated more acutely.

Net interest income from other unsecured lending in the UK increased by 4 per cent. The launch of differentiated pricing initiatives in April, notably through preferential personal lending rate offers to lower-risk customers, helped boost average loan balances by 9 per cent, and increase HSBC s market share of gross advances from 10.7 to 11.7 per cent. Focused sales and marketing, notably the January sale , also contributed to higher balances. As indebtedness levels grew, growth was curtailed through a tightening of underwriting criteria in the more difficult credit environment. The introduction of preferential pricing, and a mix change towards higher value but lower-yielding loans, led to a 48 basis point narrowing of spreads.

Recruitment of new current account customers was strong, and HSBC s market share of new current accounts increased to 14.7 per cent, largely through brand-led awareness and marketing. The launch of two new current account propositions, including HSBC s first value-driven packaged account in the UK market, and improved cross-sales aided growth of 6 per cent in overall customer accounts. This led to an increase in net interest income from UK current accounts of 5 per cent to US$1.0 billion, broadly in line with the 6 per cent increase in average balances.

Sales of new UK savings accounts increased markedly, and average balances rose by 15 per cent, driven by a greater front-line focus, competitive pricing and the launch of new products, including Regular Saver and Online Saver . Included in this was growth of over US$1.2 billion in First Direct s e-savings product, launched in September 2004. Net interest income, however, fell by 5 per cent, largely due to the non-recurrence of the benefit to spreads from base rate rises in 2004, and a slight reduction in margin. The latter arose from competitive pricing initiatives partly designed to improve brand awareness and widen product consideration.

In Turkey, innovative marketing initiatives and advertising campaigns, with an emphasis on attracting new customers, contributed to strong growth in net interest income, which more than doubled compared with 2004. Average card balances increased by 66 per cent to US$0.9 billion, and average mortgage balances more than doubled to US$0.6 billion. Higher card usage by existing customers, higher average mortgage advances and a 7 per cent increase in overall customer numbers contributed to the growth.

In France, net interest income was broadly in line with 2004. Marketing campaigns in the run-up to the rebranding exercise contributed to a 54 per cent increase in mortgage sales in a buoyant market, and a resulting 18 per cent increase in average balances. Cross-sales of current and special regulated savings accounts were strong, and average deposit balances grew by 4 per cent to US$14.9 billion. The benefit of this balance sheet expansion was largely offset by lower spreads, as competitive pricing reduced yields on lending products, and the maturing of older, higher-yielding investments reduced the funding benefit from deposits.

Excluding net interest income, net operating income before loan impairment charges grew by 16 per cent to US$3,386 million, of which 12 percentage points was in the UK and largely attributable to increased fees associated with the increase in personal lending, mortgage and credit card volumes described above. Increased card utilisation also led to higher cash advance fees and currency conversion income. An improved investment fund offering, following the depolarisation of the previously tied sales force, was reflected in a 5 per cent increase in related commissions. In Turkey, fee income benefited from increased lending activity. In France, privatisations boosted brokerage income, and new product launches and marketing aided growth in insurance and investment sales.

Under IFRSs, changes in presentation from 1 January 2005, notably for certain contracts previously accounted for as insurance, and with the designation of insurance-related assets at fair value, caused large movements within certain individual income lines. These had negligible impact on income overall. There was also a US$32 million gain from the fair value measurement of options linked to French home-savings products.

Loan impairment charges of US$1,711 million were 73 per cent higher than 2004, the majority of which occurred in the UK. In large part, this reflected the strong growth in higher margin credit card and other unsecured lending in recent years. Weakening economic conditions and sharply rising personal bankruptcies, following the change in legislation in 2004, were also significant contributors.

Loan impairment charges as a percentage of period end net customer advances rose from 0.8 to 1.4 per cent.

HSBC responded to the weaker UK credit environment by further refining its credit eligibility criteria, and by enhancing its credit scorecards with

Back to Contents

full positive credit reference data. HSBC became the first UK high street clearing bank to share full customer credit performance data in 2005. Underwriting activity was also further centralised. Collections capabilities were enhanced, resulting in an increase in amounts collected, and resources were added to the Retail Credit Risk Management function. As a result, lending activity in the second half of the year indicated that the credit quality of more recent unsecured lending had improved.

Higher charges in Turkey were broadly in line with balance sheet growth, while credit quality in France remained sound.

Operating expenses were broadly in line with 2004. The 7.5 percentage point fall in the cost efficiency ratio, to 58 per cent, was largely driven by productivity improvements in the UK. This reflected the benefits of the cost reduction strategy introduced in 2004. Increased focus on direct channels, and the greater centralisation of support functions enabled by this, reduced the UK cost base in 2005, which also benefited from the non-recurrence of the restructuring costs incurred in implementing this strategy. Costs in 2004 also included amounts for compensation expected to be payable to UK customers for shortfalls on certain mortgage endowment policies and investment products. Operating expenses in 2005 included the initial phase of a UK branch refurbishment programme designed to improve customer experience, which added US$73 million to costs.

In France, a 2 per cent increase in operating expenses was driven by the recruitment of additional sales staff, as well as the rebranding exercise and associated marketing expenditure. In Turkey, marketing costs increased by 30 per cent and staff costs by 33 per cent, largely in support of the growing credit card business.

Commercial Banking reported pre-tax profits of US$1,939 million, an increase of 18 per cent. In highly competitive markets, revenues grew by 6 per cent and profit improvement largely reflected reduced costs, more than offsetting higher loan impairment charges.

In the UK, improved market segmentation led to a more acute focus on the needs of individual customers and underpinned a 20 per cent increase in pre-tax profits. The establishment in 2004 of Corporate Banking Centres to improve the service offered to MMEs, and Commercial Centres focusing on larger SMEs, together with the recruitment of additional sales staff, contributed to a 6 per cent increase in customers and strong growth in lending. Revenues responded strongly, and costs were lower

following a reorganisation in the UK in 2004 to improve efficiency. UK credit quality experienced some weakening in the fourth quarter of 2005, reflecting higher interest rates and the resulting slowdown in consumer spending. However, the quality of HSBC s commercial lending book remained strong overall with impairment charges continuing to run below historic levels: as in prior periods, loan impairment charges principally reflected allowances against a small number of accounts.

Net interest income increased by 16 per cent. In the UK, lending and overdraft balances increased by 23 per cent, or US$6.6 billion, as a result of strong customer demand. HSBC increased its lending market share, with particularly strong growth in the property, distribution and services sectors. In invoice financing, a 12 per cent increase in customer numbers supported by a sales force realignment led to higher balances and a 10 per cent increase in net interest income. Risk-based pricing improved overdraft spreads by 15 basis points, while term lending margins were in line with 2004.

A campaign designed to secure a greater share of the commercial savings market, in part through more competitive pricing, contributed to an 11 per cent increase in UK deposit balances, with spreads falling by 16 basis points. Overall, UK commercial customer liability balances benefited from both deposit growth and a 12 per cent increase in current account balances. Current account customer numbers rose to over 700,000 with over 20,000 customers switching their business to HSBC following marketing and advertising campaigns in 2005. In the UK, HSBC attracted over 90,000 start-up accounts, representing a 20 per cent market share. Spreads on sterling current accounts fell as customers continued to migrate to interest-paying current accounts. Increases in US interest rates led to a widening of spreads on international and foreign currency current accounts.

Net interest income in Turkey increased by 29 per cent, principally as a result of higher lending and deposit balances, which increased by 25 per cent and 19 per cent respectively. HSBC deepened its relationships with its larger commercial banking customers and recruited additional sales staff to support the launch of SME banking in the second half of 2005.

In France, increased marketing activity highlighting HSBC s international capabilities as CCF rebranded to HSBC France, together with a programme to align the bank s 350 largest Commercial Banking customers with the most

Back to Contents

experienced relationship managers, led to a 10 per cent increase in medium term loan balances. Sight deposit balances grew by 7 per cent, though deposit spreads decreased as maturing funds were placed at lower prevailing interest rates.

Net fee income increased by 2 per cent to US$1,621 million, net of IFRSs changes to switch some fees into the effective interest rate calculation, which led to a 15 per cent reduction in fee income. In the UK, higher new business volumes and lending activity contributed to a US$77 million, or 27 per cent, increase in loan and overdraft fee income. Increased customer numbers, coupled with the introduction of a new small business tariff in January 2005, led to a 13 per cent increase in current account fee income. Card acquiring income increased by 8 per cent, despite a slowdown in consumer spending driven by a 6 per cent increase in transaction volumes, reflecting merchant acquisition. A 21 per cent increase in card customer numbers contributed to higher card issuing income.

HSBC benefited from the recruitment of additional sales staff, development of profitable relationships with brokers and the success of dedicated corporate and commercial centres. Invoice financing fee income increased by 9 per cent, benefiting from an expanded client base, while a tariff review contributed to a 16 per cent increase in treasury income. The recruitment, in both 2004 and 2005, of commercial independent financial advisors, together with the development of existing sales staff, led to a 13 per cent increase in insurance and investment income, with fee income from savings and investment products increasing by a third. Income in the vehicle and equipment leasing businesses decreased by 13 per cent, following an agreement to outsource the operational functions of the UK vehicle finance contract hire business to Lex Vehicle Leasing, which took effect from November 2005. Excluding the transfer, net fee income from leasing increased by 5 per cent.

Loan impairment charges and other credit risk provisions increased by 26 per cent to US$378 million. In the UK, lending growth and sizeable allowances against a small number of accounts led to a US$162 million increase in charges. Overall credit quality remained relatively strong, although some deterioration was evident in the market in the last three months of 2005 as consumer spending declined. In France, new individually assessed allowances were largely offset by higher recoveries, while in Malta net releases decreased as a large release against a single customer in 2004 was not repeated.

Operating expenses decreased by 5 per cent and, together with increased income, resulted in a 6 percentage point improvement in the cost efficiency ratio. In the UK, the non-recurrence of cost reduction expenditure in 2004, together with the resulting fall in staff numbers and strong cost control, contributed to a 10 per cent decrease in operating expenses. Although overall staff numbers declined, additional sales staff were hired to take advantage of business opportunities in support of revenue growth. These sales staff were supported by press and other advertising campaigns aimed at attracting customers switching banks and start-up businesses to HSBC, together with a campaign targeting SMEs which contributed to an increase in marketing costs.

In France, staff recruitment, increased marketing activity and re-branding led to an 8 per cent increase in costs. Staff costs rose as HSBC France recruited additional sales staff to support business expansion, and success led to higher performance-related remuneration. Campaigns targeting top tier commercial customers and supporting product launches led to an increase in marketing expenditure, while rebranding and supporting activity to emphasise the HSBC name change also contributed.

In an economy which grew by 5.5 per cent in 2005, increased business activity, the launch of SME banking and the recruitment of additional sales and support staff in Turkey contributed to a rise in income and a 17 per cent increase in operating expenses.

Corporate, Investment Banking and Markets reported a pre-tax profit of US$2,114 million, an increase of 27 per cent, compared with 2004. Revenues from all major client-related trading activities increased, particularly from the credit and rates, equities and structured derivatives businesses where HSBC has invested in upgrading its capabilities. Operating expenses rose, reflecting the first full-year cost of the expanded sales and execution capabilities. However, cost growth slowed in the second half of 2005 and in aggregate in Europe, revenue growth comfortably surpassed growth in costs. In Europe, 2005 marked the transition from the investment phase of Corporate, Investment Banking and Markets development strategy to a focus on implementation.

Total operating income increased by 15 per cent to US$5,510 million. Balance sheet management and money market revenues declined by approximately 46 per cent reflecting a challenging interest rate

Back to Contents

environment of higher short-term rates and a flattening yield curve.

Corporate lending spreads remained under pressure as customers refinanced and negotiated better terms in response to falling credit spreads on virtually all publicly traded debt instruments and strong liquidity in the banking system. In the UK, the adverse impact of a 23 basis point decrease in spreads on customer lending was partly mitigated by a 7 per cent increase in lending balances. Corporate and Institutional Banking also implemented a balance sheet securitisation programme to enhance returns. In Global Transaction Banking, net interest income increased, primarily due to an increase in balances held on behalf of customers, coupled with the favourable impact of rising short-term rates. Customer deposit balances increased by 23 per cent and spreads improved by 9 basis points.

Net fees rose by 7 per cent, partly due to an increase in earnings from the equity capital markets business. Additionally, as equity markets became more buoyant, HSBC Securities Services fees increased and assets under custody grew by 15 per cent to US$3,242 billion, primarily due to new business and market value appreciation. The asset-backed securities product also generated higher fees with several notable transactions closing in 2005. In Germany, a 31 per cent rise in net fees was driven by origination activity and higher sales of structured solutions.

The increase in income from trading activities arose from positive revenue trends on core products within Global Markets in response to the investment made in client-facing trading capabilities. Fixed income revenues were boosted by higher volumes processed through electronic trading platforms and by the expansion of primary dealing activity in European government bond markets. In the UK, a strong performance in structured derivatives reflected investment in new hybrid derivatives and structured fund derivatives businesses, while income in the credit and rates business rose by 25 per cent as a result of higher revenues from securities trading, asset-backed securities and credit default swaps. There was growth in income from currency derivatives on the back of increasing client business.

Other income was boosted by gains from the restructuring and syndication of existing assets in Global Investment Banking.

Gains from sales of financial investments increased significantly to US$396 million, due to higher realisations from Private Equity.

The overall credit environment remained favourable, with a net recovery in 2005 as in 2004. There were, however, lower recoveries of loan impairment charges in the UK and France, as HSBC had benefited from a number of successful refinancings in 2004. In Italy, a net recovery reflected relatively lower allowances against loan impairment, coupled with releases of provisions made in 2004.

Operating expenses increased by 9 per cent to US$3,647 million, partly from the first full year effect of recruitment in 2004 and partly from a further 980 people recruited in 2005 to deliver the expanded capabilities reflected in the revenue gains described above. Extensive investment was also made to develop the infrastructure and technology platform required to integrate and support the business expansion. In Global Markets, costs rose as new capabilities were added to the cash equities platform, the structured derivatives business in the UK and the credit and rates business. An increase in operational costs, particularly in Global Transaction Banking, was due to higher transaction volumes.

Private Banking reported a pre-tax profit of US$539 million, an increase of 23 per cent compared with 2004, driven by strong growth in client assets, transaction volumes and the lending book. Operating expenses rose with a recruitment-driven increase in staff costs partly offset by efficiency savings and the non-recurrence of restructuring costs in France in 2004.

Net interest income increased by 31 per cent, driven by strong balance sheet growth in the UK, Switzerland and, to a lesser extent, Germany. Overall, lending balances increased by 21 per cent to US$16.7 billion, as clients borrowed in the low interest rate environment to make alternative investments. This included strong growth in UK mortgage balances, which increased by 39 per cent, in part reflecting synergies with HSBC s residential property advisory business. Deposits increased by 20 per cent to US$38.6 billion, as new clients placed cash prior to investment.

Client assets, including deposits, increased by 22 per cent to US$174.7 billion. Net new money of US$23.4 billion reflected notably strong inflows in Switzerland, Germany, Monaco and the UK. In Switzerland, an increased marketing effort and successful product placement aided net new money of US$9.6 billion. In Germany, US$7.6 billion of new money was predominantly due to the success of a new wealth management team. In Monaco, a focus on building the onshore business generated inflows of US$4.1 billion, while in the UK, cross-referrals

Back to Contents

with the wider Group contributed to nearly one quarter of the US$1.6 billion of new money.

A US$20 million lower performance fee from a public equity fund dedicated to Russia was more than offset by increased core fees and commissions in line with growth in client assets, and transactional income as new clients invested. Higher fee income also reflected growth in discretionary and advisory managed assets, and volume growth, which was boosted by the success of new products launched in 2005, notably in alternative investments. Gains from financial investments in both 2004 and 2005 were mainly on the sale of debt instruments. The overall gain in 2005 of US$27 million was 17 per cent lower than in the previous year.

The net release of loan impairment charges in 2005 related largely to specific clients; improved credit quality overall also led to a release of collective impairment provisions.

Operating expenses rose by 11 per cent, of which front office recruitment and increased performance-related remuneration comprised 4 and 5 percentage points respectively. Investment costs, largely in IT and marketing, and supporting business growth contributed further to the increase. These were in part offset by back office efficiency savings and lower restructuring costs following 2004 s merger of HSBC s four French private banks.

Within **Other**, net operating income benefited from the change to the presentation of inter-company preference share dividends received from Hong Kong under IFRSs from 1 January 2005. Head office operating expenses increased, reflecting higher brand advertising and marketing costs, increased professional fees incurred to comply with additional regulatory requirements including Sarbanes-Oxley and Basel II, and restructuring costs. In 2004, operating expenses benefited from the release of litigation provisions.

Back to Contents

Financial Review (continued)

Profit/(loss) before tax by customer group

	Year ended 31 December 2005						
Europe	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Corporate, Investment Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination US$m**	**Total US$m**
Net interest income	5,309	2,659	827	548	95	(1,217)	8,221
Net fee income	2,314	1,621	1,339	730	295		6,299
Trading income/(expense) excluding net interest income	81	16	1,493	93	(23)		1,660
Net interest income/(expense) on trading activities	3	2	159		(5)	1,217	1,376
Net trading income/(expense)	84	18	1,652	93	(28)	1,217	3,036
Net income/(expense) from financial instruments designated at fair value .	305	71	17		(31)		362
Gains less losses from financial investments	(4)	4	396	27	16		439
Dividend income	2	7	27	9	18		63
Net earned insurance premiums	1,220	115			264		1,599
Other operating income	42	178	1,252	18	329	(216)	1,603
Total operating income	9,272	4,673	5,510	1,425	958	(216)	21,622
Net insurance claims[1]	(577)	(62)			(179)		(818)
Net operating income before loan impairment charges and other credit risk provisions	8,695	4,611	5,510	1,425	779	(216)	20,804
Loan impairment charges and other credit risk provisions	(1,711)	(378)	155	5			(1,929)
Net operating income	6,984	4,233	5,665	1,430	779	(216)	18,875
Total operating expenses	(5,058)	(2,301)	(3,647)	(891)	(958)	216	(12,639)

Operating profit/(loss)	**1,926**	**1,932**	**2,018**	**539**	**(179)**		**6,236**
Share of profit/(loss) in associates and joint ventures	**6**	**7**	**96**		**11**		**120**
Profit/(loss) before tax	**1,932**	**1,939**	**2,114**	**539**	**(168)**		**6,356**
	%	%	%	%	%		%
Share of HSBC s profit before tax	**9.2**	**9.2**	**10.1**	**2.6**	**(0.8)**		**30.3**
Cost efficiency ratio	**58.2**	**49.9**	**66.2**	**62.5**	**122.9**		**60.8**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Selected balance sheet data[2]							
Loans and advances to customers (net)	**120,302**	**66,965**	**107,899**	**17,368**	**3**		**312,537**
Total assets	**143,095**	**80,864**	**367,893**	**40,971**	**3,880**		**636,703**
Customer accounts	**122,118**	**61,789**	**109,086**	**41,206**	**1**		**334,200**
Loans and advances to banks (net)[3]			**34,218**				
Trading assets, financial instruments designated at fair value, and financial investments[3]			**168,062**				
Deposits by banks[3]			**45,075**				

1 *Net insurance claims incurred and movement in policyholders liabilities.*
2 *Third party only.*
3 *These assets and liabilities were significant to Corporate, Investment Banking and Markets.*

Back to Contents

	Year ended 31 December 2004						
Europe	Personal Financial Services US$m	Commercial Banking US$m	Corporate, Investment Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination US$m	Total US$m
Net interest income	4,644	2,305	1,403	421	325		9,098
Net fee income	2,110	1,593	1,261	658	358		5,980
Trading income		116	735	104	42		997
Net investment income/ (expense) on assets backing policyholders liabilities	445	127			(1)		571
Gains less losses from financial investments		1	122	33	(2)		154
Dividend income/(expense)		36	526	5	(9)		558
Net earned insurancepremiums	1,254	409	12		200		1,875
Other operating income	26	285	770	19	255	(180)	1,175
Total operating income	8,479	4,872	4,829	1,240	1,168	(180)	20,408
Net insurance claims[1]	(1,026)	(487)			(115)		(1,628)
Net operating income before loan impairment charges and other credit risk provisions	7,453	4,385	4,829	1,240	1,053	(180)	18,780
Loan impairment charges and other credit risk provisions	(939)	(306)	207	4	1		(1,033)
Net operating income	6,514	4,079	5,036	1,244	1,054	(180)	17,747
Total operating expenses	(4,898)	(2,422)	(3,380)	(806)	(702)	180	(12,028)
Operating profit	1,616	1,657	1,656	438	352		5,719
Share of profit in associates and joint ventures	5	6	12		14		37
Profit before tax	1,621	1,663	1,668	438	366		5,756
	%	%	%	%	%		%
Share of HSBC s profit before tax	8.6	8.8	8.8	2.3	1.9		30.4
Cost efficiency ratio	65.7	55.2	70.0	65.0	66.7		64.0
	US$m	US$m	US$m	US$m	US$m		US$m
Selected balance sheet data[2]							
Loans and advances to customers (net)	118,796	67,458	75,628	15,676	2		277,560

Total assets	143,515	83,289	273,906	40,140	4,707		545,557
Customer accounts	121,599	57,798	78,031	35,140			292,568
The following assets and liabilities were significant to Corporate, Investment Banking and Markets:							
Loans and advances to banks (net)			47,802				
Trading assets, financial instruments designated at fair value, and financial investments			116,492				
Deposits by banks			53,646				

1 *Net insurance claims incurred and movement in policyholders liabilities.*
2 *Third party only.*

Back to Contents

Financial Review (continued)

Hong Kong

Profit before tax by customer group

	Year ended 31 December	
	2005 **US$m**	2004 US$m
Personal Financial Services	**2,628**	2,063
Commercial Banking	**955**	904
Corporate, Investment Banking and Markets	**922**	1,603
Private Banking	**190**	131
Other	**(178)**	129
	4,517	4,830

Profit before tax

	Year ended 31 December	
	2005 **US$m**	2004 US$m
Net interest income	**4,064**	3,638
Net fee income	**1,674**	1,703
Trading income	**546**	659
Net expense from financial instruments designated at fair value	**(6)**	
Net investment income on assets backing policyholders liabilities		314
Gains less losses from financial investments	**108**	175
Dividend income	**41**	27
Net earned insurance premiums	**2,334**	2,247
Other operating income	**805**	536
Total operating income	**9,566**	9,299
Net insurance claims incurred and movement in policyholders liabilities	**(2,059)**	(2,154)
Net operating income before loan impairment charges and other credit risk provisions	**7,507**	7,145
Loan impairment charges and other credit risk provisions	**(146)**	220
Net operating income	**7,361**	7,365
Total operating expenses	**(2,867)**	(2,558)
Operating profit	**4,494**	4,807
Share of profit in associates and joint ventures	**23**	23
Profit before tax	**4,517**	4,830

	%	%
Share of HSBC s profit before tax	**21.5**	25.5
Cost efficiency ratio	**38.2**	35.8
Year-end staff numbers (full-time equivalent)	**25,931**	25,552
	US$m	US$m
Selected balance sheet data[1]		
Loans and advances to customers (net)	**83,208**	78,824
Loans and advances to banks (net)	**42,751**	45,710
Trading assets, financial instruments designated at fair value, and financial investments	**81,631**	75,721
Total assets[2]	**222,822**	213,458
Deposits by banks	**4,708**	4,325
Customer accounts	**173,726**	178,033

1 *Third party only.*
2 *Excluding Hong Kong Government certificates of indebtedness.*

Back to Contents

Hong Kong s economy grew by 7.3 per cent in 2005, down from the growth of 8.6 per cent achieved in 2004. Robust domestic demand provided strong support, particularly in the second half of the year, and external trade maintained its rapid rate of growth. Despite a substantial rise of more than 3 per cent in local interest rates in 2005, domestic demand continued to expand, reflecting a sustained improvement in business and consumer confidence. Increased consumer spending, spurred by greater job security as unemployment fell, and improving household incomes, became a key driver of growth in the latter part of the year. The rise in domestic spending more than offset the slower growth in tourists spending which occurred in 2005, particularly among mainland visitors, and consumer optimism remained unaffected by a cooling in the property market induced by the higher interest rate environment. Hong Kong s strong export performance also propelled growth, benefiting from sustained external demand and foreign importers building up inventories as trade talks continued on textile quotas between mainland China and its major trading partners. Domestic exports also picked up, reflecting increased local production. In 2005, inflation rose to 1.1 per cent, mainly driven by increased demand for property rentals.

HSBC s operations in Hong Kong reported a pre-tax profit of US$4,517 million, compared with US$4,830 million in 2004. IFRSs changes to the treatment of preference share dividends led to a US$387 million decrease in pre-tax profits. Excluding this, profits increased by 2 per cent. Subdued profit growth was largely attributable to a turnaround in loan impairment charges, as 2004 benefited from non-recurring releases from general provisions, and a fall in balance sheet management revenues. Pre-tax profits in Hong Kong represented around 22 per cent of HSBC s total profit at this level. In Corporate, Investment Banking and Markets, balance sheet management revenues were negatively affected by the influence of short-term interest rate rises and a flattening yield curve. Expense growth in Corporate, Investment Banking and Markets reflected the first full-year effect of the investment made to support business expansion. Pre-tax profits of Personal Financial Services and Commercial Banking grew by 27 per cent and 6 per cent respectively, benefiting from a sharp rise in deposit spreads as short-term interest rates increased in a benign credit environment.

The commentary that follows is on an underlying basis.

Personal Financial Services reported a pre-tax profit of US$2,628 million, 27 per cent higher than

in 2004. This was largely due to widening deposit spreads, deposit growth and improved credit quality. During the year, HSBC placed considerable emphasis on maintaining its leadership position and meeting customer needs in both the credit cards and insurance businesses. Market share of both spend and balances grew in respect of credit cards along with strong insurance revenue growth.

Net interest income grew by 30 per cent to US$2,618 million. During 2005, interest rates in Hong Kong rose significantly, reflecting rising US dollar interest rates. In addition, adjustments to the Hong Kong: US dollar linked exchange rate system reduced the likelihood of an upward realignment of the Hong Kong dollar, prompting a reversal of much of the inward flows from investors that had depressed local market rates in 2004. Consequently, deposit spreads widened to more normal levels after the exceptionally low spreads experienced in 2004. Interest rate rises also helped stimulate growth in average deposit balances as investor sentiment moved away from long-term equity-related investments into shorter-term liquid deposits. Despite the competitive deposit market, average balances grew by US$2.9 billion, or 3 per cent.

The mortgage market remained highly competitive during 2005. During the first half of the year, HSBC did not aggressively compete on price but maintained a selective approach to mortgage approvals, mainly by offering competitive rates to the existing customer base. Yields gradually improved during the year, as HSBC repriced upwards following a series of interest rates increases. Spreads declined compared with 2004, as improvements in yields were more than offset by higher funding costs following rising interest rates. Average mortgage balances, excluding the reduction in balances under the suspended Hong Kong Government Home Ownership Scheme (GHOS) grew by 1 per cent, despite the highly competitive environment.

Average credit card balances grew by 10 per cent, and HSBC s market share of card balances also increased by 550 basis points led by targeted promotional campaigns and rewards programmes. These volume benefits were more than offset by lower spreads, mainly due to higher funding costs as interest rates rose.

Net fees fell by 6 per cent to US$740 million, driven mainly by lower sales of unit trusts and capital guaranteed funds, partly offset by higher sales of structured deposit products and open-ended funds. A 34 per cent fall in unit trust fee income was driven by a change in market sentiment during 2005.

67

Back to Contents

The combined effect of higher interest rates and a flattening yield curve reduced customer demand for capital guaranteed funds and longer-term equity related investment products. Investors preferred shorter-term investment products which in turn generated lower fees. Revenues from open-ended fund sales reflected this, increasing by 32 per cent to US$95 million with the introduction of 173 new funds increasing the choice of funds available to investors. This was an important strategic initiative to position HSBC as the leading investment service provider in Hong Kong, where customers can now choose from over 300 funds.

Revenues from structured deposit products grew, with strong sales volumes aided by new products launched. The success of the Exclusive Placement Service, launched in 2004 for HSBC *Premier* customers, continued with year-on-year revenue growth of 178 per cent. The service offers an extensive product range of yield enhancement options, re-priced daily and linked to foreign exchange or interest rates. IPO certificate of deposit offerings doubled. These were partly offset by lower revenues from Deposit plus and Equity linked note products.

Fee income from credit cards grew by 9 per cent, reflecting a 21 per cent increase in spending along with a 15 per cent rise in the number of cards in circulation to four million. In stockbroking and custody services, new services were launched aimed at facilitating securities management by customers. Competitive pricing and a high quality of service on the internet led to a 15 per cent growth in customers holding securities with HSBC.

HSBC continued to place significant emphasis on the growth and development of its insurance business, and increased the range of products offered. Insurance revenues grew by 20 per cent, aided by new products launched which included the Five year excel and the Three year express wealth joint life insurance and wealth products. HSBC was Hong Kong s leading online insurance provider, offering 12 insurance products. This, coupled with competitive pricing, led to a 91 per cent growth in online insurance revenues. Medical insurance products were enhanced and heavily marketed in response to the growing public demand for private medical protection to complement new medical reforms being introduced.

Improvements in credit conditions, which benefited from economic growth, higher property prices and lower bankruptcies, underpinned a net release of loan impairment charges and other credit risk provisions of US$11 million in 2005, compared

with a net charge of US$56 million in 2004. This was mainly driven by continued improvement in credit quality within the credit card portfolio, and a collective provision release of US$23 million in respect of prior year impairment allowances on the restructured lending portfolio. The strong housing market also enabled individually assessed allowance releases of US$24 million in the mortgage portfolio. There was also a release of US$11 million in respect of collective loan impairment allowances, benefiting from the improved economic conditions highlighted above.

Operating expenses fell by 4 per cent to US$1,305 million. This was largely due to a change in the method by which centrally incurred costs are allocated to the customer groups. IT development costs rose in support of future growth initiatives, and higher marketing and advertising expenditures were incurred on behalf of organic growth. Staff costs were marginally lower this year. Branch teams were restructured to dedicate more staff to sales and customer service, and significant improvements were made to the reward structure to ensure retention of high calibre individuals. Overall, headcount in the branch network fell by 4 per cent, reflecting operating efficiency improvements and higher utilisation of the Group Service Centres.

Pre-tax profits in **Commercial Banking** increased by 6 per cent to US$955 million. Increased deposit spreads and a rise in lending and deposit balances led to higher net interest income, though this was partly offset by larger loan impairment charges and the non-recurrence of loan allowance releases.

Net interest income increased by 60 per cent as a result of increased deposit spreads and growth in both assets and liabilities. The appointment of a number of experienced relationship managers to service key accounts, together with the establishment of core business banking centres, contributed to growth in both deposits and lending. Interest rate rises led to a 67 basis point increase in deposit spreads and, together with active management of the deposit base, contributed to increased customer demand for savings products which resulted in a 6 per cent increase in deposit balances to US$28.7 billion. The introduction of a pre-approved lending programme for SMEs, together with strong demand for credit in the property, manufacturing, trading and retail sectors, contributed to a 29 per cent increase in lending balances. However, increased competition reduced lending spreads by 43 basis points. Current account customers rose by 2 per cent to 329,000 and, together with higher spreads, contributed to an 81 per cent increase in current account net interest income.

Back to Contents

The BusinessVantage all-in-one account continued to perform strongly, with customers increasing by 23 per cent, which led to income more than doubling in 2005.

Net fee income increased by 10 per cent to US$402 million as a result of efforts to encourage cross-sales, which led to an increase in average products per customer. Investment in HSBC s insurance business, including the establishment of a new Commercial Banking insurance division in October 2005, delivered a 10 per cent increase in insurance income. Enhanced product offerings and focused sales efforts in the areas of currency and interest rate management products more than doubled income. Growth in the number of merchant customers following targeted marketing campaigns, together with higher consumer spending, led to a 22 per cent increase in card income. However, these increases were partly offset by a reduced contribution from investment products, even though sales increased by 20 per cent, reflecting changes in the product mix, as demand for capital protected funds decreased in the rising interest rate environment.

Loan impairment charges and other credit risk provisions of US$168 million contrasted with net recoveries in 2004, and included a significant charge against a client in the manufacturing sector. Releases and recoveries in 2005 were lower, although impaired loans as a proportion of lending balances decreased.

Operating expenses were 3 per cent higher, principally as a result of staff recruitment to support business development and expansion. This was particularly true with respect to business with mainland China, where additional resources were focused on increasing cross-sales and insurance income. Expenditure on new marketing campaigns promoted HSBC s lower-cost delivery channels. These campaigns, together with additional investment to increase customer access to ATMs and cheque deposit machines, grew the proportion of transactions using low cost channels to 35 per cent from 25 per cent in 2004. This released staff to concentrate on increasing sales and offering enhanced customer service.

Corporate, Investment Banking and Markets reported a pre-tax profit of US$922 million, 43 per cent lower than in 2004, primarily driven by a decline in net interest income in Global Markets and lower recoveries and releases of loan impairment allowances. In addition, operating expenses increased in line with initiatives taken to extend the product range in Global Markets and to strengthen

the Global Investment Banking advisory platform for Asia in Hong Kong.

A 19 per cent decline in total operating income was driven by a 74 per cent fall in balance sheet management and money market revenues due to rising short-term US and Hong Kong interest rates and flattening yield curves.

In Corporate and Institutional Banking, deposit spreads increased in line with higher local interest rates, although this was offset by lending spreads which fell amidst fierce local competition. In Global Transaction Banking revenues increased, benefiting from the improvement in deposit spreads, together with higher deposit balances as business volumes grew from the upgraded cash management service delivered through HSBCnet.

Net fees fell by 19 per cent, driven primarily by a reduction in structured finance revenues. However, a number of significant equity related transactions were concluded. Fee income from Group Investment Businesses was boosted by sales of investment products and a US$3.7 billion growth in funds under management.

Income from trading activities rose as new structured product capabilities were added in respect of credit, equities, interest rate and foreign exchange trading. Higher foreign exchange derivatives revenues reflected an increased focus on sales and execution. These gains were partly offset by a decline in sales of structured product solutions to the personal and commercial businesses, as retail investors switched to shorter deposit products in the higher interest rate environment. Losses were also incurred on the trading of Asian high-yield bonds, where revenues fell following the downgrading of the automobile sector in the first half of 2005.

The overall credit environment remained favourable and there was a small net release of loan impairment charges, although this was below levels seen in 2004 when HSBC benefited from corporate restructuring and refinancing in the property, industrial and telecommunications sectors.

A 20 per cent rise in operating expenses was due to the first full-year impact of the investment made in Hong Kong s Corporate, Investment Banking and Markets businesses. Employee compensation and benefits rose by 24 per cent, in part driven by an increase in senior relationship managers recruited to extend coverage along industry sector lines. In total, over 90 people were recruited to support the expansion. Technology and infrastructure costs rose as support and control functions added new

Back to Contents

resources and improved services to facilitate business expansion.

Private Banking contributed a pre-tax profit of US$190 million, an increase of 45 per cent compared with 2004. The benefits of strong growth in client assets, and consequently higher brokerage and trading income, were partly offset by the adverse effect of a flattening yield curve on income from the investment of surplus liquidity.

Net operating income was 29 per cent higher than in 2004. A 25 per cent increase in fee income reflected higher client assets, as well as the benefits of a strategy to increase the level of higher fee generating discretionary managed assets, which increased by 50 per cent during the year. Trading income increased by 39 per cent, boosted by higher volumes which reflected growth in the customer base, and a generally buoyant market. Revenue from bond trading increased by 13 per cent, and from foreign exchange and sales of structured products by 6 and 21 per cent respectively. Gains from financial investments of US$16 million were mainly from the sale of debt instruments.

Overall, client assets increased by 17 per cent to US$47.3 billion. Net new money inflows of US$5.8 billion were notably strong, with recruitment of front office staff, the success of last year s launch of the HSBC Private Bank brand, and cross-referrals with the wider Group all contributing to the growth. Marketing, successful product placement and the enhancement of the related front office teams also aided in the increase of discretionary managed assets, with a near doubling of assets invested in the Strategic Investment Solutions product.

Operating expenses increased by 14 per cent. Costs from front office recruitment, and higher expenditure on marketing in support of the growing customer base, were partly offset by the non-recurrence of rebranding costs in 2004.

In **Other**, gains on the sale of investments and properties decreased by US$136 million in 2005, following significant sales in 2004. These were partly offset by increased gains on the revaluation of properties of US$70 million. Net interest income decreased as, from 1 January 2005 under IFRSs, dividends paid on certain intra-group preference shares were reclassified from non-equity minority interests to net interest income; this was partly offset by higher earnings on US dollar denominated assets following interest rate rises in the US.

Back to Contents

Profit/(loss) before tax by customer group

Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Corporate, Investment Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination US$m	Total US$m
	Year ended 31 December 2005						
Net interest income/(expense)	**2,618**	**1,096**	**607**	**75**	**(529)**	**197**	**4,064**
Net fee income	**740**	**402**	**431**	**93**	**8**		**1,674**
Trading income/(expense) excluding net interest income	**67**	**48**	**601**	**140**	**(83)**		**773**
Net interest income/(expense) on trading activities			**(40)**		**10**	**(197)**	**(227)**
Net trading income/(expense)	**67**	**48**	**561**	**140**	**(73)**	**(197)**	**546**
Net income/(expense) from financial instruments designated at fair value	**41**	**(84)**	**14**		**23**		**(6)**
Gains less losses from financial investments				**16**	**92**		**108**
Dividend income	**1**	**2**	**18**		**20**		**41**
Net earned insurance premiums	**2,238**	**77**	**19**				**2,334**
Other operating income	**230**	**35**	**83**	**13**	**682**	**(238)**	**805**
Total operating income	**5,935**	**1,576**	**1,733**	**337**	**223**	**(238)**	**9,566**
Net insurance claims[1]	**(2,016)**	**(34)**	**(9)**				**(2,059)**
Net operating income before loan impairment charges and other credit risk provisions	**3,919**	**1,542**	**1,724**	**337**	**223**	**(238)**	**7,507**
Loan impairment charges/(recoveries) and other credit risk provisions	**11**	**(168)**	**7**	**3**	**1**		**(146)**
Net operating income	**3,930**	**1,374**	**1,731**	**340**	**224**	**(238)**	**7,361**
Total operating expenses	**(1,305)**	**(419)**	**(809)**	**(150)**	**(422)**	**238**	**(2,867)**
Operating profit/(loss)	**2,625**	**955**	**922**	**190**	**(198)**		**4,494**
Share of profit in associates and joint ventures	**3**				**20**		**23**
Profit/(loss) before tax	**2,628**	**955**	**922**	**190**	**(178)**		**4,517**

	%	%	%	%	%		%
Share of HSBC s profit before tax	**12.5**	**4.6**	**4.4**	**0.9**	**(0.9)**		**21.5**
Cost efficiency ratio	**33.3**	**27.2**	**46.9**	**44.5**	**189.0**		**38.2**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Selected balance sheet data[2]							
Loans and advances to customers (net)	**34,318**	**20,292**	**23,712**	**3,107**	**1,779**		**83,208**
Total assets[3]	**40,244**	**25,625**	**133,005**	**7,621**	**16,327**		**222,822**
Customer accounts	**105,801**	**37,417**	**21,070**	**9,216**	**222**		**173,726**
Loans and advances to banks (net)[4]			**39,164**				
Trading assets, financial instruments designated at fair value, and financial investments[4]			**63,813**				
Deposits by banks[4]			**4,373**				

1 *Net insurance claims incurred and movement in policyholders liabilities.*
2 *Third party only.*
3 *Excluding Hong Kong Government certificates of indebtedness.*
4 *These assets and liabilities were significant to Corporate, Investment Banking and Markets.*

Back to Contents

Financial Review (continued)

Profit/(loss) before tax by customer group *(continued)*

	Year ended 31 December 2004						
Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Corporate, Investment Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination US$m	Total US$m
Net interest income/(expense)	2,015	684	998	85	(144)		3,638
Net fee income/(expense)	786	365	529	75	(52)		1,703
Trading income/(expense)	47	39	476	101	(4)		659
Net investment income on assets backing policy-holders liabilities	118	196					314
Gains less losses from financial investments	(2)		2		175		175
Dividend income	2	1	2		22		27
Net earned insurance premiums	1,620	609	19		(1)		2,247
Other operating income	294	52	101	(2)	561	(470)	536
Total operating income	4,880	1,946	2,127	259	557	(470)	9,299
Net insurance claims[1]	(1,400)	(742)	(12)				(2,154)
Net operating income before loan impairment charges and other credit risk provisions	3,480	1,204	2,115	259	557	(470)	7,145
Loan impairment charges and other credit risk provisions	(56)	110	164	4	(2)		220
Net operating income	3,424	1,314	2,279	263	555	(470)	7,365
Total operating expenses	(1,364)	(406)	(674)	(132)	(452)	470	(2,558)
Operating profit	2,060	908	1,605	131	103		4,807
Share of profit/(loss) in associates and joint ventures	3	(4)	(2)		26		23
Profit before tax	2,063	904	1,603	131	129		4,830
	%	%	%	%	%		%
Share of HSBC s profit before tax	10.9	4.7	8.5	0.7	0.7		25.5

Cost efficiency ratio	39.2	33.7	31.9	51.0	81.1	35.8
	US$m	US$m	US$m	US$m	US$m	US$m
Selected balance sheet data[2]						
Loans and advances to customers (net)	33,646	17,883	22,440	2,954	1,901	78,824
Total assets[3]	37,742	23,272	129,986	7,490	14,968	213,458
Customer accounts	114,302	35,226	18,903	9,264	338	178,033
The following assets and liabilities were significant to Corporate, Investment Banking and Markets:						
Loans and advances to banks (net)			42,515			
Trading assets, financial instruments designated at fair value, and financial investments			59,703			
Deposits by banks			4,205			

1 *Net insurance claims incurred and movement in policyholders liabilities.*
2 *Third party only.*
3 *Excluding Hong Kong Government certificates of indebtedness.*

Back to Contents

Rest of Asia-Pacific (including the Middle East)

Profit/(loss) before tax by customer group and by country

	Year ended 31 December	
	2005	2004
	US$m	US$m
Personal Financial Services	**377**	336
Commercial Banking	**818**	483
Corporate, Investment Banking and Markets	**1,207**	942
Private Banking	**78**	60
Other	**94**	26
	2,574	1,847

	Year ended 31 December	
	2005	2004
	US$m	US$m
Australia and New Zealand	**111**	84
Brunei	**35**	33
India	**212**	178
Indonesia	**113**	76
Japan	**(1)**	50
Mainland China	**334**	32
Malaysia	**236**	214
Middle East (excluding Saudi Arabia)	**481**	298
Philippines	**41**	38
Saudi Arabia	**236**	122
Singapore	**289**	272
South Korea	**94**	89
Taiwan	**68**	107
Thailand	**61**	60
Other	**264**	194
	2,574	1,847

Back to Contents

Financial Review (continued)

Profit before tax

Rest of Asia-Pacific (including the Middle East)	Year ended 31 December 2005 US$m	 2004 US$m
Net interest income	**2,412**	2,060
Net fee income	**1,340**	1,041
Trading income	**860**	494
Net income from financial instruments designated at fair value	**58**	
Net investment income on assets backing policyholders liabilities		32
Gains less losses from financial investments	**18**	17
Dividend income	**5**	3
Net earned insurance premiums	**155**	97
Other operating income	**335**	146
Total operating income	**5,183**	3,890
Net insurance claims incurred and movement in policyholders liabilities	**(166)**	(82)
Net operating income before loan impairment charges and other credit risk provisions	**5,017**	3,808
Loan impairment charges and other credit risk provisions	**(134)**	(89)
Net operating income	**4,883**	3,719
Total operating expenses	**(2,762)**	(2,087)
Operating profit	**2,121**	1,632
Share of profit in associates and joint ventures	**453**	215
Profit before tax	**2,574**	1,847
	%	%
Share of HSBC s profit before tax	**12.3**	9.8
Cost efficiency ratio	**55.1**	54.8
Year-end staff numbers (full-time equivalent)	**55,577**	41,031
	US$m	US$m
Selected balance sheet data[1]		
Loans and advances to customers (net)	**70,016**	60,663
Loans and advances to banks (net)	**19,559**	14,887
Trading assets, financial instruments designated at fair value, and financial investments	**30,348**	31,065
Total assets	**142,014**	120,530
Deposits by banks	**7,439**	8,046
Customer accounts	**89,118**	78,613

1 *Third party only.*

Mainland China s economy grew by 9.9 per cent in 2005. Despite ongoing monetary tightening, total urban fixed asset investment growth showed no sign of slowing, though investment in steel and real estate sectors moderated. Consumer spending also remained strong, with retail sales growing by 13 per cent in 2005. Producer price inflation slowed, but still remained above 3 per cent thanks to strong investment demand. In July 2005, the People s Bank of China announced that, with immediate effect, the arrangement by which the renminbi (RMB) was pegged to the US dollar would be replaced with a managed float. Initially, the exchange rate was set at US$1 to RMB8.11, equivalent to an appreciation of approximately 2 per cent. This had little impact on export growth, which remained very strong, boosting China s annual trade surplus from US$32 billion in

2004 to US$102 billion in 2005. Growth in food prices slowed as China's grain production increased 3 per cent in 2005. This lowered consumer price inflation to 1.8 per cent from 3.9 per cent at the end of 2004.

Japan s economy in 2005 achieved its strongest growth in five years, and the long process of structural readjustment following the collapse in asset prices was largely completed. In particular, the excess corporate capacity, employment and debt of the past decade was eliminated, and bank impaired loans returned to historically normal levels. After a downturn which began in mid-2004, exports began to recover vigorously in March 2005, led by strong demand from mainland China. The decline in corporate borrowing ceased, and the end of net corporate debt reduction freed up cash which drove

Back to Contents

stronger growth in private capital investment. The tightening of the labour market boosted employment and led to a sustained rise in real wages for the first time in five years, providing strong support for consumer spending. The rise in the core consumer price index in November 2005 set the stage for the end of the Bank of Japan s quantitative easing policy.

Elsewhere in the region, most economies performed impressively in 2005, in particular India s. The main drivers of growth were exports, demand for technology, and domestic consumption. Investment demand, by contrast, remained weak. Strong domestic growth and continued firmness in energy prices resulted in an increase in inflationary pressures, especially in Indonesia and Thailand, where fuel subsidies were lowered or removed. Central banks in both these countries increased rates substantially. Elsewhere, particularly in South Korea and Taiwan, energy prices did not significantly affect headline inflation, and the benign inflationary environment was maintained with less need for monetary tightening. Most Asian currencies ended the year strongly against the US dollar.

2005 was a good year economically for the **Middle East**, where growth was boosted by high oil prices and additional capacity in downstream oil and gas, real estate, transportation and tourism. Long-term growth was reinforced through economic liberalisation. The result was to encourage private sector investment in both established and new sectors of the region s economy. Regional interest rates mirrored US dollar rate increases during the year without any noticeable effect on credit growth, though inflationary pressures arose from the US dollar s weakness and general economic expansion. GDP growth is estimated by the International Monetary Fund to have been over 6 per cent in Saudi Arabia in 2005. Economies in the region which are not as dependent on oil also performed well, with the United Arab Emirates, for example, registering strong growth in non-oil sectors such as financial services and tourism.

HSBC s operations in the Rest of Asia-Pacific reported a pre-tax profit of US$2,574 million, compared with US$1,847 million in 2004, representing an increase of 39 per cent. On an underlying basis, pre-tax profits grew by 29 per cent and represented around 12 per cent of HSBC s equivalent total profit. Strong growth across the majority of countries in the region resulted in higher revenues across all customer groups.

The commentary that follows is on an underlying basis.

Personal Financial Services reported a pre-tax profit of US$377 million, an increase of 6 per cent compared with 2004, reflecting higher net interest income led by strong asset and deposit growth, increased fee income and higher income from investments in the Middle East and mainland China. Costs in support of business expansion rose and were broadly in line with revenue growth. Higher loan impairment charges reflected growth in credit card lending and the non-recurrence in 2005 of loan impairment provision releases in 2004.

Net interest income grew by 25 per cent to US$1,208 million, reflecting strong growth across the majority of countries in the region. Deposit balances generally grew strongly during 2005. This was due in part to the range of new products launched during the year, including dual currency, floating rate and higher-yielding time deposits. The number of *Premier* account holders rose significantly, with a 40 per cent growth across the region generating US$3.5 billion of additional balances. In mainland China, organic expansion continued, with the opening of ten new branches and sub-branches. The deposit base grew by 80 per cent, as considerable emphasis was placed on the provision of wealth management services through the HSBC *Premier* account service. Deposit spreads also widened as interest rates rose, contributing to higher net interest income in mainland China, Singapore and India.

In the Middle East, a rise of 37 per cent in net interest income was driven by a combination of widening deposit spreads and strong loan growth, partly offset by lower asset spreads as funding costs increased following interest rate rises.

Average mortgage balances increased by 27 per cent to US$16.7 billion. This growth reflected marketing campaigns in India, Malaysia and Singapore alongside new products introduced in Australia and Korea. Higher sales volumes were also generated by direct sales forces across the region, notably in India, where mortgage balances grew by 43 per cent. The benefits of higher mortgage balances were partly offset by lower spreads as pricing stayed highly competitive.

The credit card business continued to expand in a number of countries. Credit card spending increased by 33 per cent, contributing to a 42 per cent growth in average card balances. Other notable developments included promotional campaigns, new product launches and a series of customer acquisition strategies including the exclusive rewards programme, Home and Away . At the end of the year, the number of cards in circulation stood at

6.3 million, representing an increase of 34 per cent over 2004. In India, the number of cards in circulation exceeded one million for the first time. Higher card balances led to higher net interest income in Indonesia, India, Taiwan, Malaysia and the Philippines.

Net fee income grew by 46 per cent to US$419 million, largely attributable to strong sales of investment and insurance products, and increased account service fees. Credit card fee incomes rose, driven by the strong growth in cardholder spending. Commissions from sales of unit trusts and funds under management were particularly strong in Singapore, India and Taiwan. Sales of investment products, comprising unit trusts, bonds and structured notes, grew by 43 per cent to US$6.5 billion, generating a 56 per cent increase in fee income. The launch of over 217 tranches of structured notes and deposit products in 11 countries across the region achieved total sales of US$952 million. Total funds under management rose by 33 per cent or US$7.2 billion, led by increased marketing activity and the considerable focus placed on wealth management services during the year. HSBC Bank Malaysia maintained its position as the leading international institutional unit trust agent in the country. Brokerage and custody fees grew, particularly in Australia, where a 13 per cent rise reflected increased stock market activity.

HSBC continued to emphasise the expansion of its insurance business across the region. The number of policies in force increased by 27 per cent and revenues grew by 16 per cent.

Loan impairment charges and other credit risk provisions doubled compared with 2004. This was due to the non-recurrence of a release of a general provision in Malaysia in 2004, and a sharp rise in credit card provisions in Taiwan, reflecting deteriorating credit conditions. Growth in personal unsecured lending and credit cards across the region contributed further to the increased charge.

Operating expenses increased by 29 per cent to US$1,245 million in support of business growth. HSBC spent considerable amounts in the region enhancing its existing infrastructure in order to benefit fully from the opportunities presented by the Asian growth economies. Staff costs of US$469 million rose by 23 per cent, as employee numbers increased to support business growth and to increase sales and wealth management activities. Performance-related remuneration costs were also higher as a result of the strong growth in profitability.

Marketing costs rose as major campaigns were run to support product promotions in mortgages, credit cards, insurance and investment products. Continued emphasis was placed on brand awareness in order to generate additional business and reinforce HSBC s position as the world s local bank across the region, and this further increased costs. Various growth initiatives required investment in technology, and the development of new distribution channels resulted in higher IT costs. Other expenses, including professional fees and communications costs, rose in support of business expansion.

Increased contributions from HSBC s investments in Bank of Communications and Industrial Bank in mainland China, together with record earnings from The Saudi British Bank, contributed to strong growth in profit from associates.

Commercial Banking reported a pre-tax profit of US$818 million, 45 per cent higher than that delivered in 2004. The increase was mainly due to higher net interest income as growth in customer numbers and strong credit demand to fund infrastructure investment drove balance sheet growth. Higher contributions from Bank of Communications and Industrial Bank in China, as well as a strong performance in The Saudi British Bank, produced higher income from associates. Lending balances increased by 16 per cent, exceeded by a 24 per cent rise in deposits.

Net interest income increased by 33 per cent to US$631 million, reflecting growth in the Middle East, Singapore, mainland China, Indonesia and Taiwan. In the Middle East, strong regional economies and significant government backed infrastructure and property projects, principally in the United Arab Emirates, contributed to a 37 per cent growth in lending balances and a 42 per cent increase in customer account balances. Higher trade flows generated a 25 per cent increase in net interest income from trade services, while higher interest rates raised liability spreads by 118 basis points. A new Amanah term investment product was launched in May 2005, attracting US$120 million of deposits, principally from new customers seeking Shariah-compliant investment opportunities.

In mainland China, strong economic growth, expansion of the branch network and the recruitment of additional sales staff resulted in a 39 per cent increase in lending balances. Deposit balances also benefited from economic growth, increasing by 38 per cent, while deposit spreads widened by 76 basis points following increases in US interest rates.

In Singapore, interest rate rises prompted increased demand for savings products and

Back to Contents

consequently deposit balances grew by 13 per cent, while deposit spreads increased by 13 basis points. Lending balances rose by 27 per cent, following the selective recruitment of more experienced relationship managers and a reorganisation of customers into key industrial sectors to provide greater focus on identifying service opportunities. Asset spreads decreased by 42 basis points as a result of competitive pressures and market liquidity.

In Taiwan, a loyalty campaign designed to increase deposits, together with higher current account income and an increase in deposit spreads, contributed to an 80 per cent increase in net interest income. In Mauritius, net interest income doubled as a result of liability balance growth. In India, increased trade contributed to higher trade services net interest income and strong economic growth led to higher demand for credit. This resulted in lending balances increasing by 72 per cent, while customer acquisition increased average current account balances by 37 per cent. Liability spreads widened by 73 basis points following interest rate rises. In Indonesia, increased sales efforts and a more focused approach to customer relationship management contributed to an 84 per cent growth in asset balances and a 66 per cent increase in net interest income.

Net fee income of US$307 million was 15 per cent higher than in 2004. In the Middle East, increased trade flows led to a 17 per cent increase in trade services income, while current account income increased by 80 per cent, benefiting from the introduction of new cash management capabilities. Short-term IPO loan funding reflecting, in part, robust regional capital market, also contributed to a 40 per cent increase in net fee income. In mainland China, a 31 per cent increase in trade customers and a significant rise in imports led to higher trade services income, while a 49 per cent increase in current account customers and higher lending fees also contributed to an 8 per cent increase in fee income. Increased lending, current account and trade activities raised net fee income by 30 per cent in Indonesia. A number of sites, including Vietnam and Thailand, also reported strong growth, driven by the success of HSBC s strategy of focusing on business opportunities involving international trade.

There was a net release of loan impairment charges of US$67 million, following net charges in 2004. Credit quality in the Middle East improved. In mainland China there was a significant reduction in loan impairment charges as higher collective impairment charges were more than offset by the release of allowances against a small number of accounts and the non-recurrence of a significant charge against a single customer in 2004. In India,

strong economic growth led to improved credit quality, while in Malaysia, Singapore and Indonesia, credit quality improved significantly although releases of impairment charges were lower than in 2004.

Operating expenses were 27 per cent higher than last year, broadly in line with revenue growth. In the Middle East, the recruitment of sales and support staff substantially increased income, leading to higher incentive payments. In mainland China, revenue growth was driven by branch expansion, increased sales and support staff and higher marketing expenditure. In Malaysia, the direct sales teams were expanded and business banking units were extended to all branches in support of the bank s growth strategy, resulting in a 16 per cent increase in costs.

In India, the recruitment of additional sales staff boosted customer facing staff by 85 per cent in 2005. In South Korea, staff recruitment and heightened marketing activity supported HSBC s four recently established commercial banking centres, contributing to an increase in costs. Higher costs throughout the rest of the region largely reflected increases in sales and support staff and initiatives to support business expansion.

Increased income from associates reflected strong performance in The Saudi British Bank and gains on the sale of HSBC s stake in MISR International, an Egyptian Bank. Income from the bank s strategic investments in China, Bank of Communications and Industrial Bank, which were acquired in 2004, also increased.

Corporate, Investment Banking and Markets reported a pre-tax profit of US$1,207 million, an increase of 22 per cent compared with 2004. HSBC s progress in this region was marked by positive revenue trends across most countries, with strong growth being reported in the Middle East, Malaysia, South Korea, India and mainland China.

Operating income rose by 25 per cent to US$1,769 million. Higher Corporate and Institutional Banking revenues reflected a 53 per cent increase in lending balances in mainland China, a result of strong demand for corporate credit, primarily from the industrial and technology sector. Deposit balances increased by 36 per cent and, together with a 40 basis point rise in deposit spreads, this also contributed to the growth in revenues.

HSBC s operations in the Middle East reported a 63 per cent rise in customer advances, primarily due to strong demand for corporate credit, driven by government spending on regional infrastructure

projects.

Global Transaction Banking revenues increased, as payments and cash management benefited from an increase in regional mandates which added to average balances, together with a widening of deposit spreads, notably in Singapore, India and Thailand.

In Global Markets, balance sheet management and money market revenues fell, particularly in Singapore and Japan, due to the effect of rising short-term interest rates and a flattening of the yield curves.

Net fees increased by 17 per cent. In Global Transaction Banking, the expansion in business capabilities which took place in the latter part of 2004 drove an increase in volumes, with marked improvements in Singapore, South Korea and India. Revenues from the custody business increased against the backdrop of rising local stock market indices as investment sentiment in the region improved. Additionally, securities services in India generated higher business volumes, with assets under custody growing by US$9 billion to US$34 billion. In Singapore, fee income increased by 55 per cent, reflecting an increase in revenues from securities services activities as HSBC leveraged its relationship strength and product capabilities to attract new business.

In the Middle East, corporate lending and trade finance activity generated higher customer volumes as regional economies strengthened from an increase in foreign investment, tourism and higher real estate and oil prices. Global Investment Banking benefited from the resulting demand for cross-border business, with an increase in fees from advisory and project and export finance services.

Income from trading activities increased, in part due to higher revenues from foreign exchange and structured derivatives driven by enhanced distribution and expanded product capabilities. In South Korea, volatility in the Korean won against the US dollar encouraged strong customer flows in foreign exchange. In Malaysia, a rise in customer demand, following the move to a managed float for the Malaysian ringgit, improved trading volumes in foreign exchange. Global Markets in Taiwan generated higher revenues, due to improved sales of structured derivative products. Falling interest rates in the Philippines resulted in favourable price movements on government bond portfolios. In the Middle East, HSBC s enhanced capability in structured transactions and greater focus on trading in the regional currencies drove volumes higher in a volatile market.

Gains from the disposal of the Group s asset management business in Australia added US$8 million to other operating income.

Net recoveries on loan impairment charges were marginally lower than in 2004.

Operating expenses increased by 21 per cent to US$733 million, broadly in line with the growth in operating income and reflecting higher performance-related incentives. 2005 bore the first full-year effect of the recruitment in 2004 of over 600 additional staff, of which more than half were in Global Transaction Banking. The upgrade of corporate and support teams across the region within Corporate and Institutional Banking resulted in some 280 additional people. The cost base was further affected by investment in HSBCnet and other technology costs incurred to support business expansion.

Income from associates included increased contribution from HSBC s investments in Bank of Communications and Industrial Bank, which were acquired in 2004.

Private Banking reported a pre-tax profit of US$78 million, an increase of 32 per cent compared with 2004. Investment in the business over the past two years was reflected in strong growth in client assets and net new money inflows of US$2.3 billion, against a backdrop of intense competition in the region. Net operating income increased by 17 per cent, predominantly due to higher trading income.

Net interest income fell by 29 per cent to US$30 million compared with 2004. Balance sheet growth was mainly in Singapore and Japan, where client deposits increased by 44 and 64 per cent respectively. Lending to customers also grew strongly, with the loan book increasing by some 26 per cent. The net interest income benefits of these were more than offset by lower treasury margins earned in the rising interest rate environment, and the reclassification under IFRSs from 1 January 2005 of net interest income on certain derivatives to net trading income .

Trading income increased by 62 per cent. Strong growth in bond trading and sales of structured products, which increased by 28 and 20 per cent respectively, was compounded by the reclassification from net interest income mentioned above. Fee income was broadly in line with 2004, with the benefit of growth in client assets largely offset by the non-recurrence of exceptionally high brokerage volumes driven by the market recovery last year.

Client assets increased by 23 per cent to US$13.7 billion. Front office recruitment and marketing campaigns, and inflows from the

Back to Contents

operations launched in Dubai in 2005 and Malaysia in 2004, boosted asset growth in the region. Net new money of US$2.3 billion was 22 per cent higher than last year, with inflows strongest in Singapore and Japan.

Operating expenses increased by only 6 per cent, leading to a 5 percentage point improvement in the cost efficiency ratio. Front office recruitment in most countries contributed to a small increase in staff costs, and expenditure on marketing and administrative expenses rose to support business growth.

In **Other**, the Group s Service Centres continued to expand to support HSBC s productivity improvements, incurring US$129 million of incremental costs, offset by higher recharges to other customer groups. Higher interest rates led to increased earnings on centrally held investments. In Thailand, the sale of a residential property led to a gain of US$11 million and in India, litigation provisions raised in 2004 were not repeated.

Back to Contents

Financial Review (continued)

Profit/(loss) before tax by customer group

	Year ended 31 December 2005						
Rest of Asia-Pacific (including the Middle East)	**Personal Financial Services**	**Commercial Banking**	**Corporate, Investment Banking & Markets**	**Private Banking**	**Other**	**Inter-segment elimination**	**Total**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
Net interest income	**1,208**	**631**	**614**	**30**	**54**	**(125)**	**2,412**
Net fee income	**419**	**307**	**498**	**43**	**73**		**1,340**
Trading income/(expense) excluding net interest income	**37**	**70**	**579**	**74**	**(7)**		**753**
Net interest income/(expense) on trading activities	**1**	**(1)**	**(21)**		**3**	**125**	**107**
Net trading income	**38**	**69**	**558**	**74**	**(4)**	**125**	**860**
Net income from financial instruments designated at fair value	**44**	**1**	**4**		**9**		**58**
Gains less losses from financial investments		**4**	**12**	**2**			**18**
Dividend income			**1**		**4**		**5**
Net earned insurance premiums	**134**	**21**					**155**
Other operating income	**37**	**9**	**82**	**4**	**287**	**(84)**	**335**
Total operating income	**1,880**	**1,042**	**1,769**	**153**	**423**	**(84)**	**5,183**
Net insurance claims[1]	**(157)**	**(9)**					