

HSBC HOLDINGS PLC  
Form 20-F  
March 09, 2007

As filed with the Securities and Exchange Commission on March 9, 2007.

---

---

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, 2006

or

TRANSITION REPORT PURSUANT TO SECTION 13 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

(Translation of Registrant's name into English)

United Kingdom

(Jurisdiction of incorporation or organisation)

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:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Ordinary Shares, nominal value US\$0.50 each.	London Stock Exchange Hong Kong Stock Exchange Euronext Paris
American Depositary Shares, each representing 5 Ordinary Shares of nominal value US\$0.50 each.	New York Stock Exchange* New York Stock Exchange
6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange*
American Depositary Shares, each representing one-fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange
5.25% Subordinated Notes 2012	New York Stock Exchange

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

6.5% Subordinated Notes 2036  
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

---

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the period covered by the annual report:

Ordinary Shares, nominal value US\$0.50 each 11,333,603,942

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

Yes

No

If this report is an annual or transition report, 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17

Item 18

If this is an annual report, 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

**Annual Report and Accounts 2006**

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises over 10,000 properties in 82 countries and territories in Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by about 200,000 shareholders in over 100 countries and territories. The shares are traded on the New York Stock Exchange in the form of American Depositary Shares.

HSBC provides a comprehensive range of financial services to more than 125 million customers through four customer groups and global businesses: Personal Financial Services (including consumer finance); Commercial Banking; Corporate, Investment Banking and Markets; and Private Banking.

**Contents**

	<i>Page</i>
<b><u>Financial Highlights</u></b>	<u>1</u>
<b><u>Cautionary Statement Regarding Forward-Looking Statements</u></b>	<u>4</u>
<b><u>Report of the Directors</u></b>	<u>6</u>
<u>Business Review</u>	<u>6</u>
<u>Financial Review</u>	<u>110</u>
<u>The Management of Risk</u>	<u>165</u>
<u>Governance</u>	<u>248</u>
<b><u>Directors' Remuneration Report</u></b>	<u>280</u>
	<i>Page</i>
<b><u>Statement of Directors' Responsibilities in Relation to Financial Statements</u></b>	<u>290</u>
<b><u>Independent Auditor's Report</u></b>	<u>291</u>
<b><u>Financial Statements</u></b>	<u>293</u>
<b><u>Notes on the Financial Statements</u></b>	<u>301</u>
<b><u>Shareholder Information</u></b>	<u>435</u>
<b><u>Glossary and Index</u></b>	<u>447</u>

## 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. 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 classified as equity.

[Back to Contents](#)

HSBC HOLDINGS PLC

## Financial Highlights

For the year

- Total operating income up 13.6 per cent to US\$70,070 million (2005: US\$61,704 million).
- Net operating income up 9.9 per cent to US\$54,793 million (2005: US\$49,836 million).
- Group pre-tax profit up 5.3 per cent to US\$22,086 million (2005: US\$20,966 million).
- Profit attributable to shareholders of the parent company up 4.7 per cent to US\$15,789 million (2005: US\$15,081 million).
- Return on average invested capital of 14.9 per cent (2005: 15.9 per cent).
- Earnings per share up 2.9 per cent to US\$1.40 (2005: US\$1.36).

At the year-end

- Total equity up 17.0 per cent to US\$114,928 million (2005: US\$98,226 million).
- Customer accounts and deposits by banks up 23.2 per cent to US\$996,528 million (2005: US\$809,146 million).
- Risk-weighted assets up 13.5 per cent to US\$938,678 million (2005: US\$827,164 million).

Dividends and capital position

- Tier 1 capital ratio of 9.4 per cent and total capital ratio of 13.5 per cent.
- Fourth interim dividend for 2006 of US\$0.36 per share, an increase of 16.1 per cent; total dividends declared in 2006 of US\$0.76 per share, an increase of 10.1 per cent over 2005.

*Data for 2004 to 2006 are presented based on financial statements prepared in accordance with IFRSs; data for 2002 and 2003 in accordance with UK GAAP. Further information about the results is given in the consolidated income statement on page 294*

[Back to Contents](#)

HSBC HOLDINGS PLC

**Financial Highlights** (continued)

Ratios / 5-year comparison

**Capital and performance ratios**

	<b>2006</b>	2005
	%	%
<b>Capital ratios</b>		
Tier 1 capital	<b>9.4</b>	9.0
Total capital	<b>13.5</b>	12.8

**Performance ratios**

Return on average invested capital <sup>1</sup>	<b>14.9</b>	15.9
Return on average total shareholders' equity <sup>2</sup>	<b>15.7</b>	16.8
Post-tax return on average total assets	<b>1.00</b>	1.06
Post-tax return on average risk-weighted assets	<b>1.93</b>	2.01

**Credit coverage ratios**

Loan impairment charges as a percentage of total operating income	<b>15.05</b>	12.74
Loan impairment charges as a percentage of average gross customer advances	<b>1.39</b>	1.16
Total impairment allowances outstanding as a percentage of impaired loans at the year-end	<b>98.5</b>	99.1

**Efficiency and revenue mix ratios**

Cost efficiency ratio <sup>3</sup>	<b>51.3</b>	51.2
□ constant currency basis	<b>51.3</b>	51.3
As a percentage of total operating income:		
□ net interest income	<b>49.2</b>	50.8
□ net fee income	<b>24.5</b>	23.4
□ trading income	<b>11.7</b>	9.5

**Financial ratio**

Average total shareholders' equity to average total assets	<b>5.97</b>	5.96
--	-------------	------

**Share information at the year-end**

	<b>2006</b>	2005
US\$0.50 ordinary shares in issue (million)	<b>11,572</b>	11,334
Market capitalisation (billion)	<b>US\$212</b>	US\$182
Closing market price per ordinary share:		
□ London	<b>£9.31</b>	£9.33
□ Hong Kong	<b>HK\$142.40</b>	HK\$124.50
Closing market price per American Depositary Share <sup>4</sup>	<b>US\$91.65</b>	US\$80.47

<b>Over 1 year</b>	<b>Over 3 years</b>	<b>Over 5 years</b>
------------------------	-------------------------	-------------------------

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

HSBC total shareholder return to 31 December 2006 <sup>5</sup>	<b>104.6</b>	<b>122.0</b>	<b>148.4</b>
Benchmarks:			
□ FTSE 100	114.4	153.8	141.1
□ MSCI World	105.8	139.9	122.4

*For footnotes, see page 4.*

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards (□IFRSs□) as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as published by the International Accounting Standards Board (□IASB□) if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2006, there were no unendorsed standards effective for the year ended 31 December 2006 affecting these consolidated and separate financial statements, and there was no difference in application to HSBC between IFRSs endorsed by the EU and IFRSs issued by the IASB.

Information for the years prior to 2004 has been prepared under previous HSBC policies in accordance with UK Generally Accepted Accounting Principles (□UK GAAP□), which are 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 information presented in this document has been prepared in accordance with IFRSs.

When reference to □underlying basis□ is made in commentaries, comparative information has been expressed at constant currency (see page 110) and adjusted for the effects of acquisitions, disposals and the change in presentation of non-equity minority interests.

[Back to Contents](#)**Five-year comparison**

	Amounts in accordance with IFRSs <sup>8</sup>			Amounts in accordance with UK GAAP <sup>9</sup>	
	2006 US\$m	2005 US\$m	2004 US\$m	2003 US\$m	2002 US\$m
<b>For the year</b>					
Net interest income	34,486	31,334	31,099	25,598	15,460
Other operating income	35,584	30,370	24,889	15,474	11,135
Loan impairment charges and other credit risk provisions	(10,573)	(7,801)	(6,191)	□	□
Provisions for bad and doubtful debts	□	□	□	(6,093)	(1,321)
Total operating expenses	(33,553)	(29,514)	(26,487)	(22,532)	(15,808)
Profit before tax	22,086	20,966	18,943	12,816	9,650
Profit attributable to shareholders of the parent company	15,789	15,081	12,918	8,774	6,239
Dividends	8,769	7,750	6,932	6,532	5,001
<b>At the year-end</b>					
Called up share capital	5,786	5,667	5,587	5,481	4,741
Total shareholders' equity	108,352	92,432	85,522	□	□
Shareholders' funds	□	□	□	74,473	51,765
Capital resources <sup>10</sup>	127,074	105,449	90,780	74,042	57,430
Customer accounts	896,834	739,419	693,072	573,130	495,438
Undated subordinated loan capital	3,219	3,474	3,686	3,617	3,540
Preferred securities and date dsubordinated loan capital <sup>11</sup>	42,642	35,856	32,914	17,580	14,831
Loans and advances to customers <sup>12,13</sup>	868,133	740,002	672,891	528,977	352,344
Total assets	1,860,758	1,501,970	1,279,974	1,034,216	758,605
	US\$	US\$	US\$	US\$	US\$
<b>Per ordinary share</b>					
Basic earnings	1.40	1.36	1.18	0.84	0.67
Diluted earnings	1.39	1.35	1.17	0.83	0.66
Dividends <sup>14</sup>	0.76	0.69	0.63	0.60	0.53
Net asset value at year-end	9.24	8.03	7.66	6.79	5.46
<b>Share information</b>					
US\$0.50 ordinary shares in issue (millions)	11,572	11,334	11,172	10,960	9,481
	%	%	%	%	%
<b>Financial ratios</b>					
Dividend payout ratio <sup>15</sup>	54.3	50.7	53.4	60.6	69.7
Post-tax return on average total assets	1.00	1.06	1.14	1.01	0.97
Return on average total shareholders' equity	15.7	16.8	16.3	□	□
Return on average shareholders' funds	□	□	□	13.0	12.4
Average total shareholders' equity to average total assets	5.97	5.96	6.35	□	□
Average shareholders' funds to average total assets	□	□	□	7.06	6.91
<b>Capital ratios</b>					
Tier 1 capital	9.4	9.0	8.9	8.9	9.0
Total capital	13.5	12.8	12.0	12.0	13.3

**Foreign exchange translation rates to**



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

<b>US\$</b>						
Closing	□ £:US\$1	<b>0.509</b>	0.581	0.517	0.560	0.620
	□ □:US\$1	<b>0.759</b>	0.847	0.733	0.793	0.953
Average	□ £:US\$1	<b>0.543</b>	0.550	0.546	0.612	0.666
	□ □:US\$1	<b>0.797</b>	0.805	0.805	0.885	1.061

*For footnotes, see page 4.*

[Back to Contents](#)

HSBC HOLDINGS PLC

**Financial Highlights** (continued)

5-year comparison / Cautionary statement

Amounts in accordance with US GAAP

	<b>2006</b>	2005	2004	2003	2002
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
<b>Income statement for the year</b>					
Net income available for ordinary shareholders	<b>16,358</b>	14,703	12,506	7,231	4,900
Other comprehensive income	<b>3,133</b>	(7,271)	983	7,401	5,502
Dividends	<b>8,769</b>	7,750	6,932	6,974	4,632
<b>Balance sheet at 31 December</b>					
Total assets	<b>1,712,627</b>	1,406,944	1,266,365	1,012,023	763,565
Total shareholders' equity	<b>108,540</b>	93,524	90,082	80,251	55,831
	<b>US\$</b>	US\$	US\$	US\$	US\$
<b>Per ordinary share</b>					
Basic earnings	<b>1.45</b>	1.33	1.15	0.69	0.52
Diluted earnings	<b>1.44</b>	1.32	1.13	0.69	0.52
Dividends	<b>0.76</b>	0.69	0.63	0.685	0.495
Net asset value at year end	<b>9.38</b>	8.25	8.06	7.32	5.89

Footnotes to Financial Highlights

- The definition of return on average invested capital and a reconciliation to the equivalent GAAP measures are set out on page 146.
- The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by average total shareholders' equity.
- The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.
- Each American Depositary Share (ADS) represents five ordinary shares.
- Total shareholder return (TSR) is defined on page 281.
- The Financial Times-Stock Exchange 100 Index.
- The Morgan Stanley Capital International World Index.
- 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.
- The periods 2002 and 2003 were prepared in accordance with previous HSBC accounting policies under UK GAAP. HSBC's accounting policies under UK GAAP are stated in Note 2 on the Financial Statements in the Annual Report and Accounts 2004.
- Capital resources are total regulatory capital, the calculation of which is set out on page 243.
- Includes perpetual preferred securities, details of which can be found in Note 32 on the Financial Statements.
- Net of suspended interest and provisions for bad and doubtful debts (UK GAAP).
- Net of impairment allowances (IFRSs).
- First, second and third interim dividends for 2006, each of US\$0.15 per ordinary share, were paid on 6 July 2006, 4 October 2006 and 18 January 2007 respectively. Note 11 on the Financial Statements on page 339 gives more information on the dividends declared in 2006. On 5 March 2007, the Directors declared a fourth interim dividend for 2006 of US\$0.36 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 10 May 2007 in cash in US dollars, or in sterling or Hong Kong dollars at exchange rates to be determined on 30 April 2007, with a scrip dividend alternative. The reserves available for

distribution at 31 December 2006 were US\$12,045 million.

Quarterly dividends of US\$15.50 per 6.20 per cent non-cumulative US dollar preference share, Series A (Series A dollar preference share), equivalent to a dividend of US\$0.3875 per Series A American Depositary Shares, each of which represents one-fortieth of a Series A dollar preference share, were paid on 15 March 2006, 15 June 2006, 15 September 2006 and 15 December 2006.

15 Dividends per share expressed as a percentage of earnings per share (2002 and 2003: excluding goodwill amortisation).

## Cautionary Statement Regarding Forward-Looking Statements

The *Annual Report and Accounts 2006* 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 words and similar

expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events.

Written and/or oral forward-looking statements may also be made in the periodic reports to the

[Back to Contents](#)

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 pound sterling) and government-established exchange rates (for example, between the Hong Kong dollar and 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 funding of 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 other regulatory authorities, including the UK Financial Services Authority, the Bank of England, the Hong Kong Monetary Authority, the US Federal Reserve, the US Securities and Exchange Commission, 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;
  -

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

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
  - 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.

[Back to Contents](#)

HSBC HOLDINGS PLC

## Report of the Directors: Business Review

*Group Chairman's statement*

### Group Chairman's statement

---

It is a testament to HSBC's strength and diversity that we grew pre-tax profits in 2006 to US\$22 billion, despite a major setback in part of our mortgage business in the United States. For the third year running, return on average shareholders equity exceeded 15 per cent, revenue growth was in double digits and we maintained an essentially flat cost-efficiency ratio. In 2006, pre-tax profits from Asia, the Middle East, Latin America and other emerging markets approached 50 per cent of the Group's total.

There were a number of outstanding achievements, for example, exceeding US\$1 billion pre-tax profits for the first time in both Mexico and the Middle East, and in each of our Private Banking and Commercial Banking businesses in Asia outside Hong Kong. We added around an extra US\$1 billion of pre-tax profits in Asia outside Hong Kong and another US\$1 billion in our Commercial Banking businesses worldwide. In Hong Kong, net fee income from personal customers grew over 30 per cent to approach US\$1 billion for the first time.

However, our pre-tax profits fell by US\$725 million in our personal businesses in the United States. This was caused by one portfolio of purchased sub-prime mortgages in our US Consumer Finance subsidiary, Mortgage Services, which evidenced much higher delinquency than had been built into the pricing of these products. We are restructuring this business to avoid any repetition of the risk concentration that built up over the past two years. As part of this exercise we have effected broad changes in management and strengthened risk controls and processes.

Despite the issues in our US mortgage business, Group profit attributable to shareholders grew by 5 per cent to US\$15,789 million. We met our

objective of funding organic expansion through productivity improvements. To achieve this in a year of continuing investment in developing our distribution platforms and product capabilities is a tribute to the focus which HSBC's 312,000 staff around the world have placed on serving our customers.

Earnings continued to be well diversified both geographically and by customer group. Regionally, Asia, including Hong Kong, had record results as did our newly designated Latin American Region, which combines Mexico and Central America with our South American businesses. Within our customer groups, Commercial Banking again delivered a record performance, as did Private Banking and Corporate, Investment Banking and Markets, which made strong progress in the areas in which we have been investing in recent years. Personal Financial Services profits declined as growth in Asia and Latin America was masked by the problems in the US Mortgage Services business.

The Board has declared a fourth interim dividend of US\$0.36 per share, taking the total dividend in respect of 2006 to US\$0.81 per share, an increase of 11 per cent over the comparable payout last year. In sterling terms, dividend growth is 5 per cent. The fourth interim dividend is payable on 10 May 2007 to shareholders on the register on 23 March 2007 with a scrip dividend alternative available for shareholders who prefer this option.

### Global economic trends and their impact on HSBC

Globalisation is determining how we think about positioning HSBC to take advantage of the changing pattern of economic flows. Historical patterns based on national boundaries are becoming less relevant. In aggregate, our

operations within countries designated as emerging markets grew by 19 per cent in 2006, the third year running of high double-digit growth. However, this understates the importance of emerging markets to HSBC, as their influence is also significant to the results of our operations in developed economies. This reflects the growth in export flows to meet the infrastructure development needs of emerging markets and the reorganisation of global supply chains to optimise international resourcing. HSBC is strongly positioned to benefit from these trends. HSBC seeks to differentiate itself by taking developed market opportunities to emerging market customers and bringing emerging market products to developed investment markets. For example:

[Back to Contents](#)

- In Commercial Banking, we launched a new customer referral system, which led to international referrals with an aggregate facility value of US\$3 billion, involving over 50 sites and 4,000 relationship managers.
- Within Group Investment Businesses, the Group's India, China and BRIC (Brazil, Russia, India, China) funds were major contributors to a record performance in the year as we leveraged our reputation for emerging market expertise to become a major distributor as well as manager of such funds. Performance fees reached record levels.
- In the UK, the Passport bank account provides individuals newly arrived in the UK with discounted remittance services back home together with guidance on establishing themselves in the UK.
- Corporate, Investment Banking and Markets strategy to be a leading wholesale bank by focusing on financing and emerging markets was recognised by industry awards including European Loan House of the Year, China Loan House of the Year and Asian Domestic Currency Bond House of the Year by *International Financing Review*. Our Global Markets business was named Best at Treasury and Risk Management in Asia by *Euromoney* for the ninth consecutive year.

### **Leveraging our global services**

HSBC continued to deepen its relevance to its customer base by offering coordinated services on a worldwide scale. As the globalisation of business increasingly becomes the norm, international capabilities become more and more critical to an ever wider range of customers. We responded to this trend by developing our business in a number of ways.

Benefiting from growing international trade, the Group's payments and cash management business had a record year, particularly in Asia, as increasing numbers of commercial customers expanded internationally.

As emerging market stock exchanges outperformed, the Group's custody businesses benefited from the higher volumes and value flowing into emerging market equities. HSBC retained its position as the leading sub-custodian in Asia and the Middle East, being ranked first in 19 of the 28 markets it serves. Growth in both assets under custody and assets under administration exceeded 25 per cent, as interest in emerging market equities

increased and the alternative fund management sector expanded.

The customer base of International *Premier*, the Group's personal banking service targeted at affluent customers with financial needs in more than one country, grew by 35 per cent to reach 1.8 million. We see great opportunities to develop this service further.

Cross-border distribution was a noteworthy feature of many HSBC-led debt capital market and equity capital market transactions. Highlights included: America Movil's 8 billion Mexican peso bond, Khazanah Nasional of Malaysia's US\$750 million Islamic exchangeable [Sukuk]; Emaar Economic City's US\$680 million IPO in Saudi Arabia; and Shui On Land's US\$876 million IPO in Hong Kong.

### **Transferring best practice**

HSBC seeks to transfer best practice and product innovation internationally. Through such linkages, HSBC is able to achieve both cost efficiency and speed to market, giving us competitive advantages over purely domestic or regional peers. In 2006, we launched a number of successful initiatives.

Using Group technology and marketing expertise, we expanded the Group's card base in Asia by some 1.9 million to 11.9 million. In addition, Bank of Communications' cards business in mainland China, with which we cooperate, reached over 2 million cards in issue at the end of the year from its launch in May 2005.



## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Also in mainland China, we cooperated with Bank of Communications in launching point of sale finance in partnership with Wal-Mart and SuNing, one of China's largest consumer electronics chain. In Argentina, our relationship with C&A added 100,000 cards, while in Australia we entered the retail storecard market and now offer point of sale finance in over 1,000 locations through over 100 merchants.

We took the successful direct retail deposit service introduced in the US at the end of 2005 and used the experience to launch in Taiwan in September 2006. In the first 15 weeks, over 24,000 customers had signed up for the service and US\$182 million had been raised in deposits. In the US, by the end of 2006, the direct deposit product had raised some US\$7 billion of funding for our businesses there.

Building on our experience of Takaful (Islamic insurance) in Singapore and United Arab Emirates, we were among the first to be awarded licences to

[Back to Contents](#)

HSBC HOLDINGS PLC

## **Report of the Directors: Business Review**

(continued)

*Group Chairman's statement*

conduct Takaful business in both Malaysia and Saudi Arabia during 2006.

### **Creating advantage from scale, technology and process engineering**

We continue to make progress in streamlining our operations by focusing on straight through processing and simplifying our products.

During 2006, among other things, we introduced 2,300 advanced self-service terminals, added 13 countries to HSBCnet, which is our strategic internet platform for corporate and institutional clients and made over 900,000 online insurance sales.

HSBC in Mexico was the first bank to offer pre-approved online mortgages in 2006, allowing customers to apply and obtain details about amounts, duration and monthly payments within minutes.

In Hong Kong in the past four years, processing has been moved from the branches in favour of sales-related activities, with the result that less than 5 per cent of transactions are now being handled physically in the branches.

In the UK retail network, product simplification has reduced the range of products by two-thirds over the last two years which, together with branch relocation and refurbishment and adopting retail store hours, is having a positive impact on sales volumes.

### **Credit environment**

The global credit environment, particularly in the corporate and commercial segments, remained generally favourable throughout 2006. In part, this continued to reflect a general abundance of liquidity and the prevalence of historically low nominal interest rates. A significant proportion of the trade surpluses of the major Asian exporting countries and the oil producers continued to be recycled into government debt in developed markets.

Consequently, risk premia remained at record low levels. This encouraged increasing interest in structured products and the acceptance of greater leverage as fixed income investors sought higher yielding assets. The risks arising from this activity were widely distributed using a range of market techniques.

The major credit issue affecting the Group in 2006 arose in the US in the sub-prime mortgage market. A slowdown in the rate of growth in US house prices accelerated delinquency trends in the US sub-prime mortgage market. Deterioration was

marked in the more recent loans, as the absence of equity appreciation reduced customers' options for refinancing. Reduced refinancing options also highlighted the fact that, as adjustable rate mortgages reset over the next few years at higher interest rates than their original rates, the effect of the greater contractual payment obligations will lead to further delinquency.

We took these factors into account in determining the appropriate level of impairment allowances at 31 December 2006 against the Mortgage Services loan book. We factored into our allowances the most recent trends in delinquency and loss severity and estimated the effect of the higher payments due on adjustable rate mortgages as they reset, in particular where we hold a second lien mortgage behind an adjusting first mortgage. Going forward, the level of future impairment allowances will be sensitive to economic conditions and, in particular, to the state of the housing market, the level of interest rates and the availability of financing options for sub-prime borrowers.

Elsewhere in consumer finance in the US, the delinquency rate rose during the year, in large part due to the unusually low levels of delinquency at the end of 2005. This resulted from the effect of changes in bankruptcy law in the fourth quarter of 2005, portfolio ageing and the mix of the Metris portfolio acquired at the end of that year.

In UK Personal Financial Services, loan impairment charges as a percentage of lending remained broadly in line with last year, as actions taken on underwriting and collections mitigated the increasing trend of indebted customers to seek recourse in debt management services. Similarly, in Taiwan, measures taken to deal with the effect of mandatory regulatory relief from credit card debt, which increased impairment charges in the first half of 2006, reduced the charge in the second half of the year.

In the context of HSBC's financial strength and operating profitability, the areas of current weakness are well covered and they will not restrict our ability to develop our business opportunities as planned, or maintain our progressive dividend policy. They have, however, brought additional focus on the uncertain longevity of today's generally benign conditions and on the credit risks inherent in economies where asset prices are accelerating ahead of real wage rises and cash flows are being leveraged using financial products designed to support higher levels of debt. We will ensure that our credit appetite reflects these risks.

[Back to Contents](#)

## Group Strategy

As noted above, in 2006, pre-tax profits from Asia, the Middle East, Latin America and other emerging markets approached 50 per cent of the Group's total. We intend the contribution from these markets to trend upwards over the next five years. These economies are growing faster than developed markets and, therefore, we will concentrate investment primarily in these markets in the form of both organic development and acquisition.

During 2006, we brought together our businesses in Latin America into a single management framework to provide clarity and consistency of direction for this important region. Hong Kong and mainland China are already managed on a combined basis, reflecting the fact that this is increasingly a seamless business.

In mature markets, we will focus particularly on serving customers with international financial needs and connectivity, including the diaspora from emerging markets. In an increasingly competitive world, we will enforce tight cost control and will re-engineer or dispose of businesses that dilute our return on capital or do not fit with our core strategy. Insurance and retirement services will be a growing part of our business.

To deliver our strategy, we have articulated seven "global pillars" – the actions we will take to build a financial services company based on the concept of recommendation, both as a place to work and a place to do business. Michael Geoghegan, Group CEO and the senior management team are leading this.

We will remain a broad-based universal bank, with four strategic businesses:

- **Personal Financial Services**, within which consumer finance will remain a core competence;
- **Corporate, Investment Banking and Markets**, which will be a leading wholesale bank by focusing on financing and emerging markets;
- **Commercial Banking**, for which our international service capabilities and connectivity provide a unique competitive platform; and
- **Private Banking**, with its broad international network and connectivity with the rest of the Group's businesses.

These businesses will be increasingly interconnected. In particular, as derivatives markets

expand in product breadth and liquidity and as more risk is securitised globally, our Global Markets business will take a central role in the efficient management of HSBC's capital, risk and related profitability.

## Investments in franchise development

In November 2006, we completed the acquisition of Grupo Banistmo S.A., the leading Central American banking group, adding operations in Panama, Colombia, Costa Rica, El Salvador, Honduras and Nicaragua to our existing operations in Mexico, Brazil, Argentina, Uruguay, Chile and Paraguay. HSBC is now one of the leading foreign banks in Latin America. Apart from Banistmo, 2006 was a year of only modest acquisition activity. Very few of the opportunities we examined met our hurdle rates.

Subsequent to the end of the year, we announced our intention to acquire, when regulations permit, a further 10 per cent stake in Techcombank, the third largest joint stock bank in Vietnam, taking our ownership interest to 20 per cent as rules are relaxed to make higher levels of foreign ownership possible.

## Organic investment

In 2006 in China, where we are the largest international bank, we opened 13 new offices, taking the total to 45. We made significant progress in developing our personal and commercial distribution platforms throughout Asia, the Middle East and Latin America. We added 25 consumer finance offices in India and 28 in Indonesia. We

established a further 38 branches in Turkey and 3 in Malaysia. In Mexico our continuing development of our business added 2,000 new jobs, bringing the total of new jobs created since we acquired Bital to 8,000. We have also continued to invest in and improve our physical infrastructure in Mexico, with 372 ATMs added in 2006, bringing the total number to over 5,400.

The beginning of 2007 has been marked by our application to incorporate our operations in mainland China after 141 years of unbroken presence in the country. Today, HSBC offers renminbi deposit services in nine cities: Beijing, Dalian, Guangzhou, Qingdao, Shanghai, Shenzhen, Tianjin, Wuhan and Xiamen. The provision of diversified and international banking services to mainland Chinese citizens constitutes one of the most significant growth opportunities for HSBC in the near and long-term and we will support this opportunity with capital and technology resources as required.

Increasingly important to our ongoing success is our brand. Starting in 2007 we will progressively invest more to support and enhance the customer

[Back to Contents](#)

HSBC HOLDINGS PLC

## **Report of the Directors: Business Review**

(continued)

*Group Chairman's statement / Principal activities / Strategic direction*

experience that drives the brand's strength.

### **The Board**

It is important to HSBC to continue to ensure that the Board is representative of the Group's broad international franchise and the diversity of our businesses. As usual, there will be changes to the make-up of the Board in 2007. As previously announced, as part of planned succession, Simon Robertson will become Senior Independent non-executive Director, Rona Fairhead will become Chairman of the Group Audit Committee and Sir Brian Williamson will become Chairman of the Nomination Committee at the conclusion of this year's AGM. Raymond Chien, Sharon Hintze and Helmut Sohmen will all retire at the 2007 AGM after many years distinguished service. I thank them all for their counsel and guidance.

### **Outlook**

Although growth expectations in the US are moderating, the economic outlook elsewhere remains encouraging as globalisation expands market access and emerging markets grow stronger, forcing competitive restructuring. The financial markets are playing a major part in this realignment by financing the infrastructure needed to deliver the necessary energy and material resources from producer to consumer nations, and by facilitating trade flows. Additionally, financial markets are providing more sophisticated tools to help personal customers plan their long-term financial affairs,

corporates to hedge their business risks and investors to manage their portfolio risks. The demand for financial services, therefore, remains strong, particularly for internationally linked services. This plays to HSBC's huge competitive strengths.

The most significant risks to continuing growth currently relate to political and macro events which are outside our control. Recognising that the effect of such risks materialising could be immediate and potentially severe, we remain strongly capitalised and liquid.

The Board of HSBC Holdings plc will continue to oversee the pursuit of the company's goals by executive management and to exercise rigorous stewardship of your company.

Our focus as we enter 2007 is resolutely on continuing to play to our strengths of linking emerging and developed markets and building comparative advantage by utilising our scale and our local and international reach. We continue to see opportunities to deploy capital profitably to the long-term advantage of shareholders and are committed to so doing.

S K Green, *Group Chairman*  
5 March 2007



[Back to Contents](#)

	<i>Page</i>
<a href="#">Principal activities</a>	<a href="#">11</a>
<a href="#">Strategic direction</a>	<a href="#">11</a>
<a href="#">Customer groups and global businesses</a>	<a href="#">12</a>
<a href="#">Personal Financial Services</a>	<a href="#">13</a>
<a href="#">Commercial Banking</a>	<a href="#">16</a>
<a href="#">Corporate, Investment Banking and Markets</a>	<a href="#">18</a>
<a href="#">Private Banking</a>	<a href="#">20</a>
<a href="#">Other</a>	<a href="#">22</a>
<a href="#">Analysis by customer group and global business</a>	<a href="#">23</a>
<a href="#">Geographical regions</a>	<a href="#">26</a>
<a href="#">Summary of geographical regions</a>	<a href="#">26</a>
<a href="#">Competitive environment</a>	<a href="#">27</a>
<a href="#">Europe</a>	<a href="#">31</a>
<a href="#">Hong Kong</a>	<a href="#">48</a>
<a href="#">Rest of Asia-Pacific</a>	<a href="#">60</a>
<a href="#">North America</a>	<a href="#">75</a>
<a href="#">Latin America</a>	<a href="#">91</a>
<a href="#">Other information</a>	<a href="#">106</a>
<a href="#">Products and services</a>	<a href="#">106</a>
<a href="#">Property</a>	<a href="#">109</a>
<a href="#">Legal proceedings</a>	<a href="#">109</a>

## Principal activities

---

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US\$212 billion at 31 December 2006.

Through its subsidiaries and associates, HSBC provides a comprehensive range of banking and related financial services. Headquartered in London, HSBC operates through long-established businesses and has an international network of over 10,000 properties in 82 countries and territories in five geographical regions: Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and Latin America<sup>1</sup>. 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. Taken together, the five largest customers of HSBC do not account for more than one per cent of HSBC's income.

<sup>1</sup> In 2006, the geographical segment presentation was changed with the reclassification of Mexico and Panama from North America to South America, and the renaming of the latter as Latin America and the Caribbean ([Latin America]). Comparative data have been restated to bring them into line with the presentation adopted in 2006.

The principal acquisitions made during the year are described on page 369. There were no significant disposals.

## Strategic direction

---

HSBC's strategic direction, as set out in its 'Managing for Growth' strategy, is to be the world's leading financial services company, with 'leading' meaning the HSBC brand is preferred to others and HSBC's corporate character is admired, its earnings per share growth is dynamic and it holds leadership positions in selected markets. Financial success is measured by comparing the Group's Total Shareholder Return ('TSR') target against a weighted TSR benchmark composed of a peer group of banks.



## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

To achieve its strategy, the Group has identified seven priorities or "global pillars" that will guide the Group's strategic initiatives in 2007 and 2008. Success in achieving the priorities will be assessed by reviewing a suite of key performance indicators, which are discussed on page 115. The global pillars are:

- to exploit HSBC's global reach by more effectively joining up the company by country, distribution channel, customer group and global business;
- to improve its customer experience so that customers feel that HSBC is the best place to bank;
- to invest in developing HSBC's brand and to encourage all staff to live HSBC's brand values in their day-to-day activities;
- to improve staff engagement by ensuring employment policies are progressive, perceptive, responsive, respectful and fair;
- to grow the business by focusing on deposit-taking and achieving the right balance between risk and reward;
- to enhance working practices and use technology more effectively to make it easier for customers to do business with the Group; and
- to clearly allocate responsibility for delivery of the above initiatives to country managers and heads of customer groups and global businesses, with Group Head Office and regional head offices providing guidance and, where appropriate, delegating authority.

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

*Summary / Business highlights***Customer groups and global businesses**

HSBC manages its business through two customer groups, Personal Financial Services and Commercial Banking, and two global businesses, Corporate, Investment Banking and Markets, and Private Banking. Personal Financial Services incorporates

**Profit before tax**

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 (HSBC Finance), one of the leading consumer finance companies in the US.

	Year ended 31 December					
	2006		2005		2004	
	US\$m	%	US\$m	%	US\$m	%
Personal Financial Services	9,457	42.8	9,904	47.2	8,497	44.9
Commercial Banking	5,997	27.2	4,961	23.7	4,057	21.4
Corporate, Investment Banking and Markets	5,806	26.3	5,163	24.6	5,288	27.9
Private Banking	1,214	5.5	912	4.4	697	3.7
Other	(388)	(1.8)	26	0.1	404	2.1
	<b>22,086</b>	<b>100.0</b>	20,966	100.0	18,943	100.0

**Total assets**

	At 31 December			
	2006		2005	
	US\$m	%	US\$m	%
Personal Financial Services	546,568	29.4	484,314	32.2
Commercial Banking	213,450	11.5	175,120	11.7
Corporate, Investment Banking and Markets	994,436	53.4	755,056	50.3
Private Banking	73,026	3.9	59,827	4.0
Other	33,278	1.8	27,653	1.8
	<b>1,860,758</b>	<b>100.0</b>	1,501,970	100.0



[Back to Contents](#)**Personal Financial Services**

Profit before tax

	Year ended 31 December		
	2006 US\$m	2005 US\$m	2004 US\$m
Net interest income	26,076	23,351	21,422
Net fee income	8,762	7,313	6,406
Trading income excluding net interest income	391	360	320
Net interest income on trading activities	220	214	□
Net trading income <sup>1</sup>	611	574	320
Net income from financial instruments designated at fair value	739	574	□
Net investment income on assets backing policy-holders' liabilities	□	□	635
Gains less losses from financial investments	78	19	79
Dividend income	31	16	16
Net earned insurance premiums	5,130	4,864	3,652
Other operating income	782	729	360
<b>Total operating income</b>	<b>42,209</b>	<b>37,440</b>	<b>32,890</b>
Net insurance claims <sup>2</sup>	(4,365)	(3,716)	(2,953)
<b>Net operating income<sup>3</sup></b>	<b>37,844</b>	<b>33,724</b>	<b>29,937</b>
Loan impairment charges and other credit risk provisions	(9,949)	(7,537)	(6,500)
<b>Net operating income</b>	<b>27,895</b>	<b>26,187</b>	<b>23,437</b>
Total operating expenses	(18,818)	(16,427)	(15,009)
<b>Operating profit</b>	<b>9,077</b>	<b>9,760</b>	<b>8,428</b>
Share of profit in associates and joint ventures	380	144	69
<b>Profit before tax</b>	<b>9,457</b>	<b>9,904</b>	<b>8,497</b>
<b>By geographical region</b>			
Europe	1,909	1,932	1,621
Hong Kong	2,880	2,628	2,063
Rest of Asia-Pacific	477	377	336
North America <sup>4</sup>	3,391	4,181	3,826
Latin America <sup>4</sup>	800	786	651
Profit before tax	9,457	9,904	8,497
	%	%	%
Share of HSBC's profit before tax	42.8	47.2	44.9
Cost efficiency ratio	49.7	48.7	50.1

	US\$m	US\$m	US\$m
<b>Selected balance sheet data<sup>5</sup></b>			
Loans and advances to customers (net)	<b>448,545</b>	398,884	370,576
Total assets	<b>546,568</b>	484,314	452,992
Customer accounts	<b>388,468</b>	321,240	319,485

*For footnotes, see page 26.*

#### Strategic direction

HSBC's strategic direction in Personal Financial Services is to be the world's preferred provider, with a top class ethical sales and service culture. Growth will be driven in key markets by offering attractive products through a range of appropriate delivery channels. The strategy focuses on:

- simplifying core products, delivered directly via the latest web-based technology and supported by newly designed modern customer-friendly branches in selected markets;
- facilitating direct multi-channel access to the Group's services, and building a high quality system to help manage banking relationships;
- enhancing HSBC *Premier* as a signature product for the Group, offering a premium banking service utilising HSBC's international capabilities; and
- concentrating growth in the consumer finance business in markets affording appropriate long-term risk-adjusted returns, and in new markets offering attractive potential for growth.

#### Business highlights in 2006

- Pre-tax profits from Personal Financial Services were US\$9,457 million in 2006, a decrease of 5 per cent on the previous year. This was caused by higher impairment charges, particularly in the US, which masked the increasing contributions from a number of key emerging markets, from HSBC's strategic investments in associates and from strong growth in Hong Kong. On an underlying basis, profit before tax was 8 per cent lower.
- Underlying growth in net operating income before loan impairment charges was 9 per cent. This was lower than cost growth, however, as HSBC invested approximately US\$400 million to extend distribution in emerging markets, add deposits through direct channels in the US and Taiwan, refurbish the branch network in the UK and generally improve direct channel capabilities. HSBC also added collection resources in the US in response to the rise in loan delinquency evident towards the end of the year.
- Loan impairment charges were 32 per cent higher, or 27 per cent on an underlying basis. This primarily reflected the effect of a slowing housing market and rising interest rates on sub-prime mortgage lending in the US, in particular where HSBC had a second lien position. The increase was concentrated in the correspondent

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

**Business highlights**

channel, [mortgage services], which acquires loans from correspondent banks and mortgage brokers. Credit quality in the majority of other portfolios in the US was relatively stable. In Taiwan, a short-term increase in the first half of 2006 arose from government-sponsored measures to relieve over-indebtedness in the consumer sector, which had the effect of significantly increasing the number of customers successfully obtaining some element of debt restructuring. In Hong Kong, there was a return to a more normal level of charges following a net release in 2005; credit quality remained stable. In the UK, while overall charges as a percentage of lending were broadly stable, there was an increase in the consumer finance lending book, reflecting rising personal bankruptcies and Individual Voluntary Arrangements ([IVA]s), and the effect of increased consumer indebtedness on delinquency.

- Responding to a clear shift in customer preferences, HSBC continued to emphasise the development of direct channels within its distribution capabilities. Websites were updated to offer additional features, personalised content and improved customer accessibility. The new technology behind these developments gives HSBC enhanced targeting and analytical insights to better meet customer needs and drive sales growth. Overall, online personal customer numbers rose by nearly 40 per cent to 16 million and online sales volumes increased by more than 55 per cent compared with 2005.
- Following its successful launch in the US in 2005, HSBC's direct banking and savings proposition, HSBC Direct, was introduced in Taiwan – a first for HSBC in Asia. In the US, HSBC Direct customer numbers passed 343,000, with deposits exceeding US\$7.2 billion.
- To further its direct banking strategy, HSBC introduced 2,300 advanced self-service terminals offering a wider range of services than traditional ATMs (automated teller machines), including payments, enquiry and sales features. The functionality of over 11,000 traditional ATMs was also enhanced.
- The number of customers using HSBC *Premier* grew for the seventh consecutive year, to 1.8 million, an increase of 35 per cent compared with 2005. This service is now available in 36 countries.
- An innovation was the launch of seven-day opening in selected UK, US and Hong Kong branches. Investment in the retail network continued in Europe, North America and parts of Asia-Pacific.
- In the latter, HSBC began to introduce its Group-wide credit card system, expanded consumer finance in India and Indonesia, and agreed retail finance arrangements in mainland China and Australia.
- The efforts described above were recognised by *Retail Banker International* in naming HSBC the [Best Retail Bank] globally. HSBC was also named the [Best Global Bank - Best Consumer Bank] by *Global Finance* magazine. HSBC's online enhancements helped earn the [Best Global Consumer Internet Bank] award in the *Global Finance Awards*.

**Europe**

- In the UK, HSBC refined its approach to segmenting its customer base and aligned its products and distribution capabilities to better serve these segments. It refurbished 104 branches, increased the number of non-branch ATMs by over 35 per cent, including 135 in Marks & Spencer stores, and rolled out some 1,450 advanced self-service machines. This latter initiative was recognised by *The Banker* in awarding HSBC the

international [Technology Award for New Channels].

- In France, a focus on reinforcing HSBC's profile following the 2005 rebranding exercise drove a marked increase in brand awareness. HSBC was named [Best in Class] among French retail banks in a number of categories in the *Cosmosbay Vectis Survey*.
- HSBC opened new branches in the UK, Turkey, France and Malta. In Eastern Europe, HSBC developed its consumer finance operations with the establishment of a regional head office and management team.

### **Hong Kong**

- Efforts to expand the scope of internet banking and increase the proportion of transactions conducted online proved successful. Fewer than 4.3 per cent of all transactions were conducted through the branch network in 2006, while the proportion of sales conducted online reached nearly one quarter. HSBC was named the [Best Consumer Internet Bank] in Hong Kong in the annual *Global Finance Awards*.
- Wealth management, including insurance, was a focal point in 2006, and enhancements to

[Back to Contents](#)

HSBC's product and channel offerings delivered a 50 per cent rise in sales of investment related funds.

- HSBC maintained its position as the largest credit card issuer in Hong Kong with over 4.6 million cards in force. HSBC was named "MasterCard Hong Kong Bank of the Year" for a record sixth consecutive time.

### **Rest of Asia-Pacific**

- HSBC invested in selected markets within the region, notably in cards, consumer finance, insurance, direct banking and Islamic banking. New branches were opened in India, mainland China, Malaysia and Bangladesh.
- The Hongkong and Shanghai Banking Corporation Limited and Hang Seng Bank had 30 and 15 service outlets in mainland China respectively at 31 December 2006 and continued to maintain the largest network amongst foreign banks.
- Credit cards remained a key area of growth in the region. The number of cards in force rose by 1.2 million to 7.3 million.

### **North America**

- HSBC's growth strategy is built around deposit gathering through selective branch expansion, competitive pricing, in part enabled by increasing internet delivery, and improved marketing and customer analytics. All these strands to the strategy were developed during 2006.
- Driven by the success of the online savings product and branch expansion, deposit balances in the US grew by 25 per cent in 2006. US\$9 billion of deposits have been attracted since the launch of the deposit gathering strategy there in 2005, of which US\$718 million have been generated from new branches since the expansion programme began in the same year.
- The integration of the credit card business of Metris Companies Inc. ("Metris"), acquired in 2005 for approximately US\$1.6 billion, was completed. The business performed above expectations, generating US\$233 million of profit before tax.
- HSBC Finance Corporation ("HSBC Finance") completed the acquisition of the Champion Mortgage portfolio during 2006, adding US\$2.5 billion in mostly first lien sub-prime mortgages.
- In the US, HSBC entered into an agreement which extended the brands under which it is able to offer cards, uniquely, to American Express, Discover Network, MasterCard and Visa. The retail services business launched co-branded initiatives with Saks, Neiman Marcus and Best Buy. HSBC is now the seventh largest card issuer in the US.
- Asset growth continued in Canada with strong consumer spending resulting in higher personal lending and mortgage balances. Led by the success of new products such as the High Rate Savings Account, deposit balances rose.

### **Latin America**

- The Personal Financial Services business in Mexico continued to grow strongly in credit cards, mortgages, personal loans and the industry-leading "Tu Cuenta" packaged account which passed 1 million account holders in 2006. HSBC was the first bank to offer pre-approved online mortgages and received an award for the "Best



Integrated Consumer Bank Site in Latin America from *Global Finance* magazine.

- The credit card business across the region continued to expand strongly. In Mexico, the number of cards in circulation rose by 76 per cent to 1.7 million, average balances more than doubled, and market share improved by 230 basis points. In Brazil, record credit card sales were reported and, in Argentina, the number of cards in issue increased by 39 per cent.
- The acquisition of Banistmo, with 1.3 million existing customers, complements HSBC's existing operations in the region and establishes a presence in five new markets; Colombia, Costa Rica, El Salvador, Honduras and Nicaragua, providing access to a total population of 83 million people.
- In Argentina, HSBC acquired the operations of Banca Nazionale del Lavoro (BNL), whose 92 branches will establish a more substantial and geographically diverse presence in retail banking.
- In Brazil, the consumer finance division, Losango, saw strong growth in store loans. Vehicle finance, payroll and credit card lending all grew strongly too, augmented by new retail partnerships which increased market access.

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

**Business highlights****Commercial Banking**

Profit before tax

	Year ended 31 December		
	2006 US\$m	2005 US\$m	2004 US\$m
Net interest income	7,514	6,310	4,875
Net fee income	3,207	2,876	2,645
Trading income excluding net interest income	204	150	234
Net interest income/ (expense) on trading activities	20	(3)	□
Net trading income <sup>1</sup>	224	147	234
Net expense from financial instruments designated at fair value	(22)	(12)	□
Net investment income on assets backing policy-holders' liabilities	□	□	324
Gains less losses from financial investments	44	9	6
Dividend income	6	9	37
Net earned insurance premiums	258	236	1,072
Other operating income	250	327	513
<b>Total operating income</b>	<b>11,481</b>	<b>9,902</b>	<b>9,706</b>
Net insurance claims <sup>2</sup>	(96)	(118)	(1,264)
<b>Net operating income<sup>3</sup></b>	<b>11,385</b>	<b>9,784</b>	<b>8,442</b>
Loan impairment charges and other credit risk provisions	(697)	(547)	(200)
<b>Net operating income</b>	<b>10,688</b>	<b>9,237</b>	<b>8,242</b>
Total operating expenses	(4,979)	(4,453)	(4,220)
<b>Operating profit</b>	<b>5,709</b>	<b>4,784</b>	<b>4,022</b>
Share of profit in associates and joint ventures	288	177	35
<b>Profit before tax</b>	<b>5,997</b>	<b>4,961</b>	<b>4,057</b>
<b>By geographical region</b>			
Europe	2,234	1,939	1,663
Hong Kong	1,321	955	904
Rest of Asia-Pacific	1,034	818	483
North America <sup>4</sup>	957	892	691
Latin America <sup>4</sup>	451	357	316

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	5,997	4,961	4,057
	%	%	%
Profit before tax			
Share of HSBC's profit before tax	27.2	23.7	21.4
Cost efficiency ratio	43.7	45.5	50.0
	US\$m	US\$m	US\$m
<b>Selected balance sheet data<sup>5</sup></b>			
Loans and advances to customers (net)	172,976	142,041	130,160
Total assets	213,450	175,120	159,251
Customer accounts	190,853	148,106	137,801

For footnotes, see page 26

Strategic direction

HSBC's strategy is to be the leading international business bank for Commercial Banking customers, with a particular focus on being the best bank for small businesses in target markets, by:

- making full use of HSBC's extensive geographical network to support Commercial Banking customers in trading, investing and commencing business across borders;
- building upon HSBC's Global Transaction Banking and receivables finance expertise to facilitate domestic and international trade flows;
- deepening HSBC's understanding of its customers through research and segmentation and tailoring services to meet their needs;
- developing multi-channel relationships and further enhancing and rolling out direct Commercial Banking services; and
- enhancing service levels and driving efficiencies by making full use of HSBC's operational processing and IT capabilities.

Business highlights in 2006

- Pre-tax profit increased by 21 per cent to US\$5,997 million, driven by strongly rising operating income. This comfortably exceeded the increased loan impairment charges and higher costs associated with business expansion. The cost efficiency ratio improved from 45.5 per cent to 43.7 per cent. On an underlying basis, profits increased by 19 per cent. Since 2004, Commercial Banking's pre-tax profits have grown by approximately 48 per cent.
- Customer loans and accounts grew by 22 per cent and 29 per cent respectively and customer numbers increased by 116,000 to 2.6 million. Global Transaction Banking revenue from Commercial Banking customers increased by 14 per cent to US\$3.9 billion.
- As part of its strategy to be recognised as the leading international business bank, HSBC continued to invest in initiatives designed to facilitate customers' cross-border activities. International Business Centres were established in 16 locations and a new cross-border credit arrangement was launched, in order to recognise HSBC's global relationship with international customers in making local lending decisions. These milestones, together with the implementation of a new referral system, led to international referrals with an aggregate facility



[Back to Contents](#)

value of US\$3 billion, involving over 50 sites and 4,000 relationship managers.

- HSBC achieved considerable success in pursuit of its objective to be the best bank for small business. Customer numbers increased in response to the launch of specialised Commercial Banking centres and new products tailored to meet their needs.
- Development of HSBC's IT platform for business banking contributed to a 29 per cent increase in customers registered for internet banking. Online transaction volumes increased by 22 per cent and web traffic grew by 41 per cent to over 132 million user sessions.
- HSBC continued to develop its commercial insurance and wealth management capabilities, hiring new staff, establishing specialist teams and offering new products.

### **Europe**

- As part of its emerging market focus, HSBC expanded its Eastern European operations by adding new premises, developing Global Transaction Banking capabilities and strengthening local relationship management teams.
- BusinessDirect, which provides small and micro businesses with a no-fee internet and phone banking service, was successfully launched in the UK.
- HSBC opened 11 innovative Commercial Centres in the UK, providing state-of-the-art business facilities in more convenient locations for business customers.
- In Turkey, HSBC reinforced product launches and other initiatives undertaken in 2005 by establishing a small and micro business presence in 55 Commercial Centres. This contributed to a 40 per cent rise in active Commercial Banking customer numbers.
- In France, HSBC raised its brand profile in the business community, which led to new customer numbers increasing by approximately a third.

### **Hong Kong**

- HSBC was named "World's Best Trade Finance Bank in Hong Kong" by *Global Finance* magazine, recognising the bank's efforts in developing a centre of excellence for international trade.
- A new micro-business lending programme was launched, with a streamlined loan application process for new and existing customers which, in conjunction with campaigns to increase usage, led to a doubling of lending to micro businesses.
- Three Commercial Transaction Centres were opened to provide tailored Commercial Banking services in lower cost sites near to customers.

### **Rest of Asia-Pacific**

- As Asian trade flows expanded strongly, HSBC opened International Banking Centres in seven sites in the Rest of Asia-Pacific during 2006. HSBC's strength in international trade was recognised with a number of Trade Finance awards including *Global Finance* magazine's "World's Best Trade Finance Bank in Asia".
- Branches focused on Commercial Banking were opened in mainland China, India and Bangladesh. A commercial customer call centre was opened in South Korea, while Shariah-compliant Amanah services for commercial customers were rolled out in the Middle East.

- Small businesses benefited from a number of new products and services including an online business insurance package in the Middle East and a new receivables finance product in India.

**North America**

- HSBC continued to expand its operations outside New York State. New branches were opened in Chicago, Los Angeles, New Jersey, Connecticut and Washington D.C., supported by a 13 per cent increase in the number of relationship managers.
- The launch of International Banking Centres in the US and Canada resulted in an increased focus on international business opportunities.

**Latin America**

- HSBC opened International Banking Centres in Mexico and Brazil and commenced Commercial Banking operations in Peru. In Argentina, HSBC opened a dedicated trade services call centre.
- HSBC's share of the international trade market in Mexico grew following service enhancements and the launch of new products, including "Estimulo Empresarial", a packaged product targeted at small businesses.
- In Brazil, enhancements to the *giro fácil* revolving loan and overdraft facility for small businesses led to record sales.

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

*Business highlights***Corporate, Investment Banking and Markets**

Profit before tax

	Year ended 31 December		
	2006 US\$m	2005 US\$m	2004 US\$m
Net interest income	3,168	3,001	3,994
Net fee income	3,718	2,967	2,764
Trading income excluding net interest income	4,890	2,919	1,935
Net interest income/ (expense) on trading activities	(379)	306	□
Net trading income <sup>1</sup>	4,511	3,225	1,935
Net income from financial instruments designated at fair value	20	67	□
Net investment income on assets backing policy- holders' liabilities	□	□	9
Gains less losses from financial investments	534	475	197
Dividend income	235	79	548
Net earned insurance premiums	73	76	86
Other operating income	1,378	1,621	1,029
<b>Total operating income</b>	<b>13,637</b>	<b>11,511</b>	<b>10,562</b>
Net insurance claims <sup>2</sup>	(62)	(54)	(59)
<b>Net operating income<sup>3</sup></b>	<b>13,575</b>	<b>11,457</b>	<b>10,503</b>
Net recovery of loan impairment charges and other credit risk provisions	119	272	499
<b>Net operating income</b>	<b>13,694</b>	<b>11,729</b>	<b>11,002</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Total operating expenses	<b>(7,991)</b>	(6,838)	(5,809)
<b>Operating profit</b>	<b>5,703</b>	4,891	5,193
Share of profit in associates and joint ventures	<b>103</b>	272	95
<b>Profit before tax</b>	<b>5,806</b>	5,163	5,288
<b>By geographical region</b>			
Europe	<b>2,304</b>	2,114	1,668
Hong Kong	<b>955</b>	922	1,603
Rest of Asia-Pacific	<b>1,649</b>	1,207	942
North America <sup>4</sup>	<b>423</b>	573	879
Latin America <sup>4</sup>	<b>475</b>	347	196
Profit before tax	<b>5,806</b>	5,163	5,288

	%	%	%
Share of HSBC's profit before tax	<b>26.3</b>	24.6	27.9
Cost efficiency ratio	<b>58.9</b>	59.7	55.3

*For footnotes, see page 26*

Strategic direction

HSBC's strategy is to be a leading wholesale bank by focusing on financing and emerging markets, and:

- leveraging the Group's unique footprint and heritage;
- using HSBC's network and client franchises as the foundation on which Corporate, Investment Banking and Markets develops its hub-and-spoke business model; and
- continuing to build skills and capabilities in its major centres to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network.

Ensuring that this combination of product depth and distribution strength meets the needs of existing and new clients will allow Corporate, Investment Banking and Markets to achieve its strategic goals.

Business highlights in 2006

- Pre-tax profit rose by 12 per cent to US\$5,806 million, driven by an 18 per cent increase in total operating income. This was achieved despite a declining contribution from balance sheet management activities, which fell by US\$534 million as existing positions unwound and opportunities for reinvestment were limited by the flat interest rate yield curve environment. On an underlying basis and excluding balance sheet management activities, total operating income improved by 24 per cent, reflecting positive revenue trends in product areas in which HSBC has invested. The increase in operating expenses reflected the first full-year effect of recruitment in 2005. Performance-related compensation increased in line with robust revenue growth, while higher operational costs reflected volume increases in payments and cash management and securities services. The cost efficiency ratio improved moderately. In 2006, over 1,700 people were recruited and 1,150 departed.



- Corporate, Investment Banking and Markets strength in emerging markets was recognised by industry awards. HSBC was named European Loan House of the Year, China Loan House of the Year and Asian Domestic Currency Bond House of the Year by *International Financing Review*. Mittal Steel's acquisition of Arcelor, in which HSBC held senior financing and advisory roles, was voted European mergers and acquisitions Deal of the Year by *Financial News* and Cross-Border Deal of the Year by

[Back to Contents](#)**Management view of total operating income**

	Year ended 31 December		
	2006	2005	2004
	US\$m	US\$m	US\$m
<b>Global Markets</b>	<b>5,279</b>	3,767	3,171
Foreign exchange	<b>1,516</b>	1,200	1,125
Credit and Rates	<b>1,321</b>	931	655
Structured derivatives	<b>725</b>	387	386
Equities	<b>381</b>	324	256
HSBC Securities			
Services	<b>1,336</b>	925	749
<b>Global Banking</b>	<b>4,059</b>	3,530	3,065
Investment banking	<b>1,156</b>	1,022	877
Lending	<b>1,257</b>	1,260	1,188
Payments and cash management	<b>1,249</b>	901	694
Other transaction services	<b>397</b>	347	306
<b>Balance sheet management</b>	<b>704</b>	1,238	2,376
<b>Group Investment Businesses</b>	<b>1,104</b>	762	732
<b>Private equity</b>	<b>564</b>	648	207
Other <sup>1</sup>	<b>1,927</b>	1,566	1,011
<b>Total operating income</b>	<b>13,637</b>	11,511	10,562

**Selected balance sheet data<sup>5</sup>**

Loans and advances to:

□ customers (net)	<b>210,220</b>	169,435	145,353
□ banks (net)	<b>156,548</b>	106,123	128,032
Total assets	<b>994,436</b>	755,056	584,779
Customer accounts	<b>235,965</b>	202,361	177,449
Trading assets, financial instruments designated at fair value, and financial investments	<b>487,943</b>	373,787	252,459
Deposits by banks	<b>92,954</b>	65,853	80,443

<sup>1</sup> □Other□ includes the Corporate, Investment Banking and Markets business of HSBC Trinkaus & Burkhardt AG, the effect of consolidating investments held by HSBC□s property investment funds, and net interest earned on free capital held in Corporate, Investment Banking and Markets not assigned to products.

For other footnotes, see page 26.

*Acquisitions Monthly*. HSBC was named Best Investment Bank in the Middle East and, for the ninth consecutive year, Best at Treasury and Risk Management in Asia by *Euromoney*, and Best Foreign Bank in China, Indonesia, Malaysia and Vietnam by *FinanceAsia*.

- In Global Markets, operating income increased by 40 per cent, with robust growth in foreign exchange, Credit and Rates and structured derivatives complemented by a significant increase in securities services revenues. Foreign exchange gains were driven by increased customer activity, encouraged by US dollar weakness and volatility in emerging markets. Credit and Rates revenue was boosted by an enhanced product range, market volatility and increased investor appetite for emerging market bonds. A substantial rise in structured derivatives income reflected enhanced sales coverage. The securities services business benefited from increased customer volumes in higher-value products and strong income growth in emerging markets. Assets under custody rose by 28 per cent.

- In Global Banking, total operating income rose by 15 per cent, due to a strong performance in payments and cash management and improved results in investment banking. In the latter, satisfactory progress in capital markets resulted in HSBC being ranked fourth in the international bond league table, according to Bloomberg, up from fifth in 2005 and seventh in 2004, and first in the Asian local currency bond league table for the fifth consecutive year.

Cross-border distribution was a noteworthy feature of many HSBC-led debt capital market and equity capital market transactions. Highlights included America Movil's 8 billion Mexican peso bond; Khazanah Nasional of Malaysia's US\$750 million exchangeable Sukuk; and Shui On Land's US\$876 million Initial Public Offering (IPO) in Hong Kong.

Income from the lending business was broadly in line with 2005. Globally, the corporate credit environment was stable, though corporate spreads remained under pressure. HSBC made significant progress in leveraged and acquisition finance in 2006. Key transactions included debt facilities backing Yell Group's acquisition of Telefonica Publicidad e Informacion and a Macquarie Bank-led consortium's acquisition of Thames Water.

Payments and cash management delivered a strong performance across all regions, driven by growth in client deposits and improved spreads.

- Group Investment Businesses' operating income rose by 45 per cent partly due to higher performance fees on emerging market funds and strong results from quantitative and multi-manager products. Funds under management grew by 11 per cent, driven by supportive market conditions and US\$14 billion of net client inflows, including significant inflows into emerging market funds.

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

**Business highlights****Private Banking**

Profit before tax

	Year ended 31 December		
	2006 US\$m	2005 US\$m	2004 US\$m
Net interest income	1,011	848	718
Net fee income	1,323	1,080	962
Net trading income <sup>1</sup>	364	317	257
Net income/(expense) from financial instruments designated at fair value	1	(1)	□
Gains less losses from financial investments	166	45	39
Dividend income	5	9	5
Other operating income	61	68	24
<b>Total operating income</b>	<b>2,931</b>	2,366	2,005
Net insurance claims <sup>2</sup>	□	□	□
<b>Net operating income<sup>3</sup></b>	<b>2,931</b>	2,366	2,005
Loan impairment (charges)/recoveries and other credit risk provisions	(33)	12	11
<b>Net operating income</b>	<b>2,898</b>	2,378	2,016
Total operating expenses	(1,685)	(1,466)	(1,319)
<b>Operating profit</b>	<b>1,213</b>	912	697
Share of profit in associates and joint ventures	1	□	□
<b>Profit before tax</b>	<b>1,214</b>	912	697
<b>By geographical region</b>			
Europe	805	539	438
Hong Kong	201	190	131
Rest of Asia-Pacific	80	78	60
North America <sup>4</sup>	114	104	68
Latin America <sup>4</sup>	14	1	□
Profit before tax	1,214	912	697
	%	%	%
Share of HSBC's profit before tax	5.5	4.4	3.7
Cost efficiency ratio	57.5	62.0	65.8

	US\$m	US\$m	US\$m
<b>Selected balance sheet data<sup>5</sup></b>			
Loans and advances to customers (net)	<b>34,297</b>	27,749	24,463
Total assets	<b>73,026</b>	59,827	56,751
Customer accounts	<b>80,303</b>	67,205	57,780

*For footnotes, see page 26*

Strategic direction

The strategy for Private Banking is to be one of the world's leading international private banks, by providing excellent client service.

HSBC's global network and brand provides a base from which the private bank, working in conjunction with HSBC's other customer groups and global businesses, serves the complex international needs of its clients, utilising traditional and innovative ways of managing and preserving the wealth of high net worth individuals while optimising returns.

The private bank's strategy is to reinforce its product capabilities in areas such as credit, hedge funds, investment advice and estate planning. This will be achieved by attracting, retaining and motivating talented individuals, by surveying clients and employees on a regular basis and by increasing expenditure targeted on marketing and brand awareness initiatives. Private Banking's onshore business will also be expanded.

#### Business highlights

- Pre-tax profits of US\$1,214 million grew by 33 per cent on both reported and underlying bases compared with 2005, supported by strong growth in client assets and lending. Revenue growth comfortably exceeded cost growth leading to an improvement in the cost efficiency ratio of 4.5 percentage points to 57.5 per cent. Reported pre-tax profits have increased by 74 per cent since 2004.
- A significant gain of US\$117 million arose from the partial sale of an investment in the Hermitage fund, a public equity fund dedicated to investment in Russia.
- HSBC continued to expand its alternative investment platform as client preferences favoured such investments. Total client investment in hedge funds reached US\$39 billion. Two funds managed by HSBC Private Bank France received first and equal second place in the L'Agefi awards [International Equity Category].
- Client assets increased by 22 per cent to US\$333 billion, with net new money inflows of US\$34 billion in 2006. On an underlying basis, growth was 17 per cent.

[Back to Content](#)**Client assets**

	<b>2006</b>	2005
	<b>US\$bn</b>	US\$bn
At 1 January	<b>273</b>	239
Net new money	<b>34</b>	36
Value change	<b>21</b>	13
Exchange and other	<b>5</b>	(15)
	<hr/>	<hr/>
Total	<b>333</b>	273
	<hr/>	<hr/>

**Client assets by investment class**

	<b>2006</b>	2005
	<b>US\$bn</b>	US\$bn
Equities	<b>62</b>	51
Bonds	<b>55</b>	53
Structured products	<b>16</b>	9
Funds	<b>83</b>	67
Cash, fiduciary deposits and other	<b>117</b>	93
	<hr/>	<hr/>
Total	<b>333</b>	273
	<hr/>	<hr/>

- Strong performance of the Strategic Investment Solutions (SIS) and related Core Investment Solutions (CIS) products was reflected in greater investment by clients in this suite of discretionary managed products, which reached a value of US\$4.8 billion.
- Recognising the value to be derived from closer links with other customer groups, dedicated teams working with Commercial Banking, Personal Financial Services and Corporate, Investment Banking and Markets produced a significant increase in intra-Group referrals in 2006.
- The lending book grew strongly to satisfy demand from clients for finance to invest in residential properties and other asset classes.
- HSBC won a number of awards in the *Euromoney* annual private banking survey. In the global private banking awards, notable wins included 1st Private Bank for Services for the Super Affluent and 1st Private Bank for Islamic Services. HSBC maintained its position in the top three within the Best private banking services overall category.

**Europe**

- In Europe, HSBC's Private Banking operations had a very strong year on the back of recruitment of client-facing staff and marketing in key growth regions.
- Synergies were achieved in Switzerland, through the merger of the two existing Swiss trust businesses and the two Lugano branches.

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

- Private Banking expanded its onshore business through the launch of further regional offices in Bristol and Manchester in the UK and in Bordeaux, Marseille and Nice in France.
- Client assets increased by 25 per cent, or 18 per cent on an underlying basis, with net new money reaching US\$19 billion, primarily driven by the Swiss business.

### Asia

- Front office recruitment continued in Hong Kong and Singapore and Private Banking capabilities were expanded through the opening of representative offices in mainland China and the Philippines.
- Investment in Taiwan, Japan and the Middle East continued and, in India, the private bank network expanded to six offices with the addition of Chennai and Hyderabad.
- Client assets increased by 26 per cent, or 23 per cent on an underlying basis with net new money reaching US\$9 billion.

### Americas

- HSBC expanded its presence in the US with the opening of domestic Private Banking offices in Chicago and Greenwich.
- Wealth and Tax Advisory Services (WTAS) generated strong growth in revenue and expanded through the opening of offices in Palo Alto, Seattle, Fort Washington, Greenwich and Chicago.
- Client assets increased by 6 per cent with net new money reaching US\$6 billion.

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

**Business highlights****Other**

Profit before tax

	Year ended 31 December		
	2006 US\$m	2005 US\$m	2004 US\$m
Net interest income/(expense)	(625)	(472)	90
Net fee income	172	220	171
Trading income/(expense) excluding net interest income	(228)	(90)	40
Net interest income/(expense) on trading activities	82	(13)	□
Net trading income/(expense) <sup>1</sup>	(146)	(103)	40
Net income/(expense) from financial instruments designated at fair value	(81)	406	□
Net investment income on assets backing policy-holders' liabilities	□	□	44
Gains less losses from financial investments	147	144	219
Dividend income	63	42	16
Net earned insurance premiums	207	260	558
Other operating income	3,254	2,634	2,050
<b>Total operating income</b>	<b>2,991</b>	<b>3,131</b>	<b>3,188</b>
Net insurance claims <sup>2</sup>	(181)	(179)	(359)
<b>Net operating income<sup>3</sup></b>	<b>2,810</b>	<b>2,952</b>	<b>2,829</b>
Loan impairment charges and other credit risk provisions	(13)	(1)	(1)
<b>Net operating income</b>	<b>2,797</b>	<b>2,951</b>	<b>2,828</b>
Total operating expenses	(3,259)	(2,976)	(2,493)
<b>Operating profit/(loss)</b>	<b>(462)</b>	<b>(25)</b>	<b>335</b>
Share of profit in joint ventures and associates	74	51	69
<b>Profit/(loss) before tax</b>	<b>(388)</b>	<b>26</b>	<b>404</b>
<b>By geographical region</b>			
Europe	(278)	(168)	366
Hong Kong	(175)	(178)	129
Rest of Asia-Pacific	287	94	26
North America <sup>4</sup>	(217)	165	(196)



Latin America <sup>4</sup>	<b>(5)</b>	113	79
Profit/(loss) before tax	<b>(388)</b>	26	404
	%	%	%
Share of HSBC's profit before tax	<b>(1.8)</b>	0.1	2.1
Cost efficiency ratio	<b>116.0</b>	100.8	88.1
	<b>US\$m</b>	US\$m	US\$m

**Selected balance sheet data<sup>5</sup>**

Loans and advances to customers (net)	<b>2,095</b>	1,893	2,339
Total assets	<b>33,278</b>	27,653	26,201
Customer accounts	<b>1,245</b>	507	557

## Notes

- For a description of the main items reported under "Other", see footnote 6 on page 26.
- HSBC sold a number of properties in Hong Kong and the Rest of Asia-Pacific region, realising gains of US\$187 million, significantly higher than in 2005. These sales led to a reduction in the size of HSBC's property portfolio which, together with slower growth in Hong Kong property prices, resulted in a 59 per cent decrease in property revaluation gains to US\$61 million.
- The sale of part of HSBC's stake in UTI Bank Limited realised a gain of US\$101 million in the first half of 2006.
- HSBC reported a US\$95 million fall in the fair value of own debt designated at fair value in 2006, compared with a gain of US\$386 million in 2005. The movement was principally in North America and Europe.
- Higher US interest rates led to increased costs to HSBC of servicing its floating rate subordinated debt, partly offset by higher earnings on US dollar-denominated centrally held funds.
- The development of HSBC's ten Group Service Centres, primarily in India and mainland China, continued apace and staff numbers increased by 32 per cent to 25,000. Increased activity in the centres resulted in a 54 per cent increase in costs to US\$343 million. The recovery of substantially all of these costs from the relevant customer groups is reported under "Other operating income".
- Increased business volumes, branch expansion, the development of new IT capabilities and the integration of Metris led to an 8 per cent increase in costs at the Group's North American technology centre to US\$1,191 million, also recharged through "Other operating income".
- During 2005, HSBC in Argentina benefited from certain gains associated with the receipt of coverage bonds and other items related to the 2002 sovereign debt crisis. These benefits were not repeated in 2006.

For footnotes, see page 26.

[Back to Contents](#)**Analysis by customer group and global business**

Profit/(loss) before tax

**Year ended 31 December 2006**

<b>Total</b>	<b>Personal Financial Services US\$m</b>	<b>Commercial Banking US\$m</b>	<b>Corporate, Investment Banking &amp; Markets US\$m</b>	<b>Private Banking US\$m</b>	<b>Other<sup>6</sup> US\$m</b>	<b>Inter- segment elimination US\$m</b>	<b>Total US\$m</b>
Net interest income/(expense)	<b>26,076</b>	<b>7,514</b>	<b>3,168</b>	<b>1,011</b>	<b>(625)</b>	<b>(2,658)</b>	<b>34,486</b>
Net fee income	<b>8,762</b>	<b>3,207</b>	<b>3,718</b>	<b>1,323</b>	<b>172</b>	□	<b>17,182</b>
Trading income/(expense) excluding net interest income	<b>391</b>	<b>204</b>	<b>4,890</b>	<b>362</b>	<b>(228)</b>	□	<b>5,619</b>
Net interest income/ (expense) on trading activities	<b>220</b>	<b>20</b>	<b>(379)</b>	<b>2</b>	<b>82</b>	<b>2,658</b>	<b>2,603</b>
Net trading income/(expense) <sup>1</sup>	<b>611</b>	<b>224</b>	<b>4,511</b>	<b>364</b>	<b>(146)</b>	<b>2,658</b>	<b>8,222</b>
Net income/(expense) from financial instruments designated at fair value	<b>739</b>	<b>(22)</b>	<b>20</b>	<b>1</b>	<b>(81)</b>	□	<b>657</b>
Gains less losses from financial investments	<b>78</b>	<b>44</b>	<b>534</b>	<b>166</b>	<b>147</b>	□	<b>969</b>
Dividend income	<b>31</b>	<b>6</b>	<b>235</b>	<b>5</b>	<b>63</b>	□	<b>340</b>
Net earned insurance premiums	<b>5,130</b>	<b>258</b>	<b>73</b>	□	<b>207</b>	□	<b>5,668</b>
Other operating income	<b>782</b>	<b>250</b>	<b>1,378</b>	<b>61</b>	<b>3,254</b>	<b>(3,179)</b>	<b>2,546</b>
<b>Total operating income</b>	<b>42,209</b>	<b>11,481</b>	<b>13,637</b>	<b>2,931</b>	<b>2,991</b>	<b>(3,179)</b>	<b>70,070</b>
Net insurance claims <sup>2</sup>	<b>(4,365)</b>	<b>(96)</b>	<b>(62)</b>	□	<b>(181)</b>	□	<b>(4,704)</b>
<b>Net operating income<sup>3</sup></b>	<b>37,844</b>	<b>11,385</b>	<b>13,575</b>	<b>2,931</b>	<b>2,810</b>	<b>(3,179)</b>	<b>65,366</b>

Loan impairment (charges)/recoveries and other credit risk provisions	<u>(9,949)</u>	<u>(697)</u>	<u>119</u>	<u>(33)</u>	<u>(13)</u>	<u>□</u>	<u>(10,573)</u>
<b>Net operating income</b>	<b>27,895</b>	<b>10,688</b>	<b>13,694</b>	<b>2,898</b>	<b>2,797</b>	<b>(3,179)</b>	<b>54,793</b>
Total operating expenses	<u>(18,818)</u>	<u>(4,979)</u>	<u>(7,991)</u>	<u>(1,685)</u>	<u>(3,259)</u>	<u>3,179</u>	<u>(33,553)</u>
<b>Operating profit/(loss)</b>	<b>9,077</b>	<b>5,709</b>	<b>5,703</b>	<b>1,213</b>	<b>(462)</b>	<b>□</b>	<b>21,240</b>
Share of profit in associates and joint ventures	<u>380</u>	<u>288</u>	<u>103</u>	<u>1</u>	<u>74</u>	<u>□</u>	<u>846</u>
<b>Profit/(loss) before tax</b>	<b>9,457</b>	<b>5,997</b>	<b>5,806</b>	<b>1,214</b>	<b>(388)</b>	<b>□</b>	<b>22,086</b>
	%	%	%	%	%		%
Share of HSBC's profit before tax	<b>42.8</b>	<b>27.2</b>	<b>26.3</b>	<b>5.5</b>	<b>(1.8)</b>		<b>100.0</b>
Cost efficiency ratio	<b>49.7</b>	<b>43.7</b>	<b>58.9</b>	<b>57.5</b>	<b>116.0</b>		<b>51.3</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>		<b>US\$m</b>
<b>Selected balance sheet data<sup>5</sup></b>							
Loans and advances to customers (net)	<b>448,545</b>	<b>172,976</b>	<b>210,220</b>	<b>34,297</b>	<b>2,095</b>		<b>868,133</b>
Total assets	<b>546,568</b>	<b>213,450</b>	<b>994,436</b>	<b>73,026</b>	<b>33,278</b>		<b>1,860,758</b>
Customer accounts	<b>388,468</b>	<b>190,853</b>	<b>235,965</b>	<b>80,303</b>	<b>1,245</b>		<b>896,834</b>
The following assets and liabilities were significant to Corporate, Investment Banking and Markets:							
loans and advances to banks (net)			<b>156,548</b>				

trading assets, financial assets designated at fair value, and financial investments	<b>487,943</b>
deposits by banks	<b>92,954</b>

*For footnotes,  
see page 26.*

[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

*Customer groups and global businesses / Profit/(loss) before tax*

Profit/(loss) before tax (continued)

Year ended 31 December 2005

<b>Total</b>	Year ended 31 December 2005						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Corporate, Investment Banking & Markets US\$m	Private Banking US\$m	Other <sup>6</sup> US\$m	Inter- segment elimination 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) <sup>1</sup>	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
<b>Total operating income</b>	<b>37,440</b>	<b>9,902</b>	<b>11,511</b>	<b>2,366</b>	<b>3,131</b>	<b>(2,646)</b>	<b>61,704</b>
Net insurance claims <sup>2</sup>	(3,716)	(118)	(54)	□	(179)	□	(4,067)
<b>Net operating income<sup>3</sup></b>	<b>33,724</b>	<b>9,784</b>	<b>11,457</b>	<b>2,366</b>	<b>2,952</b>	<b>(2,646)</b>	<b>57,637</b>
Loan impairment (charges)/recoveries and other credit risk provisions	(7,537)	(547)	272	12	(1)	□	(7,801)

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

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/(loss)	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<sup>5</sup>

Loans and advances to customers (net)	398,884	142,041	169,435	27,749	1,893		740,002
Total assets	484,314	175,120	755,056	59,827	27,653		1,501,970
Customer accounts	321,240	148,106	202,361	67,205	507		739,419

The following assets and liabilities were significant

to Corporate, Investment Banking and Markets:

loans and advances to banks (net)			106,123				
trading assets, financial assets designated at fair value, and financial investments			373,787				
deposits by banks			65,853				

For footnotes, see page 26.

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

[Back to Contents](#)

Year ended 31 December 2004

	Personal Financial Services US\$m	Commercial Banking US\$m	Corporate, Investment Banking & Markets US\$m	Private Banking US\$m	Other <sup>6</sup> US\$m	Inter- segment elimination US\$m	Total US\$m
<b>Total</b>							
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
<b>Total operating income</b>	<b>32,890</b>	<b>9,706</b>	<b>10,562</b>	<b>2,005</b>	<b>3,188</b>	<b>(2,363)</b>	<b>55,988</b>
Net insurance claims <sup>2</sup>	(2,953)	(1,264)	(59)	□	(359)	□	(4,635)
<b>Net operating income<sup>3</sup></b>	<b>29,937</b>	<b>8,442</b>	<b>10,503</b>	<b>2,005</b>	<b>2,829</b>	<b>(2,363)</b>	<b>51,353</b>
Loan impairment (charges)/ recoveries and other credit risk provisions	(6,500)	(200)	499	11	(1)	□	(6,191)
<b>Net operating income</b>	<b>23,437</b>	<b>8,242</b>	<b>11,002</b>	<b>2,016</b>	<b>2,828</b>	<b>(2,363)</b>	<b>45,162</b>
Total operating expenses	(15,009)	(4,220)	(5,809)	(1,319)	(2,493)	2,363	(26,487)
<b>Operating profit</b>	<b>8,428</b>	<b>4,022</b>	<b>5,193</b>	<b>697</b>	<b>335</b>	<b>□</b>	<b>18,675</b>
Share of profit in associates and joint ventures	69	35	95	□	69	□	268
<b>Profit before tax</b>	<b>8,497</b>	<b>4,057</b>	<b>5,288</b>	<b>697</b>	<b>404</b>	<b>□</b>	<b>18,943</b>
	%	%	%	%	%		%
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

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Selected balance sheet data <sup>5</sup>						
Loans and advances to customers (net)	370,576	130,160	145,353	24,463	2,339	672,891
Total assets	452,992	159,251	584,779	56,751	26,201	1,279,974
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 26.*



[Back to Contents](#)

HSBC HOLDINGS PLC

**Report of the Directors: Business Review**

(continued)

*Geographical regions > Summary / Competitive environment***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 the analyses of customer groups and global businesses on pages 12 to 25.

- 1 *In the analyses of customer groups and global businesses, 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; in the statutory presentation internal interest income and expense are eliminated.*
- 2 *Net insurance claims incurred and movement in policyholders' liabilities.*
- 3 *Net operating income before loan impairment charges and other credit risk provisions.*
- 4 *In 2006, Mexico and Panama were reclassified from the North America segment to Latin America. Comparative information has been restated accordingly.*
- 5 *Third party only.*
- 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\$371 million in 2006 (2005: US\$460 million; 2004: US\$511 million). "Other" also includes the costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries.*

**Geographical regions****Summary of geographical regions**

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US\$1,494 million (2005: US\$938 million; 2004: US\$631 million).

**Profit before tax**

Year ended 31 December					
2006		2005		2004	
US\$m	%	US\$m	%	US\$m	%

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Europe	<b>6,974</b>	<b>31.5</b>	6,356	30.3	5,756	30.4
Hong Kong	<b>5,182</b>	<b>23.5</b>	4,517	21.5	4,830	25.5
Rest of Asia-Pacific	<b>3,527</b>	<b>16.0</b>	2,574	12.3	1,847	9.8
North America <sup>1</sup>	<b>4,668</b>	<b>21.1</b>	5,915	28.2	5,268	27.8
Latin America <sup>1</sup>	<b>1,735</b>	<b>7.9</b>	1,604	7.7	1,242	6.5
	<b>22,086</b>	<b>100.0</b>	20,966	100.0	18,943	100.0

Total assets<sup>2</sup>

At 31 December

	2006		2005	
	US\$m	%	US\$m	%
Europe	<b>828,701</b>	<b>44.6</b>	636,703	42.4
Hong Kong	<b>272,428</b>	<b>14.6</b>	235,376	15.7
Rest of Asia-Pacific	<b>167,668</b>	<b>9.0</b>	142,014	9.4
North America <sup>1</sup>	<b>511,190</b>	<b>27.5</b>	432,490	28.8
Latin America <sup>1</sup>	<b>80,771</b>	<b>4.3</b>	55,387	3.7
	<b>1,860,758</b>	<b>100.0</b>	1,501,970	100.0

<sup>1</sup> In 2006, Mexico and Panama were reclassified from the North America segment to the Latin America segment. Comparative information has been restated accordingly.

<sup>2</sup> Third party only.

[Back to Contents](#)

Additional information on results in 2006 may be found in the "Report of the Directors: Financial Review" on pages 110 to 164.

## Europe

HSBC's principal banking operations in Europe are HSBC Bank plc ("HSBC Bank") in the UK, HSBC France, HSBC Bank A.S. in Turkey, HSBC Bank Malta p.l.c., HSBC Private Bank (Suisse) S.A. ("HSBC Private Bank (Suisse)"), HSBC Trinkaus & Burkhardt AG 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 Limited ("The Hongkong and Shanghai Banking Corporation") and Hang Seng Bank Limited ("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 2006.

## 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 14 branches and 16 sub-branches. Hang Seng Bank offers personal and commercial banking services and operates seven branches, seven sub-branches and one representative office in eight cities in mainland China. HSBC also participates indirectly in mainland China through its three associates, Bank of Communications Limited ("Bank of Communications") (19.9 per cent owned), Ping An Insurance (Group) Company of China, Limited ("Ping An Insurance") (16.8 per cent) and Industrial Bank Co. Ltd ("Industrial Bank") (12.78 per cent), and has a further interest of 8 per cent in Bank of Shanghai.

Outside Hong Kong and mainland China, the HSBC Group conducts business in 21 countries in the Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, 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 Limited ("HSBC Bank Middle East") whose network

of branches, subsidiaries and associates has the widest coverage in the region; in Australia by HSBC Bank Australia Limited; and in Malaysia by HSBC Bank Malaysia Berhad ("HSBC Bank Malaysia"), which is the largest foreign-owned bank in the country by income, profits and assets. HSBC's associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom's seventh largest bank by total assets.

## North America

HSBC's North American businesses are located in the US, Canada and Bermuda. Operations in the US are primarily conducted through HSBC Bank USA, N.A. ("HSBC Bank USA") which is concentrated in New York State, and HSBC Finance, a national consumer finance company based in Chicago. HSBC Bank Canada and The Bank of Bermuda Limited ("Bank of Bermuda") are responsible for operations in their respective countries.

## Latin America

HSBC's operations in Latin America and the Caribbean principally comprise HSBC México, S.A. ("HSBC Mexico"), HSBC Bank Brasil S.A.-Banco Múltiplo ("HSBC Bank Brazil"), HSBC Bank Argentina S.A. ("HSBC Bank Argentina") and Grupo Banistmo S.A. ("Banistmo"). HSBC is also represented by subsidiaries in Chile, the Bahamas, Peru and Uruguay and, with the acquisition of Banistmo, in Costa Rica, Honduras, Colombia, Nicaragua and El Salvador, and by a representative office in Venezuela. In addition to banking services, HSBC operates large insurance businesses in Argentina, Brazil and Panama. In Argentina, HSBC's main insurance business is HSBC La Buenos Aires and, through Máxima and HSBC New York Life, HSBC offers pension and life insurance products. In Brazil, HSBC 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. 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

[Back to Contents](#)

HSBC HOLDINGS PLC

## **Report of the Directors: Business Review**

(continued)

*Geographical regions > Competitive environment*

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 continental Europe. HSBC's policy is to co-operate and work positively with all its regulators, inputting data and providing perspective on those issues which affect all financial service providers both directly and through industry bodies.

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 domestic markets of the US, the UK and Hong Kong. In the UK and the US, penetration of standard banking services is nearing saturation, and potential for growth is largely in the provision of a wider range of financial services, including consumer finance, to new and existing customers. HSBC has increased its focus on its interconnected Hong Kong and mainland China businesses, the other emerging economies in Asia-Pacific, Latin America, the Middle East, Turkey and, to a lesser extent, Eastern Europe as the engines of future growth. This is being developed by expanding domestic operations within emerging markets and by concentrating capabilities in developed markets on servicing growing financial needs in the emerging markets.

### **Advances in technology**

Over the past decade, the development of the internet and related innovative technologies has provided the financial services industry with the ability to deliver products and services through a growing number of channels, often more efficiently than by means of traditional face-to-face transactions. This has lowered barriers to entry and, as a consequence, competition has been fierce. Complementing its traditional branch network, HSBC offers a growing range of services utilising the new technologies, currently including the internet, interactive TV, mobile phone and WAP, and telephone banking. HSBC will continue to innovate

in these areas, and to offer its services through the channels preferred by its customers.

Regional factors

### **Europe**

The European Commission commenced an inquiry into retail banking across all member states in 2006, with which HSBC's individual local entities cooperated fully. Published in January 2007, a final report highlighted concerns over the ways in which competition in banking was operating in Europe. No single country received particular attention.

The Single European Payments Area programme, which will integrate retail payments through harmonising euro currency transfers, bankers' orders and cards transactions in the eurozone, reached implementation phase. Full implementation is scheduled for 2008, according to an agreement signed by the 65 member banks of the European Payments Council. This should offer strong growth opportunities for some banks but is also expected to lead to more competition. HSBC is positioning itself to capitalise fully on the opportunities presented.

The Markets in Financial Instruments Directive comes into effect on 1 November 2007, when it will replace the existing Investment Services Directive, covering a broader range of investment instruments and market structures and, because conduct of business rules are set at EU level, should mean less additional requirements when passporting into another member state.

*UK*

In April 2006, the Office of Fair Trading (OFT) concluded its inquiry into credit card terms under the Unfair Terms in Consumer Contracts Regulations, and announced that it did not intend to intervene further where issuers reduced their default fees to £12 or less. Subsequently, the OFT launched an informal high-level fact-finding exercise on overdraft fees, through the industry's representative body, the British Bankers' Association. This is due to conclude in March 2007, following which the industry and the OFT are to review their respective positions. Media interest has been considerable.

The OFT conducted a market study into Payment Protection Insurance (PPI) and referred the PPI market in the UK to the Competition Commission. The Competition Commission recently announced that they will be working with the Financial Services Authority (FSA) to investigate

[Back to Contents](#)

whether there is a case for changing the existing rules for the sale of PPI.

The OFT conducted the follow-up review of the SME market, prescribed by its report published in 2002. HSBC cooperated with this review and awaits the findings.

Following MasterCard's appeal to the Competition Commission Appeals Tribunal, the OFT withdrew its original interchange fee case to concentrate on a new case against both MasterCard and Visa. The European Commission is also investigating interchange fees, and HSBC has responded to its requests for information.

In November the winding down of the Payment Systems Taskforce was announced, and a new governance body for payment systems, the Payments Industry Association, was established. HSBC is positioned to deliver the faster electronic payments introduced by the Payment Systems Taskforce and meets its minimum standards for cheque clearing.

### *France*

Stable interest rates in the eurozone contributed to a strong growth in real estate investment in France. Competition between French banks 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 continued to enjoy improved pricing to the detriment of bank margins.

The payment of interest on sight deposits, authorised from the beginning of 2005, was introduced by one major mutual French bank, albeit linked to a quarterly fee for banking services. Market reaction was muted and, to date, no other leading French bank has followed suit.

From January 2006 the Banque Postale was able to offer real estate lending 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 reformed the household tax law for 2006/2007, notably introducing a tax exemption on capital gains on equities sold after an eight-year holding period and a cap on total household taxes (including income, wealth and local taxes) at 60 per cent of income. The higher marginal tax rate has been limited to 40 per cent. These reforms will increase disposable income for the wealthier individuals who form one of HSBC France's key customer segments.

At the end of December 2005, 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**

There was some improvement in the lending market in 2006, as the stable interest rate environment, liquid market, and moderate cost of borrowing supported growth in consumer spending, and demand for personal loans and credit cards rose in consequence.

Competition remained fierce in traditional mortgage products due to the still subdued property market. Robust equity markets buoyed sales of investment products and also benefited investment-related loans.

The sustained appreciation of the Chinese currency during 2006 had no marked effect on Hong Kong's renminbi deposit business. Instead, funds were attracted to Chinese stocks listed in Hong Kong, notably in relation to some of the substantial Chinese IPOs. Nevertheless, local currency deposits continued to grow rapidly due to rising household incomes.

### **Rest of Asia-Pacific**

*(including the Middle East)*

The competitive environment in the Rest of Asia-Pacific continued to intensify as international banks focused on targeted sectors in emerging markets in pursuit of higher returns. Local banks also actively expanded their reach and business, both within countries and across borders. Competition remained intense throughout the region in all of the customer groups served by HSBC. Regulations in certain countries act to limit the ability of foreign-owned banks to grow both by acquisition and organically by adding distribution or participating in shared networks with domestic banks. However, in many countries the growing sophistication of the relatively young population and increasing affluence of the middle class continued 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



[Back to Contents](#)

HSBC HOLDINGS PLC

## **Report of the Directors: Business Review**

(continued)

### *Competitive environment / Europe*

consolidate. Within the banking sector, consolidation continued in 2006, with a greater focus on national networks and retail branch banking.

The Group's principal US subsidiaries, HSBC Bank USA and HSBC Finance, faced 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 thus increases competitive pressure. 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 slowing US housing market has had an adverse effect on sub-prime mortgage originators and lenders, including HSBC. Numerous sub-prime lenders have exited the industry or have announced that they are exploring alternatives. Investment banks have been active purchasers of distressed competitors in an attempt to vertically integrate origination platforms to feed secondary market demands.

The six 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, growth opportunities for the larger banks will continue to exist mainly outside of Canada.

### **Latin America**

Mexico's financial system remains highly concentrated. Five banks dominate the industry, controlling some 80 per cent of banking assets. Of these five, four (including HSBC) are foreign-owned. In 2006, new banking licences were granted to 13 bank and non-bank institutions. This will increase competition, mainly in customer segments in which banking is currently under-represented. These segments also represent potential growth areas for the existing five major banks in the medium to long term.

There is increasing regulatory pressure on banking and pension management fees and commissions, which has constrained growth in non-funds income. As a result, competition is fierce in consumer lending, as financial institutions seek to build alternative income streams despite difficulties in establishing reliable consumer credit histories. HSBC seeks to differentiate through customer service, and is well positioned to capitalise on economic growth with its extensive branch and ATM network, and growing young customer base.

In Brazil, concentration in the industry increased, with the top ten banking groups accounting for some 70 per cent of assets and 87 per cent of branches at 31 December 2006 (2005: 68 per cent and 86 per cent respectively). These top ten banking groups consist mainly of state-owned, privately owned and large foreign banks (including HSBC), and the most significant change in the Brazilian financial system was the growing market share of the larger privately owned banks through consolidation in the industry and partnerships established with national retailers.

Improvements in the macro-economic environment, particularly in increased solvency and liquidity in the market and in monetary policy, have benefited the consumer through constraining inflationary growth. Notwithstanding persistently high interest rates, consumer borrowing has increased. However, total lending as a

percentage of Gross Domestic Product (GDP) remained low in international terms at 34 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.

In Argentina, HSBC's direct competition comes primarily from international financial groups that provide an equivalent range of banking, insurance, pension and annuity products and services. Given the growth experienced over recent years in the Argentine economy, there has been resurgent demand for credit products, coupled with increases in deposits. The strong recovery in consumer confidence is reflected in the level of private sector loans and private deposits that grew by 40 per cent and 22 per cent respectively compared with 2005. The life and annuities market increased by 17 per cent in terms of assets, while pension funds collections increased by 30 per cent.

[Back to Contents](#)

**Europe**

Profit/(loss) before tax by country within customer groups and global businesses

	Year ended 31 December		
	<b>2006</b>	2005	2004
	<b>US\$m</b>	US\$m	US\$m
<b>Personal Financial Services</b>	<b>1,909</b>	1,932	