Financial Highlights

1995		1996	1996	1996
£m	**For the year**	**£m**	*HK$m*	*US$m*
3,672	Profit before tax	**4,524**	*54,641*	*7,066*
2,462	Profit attributable	**3,112**	*37,587*	*4,861*
843	Dividends	**1,090**	*13,165*	*1,703*
	At year-end			
13,387	Shareholders' funds	**15,187**	*199,859*	*25,833*
21,324	Capital resources	**23,486**	*309,076*	*39,950*
162,814	Customer accounts and deposits by banks	**169,179**	*2,226,396*	*287,773*
226,818	Assets	**236,553**	*3,113,037*	*402,377*
145,218	Risk-weighted assets	**153,488**	*2,019,902*	*261,083*
Pence	**Per share**	**Pence**	*HK$*	*US$*
94.01	Earnings	**117.61**	*14.20*	*1.84*
93.89	Headline earnings	**115.42**	*13.94*	*1.80*
32.00	Dividends	**41.00**	*5.40**	*0.70**
508.05	Net asset value	**570.73**	*75.11*	*9.71*
	Number of ordinary shares in issue at year-end			
1,775m	HK$10	**1,791m**		
860m	£0.75	**870m**		
%	**Ratios**	**%**		
20.7	Return on average shareholders' funds	**21.3**		
1.28	Post-tax return on average assets	**1.45**		
	Capital ratios			
14.7	— total capital	**15.3**		
9.5	— tier 1 capital	**9.9**		
55.6	Cost:income ratio	**52.9**		

* *The dividends per share figures are translated at the closing rate. Shareholders who receive dividends in Hong Kong dollars received a first interim dividend of HK180.9 cents per share. The second interim dividend of 26 pence per share will, where required, be converted into Hong Kong dollars at the exchange rate on 22 April 1997.*

Five-Year Comparison

At year end *(£m)*	1992*	1993	1994	1995	**1996**
Share capital	2,054	2,111	2,090	2,124	**2,014**
Shareholders' funds	8,011	9,334	10,790	13,387	**15,187**
Capital resources	13,005	16,510	18,098	21,324	**23,486**
Customer accounts	119,674	128,843	128,707	142,121	**151,149**
Loans and advances to customers	93,111	97,753	98,795	109,373	**114,353**
Total assets	185,141	207,447	201,518	226,818	**236,553**
For the year *(£m)*					
Operating profit before provisions	2,024	3,588	3,060	3,772	**4,519**
Provisions for bad and doubtful debts	(905)	(1,158)	(275)	(416)	**(384)**
Pre-tax profit	1,465	2,584	3,166	3,672	**4,524**
Profit attributable to shareholders	1,027	1,806	2,053	2,462	**3,112**
Dividends	(472)	(594)	(703)	(843)	**(1,090)**
HK$/£ average exchange rate	13.664	11.582	11.853	12.203	**12.078**
Per ordinary share *(pence)*					
Earnings	51.74	71.13	79.60	94.01	**117.61**
Headline earnings	39.75	68.77	76.84	93.89	**115.42**
Dividends	19.00	23.50	27.00	32.00	**41.00**

* *Figures for 1992 have been restated to reflect the change in accounting policy for the translation of the results of overseas branches and subsidiary and associated undertakings at average exchange rates, but have not been restated to reflect the UK reporting requirements applicable under Financial Reporting Standard 5, 'Reporting the Substance of Transactions'.*

Contents

Group Chairman's Statement

Solid business growth and improved profitability in all the major regions where the HSBC Group operates generated good financial results in 1996.

Profit attributable to you, our shareholders, rose by 26 per cent to £3,112 million (HK$37,587 million, or 25 per cent). Your Directors declared a second interim dividend (in lieu of a final dividend) of 26 pence per ordinary share. This brings the total distribution for 1996 to 41 pence, an increase of 28 per cent (38 per cent in Hong Kong dollars at the exchange rate in effect on 31 December 1996).

The dividend is payable on 30 April 1997 in cash, in sterling or in Hong Kong dollars, with a scrip alternative. A second interim dividend, rather than a final dividend, is being paid in response to a shareholder's recommendation at last year's Annual General Meeting, and thus the payment will be made about a month earlier than in recent years.

The Group's capital remains strong, with a total capital ratio of 15.3 per cent and a tier 1 ratio of 9.9 per cent.

Despite intense competition, our net interest margins improved overall but, as expected, there was some contraction in Hong Kong in the second half of the year. Costs were well controlled.

The Group's credit quality remains good, although a small number of problem accounts within our commercial banks in Hong Kong led to an increase in their doubtful debt charges.

Our treasury and capital markets business performed strongly, with our two principal trading subsidiaries, Midland Bank and HongkongBank, achieving improved profitability in that business, particularly in net interest income earned from money-market activities.

Midland Bank's UK market share grew, particularly among young account holders and in residential mortgages. Cost control programmes were effective.

The 37 per cent rise in attributable profit of HSBC Investment Banking was encouraging. Funds under management by HSBC Asset Management rose to US$44.5 billion.

Throughout the year, HSBC Group members expanded their operations by growing their existing businesses or through focused acquisitions, and new marketing programmes attracted new customers around the world.

Hong Kong remains our centrepiece in Asia and Group members performed well in an extremely competitive environment. Both HongkongBank and Hang Seng Bank reported solid growth.

In China, HongkongBank was one of the first foreign banks approved to conduct renminbi business in Shanghai. The bank opened a new office in Chengdu and received approval to open a branch in Pudong and upgrade its Dalian office to a branch. Hang Seng Bank expanded its operations in China and opened six new branches in Hong Kong.

Elsewhere in Asia-Pacific, HongkongBank opened new operations in Bangladesh, Mauritius, New Zealand, the Philippines, Saipan, Sri Lanka, Taiwan and Thailand, and HongkongBank of Australia opened two new branches. HSBC Investment Bank Asia opened offices in Thailand and the Philippines; while Hang Seng Bank opened a branch in Singapore. The Group's operations in Tokyo were relocated under one roof in January 1997.

The British Bank of the Middle East, or BritishBank, opened branches in Baku, Azerbaijan and Seeb, Oman. Among our associates, The Saudi British Bank opened another branch in Riyadh and two in Eastern Province; Egyptian British Bank opened a new branch in Cairo; and The Cyprus Popular Bank opened its new headquarters building in Nicosia.

Midland Armenia Bank, in which Midland has a 70 per cent stake, opened in Yerevan in March 1996. Midland was the first foreign bank to be granted an unlimited banking licence in Malta, where it opened a branch in September 1996, and became the first

Group Chairman's Statement *(continued)*

British bank to be granted a commercial banking licence in the Czech Republic where it plans to open a branch in May 1997.

In North America, Marine Midland acquired 11 branches from the East River Savings Bank and two from Hang Seng Bank. Marine also acquired the US dollar clearing business of J P Morgan and its acquisition of First Federal Savings and Loan was completed in early 1997. Hongkong Bank of Canada opened three branches in Vancouver, two providing services in Mandarin; it acquired two branches in the northwestern United States from HongkongBank; and it expanded into telephone banking, direct motor insurance and wealth management.

HSBC Securities, Inc. received Section 20 underwriting powers from the Federal Reserve Board of Governors, enabling it to underwrite both debt and equity securities in the United States. Our New York treasury ceased interbank foreign exchange market-making. Price-making and processing are now centralised in London, while our US sales team continues to develop customer-related business.

We continued to participate in developing Mondex, the electronic cash-on-a-card system, with external trials in England, Hong Kong and Canada; and internal trials in New Zealand and the United States. MasterCard International's February 1997 agreement to acquire 51 per cent of Mondex International Limited will accelerate the worldwide implementation of the system.

Our strategic expansion has continued since the end of our financial year. Forward Trust, Midland Bank's asset-based finance subsidiary, acquired the UK rail rolling-stock company, Eversholt, in February.

As the Group Chief Executive points out in his 'Review', we enhanced the Group's presence in Latin America, most significantly through the establishment of a new bank in Brazil, Banco HSBC Bamerindus S.A. Capitalised at R$1 billion, the new bank has purchased certain of the assets, liabilities and subsidiaries of Banco Bamerindus, which was intervened by the Central Bank of Brazil in March 1997 and in which the Group held a 6.14 per cent stake since 1995.

A special section of this *Annual Report* describes in detail the Group's commitment to new technology and some of our plans for the future.

We were named Hong Kong Finance House of the Year by the *International Financing Review*, and Group members received further accolades. HongkongBank was named Asian Bank of the Year by the same magazine and Hong Kong's leading company by the *Far Eastern Economic Review*. Hang Seng Bank was Commercial Bank of the Year in Hong Kong for the third consecutive year, according to *Asiamoney*.

HSBC James Capel was named Derivatives House of the Year by *World Equity Magazine*, and HSBC Investment Banking received several awards in Europe and Asia. HSBC Investment Bank Asia completed a landmark transaction in China, for the Zhuhai Power Station, which was voted Deal of the Year by both *Infrastructure Finance* and *Project & Trade Finance*.

The Group's commitment to community causes in the countries in which its members operate continued.

HongkongBank, through the Hongkong Bank Foundation, annually supports more than 100 students with scholarships and bursaries. A China-Hong Kong student exchange was established at the Hong Kong Academy for Performing Arts for studies in dance, music and technical arts.

More than 4,300 students have graduated from the Hang Seng School of Commerce since its formation in 1980, and the bank provides other scholarship programmes for students in the territory.

HongkongBank Singapore's Care for Nature conservation programme received the prestigious 'Green Leaf' award for environmental protection from the Singapore Government. In Thailand, HongkongBank received a special award from Her Royal Highness Princess Galayanivadhana in recognition of its efforts to help save Thailand's dwindling tiger population.

Hongkong Bank Malaysia received a Crystal Award from the Institute of Public Relations Malaysia for its environmental protection and community programmes. The bank continued its support for coral reef protection, its 'Wetland Wonders' awareness campaign, and development of environmental teaching materials. It also sponsored a radio programme to teach the national language, Bahasa Melayu.

In Singapore and India, HongkongBank funded audiovisual educational programmes on the environment, while in Brunei it continued to support the Belalong rain forest project and sponsored two sell-out books in a series on Brunei's natural history.

The British Bank of the Middle East launched the £1 million BritishBank Foundation for educational sponsorships in the Gulf region.

Among the many organisations supported by Midland Bank in the UK was Young Enterprise, enabling young people to run their own small businesses while still in school. In sports, the UK's top-seeded tennis star, Tim Henman, rose from the ranks of Midland's Schools Tennis programme. In the performing arts, Midland's sponsorship of promenade performances at the Royal Opera House celebrated a record-breaking 25th year. Midland also was a major sponsor of charities for the homeless, the physically handicapped and the elderly.

In North America, the Marine Midland Arena opened in Buffalo, New York, as a centre for professional and amateur sports, performing arts and other community activities. Hongkong Bank of Canada supported a number of educational and environmental projects, particularly park improvements.

HSBC Investment Bank supported two London-based arts activities — a community education programme with an art gallery and a project for children with Shakespeare's Globe Theatre.

HSBC Holdings, too, participated in educational and environmental programmes. We funded the teaching of Asian languages to UK students. The Royal Grammar School in High Wycombe was the first school in Europe to offer Bahasa Melayu and the Levenshulme School in Manchester added Mandarin to its curriculum. We also supported Voluntary Service Overseas' teaching of English in remote parts of China.

We became one of four corporate patrons of the Royal Geographical Society; supported EarthWatch; and participated as a member of the Core Advisory Group of the United Nations Environmental Programme on the Statement for Banks.

Our support for London performing arts won two UK Government Pairing Scheme awards: for the City of London Sinfonia's series of free lunch-time concerts in churches and for the City of London Festival.

We aided people in crisis through the International Red Cross/Red Crescent movement as a corporate patron of the British Red Cross.

Most Group members ceased sending Christmas or holiday cards, and instead donated the money that would have been so spent to charities on behalf of customers and staff.

In addition to these corporate initiatives, many staff members voluntarily gave their time, expertise and money to community causes, and I commend and thank them for their efforts.

To raise our corporate profile around the world, HSBC Holdings has undertaken two major new sponsorships on behalf of the HSBC Group.

The HSBC Money Gallery at the British Museum opened in January 1997. With the help of your Group, the most-visited museum in Europe has created the world's only permanent gallery dedicated to promoting knowledge of the history, evolution and future of money. The educational exhibition is being supplemented by two books and a CD-Rom.

A first for a major financial institution, HSBC Holdings is sponsoring Stewart Grand Prix for five years beginning in 1997. Formula One motor racing has one of the largest global television audiences of any sport, resulting in the HSBC name and hexagon symbol becoming better known around the world. It also should generate new business opportunities for HSBC Group members and provide a rallying point as the Stewart-Ford team appears on the racing grids and elsewhere throughout the year.

The hexagon symbol has begun to appear across Midland's branch network following its recent adoption of the Group's corporate identity. As its implementation programme unfolds, all of our wholly-owned subsidiaries will share the Group's corporate colours.

The contributions from our staff around the world made the excellent performance of the HSBC Group possible and, on behalf of the Board, I thank each and every one of them. Their dedication and loyalty are major factors in the competitiveness of your Group.

We extended a fourth invitation to staff under our award-winning Savings-Related Share Option Scheme in March 1997, extending eligibility to staff in Australia. So far, some 37,000 employees in more than 40 countries have taken part.

In December, Northrup Knox retired as Chairman of HSBC Americas, Inc. and as a Director of HSBC Holdings and Marine Midland Bank. He was the third generation of the Knox family to be Chairman of Marine Midland. We thank him for his valuable advice and guidance over many years.

1997 is an important year for the Group, filled with challenges and opportunities for all our businesses, from commercial and investment banking to insurance, and across our range of global products.

The year will be marked by a general election in the United Kingdom and by the transition of Hong Kong to a Special Administrative Region of the People's

Group Chairman's Statement *(continued)*

Republic of China. We are confident that the economic reforms that have promoted growth in China will continue and that the commitment to the principle of 'one country/two systems' remains strong.

Around the world, financial markets are consolidating and new competitive threats are arising from non-traditional participants in those markets. I am optimistic and confident, however, that we have the people and the financial strength to meet the challenges and take full advantage of the opportunities that lie ahead.

Sir William Purves, *Group Chairman*
4 April 1997

Group Chief Executive's Review of Operations

Profitable growth in all major areas of our operations characterised the 1996 results of HSBC Holdings.

Our pre-tax profit of £4,524 million was 23 per cent higher than 1995. After a tax charge of £1,073 million and deducting minority interests, the net profit attributable to our shareholders was £3,112 million. Earnings per share rose by 25 per cent to 118 pence.

Operating profit before provisions, by which we measure our core earnings performance, improved by 20 per cent to £4,519 million. This was due primarily to a 14 per cent growth in net interest income, which accounted for 61 per cent of our total operating income. The improvement reflected growth in both average interest-earning assets and higher interest spread. Net fees and commission income grew by 15 per cent, in part reflecting geographic and product range expansion.

Income grew faster than costs. Thus our productivity improved, reflected in our cost-to-income ratio which improved by 3 percentage points to 52.9 per cent. We retained 65 per cent of the net profits to support future business growth and invest in new sources of income.

The HSBC Group has a long history of providing value for its shareholders. Under our progressive dividend policy, dividends have grown by an annual average of more than 20 per cent over the last four years. During the same period, earnings per share averaged an annual increase of about 23 per cent.

The trends in the quality of our loan portfolio were positive during 1996, despite a few new problem loans: non-performing loans declined by 20 per cent, and the bad and doubtful debt charge was lower at £384 million, or 0.33 per cent of customer advances. This included £78 million in additional general provisions, reflecting the growth in customer loans in 1996.

By the end of the year, the Group's total assets had risen by 4 per cent to £236.6 billion. At constant exchange rates, the growth was £25.1 billion or 12 per cent. Reflecting the economic strength of the region, we achieved the strongest organic growth in our lending to customers in Asia-Pacific, including Hong Kong, a trend that we expect to continue.

The transfer of products and ideas within the Group for our customers is central to our business approach. For instance, in 1996, we made progress in developing our personal banking products, already strong in Hong Kong, Malaysia and Singapore and across other countries in the Asia-Pacific region.

Our global businesses increasingly work with our regional networks. Just one example: we are providing our personal banking customers around the world with unit trusts and investment products from HSBC Asset Management.

An analysis of the results by subsidiary and by line of business follows.

Attributable profit by subsidiary and by line of business

(£m)	1996	1995
Hang Seng Bank	**703**	655
Less: minority interests	**(271)**	(252)
	432	403
HSBC Investment Bank Asia Holdings	**72**	53
HongkongBank and other subsidiaries	**1,092**	907
HongkongBank and subsidiaries	**1,596**	1,363
Midland Bank	**849**	610
— preference dividend	**(37)**	(22)
	812	588
HSBC Americas, Inc.	**245**	185
— preference dividend	**(4)**	(4)
	241	181
The British Bank of the Middle East	**62**	58
Hongkong Bank Malaysia Berhad	**84**	55
Hongkong Bank of Canada	**55**	47
HSBC Holdings sub-group	**47**	36
Other commercial banking entities	**95**	47
Less: British & Commonwealth provision release	**—**	(16)
Less: investment banking profits included above	**(108)**	(79)
Commercial banking	**2,884**	2,280
Investment banking	**228**	166*
Provision release following the British & Commonwealth settlement (after tax)	**—**	16
Group profit	**3,112**	2,462

**The 1995 figure for investment banking was restated to reflect the sale of HSBC Life Limited to a fellow Group subsidiary.*

Group Chief Executive's Review of Operations *(continued)*

We have changed the presentation of the *Annual Report*. You will notice that my 'Report' and the 'Review of the Group' have been combined as a 'Review of Operations', which contains regional commentary.

Hong Kong

The improvement in Hong Kong's economy in 1996 was led by domestic consumption, while stable interest rates helped the local equity and property markets. Real GDP increased by 4.7 per cent, the same rate of growth as 1995.

Weak global demand led to a slowing in the growth of external trade, adversely affecting Hong Kong's manufacturing industry, especially in the garment and electronics sectors. Investment growth was fuelled by continued infrastructure development.

Consumer spending rose in line with real purchasing power. Unemployment fell to 2.6 per cent from a peak of 3.6 per cent in 1995, partly due to slower growth in the supply of labour. Inflation was 6.7 per cent at the end of 1996, and averaged 6.0 per cent for the year.

Hong Kong continued to prepare for China's resumption of sovereignty, when Mr C H Tung will become the first Chief Executive of the Hong Kong Special Administrative Region. His appointment has been very well received and public confidence in Hong Kong's future is reflected in the property and equity markets.

Operations in Hong Kong contributed 40 per cent, or £1,642 million, of the Group's operating profit for 1996.

Against a background of increased competition, particularly in the residential mortgage market, the Group's Hong Kong operations reported a higher level of net interest income. This was achieved by good growth in average advances to customers and a slightly higher interest spread.

Net fee and commission income was also higher. HSBC Investment Bank Asia's strong presence in the territory enabled it to record good growth in advisory and corporate finance fees earned from new issues, infrastructure financing and loan syndications, while HongkongBank and Hang Seng Bank (HSBC Group interest: 61.51 per cent) reported good growth in fee income from securities, credit facilities and cards, and satisfactory growth in dealing profits.

Growth in our treasury and capital markets business and further investment in technology gave rise to a small increase in staff numbers in Hong Kong. The competitive employment environment there, particularly for skilled staff, contributed to continued salary pressure.

The higher charge for bad and doubtful debts in Hong Kong in 1996 was related to a small number of specific problem loans and was not indicative of a general deterioration in asset quality.

The proportion of the Group's total assets in Hong Kong remained broadly unchanged at 31 per cent. Advances to customers, in Hong Kong dollar terms, increased by 12 per cent in HongkongBank and by 16 per cent in Hang Seng Bank, as both banks recorded strong growth in residential mortgages and in corporate lending for the real estate and construction sectors.

Both our commercial banks in Hong Kong began major initiatives to broaden their customer bases and their market penetration through new product innovations and better marketing techniques. In personal banking, HongkongBank worked to expand its personal financial services business in Hong Kong and now has 73 branches offering an extended product range including unit trusts, insurance and capital protection investment accounts, as well as regular banking services. A new customer loyalty programme helped stimulate a substantial increase in funds deposited by customers.

In line with its customer segmentation, Hang Seng Bank introduced Private Wealth Management Services for high net-worth customers. Hang Seng Bank also geared more of its branch network towards providing a total financial package to its customers.

To capture the growing market for residential mortgages, both HongkongBank and Hang Seng Bank launched new, improved services. HongkongBank introduced a number of mortgage services catering for differing customer needs and published a *How to Buy Your Home* guide to help first-time buyers, while Hang Seng Bank's new packages included the Flexi-Plus Mortgage Loan, the Hang Seng Interest-Capped Mortgage Loan and a Mortgage Loan-by-Phone service.

The Group further enhanced its leading position in electronic banking. Hexagon, the Group's 'desktop bank', was upgraded with a Microsoft Windows® version and added new functions such as Electronic Trade Related Services, pooling and cash concentration.

Our card business saw the launch of the HongkongBank Purchasing Card, designed to simplify companies' purchasing procedures, and two co-branded credit card programmes with the Hong Kong Community Chest and the Hong Kong Society of Accountants. Hang Seng Bank launched a number of credit card promotions, including the Olympic Visa campaign and Travel the World Show Case, and two affinity cards — the Hong Kong Institute of Company Secretaries Gold Card and the Breakthrough Visa card.

Hang Seng Life, a joint venture company between Hang Seng Bank and HSBC Life established in 1995 to meet customers' life insurance needs, was well received while HSI Services launched the Hang Seng Asia Index to gauge the overall performance of Asian equity markets.

Significant growth in the advisory and corporate finance fee income of HSBC Investment Bank Asia arose from increased market activity in Hong Kong. Its Aircraft and Structured Finance division arranged finance totalling more than US$2.3 billion for 26 aircraft, achieved in a very competitive market. The strength of the Hong Kong stock-market, especially in new issues, led to an active year for the Corporate Finance and Equity Capital Markets division.

HSBC Investment Bank Asia maintained its leading position in capital markets activity in Hong Kong. It was joint global co-ordinator and bookrunner for the US$560 million international placement and initial public offering of Cheung Kong Infrastructure Holdings Limited, the second largest ever on the Hong Kong Stock Exchange. This transaction was named Deal of the Year by *Institutional Investor*.

Loan syndications were also buoyant. HSBC Investment Bank Asia arranged US$9.1 billion in syndicated loans in addition to lead-managing US$4 billion in equity issues. HSBC Asset Management's unit trust sales in Hong Kong were strong, and private banking in HSBC Investment Bank Asia continued to increase its assets under management, which grew by 17 per cent in 1996.

Wardley Financial Services, the retail broking business, benefited from the buoyant stock-market conditions in Hong Kong.

HongkongBank entered the corporate trust/issuer services market in 1996, providing paying agency and depository services for international capital markets issues. Its Trade Services Division reported good initial progress in promoting the Asian Documentary Credit Issuing Programme for the benefit of major US importers and financial institutions.

Rest of Asia-Pacific (including the Middle East and Africa)

Asia-Pacific

Economic conditions were largely favourable across the rest of Asia-Pacific, although a general downturn in global demand, particularly in electronics, resulted in lower rates of expansion from the second quarter of the year onwards. The Group's regional operations showed good growth in Australia, China, Indonesia, Malaysia, New Zealand and the Philippines.

The region contributed 16 per cent, or £650 million, of the Group's operating profit. Increases in net interest income were reported in all of the region's major countries where the Group operates, reflecting both growth and an improved asset and liability mix. The proportion of Group assets deployed in Asia-Pacific fell slightly in 1996, to 13 per cent, mainly as a result of the strength of sterling when translating overseas assets at year-end.

China's economy achieved a soft landing in 1996 with strong GDP growth at 9.7 per cent and sharply lower inflation at 8.3 per cent. The HSBC Group's presence in China continued to grow and HongkongBank maintained its position as the country's leading foreign bank with seven branches and three representative offices, while Hang Seng Bank, which opened its first China branch in Guangzhou in December 1995, applied to upgrade its Shanghai representative office to a full branch. HongkongBank expanded its services to customers in China by linking its ATM network with that of the Industrial and Commercial Bank of China in Shanghai and Guangzhou.

In Malaysia, net interest income rose by 25 per cent in Hongkong Bank Malaysia because of strong growth in corporate and personal lending and a higher interest spread. Corporate lending grew by 16 per cent and personal advances, including residential mortgages, grew by 28 per cent. The expansion in lending was funded principally by very strong growth in customer deposits and increased revenues resulted from higher levels of guarantee fee income, card products, securities services, trade finance and foreign exchange earnings.

The Group's expansion in Asia-Pacific was matched by higher staff numbers and an accompanying increase in operating expenses. Revenue expansion lagged cost growth only marginally in the region but productivity, as measured by the cost-to-income ratio, remained well above the Group average.

In Asia-Pacific, as in other parts of the world, one of the Group's main thrusts in 1996 was on expanding its personal banking business, partly by extending HongkongBank's AssetVantage and AssetVantage Select products to new areas.

AssetVantage and AssetVantage Select are premium customer services, aimed at professionals, managers and executives, and feature a comprehensive range of banking facilities such as interest-paying current accounts, telephone banking, special ATM cards and, often, dedicated AssetVantage counters within branches.

Group Chief Executive's Review of Operations *(continued)*

HongkongBank opened an AssetVantage Select priority banking centre in Singapore. AssetVantage was extended to Bangalore, Calcutta, Chennai and New Delhi in India, and was launched in Pakistan in October when the AssetVantage Customer Services Centre was opened in HongkongBank's Karachi branch. It was also introduced in Indonesia and extended in the Philippines.

Hongkong Bank Malaysia launched PowerVantage, a three-in-one account feature aimed at younger customers, enabling them to set aside fixed amounts for savings on a regular basis.

HongkongBank introduced credit cards in Indonesia; and, in Taiwan, where HongkongBank became the first bank approved to operate private-label card business, the bank signed an agreement to acquire the private-label business of the Chun Yo Department Store in Taichung. HongkongBank of Australia launched a GlobalAccess debit card, giving customers access to 90 per cent of Australia's ATMs. Other ATM developments included HongkongBank's expansion of ATM access in India and the linking of customers of the Bangkok branch into Thailand's ATM network.

Among other banking initiatives in Asia-Pacific, Hang Seng Bank's new branch in Singapore introduced offshore banking services to non-residents.

HongkongBank of Australia achieved strong personal banking growth and joined Giropost, enabling customers to do basic banking transactions at 2,500 post offices. The bank also launched a number of successful products, including home equity loans and introductory rate mortgage loans, while in New Zealand, HongkongBank's series of marketing campaigns and its introduction of mobile mortgage managers led to significant growth in the mortgage book.

In securities services, Hongkong Bank Malaysia's securities custodial business was awarded 'top rated' status for Malaysia by the *Global Custodian Agents Review*. Ten branches of HongkongBank across the region were also given 'top rated' status. In the Philippines, HongkongBank Securities Services Manila became the bank's first securities centre to be awarded the international quality standard, ISO 9002. Additionally, its treasury operation was granted one of the first derivatives dealing licences awarded to a bank in the Philippines.

Other regional developments saw the launch of foreign currency lending in India; good progress being made in derivatives marketing in Taiwan; and the opening of HongkongBank's second Provincial International Banking Facility in Thailand. Contracts were signed for the development of a new 12-storey building in Bangkok.

Among our investment banking facilities in the region, HSBC Investment Bank Asia's Singapore office reported strong growth in private banking operations as a result of expanding into regional markets, where it also expanded its offshore loan syndication business. Also, PT HSBC Securities Indonesia started retail broking operations in Surabaya, Indonesia and plans to launch a similar operation in Jakarta in 1997. HSBC James Capel sold most of its shareholding in Kay Hian James Capel and a new broking operation was established in Singapore. HSBC Investment Banking was granted a licence to open an investment banking operation in India.

HSBC Investment Bank Asia won mandates as financial adviser for two transport infrastructure projects in Taiwan. HSBC James Capel Australia was ranked among the country's top 10 stockbrokers during the year, and HSBC James Capel Asia became the second-largest foreign-owned broker in Korea.

Middle East and Africa

With the Gulf States benefiting from improved oil prices and buoyant trade flows in 1996, The British Bank of the Middle East recorded good profit growth in the United Arab Emirates, Oman and Jordan, and at the Middle East Finance Company and the offshore banking unit in Bahrain. Trade finance activities and card products also expanded.

Net interest income rose as the result of a higher interest spread and growth in average interest-earning assets. Operating expenses rose because we made investments in new technology and staff development to continue business expansion and enhance customer service.

The British Bank of the Middle East, which adopted the marketing name BritishBank in October 1996, increased its emphasis on developing personal banking products, resulting in an expansion of customer lending.

BritishBank purchased a 40 per cent stake in HSBC Financial Services (Middle East) Limited from Wardley International, and acquired 5 per cent of the equity of the British Arab Commercial Bank, extending the Group's stake to 46.51 per cent.

British Arab Commercial Bank experienced a quiet year in the face of relatively weak demand resulting from surplus lending capacity in its operating areas. Treasury operations expanded, particularly in foreign exchange earnings. An electronic banking package, BACB SELECT, was installed and will be offered to customers in 1997.

Elsewhere in the Middle East, our associate, The Saudi British Bank (HSBC Group interest: 40 per cent), reported record profits and increased its number of branches to 63, including seven ladies' branches. The bank's ATM network grew by 11 to 104.

The Saudi British Bank established an Investment Banking Division, comprising its existing private banking, merchant banking, equity, mutual funds and Islamic banking units, together with a new factoring unit to offer customers an increased product range.

The bank also launched a co-branded credit card with Haji Hussein Ali Reza, a major auto dealer, and further developed its expatriate remittance service which utilises ATMs and now covers nine countries.

Egyptian British Bank (HSBC Group interest: 40 per cent) continued to develop its range of products and introduced Visa cards. A pilot telephone banking scheme was introduced to staff ahead of a full launch in 1997. The bank also plans to launch a joint venture investment company and brokerage company, and to expand its securities custody operation.

HSBC Equator Bank, the HSBC Group's investment bank in sub-Saharan Africa, opened an office in Kampala, Uganda in January 1996. Elsewhere in Africa, HSBC Investment Bank and its affiliate, stockbroking and investment advisory house Simpson McKie James Capel, won the tender to advise the South African Government on the restructuring of state assets. In Zimbabwe, Simpson McKie James Capel formed a joint venture, Quincor James Capel, with the Zimbabwean stockbroking firm Quincor.

United Kingdom and Continental Europe

The UK's historically-low inflation of 2.4 per cent, lower base rates and higher real earnings led to greater buoyancy in the personal financial sector in 1996. This resulted in retail spending growth and some evidence of a sustainable recovery in the housing market. The economic growth rate in the UK exceeded that of continental Europe.

The British banking sector continued to be extremely competitive with new providers of telephone banking entering the market, several high street retailers entering financial services, and building societies converting into banks.

The business environment in continental Europe was subdued, with curtailed public sector expenditure as governments aimed to meet the Maastricht criteria for European Monetary Union. Inflation was generally low and unemployment remained high.

Europe's contribution to the Group's operating profit was 32 per cent, or £1,287 million. The UK's contribution to this was £1,208 million. In the UK, strong growth in average interest-earning assets and wider spreads on savings products more than offset reductions in interest spreads, due to competitive pressures in the residential mortgage market, and a change in asset mix, resulting from larger volumes of treasury assets held by Midland Bank.

The proportion of Group assets in Europe was broadly unchanged at 41 per cent of total assets. Midland's European assets increased by 6 per cent, reflecting additional lending to major corporates and growth in UK mortgage lending and the bank's participation in the new UK gilt repo trading market. Credit quality was satisfactory and there was a further decline in the level of non-performing loans.

The relatively buoyant European stock-markets enabled HSBC Investment Bank to report increased levels of fee income from corporate finance activities, specialised financing transactions and new issues in the equity capital markets. Markets continued to be favourable for divestment of private equity investments, leading to 29 per cent profit growth in this area. In addition, growth in net new business and higher market values led to increased commission income for HSBC Asset Management.

Increased net fee and commission income in Midland Bank resulted from strong growth in First Direct, Midland's card business, securities under custody in Midland Securities Services and assets in Midland Private Banking. The initiative to place trained financial advisers in Midland Bank's branch network generated encouraging growth in life assurance and unit trust sales.

The containment of costs in Midland was encouraging. Overall growth in staff remuneration, reflected in the annual pay awards and profit-related payments, and greater investment to support business growth were largely offset by the savings achieved through the consolidation and centralisation of back and front office activities, and lower reorganisation and branch refurbishment costs.

Midland increased its market share, particularly in residential mortgages and current accounts.The number of new first year student accounts rose by 50 per cent over 1995, and Midland's mortgage book grew by over £1 billion.

To re-emphasise the paramount importance of customer service, all of Midland's UK staff, and a number from overseas, participated in the 'Winning Team' customer service training programme.

In Jersey, Midland Private Banking extended its range of products for expatriate and international customers and launched a 24-hour telephone banking service. The number of customers increased by 12 per cent.

In the card business, Midland launched the UK's first shopping centre credit card and created a Welsh language credit card. Midland introduced access to the Cirrus network on its debit card, expanded its ATM network and launched the UK's first mobile on-line ATM.

In business banking, Midland relaunched its small business start-up package, which now includes free banking for up to 18 months. Midland provided almost 25 per cent of loans under the UK Government's Small Firms Loan Guarantee Scheme.

First Direct had another strong year in the fast-growing telephone banking market, gaining 150,000 new customers.

The new Midland Bank current account was launched in January 1997. This simplified, repriced account offers fee-free overdrafts. Special cheque-books were introduced for the bank's 600,000 left-handed customers.

Forward Trust combined its leasing and hire purchase businesses, which continued to trade in the name of Forward Trust and Swan National. Factoring, debt management and legal services were brought together under the name of Griffin Credit Services. Forward Trust Personal Finance, which provides consumer credit products, became First Direct Business to Business from January 1997.

Midland Securities Services won a number of global and domestic custody mandates, including the UK's largest-ever mandate, for Prudential Portfolio Managers Limited.

HSBC Investment Banking advised Lloyds Chemists on the £684 million sale of its business, acted as broker to Scottish Power in its acquisition of Southern Water, and was co-arranger of a £1.2 billion syndicated loan for Mercury One 2 One.

HSBC Asset Management launched two new products in the UK, the TESSA Plus and PEP Plus, generating £147 million of new funds. It also received its first two mandates for defined contribution pension schemes from the HSBC Group.

In continental Europe, both Trinkaus & Burkhardt in Germany and Guyerzeller Bank in Switzerland contributed satisfactory results, with increases in fee income from private banking.

The Cyprus Popular Bank (HSBC Group interest: 21.96 per cent) experienced considerable growth in its overseas markets in the UK and Greece. Domestic performance was restricted due to the recessionary environment where GDP growth was around 2 per cent. The bank opened its first unmanned branch in 1996, began offering leasing services through Laiki Finance, and introduced a closed-end investment company. Private banking and an improved range of custody services were also introduced during the year.

HSBC Investment Banking purchased a securities broker in Poland to complement its advisory activities in that country.

Americas

Economic growth in the United States was steady in 1996 with GDP growing at around 2.4 per cent. With inflation and interest rates relatively low, the rising level of consumer debt was an impediment to overall economic growth with the potential to affect credit quality. New York State, where most of the Group's US operations are concentrated, continued to trail the national economy, but prospects for its business environment improved with the announcement of state tax cuts and a stimulus package.

The Canadian economy featured growth of 1.4 per cent, and inflation of 1.6 per cent. Interest rates declined, and unemployment was virtually unchanged at 9.7 per cent.

The contribution to operating profit made by operations in the Americas improved to £501 million, or 12 per cent. The increase in net interest income was consistent with growth in the overall balance sheet. Hongkong Bank of Canada's net interest income increased as the result of significant organic growth in commercial loans and residential mortgages, while that of HSBC Americas was driven principally by small acquisitions.

The proportion of the Group's total assets invested in the Americas increased to 15 per cent. In local currency terms, total regional assets increased by 20 per cent due largely to acquisitions, as organic loan growth remained sluggish in New York State. The credit quality of advances remained good with a further decline in the level of non-performing loans. HSBC Americas' work-out of the Concord Leasing problem asset portfolio has now been substantially completed.

Hongkong Bank of Canada continued its emphasis on expanding its array of products and services. Consequently, other operating income increased as, in a low interest rate environment, customers sought higher returns from the alternative investment products now offered by the bank. These new business initiatives contributed to a rise in operating expenses in the Americas.

The continued strength in the overall loan portfolio and the absence of any large charge against the Concord Leasing problem asset portfolio in 1996 outweighed the effects of increased consumer loan provisions in HSBC Americas.

HSBC Securities, Inc. has made an encouraging start in developing activities associated with its new Section 20 debt and equity underwriting powers.

HSBC Americas' principal operating subsidiary, Marine Midland Bank, further expanded its branch network. Following the acquisition of 11 East River Savings Bank branches in 1996, the acquisition of First Federal Savings and Loan Association's 79 retail branches in New York State and 15 mortgage origination offices in nine states was completed early in 1997. The trade finance activities of HongkongBank's Houston, Portland and Seattle offices were transferred to Wells Fargo HSBC Trade Bank (HSBC Group interest: 20 per cent) in November and, in the following month, Hongkong Bank of Canada acquired HongkongBank's Seattle and Portland branches. Hongkong Bank of Canada also acquired all the commercial banking business of Barclays Bank of Canada in August.

HSBC Americas' core fee income growth from card fees, deposit service charges and trade finance was satisfactory. In the key area of personal banking, Marine Midland's introduction of a new debit card generated good fee income growth, and equity-linked certificates of deposit generated deposit growth as customers benefited from the product's attractive returns.

Hongkong Bank of Canada launched ServicePlus, an extended-hours telephone banking service in English, French, Cantonese and Mandarin. At the end of 1996, over 1,000 calls were being made daily to ServicePlus.

Among other new initiatives launched in Canada were a direct auto insurance scheme from Canadian Direct Insurance; and Private Client Services, a package of personal trust, investment and advisory services from Hongkong Bank Trust Company. In securities, a full retail brokerage service was launched in Montreal, Toronto, Calgary and Vancouver through HSBC James Capel, while Hongkong Bank Discount Trading introduced share trading on the Internet.

In corporate banking, Hongkong Bank of Canada and Marine Midland Bank collaborated in a joint marketing initiative highlighting the benefits of Group synergy to clients doing business on both sides of the US/Canadian border. Marine Midland also extended investment options available to retirement plan customers and began offering stock transfer services.

Vancouver-based investment counselling firm M K Wong & Associates was acquired by Hongkong Bank of Canada.

In February of this year, HSBC Holdings and Wachovia Corporation, the 20th-largest bank holding company in the US, announced a business alliance to market corporate financial services globally.

In Latin America, we are expanding our activities significantly through three strategic investments, all of which were undertaken in March 1997. We agreed to take a 10 per cent shareholding in Banco del Sur del Peru, the seventh-largest retail bank in the country with 47 branches and total assets at year-end 1996 of US$614 million. In addition, we agreed in principle to take a 19.9 per cent shareholding in Mexico's Grupo Financiero Serfin, whose principal subsidiary, Banca Serfin, is the country's third-largest bank.

On 26 March, the Central Bank of Brazil intervened Banco Bamerindus do Brasil S.A. and a newly-established subsidiary of HSBC Holdings, Banco HSBC Bamerindus S.A., has acquired selected assets, liabilities and subsidiaries. With Brazil's second-largest private branch network of more than 1,200 branches and significant insurance, leasing and securities businesses, HSBC Bamerindus gives us a major financial services presence in this growing economy.

These investments complement the Group's other Latin American interests, which include minority holdings in Banco Roberts in Argentina and Banco Santiago (formerly Banco O'Higgins) in Chile.

Global Businesses

The HSBC Group devotes considerable efforts to develop those parts of its business which benefit most from international distribution.

Investment Banking

HSBC Investment Bank plc, HSBC Asset Management and HSBC Investment Bank Asia are the principal Group members comprising HSBC Investment Banking, which is responsible for the advice and financing, equity securities, asset management and many of the private banking and trustee activities of the Group.

HSBC Investment Banking successfully brought together and rebranded the operations of James Capel and Samuel Montagu, thus combining the origination and distribution functions and strengthening industry and product expertise. Its operations in New York and Tokyo were also reorganised, underscoring its close ties with the Group's treasury and capital markets businesses. HSBC Asset Management's funds under management increased significantly, with a net increase of 93 institutional and private client mandates.

The activities of HSBC Investment Banking during the year have been reported in the regions in which they took place.

Treasury and Capital Markets

HSBC Markets has extended its regional management structure, concentrating risk management and market making for treasury and capital markets for Midland in London and for HongkongBank in Hong Kong. The regional treasury operations in Asia were reorganised to provide a reporting line to the Treasurer, HongkongBank. Treasury operations expanded across the region.

HSBC MIDLAND transferred its interbank foreign exchange market making from New York to London. This move provided customers with the better prices and greater liquidity available from our larger London operation, and generated significant cost savings for the Group. Customer-related business continued to be developed in the US through our first-rate sales team in New York.

Insurance

The HSBC Group undertook a wide range of insurance activities, including underwriting, broking and agency activities, in both the life and non-life sectors. World insurance markets were increasingly competitive in 1996, mainly as the underwriting cycle turned down.

HSBC Gibbs, our insurance broker, sold Premium Credit Limited and purchased an insurance brokerage in Glasgow, Hutchison & Craft. It also launched a joint venture, Midland Business Insurance Direct, with Midland Bank.

Midland General recorded growth in revenues from general products of 40 per cent and Midland Life increased commissions from life and pension products by a similar amount. A number of life insurance products in the UK were repriced to improve competitiveness. HSBC Insurance in Hong Kong launched a number of health care insurance products, including MediSurance. As an example of Group synergy, Midland and HongkongBank together made 800 referrals to HSBC Gibbs during the year.

Bank-to-Bank Services

The Group's business with banks and non-bank financial institutions was reorganised under the HSBC Financial Institutions banner.

The purchase of J P Morgan's international US dollar-clearing operation in 1996 underlined the Group's commitment to this business. The Group is among the top five participants in CHIPS, the New York interbank clearing house, and maintained its dominant position in sterling clearing. A major challenge for us will be the introduction of the single European currency, planned for 1999 and for which our plans are well developed.

Global Banking Services

By the end of 1996, HongkongBank Universal Banking (HUB), the Group's proprietary banking system, was installed in 45 countries to support our development of personal banking and card businesses. During the year, Hongkong Bank of Canada implemented HUB.

The Group soft-launched a commercial Electronic Data Interchange (EDI) capability under the name Hexagon-ETRS (Electronic Trade Related Services) in London, New York and Hong Kong in 1996. This enables trading partners to exchange commercial documents electronically and will be extended to other countries in 1997.

To meet the payment and transaction services requirements of corporate and institutional customers across the Group, a new brand, HSBC Global Cash Management, was launched. Our securities custody operations have not only expanded, but have also improved service quality, reflected by 'top rated' rankings in Hong Kong, London and other centres.

Strategic Outlook

The Group's capital ratios remain strong, which is appropriate given the challenges and opportunities we face. Within the Group, capital tension is achieved by allocating sufficient capital to support planned growth in each operating subsidiary with internal dividends paying back any capital generated beyond the subsidiaries' requirements. This capital is available to support unplanned business growth, but must be justified against strict financial return criteria reflecting the Group's cost of capital.

As the Group Chairman noted in his commentary, 1 July is an historic date for Hong Kong as it becomes a Special Administrative Region of the People's Republic of China. Hong Kong's economic fundamentals remain sound. The banking market will continue to be intensely competitive with pressure on margins, particularly in residential mortgage lending. The HSBC Group remains focused on retaining its position as the leading financial services organisation in Hong Kong.

Elsewhere in Asia-Pacific, the Group will further develop its personal banking capabilities. We believe the demographic growth and deregulation taking place there give us a good opportunity to achieve profitable growth by further expanding throughout the region.

In the UK and continental Europe, Midland will continue to focus on customer service, further using technology to improve the quality of services as well as to improve productivity. Controlling costs remains an essential discipline as competition increases in the financial services sector.

In North America, the focus for 1997 will be integrating First Federal and the J P Morgan clearing business into our Group, while continuing to improve the productivity and sales penetration of our existing businesses.

For the Group as a whole, we see opportunities for continuing profitable growth in commercial banking. In developing countries, the Group will target its approach, concentrating where the economy or the bankable population is growing. We will continue to take advantage of opportunities which offer long-term shareholder value, in particular by focusing on situations where we can use our historic presence, our financial strength, or the synergies available from within the Group to achieve profitable growth.

In the more mature markets, the Group will concentrate on improving efficiency and market share. As financial services consolidate, we are working to make the most of the valuable assets we possess.

Investment banking is complementary to our commercial banking activity, and particularly relevant to us in newer markets, where customers look to go beyond the traditional commercial banking services. We shall organically build our investment banking business to become a preferred provider of investment banking services to our government, corporate and institutional clients around the world.

Insurance is already an important business for us, and we plan for it to become our third defined business segment in due course. We shall continue to fine-tune the rest of the Group's business portfolio, concentrating on businesses from which synergies can be achieved.

For a Group like ours to prosper, we must continue to give our customers around the world the best possible service. We can only do this with the support of our talented staff worldwide, and I thank them all for their hard work and professionalism during the year.

J R H Bond, *Group Chief Executive*
4 April 1997

Information Technology in the HSBC Group

These are exciting times for banking technology. We are witnessing radical changes in the way that financial services are provided to customers. The steep and continuing fall in the cost of computer hardware and telecommunications gives us opportunities to improve existing services and explore new applications.

In this rapidly-changing environment, the HSBC Group focuses on delivering the products and services that our customers want in a way that they find easy to use. We also make sure that these services are secure, consistent and user friendly. We believe in maintaining a balanced approach; there are risks in being slow to grasp opportunities but also in being over-aggressive with unproven technologies.

As a global banking and financial services organisation, the challenge of information technology is to link the different parts of the HSBC Group more closely together. Our success depends on implementing our systems as widely as possible throughout the Group. By doing this, we aim to offer a full range of services to our customers, large and small, wherever they wish to conduct business.

The Group handles about 200 transactions every second, 24 hours a day, 365 days a year. In 1997, we will spend more than US$1.25 billion on developing and running computer systems and a further US$400 million on hardware and software purchases. Globally, the Group employs over 6,000 information technology professionals. Technology is vital to our future success, which is why we seek to develop our own systems in-house.

The Group's technology-based initiatives can be broadly categorised into two areas. First, customer service, where we aim to deliver faster, more convenient and more attractive services. Second, internal processes, where improving internal efficiency, effectiveness and productivity are our goals.

Customer Service

We use technology to introduce new services and upgrade existing ones for the benefit of our customers. Among the more significant are the following:

Branches and automated teller machines (ATMs)

Branches and ATM networks are used for most of our customers' banking transactions, so we continue to expand and improve them. The ATM network available to Group customers is one of the world's largest at over 280,000 machines, and growing. We now have ATMs in over 100 countries, dispensing almost US$100,000 every minute of the day. In an average month, our customers carry out 60 million ATM transactions, including 200,000 across borders.

Branches around the world are being equipped with devices built specifically for the needs of the HSBC Group, such as Intelligent Balance Terminals and Customer-Operated Banking Terminals. These reduce waiting time for customers and free up staff to provide other more personal services.

In countries where the telecommunications infrastructure is still relatively undeveloped, entire branches — including ATMs, teller terminals and funds transfer systems — are connected to computers thousands of miles away using Very Small Aperture Terminal (VSAT) technology to carry transactions via satellite. VSAT technology has allowed us to open remote branches quickly and cost effectively in such countries as Armenia, Azerbaijan, China, Indonesia and Bangladesh.

Telephone banking

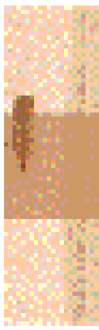
Telephone banking continues to grow strongly. First Direct is the market leader in the UK. As a Group, our telephone centres in Canada, Hong Kong, the UK and the United States receive over 200,000 calls daily from personal banking customers, placing us in the top league as a telephone banking institution.

An internal telephone banking system is being used in several other countries to promote similar services. In the Channel Islands, an international version has been successfully introduced for expatriate customers.

Cards

Card technology continues to advance, notably with the development of Mondex. This new generation 'smartcard' offers the potential to combine many credit and debit cards onto a single card. It acts as a security access device and, uniquely, can replace cash. We are playing a leading role in the development of Mondex and, currently, have some 50,000 pilot cardholders in the UK and Hong Kong.

A major launch of Mondex is planned for Hong Kong in 1997 and other countries will follow. Customer response has been encouraging and, as owners or co-owners of Mondex franchises in 14 countries, the Group will continue to play a major role in the evolution of this product.



Banking by personal computer

The use of personal computers (PCs) for direct banking has been largely confined to the corporate sector. Hexagon, our PC-based banking system, has been notably successful and is now used in more than 100 countries by 80,000 people around the clock.

In 1996, the value of customer payments and transfers processed by Hexagon exceeded US$1,000 billion. Because Hexagon is linked directly to the Group's computer systems in each country, customer-initiated transactions in one country can be applied almost immediately in several others.

Hexagon has been upgraded, most recently with an Electronic Data Interchange (EDI) extension aimed mainly at large corporate customers who are active in international trade. This is compatible with American and European EDI standards and allows the transmission and automatic processing of documents necessary for international trade.

Agreements with external network providers ensure that our customers have access to a wide range of traders, shipping agents, insurance companies and licensing authorities. As leaders in the field of progressive trade services, we are also working with SWIFT, the Society for Worldwide Interbank Financial Telecommunications, and others on the exciting possibility of removing much of the paper flow from the finance of international trade.

Personal banking on the Internet

Demand for electronic banking services on personal computers is growing rapidly, stimulated by the Internet.

An Internet-style version of Hexagon, our electronic banking system, is being developed for delivery over our private secure networks. Developed in conjunction with Microsoft®, it includes an easy-to-use connection to the home accounting system, Microsoft Money®, and other products. Many customers who use PCs for direct banking have relatively complex finances and this integration should prove useful to them.

From mid-1997, First Direct will offer a PC-based service using Internet browsers, such as Microsoft Explorer® and Netscape Navigator®.

In November 1996, Hongkong Bank Discount Trading Inc. in Canada launched netTRADER®, a 24-hour Internet stock-trading service. Other Group companies may follow.

Information Technology in the HSBC Group *(continued)*

Information about the Group and its subsidiaries can be found at our web site www.hsbcgroup.com.

Interactive television

Of the many other devices which can provide access to banking services, television offers the most immediate promise. Digital television opens up the possibility of interactive services, one of which is the ability to offer customers a normal banking service in their living rooms through their television sets. This technology promises to give the Group access to a mass market that cannot easily be reached by other technology, such as personal computers. Systems are currently being developed to exploit its potential.

Internal Processes

The re-engineering of our internal processes provides us with the opportunity to use technology to cut costs and improve service. Centralising operations lets us choose locations where the necessary skills are obtainable, and provides economies of scale.

Treasury operations

In 1996, the HSBC Group's US foreign exchange dealing room was relocated from New York to London. Customer service staff in New York now have access to computer systems, customer information and dealing staff in London via transatlantic voice, data and in-house television communication networks. TREATS, our treasury trading system, is available to New York from London and is now installed in 23 countries. The dealing room move will provide significant savings to the operation while maintaining a very high level of customer service.

District Service Centres

In the UK, many routine processes have been moved from Midland Bank branches into District Service Centres (DSCs), enabling branch staff to concentrate on providing excellent customer service. It has also created new opportunities for automation, especially by using electronic imaging systems.

DSCs process one million standing orders, payment instructions and other customer transactions per month, in addition to 100 million cheques. Midland Bank will eventually become the largest single user of batch-scanning image technology in the world and is now successfully marketing it as a customer service. Batch-scanning image technology allows documents to be scanned into Midland's computer system and then worked on at any DSC, resulting in more efficient allocation of resources.

In Hong Kong, HongkongBank transfers much routine back-office work to an operations centre in Guangzhou in southern China.

Telephone technology

The latest telephone technology also plays an important part in streamlining our internal processes. One example is the use of predictive dialling, which 'predicts' when an outgoing call will end and instantly sets up the next call for a customer service representative. Marine Midland Bank has discovered that up to two-thirds of calls made to its customers find no one at home, so this automated process is an effective time saver.

Global network

The HSBC Group operates one of the world's largest private telecommunications networks, reaching 59 countries. In 47 of these countries, the HongkongBank Universal Banking (HUB) system is used, and the network serves to interconnect them with each other and with Hexagon. The network is being upgraded to incorporate the latest telecommunications technology, enabling us to transport a wide range of voice, data, image and video services inexpensively and effectively. This will improve the quality of our service to customers using Hexagon, proprietary network PC banking, global ATM transactions and international telephone banking.

Summary

Our information technology strategy is based on harnessing the power of new technology to provide new and better services for our customers and improving our own operating efficiency.

As a global banking and financial services organisation, the challenge of information technology is to link the different parts of the Group more closely together.

Board of Directors and Group General Managers

Directors

Sir William Purves, CBE, DSO, *Group Chairman*
Age 65. An executive Director and Group Chairman since 1990. Joined HongkongBank in 1954; a Director of HongkongBank since 1982 and Chairman and Group Chief Executive Officer from 1986 to 1992. Chairman of The British Bank of the Middle East and of Midland Bank plc and a Director of HSBC Americas, Inc. and Marine Midland Bank. A non-executive Director of The 'Shell' Transport and Trading Company, plc and The East Asiatic Company Limited A/S.

*Baroness Dunn, DBE, *Deputy Chairman*
Age 56. Executive Director of John Swire & Sons Limited and a Director of Swire Pacific Limited and Christies International plc. A non-executive Director since 1990 and a non-executive Deputy Chairman since 1992. A non-executive Director of HongkongBank from 1981 to February 1996. Former senior member of the Hong Kong Executive Council and Legislative Council.

*Sir Peter Walters, *Deputy Chairman*
Age 65. Deputy Chairman of EMI Group plc, non-executive Chairman of SmithKline Beecham plc and a non-executive Director of Cordiant plc. A non-executive Director since 1992 and a non-executive Deputy Chairman since 1993. Chairman of Midland Bank plc from 1991 to 1994.

B H Asher
Age 60. Executive Director Investment Banking. An executive Director since 1990. Joined HongkongBank in 1980 and a Director of HongkongBank from 1989 to 1992. Chairman of HSBC Investment Bank Holdings plc and a Director of Midland Bank plc.

J R H Bond
Age 55. Group Chief Executive. An executive Director since 1990. Joined HongkongBank in 1961; an executive Director of HongkongBank from 1988 to 1992. Chairman of Hongkong Bank of Canada, Marine Midland Bank and HSBC Americas, Inc. and Deputy Chairman of Midland Bank plc. A Director of HongkongBank and The Saudi British Bank and a non-executive Director of the London Stock Exchange, British Steel plc, Orange plc and Visa International.

*D E Connolly, OBE
Age 65. Chartered Accountant. A Director of Kowloon-Canton Railway Corporation. A non-executive Director since 1990 and a non-executive Director of HongkongBank since 1985.

D J Flint
Age 41. Group Finance Director. An executive Director since 1995. A Director of HSBC Investment Bank Holdings plc and Hongkong Bank Malaysia Berhad. A member of the Urgent Issues Task Force of the Accounting Standards Board. A former partner of KPMG.

*Sir Joseph Hotung
Age 66. A Director of Hongkong Electric Holdings Limited. A non-executive Director of the Company since 1991 and a non-executive Director of HongkongBank from 1991 to March 1996.

*C D Mackay
Age 56. A non-executive Deputy Chairman of Thistle Hotels Plc, non-executive Chairman of DSL Group Limited and a non-executive Director designate of Gucci Group NV. A non-executive Director of the Company since 1990. A non-executive Director of HongkongBank from 1986 to 1992 and of Midland Bank plc from 1992 to 1993.

*Sir Colin Marshall
Age 63. Chairman of British Airways Plc and Inchcape plc and Deputy Chairman of British Telecommunications plc. A non-executive Director since 1993. President of the Confederation of British Industry and a member of the Board of the New York Stock Exchange. A non-executive Director of MCI Communications Corporation. A non-executive Director of Midland Bank plc from 1989 to 1994.

*C Miller Smith
Age 57. Chief Executive of Imperial Chemical Industries plc. A Director since March 1996. A former Director of Unilever plc and Unilever NV and a non-executive Director of Midland Bank plc from 1994 to May 1996.

*M Murofushi
Age 65. President and Chief Executive Officer of ITOCHU Corporation. A non-executive Director since 1992. Special Adviser and Chairman of the Policy, Planning and Co-ordination Committee of the Japan Chamber of Commerce and Industry and of the Committee on Corporate Laws and Regulations of the Keizai Doyukai (Japan Association of Corporate Executives). A member of the Executive Committee of the Trilateral Commission.

*Sir Wilfrid Newton, CBE
Age 68. Chairman of Raglan Properties plc, Jacobs Holdings PLC, Mountcity Holdings Limited and Guy Maunsell International Limited. A non-executive Director of Maunsell Holdings Limited and Sketchley plc. A non-executive Director since 1990. Former Chairman of Mass Transit Railway Corporation and of London Regional Transport and a non-executive Director of HongkongBank from 1986 to 1992. A non-executive Director of Midland Bank plc since 1992.

*C E Reichardt
Age 65. A Director and former Chairman and Chief Executive of Wells Fargo and Company. A Director since March 1996. A Director of Ford Motor Company.

*H Sohmen, OBE
Age 57. Chairman of World-Wide Shipping Agency Limited, World-Wide Shipping Group Limited, World Maritime Limited, World Shipping and Investment Company Limited and World Finance International Limited. Deputy Chairman of Nordstrom & Thulin AB. A non-executive Director since 1990. A non-executive Director of HongkongBank since 1984 and Deputy Chairman since February 1996.

J E Strickland
Age 57. Chairman of HongkongBank since June 1996. Joined HongkongBank in 1971 (previous service 1966-69). An executive Director since 1989. A Director of Midland Bank plc from 1993 to May 1996. A Director of Marine Midland Bank from 1994 to February 1996. Vice-Chairman of Hang Seng Bank Limited and Chairman of Hongkong Bank Malaysia Berhad.

*Sir Adrian Swire
Age 65. Chairman of John Swire & Sons Limited and a Director of Swire Pacific Limited and Cathay Pacific Airways Limited. A non-executive Director since 1995. A member of the General Committee of Lloyd's Register of Shipping. Former Chairman of the International Chamber of Shipping and former President of the General Council of British Shipping.

K R Whitson
Age 53. A Director since 1994. A Director of Midland Bank plc since 1992 and Chief Executive since 1994. Joined HongkongBank in 1961. Chairman of Forward Trust Group Limited and Deputy Chairman of the Supervisory Board of Trinkaus & Burkhardt KGaA. A Director of HSBC Investment Bank Holdings plc. A non-executive Director and Chairman of Young Enterprise Limited.

* *Independent non-executive Directors*

Board of Directors and Group General Managers *(continued)*

Advisers to the Board

F R Frame
Age 67. Former Deputy Chairman of HongkongBank. Chairman of Wallem Group Limited and a non-executive Director of Baxter International Inc, Edinburgh Dragon Trust plc and The British Investment Trust plc.

Sir Quo-Wei Lee, CBE
Age 78. Chairman of Hang Seng Bank Limited and Deputy Chairman of Hysan Development Company Limited. A Director of Miramar Hotel and Investment Company Limited, Furama Hotel Enterprises Limited, New World Development Company Limited, Shaw Brothers (Hong Kong) Limited, The Kowloon Motor Bus Company (1933) and Shanghai Industrial Holdings Limited. Chairman and Life Member of the Council of The Chinese University of Hong Kong. A member of the Governor's Business Council, a Hong Kong Affairs Adviser appointed by the Chinese Government and a member of the Selection Committee for the first government of the Hong Kong Special Administrative Region of the People's Republic of China. A non-executive Director of HongkongBank from 1978 to 1984.

Secretary

R G Barber
Age 46. Group Company Secretary since 1990. Joined HongkongBank as Assistant Secretary in 1980; Corporation Secretary from 1986 to 1992. Company Secretary of Midland Bank plc from 1994 to 1996.

Group General Managers

A S K Au
Age 50. Vice-Chairman and Chief Executive of Hang Seng Bank. A non-executive Director of HongkongBank since 1994. Joined Hang Seng Bank in 1969.

D Beath
Age 58. General Manager and Group Audit Controller. Joined HongkongBank in 1960.

I M Burnett
Age 49. General Manager and Chief Banking Officer, Marine Midland Bank. Joined HongkongBank in 1966.

C Carr
Age 59. General Manager and Group Legal Adviser. Joined HongkongBank in 1989.

V H C Cheng, OBE
Age 48. Executive Director, HongkongBank. Joined HongkongBank in 1978.

J H Cleave
Age 54. President and Chief Executive Officer, HSBC Americas, Inc. Joined Hongkong Bank of Canada in 1981.

W R P Dalton
Age 53. President and Chief Executive Officer, Hongkong Bank of Canada. Joined Hongkong Bank of Canada in 1981.

A Dixon, OBE
Age 52. General Manager International, HongkongBank. Joined HongkongBank in 1965.

D G Eldon
Age 51. Chief Executive Officer, HongkongBank. Joined HongkongBank in 1968.

F J French
Age 58. Group General Manager Credit and Risk. Joined HongkongBank in 1959.

M F Geoghegan
Age 43. President and Chief Executive Officer of Banco HSBC Bamerindus S.A. Joined HongkongBank in 1973.

S K Green
Age 48. General Manager and Group Treasurer. Joined HongkongBank in 1982.

A P Hope
Age 50. General Manager Group Insurance. Joined Antony Gibbs & Sons Insurance in 1971.

H H Jacobi
Age 62. Chairman of the Managing Partners, Trinkaus & Burkhardt KGaA. Joined Midland Bank plc in 1981.

A W Jebson
Age 47. Group General Manager Technical Services. Joined HongkongBank in 1978.

C P Langley, OBE
Age 52. General Manager Hong Kong and China, HongkongBank. Joined HongkongBank in 1961.

M B McPhee
Age 55. Group General Manager Credit and Risk (designate). Joined Hongkong Bank of Canada in 1984.

A Mehta
Age 50. Deputy Chairman, The British Bank of the Middle East. Joined HongkongBank in 1968.

T W O'Brien
Age 49. Deputy Chairman and Chief Executive Officer, Hongkong Bank Malaysia Berhad. Joined HongkongBank in 1969.

R M J Orgill
Age 58. Deputy Chief Executive, Midland Bank plc. Joined HongkongBank in 1958.

J C S Rankin
Age 55. General Manager and Chief Executive Officer Singapore, HongkongBank. Joined HongkongBank in 1960.

P E Selway-Swift
Age 52. Deputy Chairman of HSBC Investment Bank plc and Chairman of HSBC Investment Bank Asia Holdings Limited. Joined HongkongBank in 1962.

R A Tennant
Age 54. General Manager Group Human Resources. Joined Midland Bank plc in 1960.

Results for 1996

The Group profit for the year attributable to shareholders of the Company was £3,112 million, an increase of 26 per cent.

A first interim dividend of 15 pence per ordinary share was paid on 11 October 1996 and the Directors have declared a second interim dividend of 26 pence per ordinary share, payable on 30 April 1997, making a total distribution for the year of £1,090 million. The second interim dividend will be payable in cash, in sterling or in Hong Kong dollars at an exchange rate to be fixed on 22 April 1997, with a scrip dividend alternative. The reserves available for distribution before accounting for the second interim dividend of £693 million are £3,784 million.

Further information about the results is given in the accompanying consolidated profit and loss account on page 48.

Principal Activities and Business Review

Through its subsidiary and associated undertakings, the Group provides a comprehensive range of banking and related financial services through an international network of more than 5,000 offices in 78 countries in the Asia-Pacific region, Europe, the Americas, the Middle East and Africa.

A review of the development of the business of Group undertakings during the year, particulars of important events since the end of the year and an indication of likely future developments are given in the 'Group Chief Executive's Review of Operations' on pages 7 to 15.

Taken together, the five largest customers of the Group do not account for more than 1 per cent of the Group's income.

Group Disposal

In August 1996, Premium Credit Limited, a subsidiary, was sold to Vendcrown Limited in a leveraged buyout. Under the terms of the agreement, the Group received £40.3 million in cash and a 19.9 per cent interest in the ordinary equity of Vendcrown, together with unsecured loan notes and redeemable cumulative preference shares. The sale constituted a connected transaction under the rules of The Stock Exchange of Hong Kong.

Capital and Reserves

The following events occurred during the year:

1. 1,022,274 ordinary shares of 75p and 9,107,817 ordinary shares of HK$10 each were issued on 3 June 1996 at par in lieu of the 1995 final dividend to shareholders who elected to receive new shares in lieu of cash dividends. The average market price per share used to calculate shareholders' entitlements to new shares was 997.8p.

2. 854,857 ordinary shares of 75p and 6,937,791 ordinary shares of HK$10 each were issued on 11 October 1996 at par in lieu of the 1996 first interim dividend to shareholders who elected to receive new shares in lieu of cash dividends. The average market price per share used to calculate shareholders' entitlements to new shares was 1,147p.

3. Options over 1,514,850 ordinary shares of 75p each were awarded at nil consideration on 1 April 1996 under the Company's Executive Share Option Scheme. The options were awarded at the market value at the date of the award. The options are exercisable between the third and tenth anniversaries of the award at a price of 1,000p per share.

4. Options over 4,443,918 ordinary shares of 75p each were awarded at nil consideration on 3 April 1996 to Group employees resident in more than 40 countries under the Company's Savings-Related Share Option Scheme. The options were awarded at a 15 per cent discount to market value at the date of the award. The options are exercisable within the period of six months commencing on the fifth anniversary of the commencement of the relevant savings contract on 1 August 1996 at a price of 917.7p per share.

5. Options over 300,023 ordinary shares of 75p each were exercised at prices ranging from 541.8p to 917.7p per share under the Company's Savings-Related Share Option Scheme and options over 2,026,074 shares lapsed.

6. Options over 153,071 ordinary shares of 75p each were exercised at prices ranging from 651.8p to 851.27p under the Company's Executive Share Option Scheme and options over 60,032 ordinary shares of 75p each lapsed.
7. Options under the Midland Bank Savings-Related and Executive Share Option Schemes were exercised over 7,920,325 ordinary shares of 75p each of the Company at prices ranging from 118.43p to 238.47p and options over 282,941 shares lapsed.

Valuation of Freehold and Leasehold Land and Buildings

The Group's freehold and long leasehold properties, and properties in Hong Kong with an unexpired lease term between 30 and 50 years, were revalued by professionally qualified valuers at the end of 1996 in accordance with the Group's policy of annual valuation. As a result of this revaluation, the net book value of land and buildings has been increased by £719 million.

Further details are included in Note 21 of the 'Notes on the Accounts'.

Directors

The names of the Directors of the Company serving at the date of this Report and brief biographical notes are set out on page 19.

C Miller Smith and C E Reichardt were appointed Directors of the Company on 22 March 1996.

J M Gray and G Maitland Smith retired as Directors of the Company on 31 May 1996 and N R Knox retired as a Director of the Company on 15 December 1996.

D E Connolly, Sir Joseph Hotung, C D Mackay, Sir Wilfrid Newton, H Sohmen and K R Whitson will retire by rotation at the Annual General Meeting and they offer themselves for re-election.

None of the Directors had during the year or at the end of the year a material interest, directly or indirectly, in any contract of significance with the Company or any of its subsidiary undertakings.

Corporate Governance

The Company has complied throughout the year with the provisions of the Code of Best Practice ('the Code') contained in the Report of the Committee on the Financial Aspects of Corporate Governance ('the Cadbury Committee') and with the provisions of the Code of Best Practice set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong. The Auditor, KPMG Audit Plc, has confirmed to the Directors that this statement appropriately reflects the Company's compliance with the Code, insofar as it relates to the paragraphs of the Code which the London Stock Exchange has specified for review by the Auditor.

Internal Financial Control

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

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

- Authority to operate the various subsidiaries is delegated to their respective chief executive officers within limits set by the Board of Directors of the Company or the Group Executive Committee. The appointment of executives to the most senior positions within the Group requires the approval of the Board of Directors of the Company. Functional operating and financial reporting standards are established by Group Head Office management for application across the whole Group. These are supplemented by operating standards set by the local management, as required for the type of business and geographical location of each subsidiary.
- Systems and procedures are in place in the Company and subsidiaries to report on and control the major financial risks: credit; changes in the market prices of financial instruments; funding of assets; operational error and fraud. Exposure to these risks is monitored by asset and liability committees and executive committees in subsidiaries and by the Group Executive Committee for the Group as a whole.

- Comprehensive annual financial plans are prepared by subsidiaries and are reviewed and approved at Group Head Office. Results are monitored regularly and reports on progress compared with plan are prepared throughout the Group each quarter. A strategic plan is prepared by all major operating subsidiaries every three years. Financial accounting and reporting and certain management reporting standards are established for application across the whole Group. Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in subsidiaries and aggregated for review of risk concentrations on a Group-wide basis.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management in the subsidiaries. In addition, functional management in Group Head Office set policies and standards in the areas of Finance; Legal and Regulatory Compliance; Human Resources; Credit; Market Risk; Computer Systems and Operations; Property Management; and for certain global product lines.
- The Internal Audit function, which is centrally controlled, monitors compliance with policies and standards and the effectiveness of internal control structures across the whole Group. The work of the Internal Audit function is focused on areas of greatest risk to the Group as determined by a risk management approach. The head of this function reports to the Group Chairman and the Group Audit Committee. The Group's independent Auditor, KPMG Audit Plc, reviews the internal financial controls of the Group and conducts such tests and other auditing procedures as it considers necessary to express the opinion in its report on the financial statements. KPMG Audit Plc has free access to the Group Audit Committee, with and without members of management present, to discuss its audit and its findings as to the integrity of the Group's financial reporting and the adequacy of the internal financial control structure.

The Group Audit Committee has reviewed the effectiveness of the system of internal financial control throughout 1996 and the subsequent period up to 3 March 1997 when the financial statements were signed.

KPMG Audit Plc has reviewed both the statement on the Group's internal financial control systems and the reference to the Group's continued adoption of the going concern basis in preparing the Group's financial statements, contained in the 'Statement of Directors' Responsibilities in Relation to Financial Statements' on page 46. KPMG Audit Plc has reported that in its opinion these statements: (i) provide the information required by the Code, as supplemented by the related guidance for directors, and (ii) are consistent with the information of which it is aware from its work in connection with the audit of the Accounts. The Directors note that KPMG Audit Plc has performed its reviews in accordance with the guidance issued by the Auditing Practices Board and has not therefore performed any additional procedures to express separate opinions on internal financial controls or going concern.

Board Committees

The Board has appointed a number of committees consisting of certain Directors and senior executives. The following are the principal committees:

Group Executive Committee

The Group Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board. The members of the Committee at the date of this report are J R H Bond (Chairman), B H Asher, D J Flint, Sir William Purves, J E Strickland and K R Whitson, who are executive Directors, and J H Cleave, D G Eldon, F J French, S K Green, A W Jebson and A Mehta, who are Group General Managers.

Group Audit Committee

The Group Audit Committee meets regularly with the Group's senior financial, internal audit and compliance management and the external auditor to consider the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance. The members of the Group Audit Committee are Sir Wilfrid Newton (Chairman), D E Connolly and Sir Joseph Hotung, all of whom are non-executive Directors, and F R Frame, Adviser to the Board.

Nomination Committee

The Nomination Committee carries out the process of nominating candidates to fill vacancies on the Board of Directors. The members of the Committee are the members of the Remuneration Committee, together with the Group Chairman.

Remuneration Committee

The Remuneration Committee meets regularly to consider human resource issues, particularly terms and conditions of employment, remuneration, retirement benefits, development of high potential employees and key succession planning.

Report by the Remuneration Committee

The following is a Report by the Remuneration Committee which has been approved and adopted by the Board for submission to shareholders.

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

Policy

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

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

The Committee strives to ensure that total remuneration is fair and attractive to potential employees, whilst motivating and retaining existing high-calibre staff. The remuneration packages are structured to take due account of levels and composition of pay and the market positioning in the many countries and businesses in which the Group operates. In appropriate circumstances, performance-related payments and share awards are provided with the objective of rewarding achievement and aligning the interests of the individual with those of the Group’s shareholders. The Committee seeks to respond to the variety of environments and circumstances which are faced by different businesses in different markets at different times.

In determining the terms of annual bonus and incentive schemes and individual remuneration awards, including retirement benefit arrangements, notice periods and severance terms, the Committee considers the practices and levels of remuneration in appropriate comparator companies which operate in similar industry sectors and territories to those in which the individual Group company operates and the executive Director or employee is employed. Due regard is paid to advice rendered by external professional consultants.

Basic Salary and Benefits

Salaries are reviewed annually in the context of individual and business performance, market practice and internal relativities. Allowances and benefits are largely determined by local market practice.

Annual Performance-Related Payments

The level of payment depends upon the performance of the Company, constituent businesses and the individual concerned. Key measures of success include achievement of financial goals, concerning both revenue generation and expense control; maintenance of customer relationships; full utilisation of professional skills; and adherence to the Group’s ethical standards.

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

Long-Term Share Awards

The Restricted Share Plan is designed to align the interests of executives with those of shareholders by linking executive rewards to the creation of superior shareholder value. This is achieved by focusing on progressive earnings growth without undue volatility. Details of conditional awards and the related performance requirements are set out on pages 28 to 30.

Executive Directors and Group General Managers in receipt of a conditional award under the Restricted Share Plan will not be granted options under the Executive Share Option Scheme, although options granted in the years up to and including 1996 will remain in force.

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

Pensions

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

The pension arrangements for J R H Bond and K R Whitson to contractual retirement age of 60 are provided under the HongkongBank Group London Staff Pension Fund which has now been merged with the Midland Bank Pension Scheme. The pensions accrue at a rate of one-thirtieth of pensionable salary per year of pensionable service in the United Kingdom.

The pension provision for J E Strickland is covered under the International Staff Retirement Benefits Scheme of The Hongkong and Shanghai Banking Corporation Limited. The pension accrues at a rate of one twenty-seventh of pensionable salary per year of pensionable service.

Only basic salary is pensionable. No other Director participates in any Group pension arrangements and none of the Directors participating in Group pension arrangements is subject to the earnings cap introduced by the 1989 Finance Act.

	Accrued annual pension at 31 December 1996 (£000 pa)	*Increase in accrued pension during 1996 (£000 pa)*	*Personal contributions towards pension (£000)*	*Transfer value relating to increase in accrued pension (£000)*
J R H Bond	57	15	—	167
J E Strickland	145	14	10	184
K R Whitson	46	11	—	113

Directors' Service Contracts

No executive Director has a service contract with the Company or any of its subsidiaries with a notice period in excess of one year or with provisions for predetermined compensation on termination which exceeds one year's salary and benefits in kind. Non-executive Directors are appointed for a three-year term.

K R Whitson, who is to retire by rotation and stand for re-election at the forthcoming Annual General Meeting, is employed on a contract which provides for 12 months' notice to be given by the Company and 12 months' notice to be given by Mr Whitson.

Directors' Individual Remuneration and Interests

Particulars of the Directors' individual share interests and remuneration are set out on pages 26 to 29.

Other Directorships

Executive Directors, if so authorised by the Board, may accept appointments as non-executive Directors of suitable companies which are not part of the Group. Executive Directors normally would be permitted to take on no more than two such appointments. Any remuneration receivable in respect of these appointments is paid to the Group company by which the executive Director is employed.

Compliance

The Company has complied throughout the year with the London Stock Exchange's Best Practice Provisions relating to remuneration committees, save that members of the Committee were not identified as such on the Forms of Proxy for the 1996 Annual General Meeting. All members of the Committee were identified in the Committee's Report to shareholders.

Directors' Interests

According to the registers of Directors' interests kept by the Company under section 325 of the Companies Act 1985 and Section 29 of the Securities (Disclosure of Interests) Ordinance, the Directors of the Company at the year-end had the following interests, all beneficial unless otherwise stated, in the shares and loan capital of the Company:

	At 1 January 1996	*At 31 December 1996* Personal	Family	Corporate	Other	Total
Ordinary Shares of HK$10						
B H Asher	2,100	2,100	—	—	—	2,100
J R H Bond	17,156	17,776	—	—	—	17,776
D E Connolly	193,181	195,707	—	—	—	195,707
Baroness Dunn	—	20,000	—	—	—	20,000
Sir Joseph Hotung	679,184	267	—	703,487*	—	703,754
Sir Wilfrid Newton	3,636	3,767	—	—	—	3,767
Sir William Purves	35,615	36,903	—	—	—	36,903
H Sohmen	755,946	—	120,666	525,727*	—	646,393
J E Strickland	29,115	29,160	1,008	—	—	30,168
Sir Adrian Swire	60,000	—	—	—	60,000†	60,000
K R Whitson	1,650	1,709	—	—	—	1,709
Ordinary Shares of 75p						
C D Mackay	7,500	3,750	3,750	—	—	7,500
Sir Colin Marshall	1,994	2,066	—	—	—	2,066
Sir Wilfrid Newton	2,000	2,000	—	—	—	2,000
Sir William Purves	1,420	1,471	—	—	—	1,471
J E Strickland	—	10,090	—	—	—	10,090
Sir Adrian Swire	—	—	—	—	109†	109
Sir Peter Walters	13,005	13,005	—	—	—	13,005
11.69% Subordinated Bonds 2002 of £1						
J R H Bond	500,000	500,000	—	—	—	500,000
Baroness Dunn	70,000	70,000	—	—	—	70,000
Sir Colin Marshall	975	975	—	—	—	975
Sir Wilfrid Newton	35,000	35,000	—	—	—	35,000
Sir Adrian Swire	300	—	—	—	359†	359
Sir Peter Walters	6,500	6,500	—	—	—	6,500

* *Interests held by private investment companies*

† *Non-beneficial*

At 31 December 1996, the undernamed Directors held options to acquire the number of HSBC Holdings plc ordinary shares of 75p each set against their respective names. The options were awarded for nil consideration at exercise prices equivalent to the market value at the date of award, except that options awarded under the Company's Savings-Related Share Option Scheme were awarded at a 15 per cent discount to market value. Except as otherwise indicated, there are no performance criteria conditional upon which the outstanding options are exercisable. The market value of the ordinary shares of 75p each at 31 December 1996 was 1,306p. The highest and lowest market values during the year were 1,324p and 932p. Market value is the mid-market price quoted on the London Stock Exchange on the relevant date.

	Options held at 1 January 1996	Options awarded during year	Options exercised during year	Options held at 31 December 1996	Exercise price in pence	Date of award	Exercisable from	Exercisable until
B H Asher	12,613	—	—	12,613	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	15,136	—	—	15,136	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	15,000	—	—	15,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	—	—	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
J R H Bond	20,181	—	—	20,181	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	20,181	—	—	20,181	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	25,000	—	—	25,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	—	—	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	—	25,000	—	25,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
D J Flint	—	12,000	—	12,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
Sir William	25,227	—	—	25,227	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
Purves	45,408	—	—	45,408	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	45,000	—	—	45,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	1,476	—	—	1,476[1]	700.84	11 Apr 1994	1 Jul 1999	31 Dec 1999
	1,273	—	—	1,273[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	—	35,000	—	35,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
J E Strickland	10,090	—	10,090[3]	—	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	15,136	—	—	15,136	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	15,000	—	—	15,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	—	15,000	—	15,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006
K R Whitson	8,577	—	8,577[4]	—	721.84	12 Oct 1993	12 Oct 1996	12 Oct 2003
	12,613	—	—	12,613	851.27	8 Mar 1994	8 Mar 1997	8 Mar 2004
	20,000	—	—	20,000	651.80	7 Mar 1995	7 Mar 1998	7 Mar 2005
	3,183	—	—	3,183[1]	541.80	10 Apr 1995	1 Aug 2000	31 Jan 2001
	—	20,000	—	20,000[2]	1,000.00	1 Apr 1996	1 Apr 1999	1 Apr 2006

1 *Options awarded under the Company's Savings-Related Share Option Scheme.*

2 *The exercise of these options is conditional upon the growth in earnings per share over a three-year period being equal to or greater than a composite rate of inflation (comprising 50 per cent of the Hong Kong Composite Consumer Price Index, 35 per cent of the UK Retail Price Index and 15 per cent of the USA All Urban Consumer Price Index) plus 2 per cent per annum.*

3 *Market price at date of exercise (19 November 1996) 1,252 pence.*

4 *Market price at date of exercise (14 October 1996) 1,269.5 pence.*

Sir Joseph Hotung has a personal interest in HK$10 million of The Hongkong and Shanghai Banking Corporation Limited Subordinated Collared Floating Rate Notes 2003, which he held throughout the year.

H Sohmen has a corporate interest in £1,200,000 of Midland Bank plc 9% Subordinated Notes 2005, which were acquired during the year.

Save as stated above, none of the Directors had an interest in any shares or debentures of any Group company at the beginning or at the end of the year and none of the Directors, or members of their immediate families, were awarded or exercised any right to subscribe for any shares or debentures during the year. No options held by Directors lapsed during the year.

There have been no changes in Directors' interests since 31 December 1996.

Report of the Directors *(continued)*

Directors' Emoluments

The emoluments of the Directors of the Company for 1996 were as follows:

	Fees £000	*Salary and other remuneration £000*	*Benefits in kind £000*	*Discretionary bonuses[7] £000*	*Employer pension contributions[8] £000*	*Total 1996 £000*	*Total 1995 £000*
Executive Directors							
Sir William Purves	20	520	36	150	—	726	680
— waived	(16)					(16)	(16)
J E Strickland[1]	16	352	304	—	41	713	414
— waived	(20)					(20)	(16)
J R H Bond	20	435	10	150	69	684	682
— waived	(16)					(16)	(16)
B H Asher	20	400	8	150	—	578	554
K R Whitson	20	313	25	75	49	482	475
J M Gray[2]	7	187	231	—	28	453	1,000
— waived	(8)					(8)	(20)
D J Flint	20	322	7	60	—	409	28
Non-executive Directors							
N R Knox[3]	19	34	—	—	—	53	58
G Maitland Smith[4]	38	9	—	—	—	47	62
Sir Wilfrid Newton	40	7	—	—	—	47	47
D E Connolly	36	5	—	—	—	41	41
Sir Joseph Hotung	24	4	—	—	—	28	40
Baroness Dunn	21	3	—	—	—	24	39
Sir Peter Walters	20	3	—	—	—	23	23
H Sohmen	16	4	—	—	—	20	20
— waived	(20)	(3)				(23)	(23)
C D Mackay	20	—	—	—	—	20	20
Sir Colin Marshall	20	—	—	—	—	20	20
C Miller Smith[5]	19	1	—	—	—	20	—
M Murofushi	20	—	—	—	—	20	20
Sir Adrian Swire	20	—	—	—	—	20	17
C E Reichardt[6]	16	—	—	—	—	16	—
Total	452	2,599	621	585	187	4,444	4,240

1 *The emoluments of J E Strickland include housing and other expatriate benefits in kind which are normal within the location in which he is employed.*
2 *Resigned on 31 May 1996.*
3 *Resigned on 15 December 1996.*
4 *Resigned on 31 May 1996.*
5 *Appointed on 22 March 1996.*
6 *Appointed on 22 March 1996.*
7 *These discretionary bonuses are in respect of 1996 and will be paid in 1997.*
8 *Particulars of accrued pension benefits and transfer values are given on page 25.*

Executive Directors who are also Directors of HongkongBank may elect to receive a fee from either the Company or HongkongBank. H Sohmen has elected to waive any fees payable to him by the Company.

Conditional Awards under the Restricted Share Plan

The Committee has decided that conditional awards under the Restricted Share Plan should be made in 1997 and that the Trustee to the Plan should be provided with funds to acquire HSBC Holdings plc ordinary shares of 75p each between 3 and 14 March 1997. The 1997 conditional awards of shares to executive Directors and Group

General Managers in respect of 1996 will have an aggregate value at the date of award of £1.08 million and will include conditional awards of shares to the following values to executive Directors:

	£000
J R H Bond	120
D J Flint	75
J E Strickland	90
K R Whitson	90
	375

Purpose

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

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

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

Vesting Schedule

Having regard to the Group's diverse profits stream, the Committee has determined that earnings growth will be measured by reference to a composite rate of inflation applicable to the major geographical areas in which the Group operates. The composite rate of inflation for the 1997 awards will comprise a weighted average of the rates of inflation as measured by the following indices during the performance period:

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

For vesting to be achieved in whole or in part, the following tests must be satisfied:

Test 1 Earnings per share in the year 2000 (the fourth year of the performance period) must be greater than earnings per share in 1996 (the base year for the calculation) by a factor equivalent to the composite rate of inflation plus 2 per cent, compounded over each year of the performance period;

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

Test 3 Cumulative earnings per share over the four years of the performance period, 1997 to 2000 inclusive, must exceed an aggregate figure calculated by compounding 1996 earnings per share by a factor equivalent to the annual composite rate of inflation plus 2 per cent for each year of the performance period.

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

If the cumulative earnings per share over the performance period exceed an aggregate figure calculated by compounding 1996 earnings per share by a factor equivalent to the annual composite rate of inflation plus 5 per cent or more, or 8 per cent or more, for each year of the performance period, the Trustees will release 75 per cent or 100 per cent of the conditional awards respectively.

If the tests are not satisfied over the years 1997 to 2000, the same tests will be applied over the years 1998 to 2001. If the tests still have not been satisfied at the end of that period, the conditional share awards will be forfeited.

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

By way of an example, if the composite rate of inflation were 5 per cent per annum over the period 1997-2000, the maximum number of shares would vest in 2001 if:

1. earnings per share for the year 2000 exceeded 188.2 pence;
2. there had been earnings per share growth in at least three of the four years; and
3. cumulative earnings per share over the four years 1997-2000 exceeded 632.5 pence.

On behalf of the Board
Dunn, *Chairman, Remuneration Committee*'

Directors' and Officers' Liability Insurance
Directors' and officers' liability insurance was maintained during the year.

Employees' Emoluments
Set out below is information in respect of the five individuals, who are not Directors of the Company, and whose emoluments (excluding commissions or bonuses related to the revenue or profits generated by employees individually or collectively with others engaged in similar activities) were the highest in the Group for the year ended 31 December 1996.

	£000
Basic salaries, allowances and benefits in kind	2,185
Pension contributions	168
Bonuses paid or receivable	—
Amounts paid as inducements to join or on joining the Group	1,336
Compensation for loss of office	—
Total	3,689

Their emoluments are within the following bands:

	Number of employees
£500,001 – £600,000	1
£600,001 – £700,000	2
£700,001 – £800,000	1
£1,000,001 – £1,100,000	1

Employee Involvement
The Company continues to regard communication with its employees as a key aspect of its policies. Information is given to employees about employment matters and about the financial and economic factors affecting the Group's performance through management channels, in-house magazines and by way of attendance at internal seminars and training programmes. Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance. The involvement of employees in the performance of the Group is further encouraged through participation in bonus and share option schemes as appropriate.

There are some 37,000 Group employees in more than 40 countries worldwide now participating in the

Company's Savings-Related Share Option Scheme, which in 1995 won an award for excellence from Proshare, the UK-based organisation promoting wider share ownership. During 1996, the scheme was extended to include Group entities located in the United States and some 4,000 employees in that country have taken the opportunity to participate.

Employment of Disabled Persons

The Company continues to be committed to providing equal opportunities to employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons are based on the aptitudes and abilities of the individual. Should employees become disabled during employment, every effort would be made to continue their employment and, if necessary, appropriate training would be provided.

Supplier Payment Policy

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

Substantial Interests in Share Capital

The following interests in the Company's ordinary shares of 75p each are recorded in the register maintained under Section 211 of the Companies Act 1985:

Standard Life Group	5.31 per cent
The Prudential Corporation Group of Companies	3.71 per cent
Legal & General Group	3.32 per cent

No substantial interest, being 10 per cent or more, in any of the equity share capital is recorded in the register maintained under Section 16(1) of the Securities (Disclosure of Interests) Ordinance.

Dealings in HSBC Holdings plc Shares

During the year a subsidiary undertaking of the Company sold on The Stock Exchange of Hong Kong 6,400 ordinary shares of HK$10 each. The consideration for the sale was HK$0.7 million.

HSBC Investment Bank plc, trading as HSBC James Capel, is a market-maker in London in the shares of the Company.

Donations

During the year, the Group made charitable donations totalling £14,079,000. Of this amount, £2,805,000 was given for charitable purposes in the United Kingdom.

No political donations were made during the year.

Annual General Meeting

The Annual General Meeting of the Company will be held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 30 May 1997 at 11.00 a.m.

Auditor

Consequent upon the transfer of the Head Office of the Company to London on 1 January 1993, KPMG Peat Marwick of Hong Kong retired at the 1993 Annual General Meeting and KPMG Peat Marwick of London, their associated firm, were appointed in their place. On 6 February 1995, KPMG Peat Marwick changed the name under which they practise to KPMG. At the Annual General Meeting on 31 May 1996, KPMG resigned as auditors following their decision to form a limited liability company, KPMG Audit Plc, to undertake that part of their audit business that included the Company and its subsidiaries and KPMG Audit Plc was appointed.

KPMG Audit Plc has expressed its willingness to continue in office. A resolution proposing the reappointment of KPMG Audit Plc as auditor of the Company and giving authority to the Directors to fix its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board
R G Barber, *Secretary* 3 March 1997

Summary of Financial Performance

Group profit

The HSBC Group made a profit before tax of £4,524 million in 1996, an increase of £852 million, or 23 per cent, over 1995. In Hong Kong dollar terms, pre-tax profit grew by 22 per cent from HK$ 44,809 million to HK$54,641 million.

Net interest income of £5,821 million was £702 million, or 14 per cent, higher than 1995. Other operating income rose by £389 million, or 12 per cent, to £3,767 million.

The Group's cost:income ratio improved to 52.9 per cent from 55.6 per cent in 1995, as income increased 6 per cent faster than operating expenses.

The charge for bad and doubtful debts was £384 million, which was £32 million, or 8 per cent, lower than 1995. It included a general provision of £78 million, compared with £130 million in 1995.

Profit on disposal of fixed assets and investments was £356 million, £124 million higher than in 1995. Significant items were disposals of venture capital investments by HSBC Private Equity Europe, the sale of the remainder of Midland Bank's investment in the 3i Group, the sale of most of the Group's investment in an associate, Kay Hian James Capel, and the sale of a subsidiary, Premium Credit.

Profit attributable to shareholders was £3,112 million (HK$37,587 million) in 1996, an increase of 26 per cent (25 per cent in Hong Kong dollar terms).

Shareholder ratios

Earnings per share increased by 25 per cent, from 94.0 pence to 117.6 pence.

The headline earnings per share, which is calculated in accordance with the Institute of Investment Management and Research Statement of Investment Practice, increased by 21.5 pence, or 23 per cent. The headline earnings per share excluded profits on the sale of tangible fixed assets and, in 1996, the profit on disposal of most of Kay Hian James Capel, the profit on disposal of Premium Credit and the provision against the Group's investment in Banco Bamerindus do Brasil.

Return on average shareholders' funds, at 21.3 per cent, increased from 20.7 per cent in 1995.

Shareholders' funds rose by a net £1,800 million to £15,187 million, including the retention of £2,022 million of Group profits, additional capital of £190 million arising from scrip dividends and a surplus on revaluation of Group premises of £639 million, partly offset by the impact from foreign exchange translation movements.

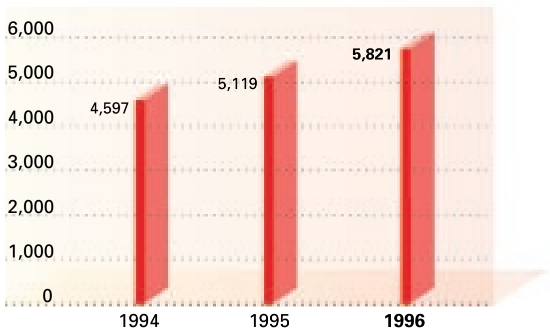
The Directors have declared a second interim dividend of 26 pence per ordinary share (in lieu of a final dividend), which, together with the first interim dividend of 15 pence, will make a total distribution for the year of 41 pence (1995: 32 pence), an increase of 28 per cent. The dividend is covered 2.9 times by attributable profit (1995: 2.9 times).

Net interest income

In 1996, net interest income grew by £702 million, or 14 per cent, to £5,821 million. This reflected both growth in average interest-earning assets and higher net interest spread and included an improved contribution from the money-market activities of the Group's treasury operations. Income levels were higher in all regions, with the exception of continental Europe where Midland Bank sold most of its French mortgage book in early 1996. Growth ranged from 8 per cent in the Americas to 21 per cent in both Hong Kong and the rest of Asia-Pacific.

Average interest-earning assets increased by £22 billion, or 12 per cent, to £202 billion in 1996. The growth, principally in customer accounts and debt securities, was financed substantially by increased customer deposits.

Net interest income (£m)



The Group's net interest margin improved from 2.85 per cent to 2.89 per cent, in an environment of keen competition and downward pressure on lending spreads in the principal areas in which the Group operates. In addition, there was a 15 per cent reduction in average non-performing loans during the year.

In the UK, Midland Bank's domestic margin fell to 2.81 per cent. This resulted principally from a decline in spreads arising from competitive pressure in the retail mortgage market and a change in mix resulting from larger volumes of lower-yielding treasury assets. These effects were partly offset by the benefit of a continuing decline in non-performing loans.

The improvement in margins in Hong Kong mainly reflected strong growth in customer advances (particularly in Hang Seng Bank, whose advances to deposits ratio increased from 49.0 per cent to 51.2 per cent), improved asset and liability mix, and more effective management of both yield and cost of funds. Lower interest rates reduced the contribution from net free funds.

Similarly, in the Americas, lower interest rates reduced the contribution from net free funds. Although the downward pressure on lending spreads continued, the replacement of wholesale funds with customer deposits (as a result of acquisitions) led to a reduction in the cost of funds.

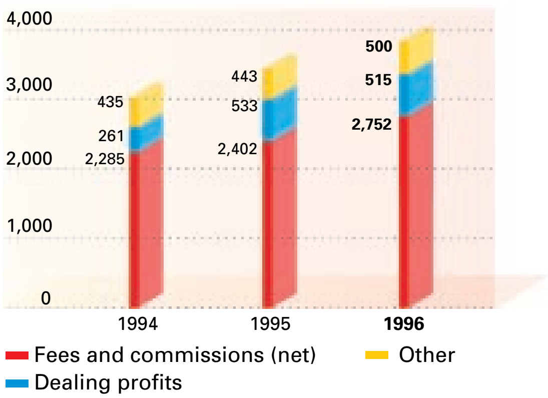
Hongkong Bank Malaysia's net interest margin improvement mainly reflected higher-yielding customer lending and the benefits of repricing opportunities in a rising interest rate environment. The improvement in the net interest margin of the Asia-Pacific operations of the HongkongBank Group was mainly due to improved asset and liability mix. The margin in The British Bank of the Middle East improved 20 basis points, reflecting improved interest spread mainly arising from a favourable change in asset mix as funds were switched out of interbank placements to support growth in customer lending.

Non-interest income

Non-interest income of £3,767 million was £389 million, or 12 per cent, higher than 1995, mainly due to a substantial increase in net fees and commissions. Income levels were higher in all geographic regions except continental Europe where levels remained static. There was particularly strong growth in the Americas (18 per cent), Hong Kong (14 per cent) and the rest of Asia-Pacific (30 per cent). Excluding net fees and commissions, other operating income rose by £39 million, or 4 per cent, from £976 million in 1995 to £1,015 million in 1996.

Net fees and commissions increased by £350 million, or 15 per cent, to £2,752 million, with increases reported in all regions. Fees and commissions increased in investment banking due to increased advisory business in Asia-Pacific and continental Europe, a higher level of funds under management and higher equity market volumes contributing to an increase in commission revenues for equity securities. The recent expansion in the geographical coverage of HSBC James Capel also assisted in the generation of higher fees and commissions. Lending and deposit growth yielded higher levels of facility and account service fees. Commissions on trade finance business grew more slowly, reflecting lower trade growth in Asia-Pacific during 1996. The cards business once again achieved strong growth in fees and commissions earned. Midland Bank's initiative to place trained financial advisers in its branch network generated encouraging results; growth in life assurance and unit trust sales reflected market share improvement.

Non-interest income (£m)



Dealing profits, which excluded net interest income attributable to dealing activities and dividend income on trading equities, fell slightly by £18 million, or 3 per cent. Continued settled conditions in the bond markets and increased customer-driven business kept treasury dealing profits across the Group's commercial banking subsidiaries stable.

The term 'dealing profits' is a prescribed heading under the UK's implementation of the European Union's Bank Accounts Directive; it excludes net interest income, fees and commissions, dividend income, and the cost of associated staff and other administrative expenses. The table below shows the dividend income and net interest income attributable to dealing activities. The net interest income on securities trading arises on marked-to-market debt securities and treasury bills.

Financial Review *(continued)*

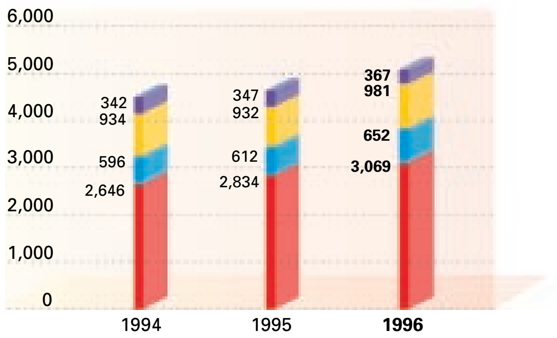
Analysis of income from dealing in financial instruments (£m)	**1996** Dealing profits	**1996** Dividend and net interest income	**1996** Total	1995 Dealing profits	1995 Dividend and net interest income	1995 Total
Foreign exchange	**354**	**26**	**380**	362	10	372
Interest rate derivatives	**53**	**10**	**63**	44	9	53
Debt securities	**61**	**98**	**159**	61	94	155
Equities and other trading	**47**	**30**	**77**	66	9	75
	515	**164**	**679**	533	122	655

Other income mainly comprises rental income, increases in the net present value of the future earnings inherent in life assurance policies in force and other insurance premiums. Other income in Hong Kong rose by £24 million, or 12 per cent, to £227 million and in the rest of Asia-Pacific rose by £15 million, or 45 per cent, to £48 million. Other income in the UK increased by £54 million, or 21 per cent, to £316 million.

Operating expenses

Operating expenses increased by £344 million, or 7 per cent, to £5,069 million in 1996. The Group's further expansion into financial markets in Asia outside Hong Kong required growth in staff numbers, particularly in Taiwan, the Philippines, Indonesia and Thailand. Headcount in Hong Kong also grew, reflecting growth in the treasury and capital markets businesses and to support the further development of computer systems.

Operating expenses (£m)



Staff costs were up by £235 million, or 8 per cent, compared with 1995. Although Midland Bank's staff numbers were largely unchanged, a reduction in redundancy costs associated with the reorganisation of Midland Bank's domestic retail and corporate operations more than offset the cost of the annual pay award and an increase in the profit-related payments, reflecting improved performance in the domestic operations and HSBC MIDLAND. Although salary increases within the HongkongBank Group were held broadly in line with inflation, staff costs rose as a result of increased headcount required to support business growth, higher performance-related bonuses in investment banking and treasury and the costs of restructuring in Australia, the UK and the Americas.

	Full-time equivalent		
Staff numbers	**1996**	1995	1994
HongkongBank	**22,468**	21,953	21,877
Hang Seng Bank	**7,960**	7,926	7,499
Other HongkongBank Group	**3,404**	3,346	3,108
Midland Bank	**43,019**	43,572	45,900
HSBC Americas, Inc.	**7,985**	8,012	8,371
Hongkong Bank Malaysia	**4,160**	4,093	4,057
Hongkong Bank of Canada	**3,816**	3,373	3,100
The British Bank of the Middle East	**2,570**	2,397	2,333
Other	**7,088**	6,398	5,492
Total staff numbers	**102,470**	101,070	101,737

Premises and equipment costs rose by £40 million, or 7 per cent, over 1995.

The **charge for depreciation** increased by 6 per cent to £367 million, mainly attributable to the higher carrying values of properties following the 1995 property revaluation.

The Group's **cost:income ratio** improved to 52.9 per cent from 55.6 per cent in 1995.

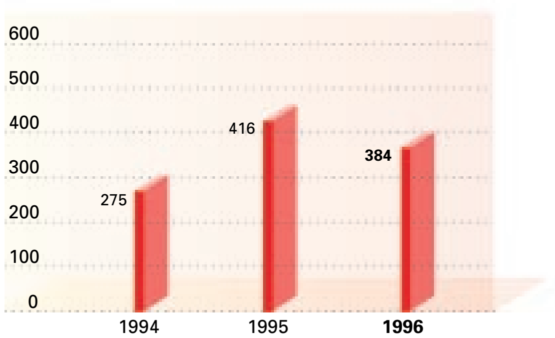
Bad and doubtful debts

The £384 million charge against profit for the year was £32 million lower than 1995. Specific provisions (net) on customer lending at £320 million were £34 million, or 12 per cent, higher. New specific provisions of £740 million were £73 million, or 11 per cent, higher than 1995 while specific provisions of £322 million were released (1995: £279 million) and debts recovered which had previously been written off amounted to £112 million (1995: £102 million). The smaller increase in the general provision in 1996 reflected the level of growth in customer advances since this was the principal driver of the general provision. The general provision cover at 31 December 1996 was virtually unchanged at 0.79 per cent of gross lending.

The charge in Midland Bank of £172 million was £26 million lower than 1995. In UK Banking, new specific charges were £272 million, £62 million higher than 1995, principally due to an increased provision against one corporate exposure, although this was partly offset by a £21 million increase in recoveries. In addition, there was a lower general bad debt charge. Midland Bank's LDC debt sales and capital redemptions generated a net LDC recovery of £38 million, compared with a charge of £1 million in 1995.

The charge in HSBC Americas, Inc. fell significantly to £44 million from £109 million in 1995. The 1995 figure reflected a large charge against the Concord Leasing problem asset portfolio: the workout of this portfolio has now substantially been completed. Aside from that specific charge, commercial write-offs in 1996 were well below the prior year, although higher bankcard delinquencies led to increased consumer loan provisions.

Charge for bad and doubtful debts (£m)



There was a charge of £119 million in the HongkongBank Group, compared with a charge of £53 million in 1995. New specific provisions increased, with most of the new provisions in Hong Kong in both HongkongBank and Hang Seng Bank. Releases and recoveries were also higher than 1995, mainly arising in Singapore and the Bahamas. The general provision charge increased, reflecting higher advances to customers.

Profit on disposal of fixed assets and investments

The Group's profits on disposal of fixed assets and investments was £356 million, £124 million higher than in 1995. Significant items were disposals of venture capital investments by HSBC Private Equity Europe, the sale of the remainder of Midland Bank's investment in the 3i Group, the sale of most of the Group's investment in an associate, Kay Hian James Capel, and the sale of a subsidiary, Premium Credit.

Taxation

The 1996 effective rate of tax was 23.7 per cent, compared with 24.4 per cent in 1995. For both years, the effective rate of tax was below the standard 33 per cent rate of UK corporation tax, mainly because of lower rates of tax in major subsidiaries overseas. The benefit of these lower rates of tax was increased in both years as the result of partial recognition of previously unrecognised trading losses in the US, and capital losses in the UK.

Analysis of overall tax charge (£m)	**1996**	1995
Taxation at UK corporation tax rate of 33 per cent	**1,493**	1,212
Impact of differently taxed overseas profits in principal locations	**(346)**	(234)
Utilisation of previously unrecognised tax benefits	**(104)**	(70)
Other items	**30**	(11)
Overall tax charge	**1,073**	897

Financial Review *(continued)*

Assets

Total assets, including Hong Kong Government certificates of indebtedness, rose by £9.8 billion, or 4 per cent, from £226.8 billion to £236.6 billion, compared with December 1995. At constant exchange rates, assets grew by £25.1 billion, or 12 per cent.

Net customer loans as a percentage of total assets (excluding Hong Kong Government certificates of indebtedness) remained constant at 49 per cent. The increase in net loans and advances to customers of £5.0 billion, or 5 per cent (£11.8 billion, or 12 per cent at constant exchange rates), was across all sectors, with the strongest growth occurring in residential mortgages and commercial real estate.

The Group's personal banking book grew by over £2 billion to £41.2 billion, representing 35 per cent of gross customer advances. Residential mortgages were again the main driver of this increase with strong growth in Hong Kong, the UK and New Zealand. First Direct achieved strong growth in unsecured consumer credit.

The buoyant Hong Kong property market was reflected in higher lending to this sector. Continued merger and acquisition activity in the UK corporate sector supported strong growth in corporate lending. In North America, acquisitions contributed significantly to asset growth.

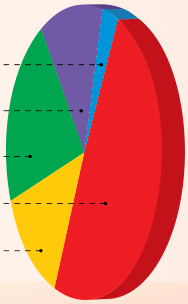
Net loans and advances to banks increased, in part, due to the acquisition by HSBC Americas of J P Morgan's US dollar clearing business and business opportunities arising from the Group's new section 20 powers in the United States and from participation in the UK's new gilts repo market. The increase in net loans and advances to banks was £6.0 billion, or 14 per cent (£9.6 billion, or 24 per cent, at constant exchange rates).

Debt securities increased by £4.9 billion, or 20 per cent (£6.6 billion, or 29 per cent at constant exchange rates), principally due to a switch from treasury bills and other eligible bills which fell by £4.8 billion, or 38 per cent (£4.1 billion, or 34 per cent at constant exchange rates), in order to improve yields.

The debt securities held in accrual books showed an unrecognised gain, net of off-balance-sheet hedges,

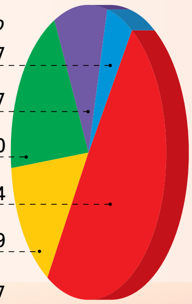
*Assets **1996** (excluding Hong Kong Government certificates of indebtedness)*

	%	£b
Treasury and other eligible bills	3.4	**7.9**
Debt securities	12.8	**29.6**
Loans and advances to banks	21.1	**49.0**
Loans and advances to customers	49.4	**114.4**
Other	13.3	**30.9**
Total	100.0	**231.8**



Assets 1995 (excluding Hong Kong Government certificates of indebtedness)

	%	£b
Treasury and other eligible bills	5.8	12.7
Debt securities	11.1	24.7
Loans and advances to banks	19.4	43.0
Loans and advances to customers	49.3	109.4
Other	14.4	31.9
Total	100.0	221.7



of £144 million compared with a net gain of £172 million at December 1995.

Equity shares included £757 million (December 1995: £694 million) held on investment account, on which there was an unrealised gain of £720 million (December 1995: £654 million).

The Group has changed the frequency of valuation of its non-investment properties from a triennial to an annual basis. The increase in other assets, therefore, reflects a revaluation surplus of £719 million arising on the revaluation of the Group's freehold and long-leasehold properties, including investment properties.

Capital Management

Capital measurement and allocation

The Bank of England is the supervisor of the HSBC Group on a consolidated basis and in this capacity receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by the appropriate local banking supervisors, which set and monitor capital adequacy requirements for them. Similarly, non-banking subsidiaries including investment and broking firms are subject to supervision and capital requirements of relevant local regulatory authorities. Since 1988, when the governors of the Group of Ten central banks agreed to guidelines for the international convergence of capital measurement and standards, the banking supervisors of the HSBC Group's major banking subsidiaries have exercised capital adequacy supervision in a broadly similar framework.

The Bank of England, in implementing the European Union's Own Funds and Solvency Ratio Directives, requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets. From 1 January 1996, the method the Bank of England uses to assess the capital adequacy of banks and banking groups has been modified as a result of its implementation of the European Union's Capital Adequacy Directive (CAD).

It is the Group's policy to maintain a strong capital base to support development of the Group's business. It seeks to maintain a prudent balance between the different components of Group capital and, in the holding company, between the composition of its capital and that of its investment in subsidiaries.

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

Capital is divided into two tiers: tier 1, comprising shareholders' funds and minority interests, and tier 2, comprising general loan loss provisions, property revaluation reserves and qualifying subordinated loan capital. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital, and term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of general provisions which may be included in the tier 2 capital. Deductions in respect of intangible assets and unconsolidated investments are made from tier 1 capital and total capital, respectively.

Under CAD, banking operations are categorised as either trading book (broadly, marked-to-market activities) or banking book (all other banking activities) and risk-weighted assets are determined accordingly. Banking book risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of each asset and counterparty. Banking book off-balance-sheet items giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty. Trading book risk-weighted assets are determined by taking into account market-related risks, such as foreign exchange, interest rate and equity position risks, as well as counterparty risk.

Group capital structure

The table on the next page sets out the analysis of regulatory capital at the end of 1996 and 1995.

During 1996, the Group's total capital ratio increased from 14.7 per cent to 15.3 per cent and its tier 1 capital ratio increased from 9.5 per cent to 9.9 per cent.

Tier 1 capital increased by £1,310 million from the level at the end of 1995, mainly due to profit retentions of £2,022 million. An issue of US$200 million of non-cumulative preference shares by Midland Bank contributed £124 million to minority interests. Additional capital of £203 million arose from scrip dividends and the issue of shares under option schemes. These increases were partly offset by a reduction of £1,039 million which was principally due to foreign exchange movements arising from the appreciation of sterling in the last quarter of 1996.

Tier 2 capital increased by £562 million. Property revaluation reserves increased by a net £478 million, mainly due to the £639 million annual Group property revaluation, partly offset by the £156 million effect of exchange rate movements. Additional term subordinated debt of US$800 million (£524 million) together with £150 million undated subordinated debt was issued by Midland Bank during the year, but there was a net reduction of £612 million arising from regulatory amortisation of qualifying capital, repayments, exchange and other adjustments.

Financial Review *(continued)*

£m	1996	1995
Composition of capital		
Tier 1:		
Shareholders' funds	**15,187**	13,387
Minority interests	**2,695**	2,700
Less: property revaluation reserves	**(2,700)**	(2,222)
Intangibles/Other	**(38)**	(31)
Total qualifying tier 1 capital	**15,144**	13,834
Tier 2:		
Property revaluation reserves	**2,700**	2,222
General provisions	**943**	916
Perpetual subordinated debt	**1,783**	1,795
Term subordinated debt	**3,552**	3,478
Minority interests (in tier 2 preference shares)	**58**	63
Total qualifying tier 2 capital	**9,036**	8,474
Unconsolidated investments	**(551)**	(657)
Investments in other banks	**(131)**	(232)
Other deductions	**(12)**	(95)
Total capital	**23,486**	21,324
Total risk-weighted assets	**153,488**	145,218
Capital ratios		
Total capital/risk-weighted assets	**15.3**	14.7
Tier 1 capital/risk-weighted assets	**9.9**	9.5

Capital deductions for unconsolidated investments decreased as, under CAD, certain investment firms are now consolidated.

The Group's risk-weighted assets increased by £8.3 billion after taking account of the offsetting effect of exchange rate movements amounting to £10.0 billion.

As at 1 January 1996, the change to the CAD basis did not have a material impact on risk-weighted assets. The banking book risk-weighted assets increased by £7.3 billion, which arose across all balance sheet and off-balance-sheet categories, but most notably in loans and advances to customers. The increase of £1.0 billion in the trading book notional risk-weighted assets arose principally in investment and broking subsidiaries.

Deployment of shareholders' funds

The shareholders' funds of HSBC Holdings plc are deployed mainly in investments in its subsidiaries. At 31 December 1996, the major investments of shareholders' funds, compared with the previous year, were:

£m	1996	1995
Hang Seng Bank (61.51% owned)	**2,257**	2,206
HongkongBank and other subsidiaries	**4,083**	3,447
HongkongBank and subsidiaries	**6,340**	5,653
Midland Bank plc	**3,491**	2,850
HSBC Americas, Inc.	**1,102**	1,010
Hongkong Bank Malaysia Berhad	**335**	302
Hongkong Bank of Canada	**267**	273
The British Bank of the Middle East	**164**	157
HSBC Investment Bank plc	**298**	267*
Holding company and non-trading subsidiaries	**2,136**	2,268
Other subsidiaries	**803**	354
Consolidated associates	**251**	253
	15,187	13,387

** HSBC Investment Bank Limited in 1995.*

It is Group policy for subsidiaries to retain sufficient profits to support planned business growth and to dividend any surplus profits to the holding company. Movements in the figures principally reflect these retentions, and the impact of the property revaluation in 1996, partly offset by the effect of exchange rate movements.

HSBC Investment Bank plc, a UK-based holding company, had consolidated shareholders' funds as at 31 December 1996 that were substantially less than the sum of the share capital and reserves of all the subsidiaries included in the investment banking line of business (most notably due to HSBC Investment Bank Asia Holdings Limited being a subsidiary of HongkongBank).

The shareholders' funds of the holding company and non-trading subsidiaries represent the surplus of HSBC Holdings plc's equity capital over its equity investments, after adjusting for the capital structure of its immediate non-trading holding companies.

Credit Risk Management

Credit Risk

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

Group Head Office is responsible for the formulation of high-level credit policies; the independent review of the Group's largest credit exposures; the control of the Group's cross-border exposures; and portfolio management of risk concentrations. It also reviews the efficiency of Group companies' credit approval processes, a key element of which is the Group's universal facility grading system. The Group Executive Committee receives regular reports on credit exposures at both Group and subsidiary levels. These include information on asset concentrations, industry exposures, levels of bad debt provisioning and country exposure limits.

In each of the Group's subsidiaries, local management is responsible for the quality of its credit portfolios. Each subsidiary has established a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality.

The Group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. Group companies remain responsible for their own credit exposures. In addition to the portfolio management undertaken at Group level, each subsidiary manages its own risk concentrations on a market sector, geographical and product basis.

Cross-border risk is controlled through the imposition of country limits, with sub-limits by maturity and type of business. Transactions with higher risk countries are considered on a case-by-case basis.

Special attention is paid to the management of problem loans. Where deemed appropriate, specialist units are established to provide intensive management and control to maximise recoveries of doubtful debts.

Industry exposures

Loans and advances to customers are spread throughout the various industrial sectors, as well as geographically. Approximately one-third of loans and advances to customers are to the personal banking sector and two-thirds are to commercial enterprises.

Residential mortgages now comprise 22.5 per cent of the overall portfolio, having increased by £1,511 million, or 6.1 per cent, during 1996. Much of this increase was due to continued growth in the mortgage books of Midland in the UK, HongkongBank and Hang Seng Bank in Hong Kong, Marine Midland in the US and HongkongBank in New Zealand. Loan loss experience in this sector remains very good. Other personal banking advances increased by 3.5 per cent during 1996, to £14,772 million.

Commercial, industrial and international trade loans decreased by £82 million, or 0.2 per cent, to £32,731 million.

Commercial real estate advances increased by £2,222 million, or 21.4 per cent, to £12,598 million and other property-related advances increased by £236 million, or 6.2 per cent, to £4,070 million.

Advances to financial institutions other than banks increased by £135 million, or 2.4 per cent.

Other advances increased by £145 million, or 0.7 per cent.

Gross loans and advances to customers by industry exposure

	1996		1995	
	£m	**%**	£m	%
Personal banking:				
Residential mortgages	**26,449**	**22.5**	24,938	22.1
Other personal*	**14,772**	**12.6**	14,267	12.7
Total personal banking	**41,221**	**35.1**	39,205	34.8
Commercial:				
Commercial, industrial and international trade	**32,731**	**27.8**	32,813	29.1
Commercial real estate	**12,598**	**10.7**	10,376	9.2
Other property related	**4,070**	**3.5**	3,834	3.4
Non-bank financial institutions	**5,737**	**4.9**	5,602	5.0
Other commercial	**21,096**	**18.0**	20,951	18.5
Total commercial	**76,232**	**64.9**	73,576	65.2
Total	**117,453**	**100.0**	112,781	100.0

** Advances to individuals under the Hong Kong Government's Home Ownership Scheme are included under 'Other personal' lending.*

Financial Review *(continued)*

Bad debt provisions

Total provisions against loans and advances to customers amounted to £2,766 million at 31 December 1996 and represented 2.4 per cent of lending, compared with 2.7 per cent at the end of 1995.

The general improvement in credit quality of the Group's customer loan portfolio is reflected in the fall in non-performing loans and advances of £840 million, or 20.1 per cent, to £3,341 million. Non-performing loans amounted to 2.9 per cent of total loans and advances to customers, compared with 3.7 per cent at the end of December 1995. The majority of the reduction was in Midland Bank.

Specific provisions against loans and advances to banks of £48,980 million (1995: £42,966 million) amounted to £31 million (1995: £53 million). Non-performing loans to banks decreased by £24 million to £36 million in 1996.

Customer loans and advances (£m)	**1996**	1995
Gross loans and advances	**117,453**	112,781
Suspended interest	**(334)**	(385)
	117,119	112,396
Provisions	**(2,766)**	(3,023)
Net loans and advances	**114,353**	109,373

Provisions to customer loans and advances (%)	**1996**	1995
Specific provisions	**1.6**	1.9
General provisions	**0.8**	0.8
Total provisions	**2.4**	2.7

Non-performing customer loans and provisions (£m)	**1996**	1995
Non-performing loans	**3,341**	4,181
Provisions	**2,766**	3,023

LDC exposure and provisions (£m)	**1996**	1995
LDC provisionable exposure	**1,083**	1,362
Provisions	**217**	306
Provisions as a percentage of LDC provisionable exposure (%)	**20**	22

Market Risk Management

Market risk

Market risk is the risk that interest rates, foreign exchange rates or equity and commodity prices will move relative to positions taken, causing profits or losses to the Group. Market risk arises on financial instruments which are valued at current market prices (mark-to-market basis) and those valued at cost plus any accrued interest (accruals basis).

The Group makes markets in interest rate and exchange rate derivative instruments, as well as in debt, equity and other securities. Trading risks arise either from customer-related business or from position taking.

Market risk is managed within risk limits approved by the Group Executive Committee. Group Market Risk, an independent unit within Group Treasury, develops risk management policies and measurement techniques, and reviews limit utilisation for all treasury centres.

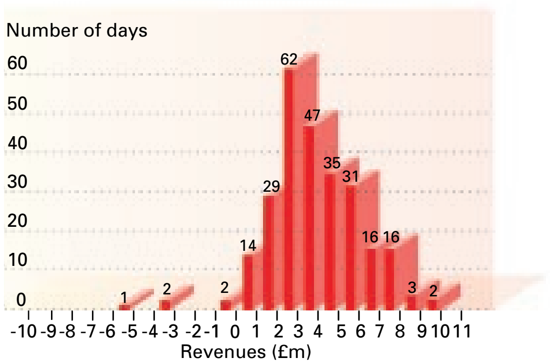
Risk limits are determined for each location and within location, for each portfolio, subject to restrictions on product, currency, interest rate repricing and market volatility risks. Liquidity considerations are also taken into account in determining the limits set. Only those offices within major subsidiaries with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. Actual risk levels compared with approved limits are monitored daily by each subsidiary and by Group Market Risk.

A key component of market risk management is the estimation of potential losses that could occur on risk positions taken due to movements in market rates and prices — generally referred to as 'value at risk'. Value at risk is computed for all treasury centres across the Group on a regular basis, incorporating positions subject to both mark-to-market and accrual valuation bases. The value at risk measure employed assesses the potential loss that could occur due to the change in value of treasury portfolios caused by movements in interest rates and foreign exchange rates. The calculation uses historical one-day movements in market rates and prices, a 95 per cent confidence level and takes account of correlations between different markets and rates. This analysis is augmented by stress testing, both on individual portfolios and on a consolidated basis. Stress testing looks at the potential profit and loss impact of more extreme moves in market prices.

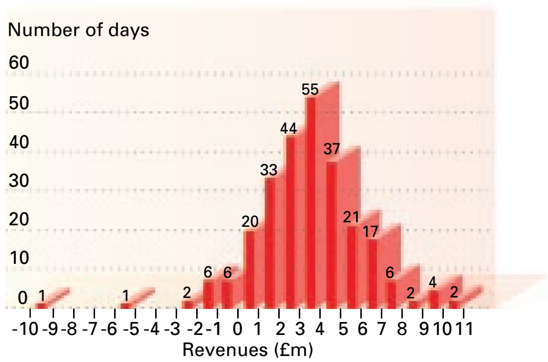
Value at risk measurement techniques have been applied in respect of treasury activities throughout the year. The value at risk for all interest rate risk and foreign exchange risk positions at 31 December 1996 was £13.0 million, compared with £16.8 million at 31 December 1995, and an average for 1996 of £19.9 million.

The average daily revenue earned from market risk-related treasury activities in 1996, including accrual book net interest income and funding related to dealing positions, was £3.7 million compared with £3.2 million in 1995. The standard deviation of these daily revenues was £2.1 million. An analysis of the frequency distribution of daily revenues below shows a maximum daily loss of £6 million, with only five out of 260 days showing losses. The most frequent result was a daily revenue of between £2 million and £3 million, with 62 occurrences. The highest daily revenue was £9 million.

*Daily distribution of market risk revenues **1996***
Group Treasury centres



Daily distribution of market risk revenues 1995
Group Treasury centres



Foreign exchange exposure

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

Value at risk related to foreign exchange dealing positions as at 31 December 1996 was £2.3 million (£1.8 million at 31 December 1995) and the average for 1996 was £3.2 million. The average one-day foreign exchange trading profit for 1996 was £1.4 million (£1.4 million for 1995). The value at risk and average dealing profit information noted excludes structural foreign currency exposures, since related gains or losses are taken through reserves.

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

Foreign currency investments amounted to the foreign currency equivalent of £9,856 million (65 per cent of shareholders' funds) at 31 December 1996, an increase from £8,356 million (62 per cent of shareholders' funds) at 31 December 1995. The large majority of the Group's structural foreign currency exposures are to the US dollar or US dollar related

Financial Review *(continued)*

currencies. The higher level of structural foreign currency exposure is principally due to profit retentions in overseas subsidiaries and the increase in property revaluation surplus in the HongkongBank Group. This was partially offset by the effect of the strength of sterling which reduced the opening value of structural investments by £767 million.

Interest rate exposure

The Group's interest rate exposures comprise those originating in its treasury trading activities and structural interest rate exposures; both are managed under limits described above. Interest rate risk arises in both dealing portfolios and accrual books.

Value at risk at 31 December 1996 related to interest rate exposures, including interest rate risk related to accrual book positions, was £11.2 million (£15.7 million at 31 December 1995) and the average for 1996 was £17.9 million. The average daily revenues earned from treasury-related interest rate activities for 1996 was £2.3 million (£1.8 million for 1995).

Structural interest rate risk arises primarily from the employment of non-interest bearing liabilities, such as shareholders' funds and some current accounts, as well as fixed rate loans and liabilities other than those generated by treasury business. Each major Group subsidiary assesses the structural interest rate risks which arise in its business and either transfers such risks to its local treasury unit or to separate books managed by the local asset and liability management committee. These interest rate positions are regularly monitored by subsidiaries' asset and liability management committees and, where necessary, quantitative models are used to assess the potential net interest income and market value effects of these interest rate positions in different interest rate scenarios. While the primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income, the subsidiaries also seek to enhance net interest income, subject to risk limits approved by the Group Executive Committee.

Liquidity Management

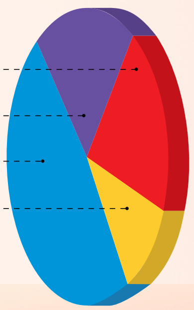
The Group manages the liquidity structure of its assets, liabilities and commitments so as to ensure that cash flows are sufficiently balanced within each of the subsidiaries. Where cash flow imbalances arise, the Group's policy is to establish minimum ratios of liquid assets to customer deposits.

Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of the Group's overall funding. Considerable importance is attached to the stability of this core deposit base, achieved through the Group's diverse geographical retail banking activities. The Group prefers to grow its balance sheet through increasing core retail deposits where possible. Professional market funds are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

As at 31 December 1996, customer accounts totalled £151.2 billion, an increase of 6.4 per cent from 31 December 1995. Deposits by banks decreased by 13.0 per cent to £18.0 billion at 31 December 1996.

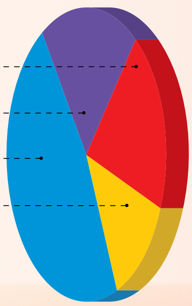
*Customer accounts and deposits by banks **1996***

	%	£b
Current	21.0	**35.6**
Savings	20.5	**34.7**
Other deposits	47.9	**80.9**
Deposits by banks	10.6	**18.0**
Total	100.0	**169.2**



Customer accounts and deposits by banks 1995

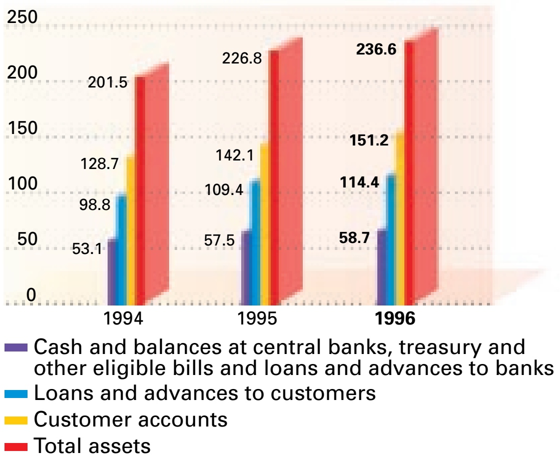
	%	£b
Current	20.0	32.5
Savings	20.4	33.2
Other deposits	46.9	76.4
Deposits by banks	12.7	20.7
Total	100.0	162.8



Customer current, deposit and savings accounts accounted for 89.4 per cent of the Group's deposit base at 31 December 1996, compared with 87.3 per cent at 31 December 1995. As at 31 December 1996, 75.7 per cent of the Group's customer accounts were deployed in loans and advances to customers, compared with 77.0 per cent at 31 December 1995.

Cash and balances at central banks, treasury bills and other eligible bills, and loans and advances to banks accounted for 24.8 per cent of total assets and 34.7 per cent of deposits at 31 December 1996, compared with 25.4 per cent and 35.3 per cent, respectively, at 31 December 1995.

Assets, deposits and advances (£b)



Off-Balance-Sheet Financial Instruments

Derivatives

Off-balance-sheet financial instruments, commonly referred to as derivatives, are contracts whose characteristics are derived from those of underlying assets, interest and exchange rates or indices. They include futures, forwards, swap and options transactions in the foreign exchange, interest rate and equity markets. Deals are negotiated directly with customers, with the bank acting as a counterparty, or can be dealt through exchanges.

Users of derivatives typically want to convert an unwanted risk generated by their business to a more acceptable risk, or cash. Derivatives provide an effective tool for companies to manage the financial risks associated with their business and, as a consequence, there has been a significant growth in derivatives transactions in recent years.

The Group, through the dealing operations of its subsidiaries, acts as an intermediary between a broad range of users, structuring deals to produce risk management products to suit individual customer needs. As a result, the Group can accumulate significant open positions in derivatives portfolios. These positions are managed constantly to ensure that they are within acceptable risk levels, with offsetting deals being undertaken to achieve this where necessary. As well as acting as a dealer, the Group also uses derivatives (principally interest rate swaps) in the management of its own asset and liability portfolios and structural positions.

The following table gives a summary of the outstanding notional principal contract amounts with third parties and the cost of replacing the contracts at current market rates if counterparties were not to meet their commitments under the contracts, as at 31 December 1995 and 31 December 1996. Contract amounts shown indicate the volume of transactions outstanding; they do not represent values at risk.

Derivatives contracts with third parties (£m)

	1996		1995	
	Contract amount	Replacement cost	Contract amount	Replacement cost
Exchange rate contracts	**411,216**	**5,405**	376,018	4,916
Interest rate contracts	**481,441**	**4,325**	608,922	7,014
Total	**892,657**	**9,730**	984,940	11,930

At 31 December 1996, the total notional principal of outstanding contracts with third parties was £893 billion, compared with a value of £985 billion at 31 December 1995. The net decrease of £92 billion, or 9 per cent, represents a £127 billion decline in interest rate contracts, principally reflecting reduced market-making activity in forward rate agreements and related futures hedges. This decline was partially offset by a £35 billion increase in exchange rate contracts.

The replacement cost amount decreased from £11.9 billion at 31 December 1995 to £9.7 billion at 31 December 1996. £2.7 billion of this decrease related to interest rate contracts, mainly because of the decrease in contract amounts outstanding following reduced demand and a more stable interest rate environment. This was offset by an increase of £0.5 billion related to exchange rate contracts, due to the

Financial Review *(continued)*

Total derivatives contracts outstanding (£m)	1996 Contract amounts Trading	Non-trading*	Mark-to-market values Positive	Negative
Spot and forward foreign exchange	341,029	25,911	3,904	(3,981)
Currency swaps, futures and options purchased	34,358	889	900	(275)
Currency options written	24,376	—	—	(453)
Equity and other	6,820	337	601	(886)
Total exchange rate contracts	406,583	27,137	5,405	(5,595)
Less: not recognised in the balance sheet			(35)	28
Balance sheet values			5,370	(5,567)
Interest rate swaps	242,992	57,757	3,648	(3,674)
Interest rate futures, forward rate agreements and options purchased	168,933	15,499	677	(123)
Interest rate options written	40,815	—	—	(405)
Total interest rate contracts	452,740	73,256	4,325	(4,202)
Less: not recognised in the balance sheet			(117)	132
Balance sheet values			4,208	(4,070)

* *Including internal deals.*

increase in contract amounts outstanding and increased currency volatility during the last quarter of 1996, partially offset by increased netting benefits taken.

The table above provides an analysis of derivatives by product at 31 December 1996, showing those contracts undertaken for trading purposes and those used for asset and liability management purposes (non-trading). The sum total of the contract amounts outstanding is greater than the total outstanding with third party counterparties shown above since it includes internal deals undertaken for asset and liability management purposes. An analysis of positive and negative mark-to-market values is also shown. Positive amounts represent the replacement cost values, whilst negative amounts represent losses on contracts where the current mark-to-market value is less than the value contracted.

Risks associated with derivatives

Derivative instruments are subject to both market risk and credit risk.

The market risk associated with derivatives can be significant since large positions can be accumulated with a substantially smaller initial outlay than required in cash markets. Recognising this, only certain offices within major subsidiaries with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. The management of market risk arising from derivatives business is monitored by Group Market Risk, in combination with market risks arising from on-balance-sheet instruments.

Unlike assets recorded on the balance sheet, where the credit risk is typically the full amount of the principal value, together with any unrealised interest accrued or mark-to-market gain, the credit risk relative to a derivative is principally the replacement cost of any contract with a positive mark-to-market gain and an estimate for the potential future change in value, reflecting the volatilities affecting the contract. Credit risk on contracts having a negative mark-to-market value is restricted to the potential future change in value. Credit risk on derivatives is therefore small in relation to a comparable balance sheet risk. In addition, credit exposure with individual counterparties can be reduced by close-out netting agreements which allow for positive and negative mark-to-market values on different transactions to be offset and settled by a single payment in the event of default by either party. Such agreements are enforceable in the jurisdictions of the major market makers and the Group has executed close out netting agreements with the majority of these counterparties, notwithstanding the fact that the Group deals only with the most creditworthy counterparties.

The following table analyses the replacement cost of all exchange rate and interest rate contracts with positive mark-to-market gains, after netting where possible, by maturity and by category of counterparty at 31 December 1996 and 31 December 1995. The table shows that the replacement cost of derivatives is predominantly with banks and under five years.

£m	Residual maturity 1996 Less than 1 year	1-5 years	Over 5 years	Total	1995 Total
Governments	**10**	**21**	**9**	**40**	82
Banks	**4,515**	**2,350**	**886**	**7,751**	9,782
Non-bank financial institutions					
– exchanges*	**31**	**4**	**—**	**35**	88
– other	**264**	**52**	**10**	**326**	360
Other sectors	**774**	**650**	**154**	**1,578**	1,618
Total **1996**	**5,594**	**3,077**	**1,059**	**9,730**	
Total 1995	6,489	4,412	1,029		11,930

** Exchanges with margining requirements.*

The maturity profile of the notional principal values of third party derivative contracts outstanding as at 31 December 1996 and 31 December 1995 above shows that the vast majority of contracts are executed over the counter and mature within one year.

£m	**1996** Less than 1 year	1-5 years	Over 5 years	Total	1995 Total
Exchange and interest rate contracts					
– exchanges*	**53,071**	**4,985**	**—**	**58,056**	72,265
– other contracts	**618,809**	**183,429**	**32,363**	**834,601**	912,675
Total	**671,880**	**188,414**	**32,363**	**892,657**	
Total 1995	723,327	228,404	33,209		984,940

** Exchanges with margining requirements.*

Financial Reporting

The 1996 financial accounts have been presented in the same format as last year, which reflected the application of the Companies Act 1985 (Bank Accounts) Regulations 1991 applicable to UK banking groups.

Accounting policies used in the preparation of the accounts are consistent with previous years.

The Group complies with the requirements of Financial Reporting Standard 8, 'Related Party Disclosures', which is effective for transactions between the Group and its related parties during 1996.

In 1996, the Group has also adopted Financial Reporting Standard 1 (revised 1996), 'Cash Flow Statements', for which early implementation was encouraged.

The following change in presentation has been made and comparative data have been restated accordingly.

A review of the classification of costs in respect of payments and securities transactions and administrative charges has resulted in the reclassification of certain amounts previously included in 'Administrative expenses' to 'Fees and commissions payable'. This presentation reflects the nature of these costs more appropriately.

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the Auditor's statement of its responsibilities set out in its report on the facing page, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditor in relation to the financial statements.

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and its subsidiary undertakings as at the end of the financial year and of the profit or loss for the financial year. The Directors are required to prepare these financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the Group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors consider that in preparing the financial statements on pages 48 to 88, the Company has used appropriate accounting policies, consistently applied, save as disclosed in the 'Notes on the Accounts', and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

On behalf of the Board — 3 March 1997
R G Barber, *Secretary*

Report of the Auditors, KPMG Audit Plc, to the Members of HSBC Holdings plc

We have audited the financial statements on pages 48 to 88 and the detailed information set out in the 'Report by the Remuneration Committee' on pages 26 to 29.

Respective responsibilities of Directors and Auditors
As described on page 46, the Company's Directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

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

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

Opinion
In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 1996 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc — 3 March 1997
Chartered Accountants/Registered Auditor
London

Consolidated Profit and Loss Account for the Year Ended 31 December 1996

1995 £m		Note	**1996 £m**	*1996 HK$m*	*1996 US$m*
	Interest receivable				
	— interest receivable and similar				
1,306	income arising from debt securities		**1,770**	*21,379*	*2,765*
	— other interest receivable and				
11,878	similar income		**12,525**	*151,276*	*19,563*
(8,065)	Interest payable		**(8,474)**	*(102,349)*	*(13,236)*
5,119	**Net interest income**		**5,821**	*70,306*	*9,092*
72	Dividend income	*3*	**103**	*1,245*	*162*
2,744	Fees and commissions receivable		**3,171**	*38,298*	*4,952*
(342)	Fees and commissions payable	*5*	**(419)**	*(5,061)*	*(654)*
533	Dealing profits		**515**	*6,221*	*804*
371	Other operating income		**397**	*4,795*	*620*
8,497	**Operating income**		**9,588**	*115,804*	*14,976*
(4,378)	Administrative expenses	*4,5*	**(4,702)**	*(56,790)*	*(7,344)*
(347)	Depreciation and amortisation	*21*	**(367)**	*(4,434)*	*(573)*
3,772	**Operating profit before provisions**		**4,519**	*54,580*	*7,059*
	Provisions				
(416)	— provisions for bad and doubtful debts	*14*	**(384)**	*(4,638)*	*(600)*
	— provisions for contingent liabilities				
24	and commitments	*28*	**(7)**	*(84)*	*(11)*
	Amounts written off fixed				
(16)	asset investments		**(48)**	*(580)*	*(75)*
3,364	**Operating profit**		**4,080**	*49,278*	*6,373*
	Profit on disposal of fixed assets				
232	and investments		**356**	*4,300*	*556*
76	Income from associated undertakings		**88**	*1,063*	*137*
3,672	**Profit on ordinary activities before tax**	*5*	**4,524**	*54,641*	*7,066*
(897)	Tax on profit on ordinary activities	*6*	**(1,073)**	*(12,960)*	*(1,676)*
2,775	**Profit on ordinary activities after tax**		**3,451**	*41,681*	*5,390*
	Minority interests				
(287)	— equity		**(298)**	*(3,599)*	*(465)*
(26)	— non-equity		**(41)**	*(495)*	*(64)*
	Profit for the financial year				
2,462	**attributable to shareholders**		**3,112**	*37,587*	*4,861*
(843)	Dividends	*8*	**(1,090)**	*(13,165)*	*(1,703)*
1,619	**Retained profit for the year**		**2,022**	*24,422*	*3,158*
Pence			**Pence**	*HK$*	*US$*
94.01	**Earnings per ordinary share**	*9*	**117.61**	*14.20*	*1.84*
93.89	**Headline earnings per ordinary share**	*9*	**115.42**	*13.94*	*1.80*
32.00	**Dividends per ordinary share**	*8*	**41.00**	*4.95*	*0.64*

Movements in reserves are set out in Note 32

Consolidated Balance Sheet at 31 December 1996

1995 £m		Note	**1996 £m**	*1996 HK$m*	*1996 US$m*
	ASSETS				
1,806	Cash and balances at central banks		**1,814**	*23,872*	*3,086*
2,657	Items in the course of collection from other banks		**2,653**	*34,913*	*4,513*
12,766	Treasury bills and other eligible bills	*10*	**7,944**	*104,543*	*13,513*
5,098	Hong Kong Government certificates of indebtedness	*11*	**4,731**	*62,254*	*8,047*
42,966	Loans and advances to banks	*12*	**48,980**	*644,577*	*83,315*
109,373	Loans and advances to customers	*13*	**114,353**	*1,504,885*	*194,514*
24,669	Debt securities	*17*	**29,550**	*388,878*	*50,265*
1,210	Equity shares	*18*	**1,676**	*22,056*	*2,851*
531	Interests in associated undertakings	*19*	**519**	*6,830*	*883*
127	Other participating interests	*20*	**43**	*566*	*73*
5,790	Tangible fixed assets	*21*	**6,238**	*82,092*	*10,611*
17,287	Other assets	*23*	**15,878**	*208,961*	*27,008*
2,538	Prepayments and accrued income		**2,174**	*28,610*	*3,698*
226,818	Total assets		**236,553**	*3,113,037*	*402,377*
	LIABILITIES				
5,103	Hong Kong currency notes in circulation	*11*	**4,735**	*62,314*	*8,054*
20,693	Deposits by banks	*24*	**18,030**	*237,275*	*30,669*
142,121	Customer accounts	*25*	**151,149**	*1,989,121*	*257,104*
1,366	Items in the course of transmission to other banks		**1,573**	*20,701*	*2,676*
8,650	Debt securities in issue	*26*	**10,040**	*132,126*	*17,078*
24,827	Other liabilities	*27*	**24,894**	*327,605*	*42,345*
2,319	Accruals and deferred income		**1,997**	*26,280*	*3,397*
	Provisions for liabilities and charges	*28*			
367	— deferred taxation		**393**	*5,172*	*669*
404	— other provisions for liabilities and charges		**455**	*5,988*	*774*
	Subordinated liabilities	*29*			
1,774	— undated loan capital		**1,768**	*23,267*	*3,007*
3,765	— dated loan capital		**4,207**	*55,364*	*7,156*
	Minority interests				
1,590	— equity		**1,599**	*21,043*	*2,720*
452	— non-equity	*30*	**526**	*6,922*	*895*
2,124	Called up share capital	*31*	**2,014**	*26,504*	*3,426*
307	Share premium account	*32*	**299**	*3,935*	*509*
148	Reserves	*32*	**26**	*342*	*44*
2,218	Revaluation reserves	*32*	**2,697**	*35,493*	*4,588*
8,590	Profit and loss account	*32*	**10,151**	*133,585*	*17,266*
13,387	Shareholders' funds		**15,187**	*199,859*	*25,833*
226,818	Total liabilities		**236,553**	*3,113,037*	*402,377*
	MEMORANDUM ITEMS				
	Contingent liabilities	*34*			
2,076	— acceptances and endorsements		**2,162**	*28,452*	*3,678*
13,769	— guarantees and assets pledged as collateral security		**14,389**	*189,359*	*24,476*
180	— other contingent liabilities		**167**	*2,198*	*284*
16,025			**16,718**	*220,009*	*28,438*
69,184	Commitments	*34*	**72,001**	*947,533*	*122,474*

W Purves, *Group Chairman*

Company Balance Sheet at 31 December 1996

1995 £m		Note	1996 £m	1996 HK$m	1996 US$m
	FIXED ASSETS				
10	Tangible assets	21	**9**	118	15
	Investments	22			
11,993	— shares in Group undertakings		**14,230**	187,267	24,206
1,034	— loans to Group undertakings		**912**	12,002	1,551
222	— other investments other than loans		**244**	3,211	415
13,259			**15,395**	202,598	26,187
	CURRENT ASSETS				
	Debtors				
1,052	— money market deposits with Group undertakings		**1,851**	24,359	3,149
786	— other amounts owed by Group undertakings		**659**	8,672	1,121
182	— amounts owed by Group undertakings (falling due after more than 1 year)		**222**	2,922	378
5	— other debtors		**6**	79	10
2,025			**2,738**	36,032	4,658
	Cash at bank and in hand				
471	— balances with Group undertakings		**144**	1,895	245
2,496			**2,882**	37,927	4,903
	CREDITORS: amounts falling due within one year				
(166)	Amounts owed to Group undertakings		**(807)**	(10,620)	(1,373)
(113)	Other creditors		**(118)**	(1,553)	(201)
(195)	Taxation		**(259)**	(3,408)	(441)
(600)	Proposed dividend	8	**(693)**	(9,120)	(1,179)
(1,074)			**(1,877)**	(24,701)	(3,194)
1,422	**NET CURRENT ASSETS**		**1,005**	13,226	1,709
14,681	**TOTAL ASSETS LESS CURRENT LIABILITIES**		**16,400**	215,824	27,896
	CREDITORS: amounts falling due after more than one year				
	Subordinated liabilities	29			
(819)	— owed to third parties		**(806)**	(10,609)	(1,371)
(224)	— owed to Group undertakings		**(205)**	(2,698)	(349)
(133)	Amounts owed to Group undertakings		**(133)**	(1,750)	(226)
	PROVISIONS FOR LIABILITIES AND CHARGES				
(118)	Deferred taxation	28	**(69)**	(908)	(117)
13,387	**NET ASSETS**		**15,187**	199,859	25,833
	CAPITAL AND RESERVES				
2,124	Called up share capital	31	**2,014**	26,504	3,426
307	Share premium account	32	**299**	3,935	509
7,772	Revaluation reserve	32	**9,783**	128,744	16,641
3,184	Profit and loss account	32	**3,091**	40,676	5,257
13,387			**15,187**	199,859	25,833

W Purves, *Group Chairman*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 1996

	1996 **£m**	1995 £m
Profit for the financial year attributable to shareholders	**3,112**	*2,462*
Unrealised surplus on revaluation of investment properties		
— subsidiaries	**9**	*(38)*
— associates	**12**	*45*
Unrealised surplus on revaluation of land and buildings (excluding investment properties)	**639**	*776*
Permanent diminution in value of land and buildings	**—**	*(41)*
Exchange and other movements	**(960)**	*129*
Total recognised gains and losses for the year	**2,812**	*3,333*

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 1996

	1996 **£m**	1995 £m
Profit for the financial year attributable to shareholders	**3,112**	*2,462*
Dividends	**(1,090)**	*(843)*
	2,022	*1,619*
Other recognised gains and losses relating to the year	**(300)**	*871*
New share capital subscribed	**13**	*12*
Arising on shares issued in lieu of dividends	**190**	*173*
Goodwill written back on disposal	**9**	—
Goodwill on acquisition of subsidiary and associated undertakings	**(134)**	*(78)*
Net addition to shareholders' funds	**1,800**	*2,597*
Shareholders' funds at 1 January	**13,387**	*10,790*
Shareholders' funds at 31 December	**15,187**	*13,387*

No note of historical cost profits and losses has been presented as there is no material difference between the Group's results as disclosed in the consolidated profit and loss account and the results on an unmodified historical cost basis.

Consolidated Cash Flow Statement for the Year Ended 31 December 1996

	Note	1996 £m	1995 £m
Net cash inflow from operating activities	*35*	**8,787**	*3,175*
Returns on investments and servicing of finance:			
Dividends received from associated undertakings		**49**	*38*
Interest paid on finance leases and similar hire purchase contracts		**(13)**	*(7)*
Interest paid on subordinated loan capital		**(385)**	*(385)*
Dividends paid to minority interests			
— equity		**(226)**	*(171)*
— non-equity		**(32)**	*(26)*
Net cash (outflow) from returns on investments and servicing of finance		**(607)**	*(551)*
Taxation paid		**(713)**	*(803)*
Capital expenditure and financial investment:			
Purchase of investment securities		**(13,486)**	*(10,187)*
Proceeds from sale of investment securities		**10,615**	*8,832*
Purchase of tangible fixed assets		**(651)**	*(584)*
Proceeds of sale of tangible fixed assets		**167**	*167*
Net cash (outflow) from capital expenditure and financial investments		**(3,355)**	*(1,772)*
Acquisitions and disposals			
Net cash outflow from acquisition of subsidiary undertakings		**(29)**	*(91)*
Net cash inflow from disposal of subsidiary undertakings		**33**	—
Purchase of interest in associated undertakings and other participating interests		**(53)**	*(69)*
Proceeds from disposal of associated undertakings and other participating interests		**87**	*7*
Net cash inflow/(outflow) from acquisitions and disposals		**38**	*(153)*
Equity dividends paid		**(807)**	*(565)*
Net cash inflow/(outflow) before financing		**3,343**	*(669)*
Financing:			
Issue of ordinary share capital		**13**	*12*
Issue of preference share capital		**124**	*233*
Subordinated loan capital issued		**1,005**	*394*
Subordinated loan capital repaid		**(90)**	*(124)*
Net cash inflow from financing	*36*	**1,052**	*515*
Increase/(decrease) in cash	*37*	**4,395**	*(154)*

Notes on the Accounts

1 Basis of preparation

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

The consolidated accounts are prepared in accordance with the special provisions of Part VII Chapter II of the Companies Act 1985 (‘the Act’) relating to banking groups. The consolidated accounts comply with Schedule 9 and the accounts of HSBC Holdings plc (‘the Company’) comply with Schedule 4 to the Act.

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

The Group complies with the requirements of Financial Reporting Standard 8, ‘Related Party Disclosures’, which is effective for transactions between the Group and its related parties during 1996. The Group has also adopted, in 1996, Financial Reporting Standard 1 (revised 1996) ‘Cash Flow Statements’ for which early implementation was encouraged and the 1995 comparative figures have been restated accordingly.

The following change in presentation has been made in the accounts and comparative data have been restated.

A review of the classification of costs in respect of payments and securities transactions and administrative charges has resulted in the reclassification of certain amounts previously included in ‘Administrative expenses’ to ‘Fees and commissions payable’. This presentation reflects the nature of these costs more appropriately. The effect of restating the 1995 comparative data for the change is provided in Note 5 on the Accounts.

b The consolidated accounts of the Group comprise the accounts of the Company and its subsidiary undertakings. Accounts of subsidiary undertakings are made up to 31 December, except in the case of Midland Life Limited, which has a year-end of 31 August and for which, therefore, the Group uses interim accounts, drawn up to 31 December annually, and Hongkong Bank of Canada, which has a 31 October year-end. The consolidated accounts include the attributable share of the results and reserves of associated undertakings, based on accounts made up to dates not earlier than six months prior to 31 December.

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

2 Principal accounting policies

a *Income recognition*

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

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

b *Loans and advances and doubtful debts*

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

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

Assets acquired in exchange for advances in order to achieve an orderly realisation continue to be reported as advances. The asset acquired is recorded at the carrying value of the advance disposed of at the date of the exchange, and provisions are based on any subsequent deterioration in its value.

c *Debt securities and equity shares*

Debt securities and equity shares intended to be held on a continuing basis are disclosed as investment securities and are included in the balance sheet at cost less provision for any permanent diminution in value.

Where dated investment securities have been purchased at a premium or discount, these premiums and discounts are amortised through the profit and loss account over the period from the date of purchase to the date of maturity. If the maturity is at the borrowers’ option within a specified range of years, the maturity date

2 Principal accounting policies *(continued)*

which gives the more conservative result is adopted. These securities are included in the balance sheet at cost adjusted for the amortisation of premiums and discounts arising on acquisition. The amortisation of premiums and discounts is included in 'Interest receivable'. Any profit or loss on realisation of these securities is recognised in the profit and loss account as it arises and included in 'Profit on disposal of fixed assets and investments'.

Debt securities held for the purpose of hedging are valued on the same basis as the liabilities which are being hedged.

Other debt securities and equity shares are included in the balance sheet at market value. Changes in the market value of such assets are recognised in the profit and loss account as 'Dealing profits' as they arise.

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Conversely, securities purchased under analogous commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to customers' or 'Loans and advances to banks'.

d *Subsidiary and associated undertakings and other participating interests*

i The Company's investments in subsidiary undertakings are stated at attributable net asset values. Changes in net tangible assets of subsidiary undertakings are accounted for as movements in the revaluation reserve.

ii Interests in associated undertakings are stated at the Group's attributable share of the net tangible assets of the relevant companies.

iii Other participating interests are investments in the shares of undertakings which are held on a long-term basis for the purpose of securing a contribution to the Group's business, other than subsidiary or associated undertakings. Other participating interests are stated at cost less any permanent diminution in value.

iv Goodwill arising on the acquisition of subsidiary or associated undertakings, being the excess of the cost of acquisition over the fair value of the Group's share of separable net assets acquired, is charged against reserves in the year of acquisition. At the date of disposal of subsidiary or associated undertakings, goodwill is reinstated in reserves and included in the calculation of the profit on disposal of the undertaking.

e *Tangible fixed assets*

i Land and buildings are stated at valuation or cost less depreciation calculated to write off the assets over their estimated useful lives as follows:

— freehold land and land held on leases with more than 50 years to expiry are not depreciated;

— land held on leases with 50 years or less to expiry is depreciated over the unexpired terms of the leases; and

— buildings and improvements thereto are depreciated on cost or valuation at the greater of 2% per annum on the straight line basis or over the unexpired terms of the leases.

ii Equipment, fixtures and fittings are stated at cost less depreciation calculated on the straight line basis to write off the assets over their estimated useful lives, which are generally between 5 years and 20 years.

iii The Group holds certain properties as investments. No depreciation is provided in respect of such properties other than leaseholds with 20 years or less to expiry. Investment properties are included in the balance sheet at their open market value and the aggregate surplus or deficit, where material, is transferred to the investment property revaluation reserve.

f *Finance and operating leases*

i Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Where the Group is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to customers' or 'Loans and advances to banks'. Finance charges receivable are recognised over the periods of the leases in proportion to the funds invested.

ii Where the Group is a lessee under finance leases, the leased assets are capitalised and included in 'Equipment, fixtures and fittings' and the corresponding liability to the lessor is included in 'Other liabilities'. Finance charges payable are recognised over the periods of the leases based on the interest rates implicit in the leases.

2 Principal accounting policies *(continued)*

iii All other leases are classified as operating leases and, where the Group is the lessor, are included in 'Tangible fixed assets'. Rentals payable and receivable under operating leases are accounted for on the straight line basis over the periods of the leases and are included in 'Administrative expenses' and 'Other operating income' respectively.

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g *Deferred taxation*

Deferred taxation is provided on timing differences, using the liability method, between the accounting and taxation treatment of income and expenditure. Provision is made for deferred tax only to the extent that it is probable that an actual liability will crystallise.

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h *Pension and other post-retirement benefits*

The Group operates a number of pension and other post-retirement benefit schemes throughout the world and the majority of staff are members of defined benefit schemes.

For UK defined benefit schemes annual contributions are made, on the advice of qualified actuaries, for funding of retirement benefits in order to build up reserves for each scheme member during the employee's working life and used to pay a pension to the employee or dependant after retirement. The costs of providing these benefits are charged to the profit and loss account on a regular basis.

Arrangements for staff retirement benefits in overseas locations vary from country to country and are made in accordance with local regulations and custom. The pension cost of the major overseas schemes is assessed in accordance with the advice of qualified actuaries so as to recognise the cost of pensions on a systematic basis over employees' service lives.

The cost of providing post-retirement health-care benefits, which is assessed in accordance with the advice of qualified actuaries, is recognised on a systematic basis over employees' service lives. At 1 January 1993, there was an accumulated obligation in respect of these benefits relating to current and retired employees. This is being charged in the profit and loss account in equal instalments over 20 years.

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i *Foreign currencies*

i Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the year-end. The results of overseas branches and subsidiary and associated undertakings are translated into sterling at the average rates of exchange for the year.

ii Exchange differences arising from the retranslation of opening foreign currency net investments and the related cost of hedging and exchange differences arising from retranslation of the result for the year from the average rate to the exchange rate ruling at the year-end are accounted for in reserves.

iii Other exchange differences are recognised in the profit and loss account.

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j *Off-balance-sheet financial instruments*

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

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

Transactions undertaken for trading purposes are marked to market value and the net present value of any gain or loss arising is recognised in the profit and loss account as 'Dealing profits', after appropriate deferrals for unearned credit margin and future servicing costs.

Non-trading transactions are accounted for on an equivalent basis to the underlying assets, liabilities or net positions. Any profit or loss arising is recognised on the same basis as that arising from the related assets, liabilities or positions.

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

3 Dividend income

	1996	1995
	£m	£m
Income from equity shares	**98**	66
Income from participating interests other than associated undertakings	**5**	6
	103	72

4 Administrative expenses

a

	1996	1995
	£m	£m
Staff costs		
— wages and salaries	**2,663**	2,464
— social security costs	**138**	136
— other pension costs (Note 4b below)	**268**	234
	3,069	2,834
Premises and equipment (excluding depreciation)	**652**	612
Other administrative expenses	**981**	932
	4,702	4,378

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

	1996	1995
	Number	Number
Commercial banking	**103,542**	104,015
Investment banking	**5,756**	5,078
	109,298	109,093

b *Retirement benefits*

The Group operates some 114 pension schemes throughout the world, covering 92% of the Group's employees, with a total pension cost of £268 million (1995: £234 million), of which £145 million (1995: £103 million) relates to overseas schemes. Of the overseas schemes, £17 million (1995: £16 million) has been determined in accordance with best practice and regulations in the United States and Canada.

The majority of the schemes are funded defined benefit schemes, which cover 83% of the Group's employees, with assets, in the case of the larger schemes, held in trust or similar funds separate from the Group. The pension cost relating to these schemes was £252 million (1995: £218 million) which is assessed in accordance with the advice of qualified actuaries; the schemes are reviewed at least on a triennial basis or in accordance with local practice and regulations. The actuarial assumptions used to calculate the projected benefit obligations of the Group's pension schemes vary according to the economic conditions of the countries in which they are situated.

For the principal UK scheme, the Midland Bank Pension Scheme, the latest valuation was made at 31 December 1993 and was performed by P Lofthouse, Fellow of the Institute of Actuaries, of Watson Wyatt Partners (formerly R Watson & Sons). At that date the market value of the scheme's assets was £3,685 million. The actuarial value of the assets represented 99.5% of the benefits accrued to members, after allowing for expected future increases in earnings, and the resulting deficit amounted to £18 million. On the basis of the actuary's recommendations, contributions were increased from 14.0% to 16.1% of pensionable salaries with effect from 1 January 1994, to remain at that percentage at least until the next actuarial valuation. The actuarial method used is the projected unit method. The main assumptions used in this valuation were a long-term investment return of 9.2% per annum; salary increases of 6.3% per annum; equity dividend increases and rental growth of 4.5% per annum; and post-retirement pension increases of 4.0% per annum. The next actuarial valuation, due as at 31 December 1996, is currently in progress. Based upon the method and assumptions adopted at the 1993 valuation, preliminary indications are that there is unlikely to be a deficit within the Scheme. With effect from 1 July 1996, UK staff joining the Group are provided with defined contribution benefits from the principal UK scheme.

4 Administrative expenses *(continued)*

For the principal non-UK scheme, The Hongkong and Shanghai Banking Corporation Limited Defined Benefit Scheme, the latest valuation was made at 31 December 1996 and was performed by E Chiu, Fellow of the Society of Actuaries of the United States of America, of HSBC Life (International) Limited. At that date, the market value of the scheme's assets was £310 million. On an ongoing basis, the actuarial value of the assets represents 97% of the benefits accrued to members, after allowing for expected future increases in salaries, and the resulting deficit amounted to £9 million. On a wind-up basis, the actuarial value of the assets represents 108% of the benefits accrued to members, based on current salaries, and the resulting surplus amounted to £24 million. On the basis of the actuary's recommendations, contributions will continue at 19% of pensionable salaries for 1997. The actuarial method used is the projected unit method and the main assumptions used in this valuation were a long-term investment return of 9% per annum and salary increases of 8% per annum.

The Midland Bank Pension Scheme and The Hongkong and Shanghai Banking Corporation Limited Defined Benefit Scheme cover 48% (1995: 51%) of the Group's employees.

The pension cost for defined contribution schemes, which cover 9% (1995: 6%) of the Group's employees, was £16 million (1995: £16 million).

The Group also provides post-retirement health-care benefits under schemes, mainly in the UK and also in the United States and Canada. The charge relating to these schemes, which are unfunded, is £23 million for the year (1995: £28 million). The latest actuarial review as at 31 December 1996 estimated the present value of the accumulated post-retirement benefit obligation at £188 million (1995: £193 million), of which £76 million (1995: £61 million) has been provided. The actuarial assumptions used to estimate this obligation vary according to the claims experience and economic conditions of the countries in which the schemes are situated. For the UK schemes, the main financial assumptions used at 31 December 1996 are price inflation at 4.5% per annum, health-care claims cost escalation of 8% per annum and a discount rate of 8% per annum.

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c *Directors' emoluments*

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

	1996	1995
	£000	£000
Fees	**452**	501
Salaries and other emoluments	**3,220**	3,357
Discretionary bonuses	**585**	535
Pension contributions	**187**	1,108
	4,444	5,501

The emoluments of the Directors, excluding pension contributions, are within the following bands:

£	**1996 Number of Directors**	1995 Number of Directors	£	**1996 Number of Directors**	1995 Number of Directors
5,001– 10,000	**—**	1	410,001–415,000	**—**	1
15,001– 20,000	**6**	4	420,001–425,000	**1**	—
20,001– 25,000	**3**	2	425,001–430,000	**—**	1
25,001– 30,000	**1**	1	430,001–435,000	**1**	—
35,001– 40,000	**—**	1	550,001–555,000	**—**	1
40,001– 45,000	**1**	2	575,001–580,000	**1**	—
45,001– 50,000	**2**	1	610,001–615,000	**1**	—
50,001– 55,000	**1**	—	615,001–620,000	**—**	1
55,001– 60,000	**—**	1	670,001–675,000	**1**	—
60,001– 65,000	**—**	1	680,001–685,000	**—**	1
325,001–330,000	**—**	1	725,001–730,000	**1**	—
405,001–410,000	**1**	—	930,001–935,000	**—**	1

Notes on the Accounts *(continued)*

4 Administrative expenses *(continued)*

The emoluments of the Chairman and the highest paid Director were:

	1996	1995	
	Chairman	Chairman	Highest paid Director
	£000	£000	£000
Fees	**20**	20	16
Salary and other emoluments	**556**	540	917
Discretionary bonuses	**150**	120	—
Pension contributions	**—**	—	67
	726	680	1,000

The Chairman was the highest paid Director in 1996 and in 1995 he was the highest paid Director of those Directors who discharge their duties mainly in the United Kingdom. The emoluments of the highest paid Director in 1995, who discharged his duties mainly outside the United Kingdom, included housing and other expatriate benefits in kind which are normal within the location in which he was employed and which constituted a significant portion of his emoluments.

In addition, pensions and other amounts paid under retirement benefit agreements in respect of past services of £143,000 (1995: £221,000) were paid. The provision as at 31 December 1996 in respect of unfunded pension obligations to a former Director amounted to £1,496,000 (1995: £1,508,000).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee, whose report, together with details of Directors' share options and conditional awards under the Restricted Share Plan, are disclosed in the 'Report of the Directors' (see pages 24 to 30).

Five Directors waived the right to receive emoluments totalling £83,000 (1995: five Directors £91,000).

Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 28.

d *Auditor's remuneration*

Auditor's remuneration amounted to £9.7 million (1995: £9.4 million). In addition, £4.2 million (1995: £3.5 million) was paid by Group companies to the auditor and its associates for non-audit work as analysed below:

	1996	1995
	£m	£m
Regulatory work	**1.7**	1.5
Tax services	**0.7**	0.7
Consultancy	**0.8**	0.3
Other	**1.0**	1.0
	4.2	3.5

5 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after:	1996	1995
	£m	£m
i *Income*		
Aggregate rentals receivable, including capital repayments, under		
— finance leases	**2,019**	1,840
— operating leases	**133**	124
Income from listed investments	**1,408**	1,096
Profits less losses on debt securities and equities dealing	**121**	125
Profits less losses on disposal of investment securities	**246**	229

5 Profit on ordinary activities before tax *(continued)*

	1996 £m	1995 £m
ii *Charges*		
Charges incurred with respect to subordinated liabilities	**426**	399
Finance charges in respect of finance leases and similar hire purchase contracts	**10**	11
Hire of plant and machinery	**59**	53
Rentals payable on premises held under operating leases	**252**	230

Profit on the disposal of fixed assets and investments attracted a tax charge of £43 million (1995: £26 million). Of the after tax amount, £15 million (1995: £33 million) is attributable to minority interests.

The effect of restating the 1995 comparative data for the change in classification of costs in respect of payments and securities transactions is to increase ‘Fees and commissions payable’ by £56 million and to reduce ‘Adminstrative expenses’ by £56 million.

6 Tax on profit on ordinary activities

The charge for taxation comprises:	1996 £m	1995 £m
United Kingdom corporation tax charge	**513**	489
Relief for overseas taxation	**(107)**	(138)
	406	351
Overseas taxation	**598**	522
Deferred taxation (Note 28)	**58**	13
	1,062	886
Associated undertakings	**11**	11
	1,073	897

The Company and its subsidiary undertakings in the UK provide for UK corporation tax at 33% (1995: 33%). Overseas tax includes Hong Kong profits tax of £250 million (1995: £202 million). Subsidiary undertakings in Hong Kong provide for Hong Kong profits tax at the rate of 16.5% (1995: 16.5%) on the profits for the year assessable in Hong Kong. Other overseas subsidiary undertakings and overseas branches provide for taxation in the countries in which they operate at the appropriate rates of taxation.

7 Profit of the Company

The profit of the Company for the year is £807 million (1995: £924 million).

8 Dividends

	1996		1995	
	Pence per share	£m	Pence per share	£m
First interim	**15.00**	**397**	9.25	243
Second interim	**26.00**	**693**	—	—
Final	**—**	**—**	22.75	600
	41.00	**1,090**	32.00	843

Of the first interim dividend for 1996, £89 million (1995: £53 million) was settled by the issue of shares. Of the final dividend for 1995, £101 million (1994: £120 million) was settled by the issue of shares in 1996.

9 Earnings per ordinary share

Earnings per ordinary share is calculated by dividing the earnings of £3,112 million (1995: £2,462 million) by the weighted average number of ordinary shares in issue in 1996 of 2,646 million (1995: 2,619 million). Fully diluted earnings per share is not materially different from the basic earnings per ordinary share shown.

9 Earnings per ordinary share *(continued)*

Headline earnings per share has been calculated in accordance with the definition in the Institute of Investment Management Research (IIMR) Statement of Investment Practice No. 1, 'The Definition of IIMR Headline Earnings', as follows:

	1996	1995
	Pence	Pence
Earnings per ordinary share	**117.61**	94.01
Adjustments:		
Profit on sale of tangible fixed assets	**(1.06)**	(0.12)
Profit on disposal of subsidiary undertaking	**(1.10)**	—
Profit on partial sale of associated undertaking	**(1.47)**	—
Provision for permanent diminution in value of other participating interests	**1.44**	—
Headline earnings per ordinary share	**115.42**	93.89

10 Treasury bills and other eligible bills

	1996	1995
	£m	£m
Treasury bills and similar securities	**6,755**	11,602
Other eligible bills	**1,189**	1,164
	7,944	12,766

None of the treasury and other eligible bills has been accounted for as an investment security.

11 Hong Kong currency notes in circulation

	1996	1995
	£m	£m
Authorised note issue (HK$60 million)	**4**	5
Excess note issue (HK$62,254 million)	**4,731**	5,098
	4,735	5,103

The authorised note issue is secured by the deposit of investments having a market value of £5 million (1995: £6 million). The excess note issue is secured by the deposit of funds in respect of which the Hong Kong Government certificates of indebtedness are held.

12 Loans and advances to banks

	1996	1995
	£m	£m
Remaining maturity		
— repayable on demand	**7,066**	3,376
— 3 months or less	**36,775**	33,324
— 1 year or less but over 3 months	**3,748**	4,756
— 5 years or less but over 1 year	**421**	404
— over 5 years	**1,001**	1,159
Specific bad and doubtful debt provisions (Note 14)	**(31)**	(53)
	48,980	42,966

The bad and doubtful debt provisions against loans and advances to banks relate principally to less developed country exposures.

12 Loans and advances to banks *(continued)*

	1996	1995
	£m	£m
Amounts include:		
Due from associated undertakings		
— unsubordinated	**62**	14

13 Loans and advances to customers

	1996	1995
	£m	£m
Remaining maturity		
— repayable on demand or at short notice	**32,548**	29,950
— 3 months or less but not repayable on demand or at short notice	**9,212**	9,199
— 1 year or less but over 3 months	**13,425**	13,819
— 5 years or less but over 1 year	**32,481**	31,616
— over 5 years	**29,453**	27,812
General and specific bad and doubtful debt provisions (Note 14)	**(2,766)**	(3,023)
	114,353	109,373
Amounts include:		
Subordinated	**68**	80
Securitised advances not qualifying for linked presentation under FRS 5	**117**	198
Due from associated undertakings		
— unsubordinated	**132**	156
Due from other undertakings in which the Group has a participating interest		
— unsubordinated	**3**	1

14 Provisions for bad and doubtful debts

	Provisions against advances			Suspended
	Specific	*General*	*Total*	*interest*
	£m	£m	£m	£m
At 1 January 1996	**2,182**	**894**	**3,076**	**453**
Amounts written off	**(604)**	**—**	**(604)**	**(36)**
Recoveries of advances written off in previous years	**112**	**—**	**112**	**—**
Charge to profit and loss account	**306**	**78**	**384**	**—**
Interest suspended during the year	**—**	**—**	**—**	**145**
Suspended interest recovered	**—**	**—**	**—**	**(137)**
Exchange and other movements	**(123)**	**(48)**	**(171)**	**(31)**
At 31 December 1996	**1,873**	**924**	**2,797**	**394**
Included in:				
Loans and advances to banks (Note 12)			**31**	
Loans and advances to customers (Note 13)			**2,766**	
			2,797	

14 Provisions for bad and doubtful debts *(continued)*

		Provisions against advances		*Suspended*
	Specific	*General*	*Total*	*interest*
	£m	£m	£m	£m
At 1 January 1995	2,506	760	3,266	494
Amounts written off	(761)	—	(761)	(111)
Recoveries of advances written off in previous years	102	—	102	—
Charge to profit and loss account	286	130	416	—
Interest suspended during the year	—	—	—	167
Suspended interest recovered	—	—	—	(95)
Exchange and other movements	49	4	53	(2)
At 31 December 1995	2,182	894	3,076	453

Included in:	
Loans and advances to banks (Note 12)	53
Loans and advances to customers (Note 13)	3,023
	3,076

The total of advances, net of suspended interest, on which interest is being placed in suspense, is as follows:

	1996	1995
	£m	£m
Gross	**1,991**	2,244
Net of specific provisions	**777**	924

15 Less developed country exposure

	1996	1995
	£m	£m
Total less developed country provisionable exposures to banks and customers (net of provisions in respect of commercial risk)	**1,083**	1,362
Total accrued interest	**28**	51
	1,111	1,413
Less developed country risk provisions	**(217)**	(306)
Suspended interest	**(28)**	(51)
Net exposure to less developed countries	**866**	1,056
As a percentage of shareholders' funds	**5.7%**	7.9%

Less developed country provisionable exposure includes the holding of par and discount bonds issued as a result of debt restructuring by Argentina, Brazil, Mexico, the Philippines and Venezuela. The principal amount of these bonds is secured by US Treasury instruments and as at 31 December 1996 the gross carrying value was £984 million (1995: £1,152 million).

16 Concentrations of exposure

The Group has the following concentrations of loans and advances to customers:

Total gross advances to customers:	*UK*	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
At 31 December 1996	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Residential mortgages	**9,861**	**99**	**10,821**	**1,192**	**4,476**	**26,449**
Other personal	**5,300**	**238**	**4,609***	**1,418**	**3,207**	**14,772**
Commercial, industrial and international trade	**13,647**	**1,120**	**6,471**	**8,384**	**3,109**	**32,731**
Commercial real estate	**2,956**	**280**	**4,710**	**2,010**	**2,642**	**12,598**
Other property related	**986**	**183**	**1,301**	**1,040**	**560**	**4,070**
Non-bank financial institutions	**2,580**	**87**	**1,477**	**880**	**713**	**5,737**
Other commercial	**9,213**	**1,443**	**3,518**	**3,370**	**3,552**	**21,096**
	44,543	**3,450**	**32,907**	**18,294**	**18,259**	**117,453**

Total gross advances to customers:	*UK*	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
At 31 December 1995	£m	£m	£m	£m	£m	£m
Residential mortgages	8,537	811	10,176	1,109	4,305	24,938
Other personal	4,620	355	4,676*	1,168	3,448	14,267
Commercial, industrial and international trade	12,778	1,416	6,715	8,072	3,832	32,813
Commercial real estate	2,532	337	3,775	1,473	2,259	10,376
Other property related	1,009	164	1,058	857	746	3,834
Non-bank financial institutions	2,311	51	1,531	1,253	456	5,602
Other commercial	9,170	1,674	3,677	2,848	3,582	20,951
	40,957	4,808	31,608	16,780	18,628	112,781

* *Advances to individuals under the Hong Kong Government Home Ownership Scheme are included under 'Other personal' lending.*

The geographical information shown above has been classified by the location of the principal operations of the subsidiary undertaking, or in the case of HongkongBank, Midland and The British Bank of the Middle East operations, by the location of the branch responsible for advancing the funds.

The analysis of concentration of exposure is based on the categories used by the Group to manage the associated risks; refinements in this process have resulted in reclassifications to 1995 comparative figures.

Notes on the Accounts *(continued)*

17 Debt securities

	1996		1995	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	£m	£m
Issued by public bodies				
Investment securities				
— government securities	**8,602**	**8,675**	7,691	7,829
— other public sector securities	**689**	**702**	488	500
	9,291	**9,377**	8,179	8,329
Other securities				
— government securities	**4,859**		5,155	
— other public sector securities	**213**		417	
	14,363		13,751	
Issued by other bodies				
Investment securities				
— bank and building society certificates of deposit	**1,597**	**1,596**	1,091	1,098
— other debt securities	**4,403**	**4,495**	4,011	4,102
	6,000	**6,091**	5,102	5,200
Other securities				
— bank and building society certificates of deposit	**3,578**		1,888	
— other debt securities	**5,609**		3,928	
	15,187		10,918	
	29,550		24,669	
Due within 1 year	**9,954**		7,352	
Due 1 year and over	**19,596**		17,317	
	29,550		24,669	
Amounts include:				
Subordinated debt securities	**134**		98	
Unamortised net (discounts) on investment securities	**(19)**		(25)	
Investment securities				
— listed on a recognised UK exchange	**4,023**	**4,028**	2,617	2,632
— listed in Hong Kong	**386**	**390**	592	601
— listed elsewhere	**5,352**	**5,463**	5,154	5,298
— unlisted	**5,530**	**5,587**	4,918	4,998
	15,291	**15,468**	13,281	13,529
Other debt securities				
— listed on a recognised UK exchange	**1,795**		1,664	
— listed in Hong Kong	**184**		121	
— listed elsewhere	**6,335**		6,046	
— unlisted	**5,945**		3,557	
	29,550		24,669	

17 Debt securities *(continued)*

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

The above market valuations do not take account of transactions entered into to hedge the value of the Group's investment securities. If these transactions were included, the market valuation of investment securities would be £15,435 million (1995: £13,453 million).

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
At 1 January 1996	**13,321**	**(40)**	**13,281**
Exchange movements	**(1,239)**	**2**	**(1,237)**
Acquisitions	**13,007**	**—**	**13,007**
Disposals and amounts repaid	**(9,952)**	**10**	**(9,942)**
Transfers	**191**	**—**	**191**
Provisions made	**—**	**(5)**	**(5)**
Provisions written off	**(15)**	**15**	**—**
Amortisation of discounts and premiums	**(4)**	**—**	**(4)**
At 31 December 1996	**15,309**	**(18)**	**15,291**

18 Equity shares

	1996		1995	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	£m	£m
Investment securities				
— listed on a recognised UK exchange	**47**	**104**	76	207
— listed in Hong Kong	**261**	**695**	137	496
— listed elsewhere	**181**	**257**	204	258
— unlisted	**268**	**421**	277	387
	757	**1,477**	694	1,348
Other securities				
— listed on a recognised UK exchange	**549**		109	
— listed in Hong Kong	**77**		48	
— listed elsewhere	**269**		349	
— unlisted	**24**		10	
	1,676		1,210	

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

Included in the above are 907,712 (1995: 3,951,727) shares in the Company held by subsidiary undertakings as equity market-makers.

18 Equity shares *(continued)*

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
At 1 January 1996	**794**	**(100)**	**694**
Exchange movements	**(58)**	**—**	**(58)**
Acquisitions	**479**	**—**	**479**
Disposals	**(438)**	**11**	**(427)**
Transfers from other participating interests (Note 20)	**32**	**(1)**	**31**
Other transfers	**43**	**—**	**43**
Provisions made	**—**	**(5)**	**(5)**
Provisions written off	**(32)**	**32**	**—**
At 31 December 1996	**820**	**(63)**	**757**

19 Interests in associated undertakings

	1996
	£m
At 1 January 1996	**531**
Exchange and other movements	**(37)**
Additions	**48**
Capitalisation of reserves	**1**
Retained profits	**4**
Disposals	**(47)**
Surplus on revaluation of property	**21**
Write-off of goodwill	**(2)**
At 31 December 1996	**519**

		1996	1995
		£m	£m
a	Shares in banks	**361**	352
	Other	**158**	179
		519	531
	Listed shares (all listed outside the UK and Hong Kong)	**224**	250
	Unlisted shares	**295**	281
		519	531

19 Interests in associated undertakings *(continued)*

b The principal associated undertakings of the Group are:

	Accounts made up to	*Country of incorporation*	*Principal activity*	*Group's interest in equity capital*	*Issued equity capital*
Banco Roberts S.A.	30.6.96	Argentina	Banking	30%	AP140m
Barrowgate Limited	31.12.96	Hong Kong	Property	25%	—*
British Arab Commercial Bank Limited (formerly UBAF Bank Ltd)	31.12.96	England	Banking	47%	US$81m £32m fully paid, £5m nil paid
The Cyprus Popular Bank Limited	31.12.96	Cyprus	Banking	22%	C£75m
Egyptian British Bank S.A.E.	31.12.96	Egypt	Banking	40%	E£101m
Mondex International Limited	31.12.96	England	Electronic cash	28%	—†
Mondex UK Limited	31.12.96	England	Electronic cash	50%	—†
The Saudi British Bank	31.12.96	Saudi Arabia	Banking	40%	SR1,250m
Wells Fargo HSBC Trade Bank, N.A.	31.12.96	United States	Trade finance	20%	—¶
World Finance International Limited	30.6.96	Bermuda	Shipping	38%	US$58m

** Issued equity capital is less than HK$1 million.*
† Issued equity capital is less than £1 million.
¶ Issued equity capital is less than US$1 million.

All the above interests in associated undertakings are owned by subsidiaries of the Company.

The principal countries of operation are the same as the countries of incorporation, except for World Finance International Limited and Mondex International Limited which operate worldwide.

c The associated undertakings listed above have no loan capital, except for British Arab Commercial Bank Limited which has issued US$44.5million of subordinated unsecured loan stock in which the Group has a 34.7% interest; and Barrowgate Limited which has HK$845 million of loan capital in which the Group has a 25% interest. The Group also has a 100% interest in the issued preferred stock (less than US$1 million) of Wells Fargo HSBC Trade Bank, N.A.

20 Other participating interests

	1996	1995
	£m	£m
Listed other than on a recognised UK exchange or in Hong Kong	**3**	60
Unlisted	**40**	67
	43	127
Market value of listed securities	**6**	95
Other participating interests in banks	**24**	65

	Cost	*Provisions*	*Carrying value*
	£m	**£m**	**£m**
At 1 January 1996	**145**	**(18)**	**127**
Exchange and other movements	**(18)**	**2**	**(16)**
Additions	**5**	**—**	**5**
Disposals	**(2)**	**1**	**(1)**
Provisions made	**—**	**(38)**	**(38)**
Transfers to equity shares (Note 18)	**(32)**	**1**	**(31)**
Reclassifications	**(3)**	**—**	**(3)**
At 31 December 1996	**95**	**(52)**	**43**

Notes on the Accounts *(continued)*

21 Tangible fixed assets

a *Group*

	Freehold land and buildings	*Long leasehold land and buildings*	*Short leasehold land and buildings*	*Equipment, fixtures and fittings*	*Equipment on operating leases*	*Total*
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Cost or valuation at 1 January 1996	**1,201**	**3,040**	**900**	**1,884**	**395**	**7,420**
Exchange and other movements	**(68)**	**(284)**	**(71)**	**(90)**	**—**	**(513)**
Additions	**45**	**43**	**75**	**218**	**270**	**651**
Disposals	**(22)**	**(4)**	**(16)**	**(165)**	**(153)**	**(360)**
Reclassification	**—**	**(8)**	**8**	**—**	**—**	**—**
Transfer of accumulated depreciation arising on revaluation	**(20)**	**(25)**	**(15)**	**—**	**—**	**(60)**
Surplus on revaluation	**15**	**554**	**150**	**—**	**—**	**719**
Cost or valuation at 31 December 1996	**1,151**	**3,316**	**1,031**	**1,847**	**512**	**7,857**
Accumulated depreciation at 1 January 1996	**—**	**—**	**(314)**	**(1,201)**	**(115)**	**(1,630)**
Exchange and other movements	**—**	**1**	**29**	**62**	**—**	**92**
Disposals	**—**	**—**	**13**	**151**	**62**	**226**
Transfer of accumulated depreciation arising on revaluation	**20**	**25**	**15**	**—**	**—**	**60**
Charge for the year	**(20)**	**(26)**	**(53)**	**(187)**	**(81)**	**(367)**
Accumulated depreciation at 31 December 1996	**—**	**—**	**(310)**	**(1,175)**	**(134)**	**(1,619)**
Net book value at 31 December 1996	**1,151**	**3,316**	**721**	**672**	**378**	**6,238**
Net book value at 31 December 1995	1,201	3,040	586	683	280	5,790

b *Company*

	Freehold land and buildings
	£m
Valuation at 1 January 1996	**10**
Exchange and other movements	**(1)**
Valuation at 31 December 1996	**9**

21 Tangible fixed assets *(continued)*

c *Valuations*

	Group		*Company*	
	1996	1995	**1996**	1995
	£m	£m	**£m**	£m
Cost or valuation of freehold and long and short leasehold land and buildings (excluding investment properties):				
At 1996 valuation (1995: at 1995 valuation)	**4,630**	4,157	**9**	10
At cost	**423**	472	**—**	—
	5,053	4,629	**9**	10
On the historical cost basis, freehold and long and short leasehold land and buildings would have been included as follows (excluding investment properties):				
Cost	**2,822**	2,906	**1**	1
Accumulated depreciation	**(430)**	(410)	**—**	—
	2,392	2,496	**1**	1

The Group has changed the frequency with which its non-investment properties are revalued from a triennial basis to an annual basis. Accordingly, in November 1996, the Group's freehold and long leasehold properties, together with properties in Hong Kong with an unexpired lease term between 30 and 50 years, were revalued on an existing use basis or, in the case of a few specialised properties, at depreciated replacement cost. The properties were valued either by professional external valuers or by professionally qualified staff.

As a result of the revaluation, the net book value of land and buildings (excluding investment properties) increased by £706 million. A surplus of £638 million (net of minority interest of £68 million) was credited to reserves at 31 December 1996.

Permanent diminutions in the value of some premises have been identified and £8 million has been transferred from the revaluation reserve to the profit and loss account reserve, eliminating temporary diminutions arising on previous revaluations.

Included within 'Short leasehold land and buildings' are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

	Cost	*Accumulated depreciation*
	£m	**£m**
At 1 January 1996	**411**	**(256)**
Exchange and other movements	**(13)**	**5**
Additions	**37**	**—**
Disposals	**(12)**	**10**
Charge for the year	**—**	**(27)**
At 31 December 1996	**423**	**(268)**
Net book value at 31 December 1996 (1995: £155 million)	**155**	

The property of the Company was also valued by an independent, professionally qualified valuer on an existing use basis. No surplus or deficit arose.

21 Tangible fixed assets *(continued)*

d *Investment properties*

The valuation at which investment properties are included in Group tangible fixed assets, together with the net book value of these properties calculated under the historical cost basis, is as follows:

	1996		1995	
	At valuation £m	**At cost £m**	At valuation £m	At cost £m
Freehold land and buildings	**10**	**12**	1	1
Short and long leasehold land and buildings	**435**	**73**	511	73
	445	**85**	512	74

Investment properties are valued on an open market value basis at 31 December annually by professional external valuers. As a result of the revaluation, the net book value of investment properties has increased by £13 million (1995: deficit of £73 million). A surplus of £9 million net of minority interests of £4 million has been credited to reserves at 31 December 1996.

The Company had no investment properties at 31 December 1996 or 1995.

e *Group properties leased to customers*

Group properties leased to customers, none of which was held by the Company, included £360 million at 31 December 1996 (1995: £406 million) let under operating leases, net of accumulated depreciation of £7 million (1995: £9 million).

f *Land and buildings occupied for own activities*

	1996 £m	1995 £m
Net book value	**4,525**	4,090

There were no such assets in the Company at 31 December 1996 or 1995.

22 Investments

a

	Shares in Group undertakings	*Loans to Group undertakings*	*Other investments other than loans*	*Total*
	£m	**£m**	**£m**	**£m**
At 1 January 1996	**11,993**	**1,034**	**222**	**13,249**
Exchange movements	**—**	**(73)**	**—**	**(73)**
Additions	**8,690**	**311**	**101**	**9,102**
Repayments and redemptions	**(285)**	**(360)**	**—**	**(645)**
Disposals	**(8,059)**	**—**	**(77)**	**(8,136)**
Amortisation of discounts and premiums	**—**	**—**	**(2)**	**(2)**
Write-up of subsidiary undertakings to net asset value (Note 32)	**1,891**	**—**	**—**	**1,891**
At 31 December 1996	**14,230**	**912**	**244**	**15,386**

'Loans to Group undertakings' includes qualifying or regulatory capital and similar financing which can only be repaid by the relevant Group undertaking with the consent of its local regulatory authority.

'Other investments other than loans' represents the Company's holdings of listed investments in UK government stock and other investments as follows:

22 Investments *(continued)*

	1996		1995	
	Book value	*Market value*	*Book value*	*Market value*
	£m	**£m**	£m	£m
Listed on a recognised UK exchange	**244**	**241**	145	143
Listed other than on a recognised UK exchange or in Hong Kong	**—**	**—**	77	83
	244	**241**	222	226

	1996	1995
	£m	£m
On the historical cost basis, shares in Group undertakings would have been included as follows:		
Cost	**14,388**	9,887

There are no provisions for permanent diminution against these investments (1995: £ nil).

b The principal subsidiary undertakings of the Company are:

	Country of incorporation or registration	*Principal activity*	*Issued equity capital*
The British Bank of the Middle East	England	Banking	£125m
Forward Trust Limited	England	Finance	£265m
Guyerzeller Bank AG (75% owned)	Switzerland	Banking	SFr5m
Hang Seng Bank Limited (61.51% owned)	Hong Kong	Banking	HK$9,658m
The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	Banking	HK$16,254m
HongkongBank of Australia Limited	Australia	Banking	A$500m
Hongkong Bank of Canada	Canada	Banking	C$75m
Hongkong Bank Malaysia Berhad	Malaysia	Banking	M$100m
HSBC Americas, Inc.	United States	Holding company	—*
HSBC Asset Management Asia Pacific Limited	Bahamas	Asset management	—*
HSBC Gibbs Limited	England	Insurance	£3m
HSBC Greenwell	England	Capital markets	£30m
HSBC Insurance Limited (82.5% owned)	Hong Kong	Insurance	HK$25m
HSBC Investment Bank Asia Limited	Hong Kong	Investment banking	HK$770m
HSBC Investment Bank plc (formerly James Capel & Co. Limited)	England	Investment banking	£180m
HSBC Securities, Inc.	United States	Investment banking	—*
Marine Midland Bank	United States	Banking	US$185m
Midland Bank plc	England	Banking	£797m
Midland Life Limited	England	Insurance	£14m
Samuel Montagu & Co. Limited	England	Private banking	£112m
Trinkaus & Burkhardt KGaA (partnership limited by shares, 73% owned)	Germany	Banking	DM131m
Wayfoong Finance Limited	Hong Kong	Finance	HK$300m

** Issued equity capital is less than US$1 million.*

Details of all Group companies will be annexed to the next Annual Return of the Company.

Notes on the Accounts *(continued)*

22 Investments *(continued)*

Except where indicated otherwise, the issued equity capital of the above undertakings is wholly-owned by the Group and, except for Midland Bank plc, is held by subsidiaries of the Company. All the above make their accounts up to 31 December, except Hongkong Bank of Canada, whose accounts are made up to 31 October annually and Midland Life Limited, whose accounts are made up to 31 August to avoid undue delay in the publication of the Group's accounts.

The principal countries of operation are the same as the countries of incorporation except for The British Bank of the Middle East which operates mainly in the Middle East. All the above subsidiaries are included in the consolidation.

23 Other assets

	1996	1995
	£m	£m
Bullion	**133**	152
Assets, including gains, resulting from off-balance-sheet interest rate and exchange rate contracts which are marked-to-market	**9,578**	11,605
Current taxation recoverable	**63**	65
Deferred taxation (Note 28)	**52**	72
Long-term assurance assets attributable to policyholders (Note 27)	**3,383**	2,925
Other accounts	**2,669**	2,468
	15,878	17,287

Included in the above are 2,392,214 (1995: 2,319,872) shares in the Company held by subsidiary undertakings, as part of their insurance and retirement funds for the benefit of the policyholders.

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

	1996	1995
	£m	£m
Loans and advances to banks — with Group companies	**351**	428
Debt securities	**1,086**	932
Equity shares	**1,593**	1,475
Other assets	**888**	623
Prepayments and accrued income	**12**	28
Other liabilities	**(547)**	(561)
	3,383	2,925

24 Deposits by banks

	1996	1995
	£m	£m
Repayable on demand	**5,271**	5,595
With agreed maturity dates or periods of notice, by remaining maturity:		
— 3 months or less but not repayable on demand	**11,319**	12,912
— 1 year or less but over 3 months	**1,191**	1,537
— 5 years or less but over 1 year	**171**	348
— over 5 years	**78**	301
	18,030	20,693
Amounts include:		
Due to associated undertakings	**16**	36

25 Customer accounts

	1996 £m	1995 £m
Repayable on demand	**78,586**	72,997
With agreed maturity dates or periods of notice, by remaining maturity:		
— 3 months or less but not repayable on demand	**64,881**	62,008
— 1 year or less but over 3 months	**5,743**	4,900
— 5 years or less but over 1 year	**1,726**	1,723
— over 5 years	**213**	493
	151,149	142,121
Amounts include:		
Due to associated undertakings	**6**	10

26 Debt securities in issue

	1996 £m	1995 £m
Bonds and medium-term notes, by remaining maturity:		
— within 1 year	**29**	111
— between 1 and 2 years	**51**	35
— between 2 and 5 years	**182**	189
— over 5 years	**175**	251
	437	586
Other debt securities in issue, by remaining maturity:		
— 3 months or less	**4,688**	3,727
— 1 year or less but over 3 months	**2,470**	2,334
— 5 years or less but over 1 year	**2,376**	1,979
— over 5 years	**69**	24
	10,040	8,650

27 Other liabilities

	1996 £m	1995 £m
Short positions in securities:		
Treasury bills and other eligible bills	**1,576**	778
Debt securities		
— government securities	**3,914**	3,283
— other public sector securities	**32**	65
— other debt securities	**230**	217
Equity shares	**305**	551
	6,057	4,894
Liabilities, including losses, resulting from off-balance-sheet interest rate and exchange rate contracts which are marked-to-market	**9,637**	12,234
Current taxation	**1,008**	836
Obligations under finance leases	**50**	82
Dividend payable by the Company	**693**	600
Long-term assurance liabilities attributable to policyholders (see Note 23)	**3,383**	2,925
Other liabilities	**4,066**	3,256
	24,894	24,827

27 Other liabilities *(continued)*

	1996	1995
	£m	£m
Obligations under finance leases fall due as follows:		
— within 1 year	**18**	34
— between 1 and 5 years	**17**	30
— over 5 years	**15**	18
	50	82

28 Provisions for liabilities and charges

a *Deferred taxation*

i Deferred taxation is provided for in accordance with the Group's accounting policy in Note 2g.

	Group	*Company*
	£m	**£m**
At 1 January 1996	**295**	**118**
Exchange and other movements	**(12)**	**(24)**
Charge/(credit) to profit and loss account (Note 6)	**58**	**(25)**
At 31 December 1996	**341**	**69**

	Group		*Company*	
	1996	1995	**1996**	1995
	£m	£m	**£m**	£m
Included in 'Provisions for liabilities and charges'	**393**	367	**69**	118
Included in 'Other assets' (Note 23)	**(52)**	(72)	**—**	—
Net deferred taxation provision	**341**	295	**69**	118
Comprising:				
Short-term timing differences	**21**	27	**3**	—
Leasing transactions	**368**	255	**—**	—
Relief for tax losses	**(15)**	(48)	**—**	—
Advance corporation tax carried forward in Midland	**(1)**	(80)	**—**	—
Advance corporation tax on dividends proposed	**(173)**	(150)	**(173)**	(150)
Provision for additional UK tax on profit remittances from overseas	**170**	188	**170**	188
Other items	**(29)**	103	**69**	80
	341	295	**69**	118

Save as disclosed below, there is no significant deferred taxation liability not provided for.

ii The distribution of the reserves of certain subsidiary and associated undertakings may give rise to additional tax liabilities. Of the £200 million provision for a potential UK tax charge established upon the acquisition of Midland, £170 million remained at 31 December 1996 (1995: £188 million). £18 million of this provision was utilised in the year to 31 December 1996 (1995: £12 million).

iii No provision is made for deferred taxation on revalued premises. The Directors are of the opinion that, in respect of properties occupied for the purposes of the Group's business, the likelihood of a material taxation liability arising is remote and no useful purpose would be served by attempting to quantify it. In respect of investment and other properties which have been revalued, no material taxation liability is judged likely to arise in the foreseeable future under management's current intentions for these properties.

28 Provisions for liabilities and charges *(continued)*

iv At 31 December 1996, there were potential future tax benefits of approximately £210 million (1995: £240 million) in respect of trading losses, allowable expenditure charged to the profit and loss account but not yet allowed for tax and capital losses which have not been recognised because recoverability of the potential benefits is not considered certain.

v Unprovided deferred tax in respect of leasing transactions carried out by Midland totalled £63 million as at 31 December 1996 (1995: £63 million).

b *Other provisions for liabilities and charges*

	Provisions for pension and other post-retirement obligations	*Provisions for contingent liabilities and commitments*	*Other provisions*	*Total*
	£m	**£m**	**£m**	**£m**
At 1 January 1996	**122**	**117**	**165**	**404**
Exchange movements	**(13)**	**(4)**	**(13)**	**(30)**
Charge to the profit and loss account	**53**	**7**	**45**	**105**
Provisions utilised	**(9)**	**(7)**	**(33)**	**(49)**
Other movements	**10**	**(23)**	**38**	**25**
At 31 December 1996	**163**	**90**	**202**	**455**

Acquisition provisions reflecting the restructuring costs of achieving the synergy benefits of the merger with Midland were established in 1992. Of these provisions, £5 million was utilised during the year, £2 million was released to the profit and loss account, and the unutilised balance of £3 million (1995: £10 million) is included in 'Other provisions' in the table above. The unutilised balance relates to the cost of surplus space arising as a result of the merger.

None of the above provisions relates to the Company (1995: £ nil).

29 Subordinated liabilities

	1996	1995
	£m	£m
Undated subordinated loan capital:		
— the Company	**—**	—
— other Group	**1,768**	1,774
	1,768	1,774
Dated subordinated loan capital:		
— the Company	**806**	819
— other Group	**3,401**	2,946
	4,207	3,765
Total subordinated liabilities:		
— the Company	**806**	819
— other Group	**5,169**	4,720
	5,975	5,539
Dated subordinated loan capital is repayable:		
— within 1 year	**73**	83
— between 1 and 2 years	**155**	81
— between 2 and 5 years	**781**	779
— over 5 years	**3,198**	2,822
	4,207	3,765

Notes on the Accounts *(continued)*

29 Subordinated liabilities *(continued)*

		1996	1995
		£m	£m
The total subordinated borrowings of the Company are as follows:			
£413m	11.69% subordinated bonds 2002	**413**	413
£250m	9.875% subordinated bonds 2018	**246**	246
US$250m	Subordinated collared floating rate notes 2008	**147**	160
		806	819
Amounts owed to Group undertakings:			
US$350m	7.525% subordinated loan 2003 — HSBC Finance Nederland BV	**205**	224
		1,011	1,043

The Company's dated subordinated loan capital is all repayable in five years or more.

At 31 December 1996, the following other Group subordinated borrowings were £100 million or over:

		1996	1995
		£m	£m
US$1,200m	Primary capital subordinated undated floating rate notes	**705**	773
US$750m	Undated floating rate primary capital notes	**441**	483
US$500m	Undated floating rate primary capital notes	**294**	322
US$500m	7.625% subordinated notes 2006*	**294**	—
£250m	Subordinated unsecured floating rate notes 2001	**250**	250
US$400m	8.625% subordinated notes 2004	**233**	255
HK$3,000m	Subordinated collared floating rate notes 2003	**228**	250
US$350m	7.4% subordinated guaranteed notes 2003	**206**	226
£200m	9% subordinated notes 2005	**200**	200
US$300m	Undated floating rate primary capital notes (Series 3)	**176**	193
US$300m	6.95% subordinated notes 2011*	**176**	—
US$300m	7.65% subordinated notes 2025	**176**	192
US$300m	7% fixed rate subordinated notes 2006†	**176**	—
£150m	9.25% step up undated subordinated notes*	**150**	—
¥24.8b	Fixed rate (5.0% to 5.5%) subordinated loans 2004	**125**	154
US$200m	7.808% capital securities 2026†	**118**	—
US$200m	Guaranteed floating rate notes 1999	**118**	129
US$200m	Floating rate subordinated notes 2000	**118**	129
DM300m	Guaranteed floating rate notes 1986/98	**114**	135
£100m	14% subordinated unsecured loan stock 2002/07	**100**	100
	Other subordinated liabilities less than £100m	**771**	929
		5,169	4,720

** The proceeds of the issue of 7.625% subordinated notes 2006, 6.95% subordinated notes 2011 and 9.25% step up undated subordinated notes during the year were used to support the development of Midland Bank plc and to strengthen further Midland's capital base.*

† The proceeds of the issue of 7% fixed rate subordinated notes 2006 and 7.808% capital securities 2026 during the year will be added to the general funds of HSBC Americas, Inc. and will be available for general corporate purposes.

Generally, subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, in certain cases at a premium over par. Interest rates on the floating rate loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 14%.

30 Minority interests — non-equity

Preference shares issued by subsidiaries:

		1996	1995
		£m	£m
US$98m	Perpetual preference shares	**58**	63
US$825m	Non-cumulative preference shares	**468**	389
		526	452

During 1996, Midland Bank issued US$200 million Series D non-cumulative preference shares to strengthen its capital base.

31 Called up share capital

Authorised:

The authorised ordinary share capital of the Company at 31 December 1996 and 1995 is HK$20,000 million divided into 2,000 million ordinary shares of HK$10 each, £1,125 million divided into 1,500 million ordinary shares of 75p each, and £301,500 divided into 301,500 non-voting deferred shares of £1 each. In addition, at 31 December 1996 and 1995, the authorised preference share capital of the Company is £500 million divided into 500 million non-cumulative preference shares of £1 each.

	HK$10 shares Number	*75p shares Number*	**£m**
Issued:			
At 1 January 1996	1,774,582,999	860,306,302	**2,124**
Shares issued under option schemes	—	8,373,419	**6**
Shares issued in lieu of dividends	16,045,608	1,877,131	**15**
Exchange movements	—	—	**(131)**
At 31 December 1996	1,790,628,607	870,556,852	**2,014**

The exchange movement above arises on the translation of the Hong Kong dollar share capital. This reduction has no impact on total shareholders' funds because the corresponding increase is included in reserves.

The 301,500 non-voting deferred shares are held by a subsidiary undertaking of the Company.

Options outstanding to subscribe for the Company's ordinary shares of 75p each under the Group's Executive and Savings-Related Share Option Schemes and Midland's Executive and Savings-Related Share Option Schemes are as follows:

	Number of shares	*Period of exercise*	*Exercise price*
31 December 1996	**38,376,784**	**1997 to 2006**	**£1.1843 to £10.00**
31 December 1995	43,160,482	1996 to 2005	£1.1843 to £8.5127

32 Reserves

	Group	*Company*	*Associated undertakings*
	£m	**£m**	**£m**
Share premium account:			
At 1 January 1996	**307**	**307**	**—**
Shares issued under option schemes	**7**	**7**	**—**
Shares issued in lieu of dividends and associated issue costs	**(15)**	**(15)**	**—**
At 31 December 1996	**299**	**299**	**—**

Notes on the Accounts *(continued)*

32 Reserves *(continued)*

	Group	Company	Associated undertakings
	£m	**£m**	**£m**
Reserves:			
— Merger reserve			
At 1 January 1996	**148**	**—**	**—**
Goodwill written off on acquisition	**(122)**	**—**	**—**
At 31 December 1996	**26**	**—**	**—**
Revaluation reserves:			
— Investment property revaluation reserve			
At 1 January 1996	**340**	**—**	**45**
Exchange and other movements	**(18)**	**—**	**(3)**
Unrealised surplus on revaluation of land and buildings	**21**	**—**	**12**
Transfer to revaluation reserve	**(29)**	**—**	**—**
Realisation on disposal of properties	**(1)**	**—**	**—**
At 31 December 1996	**313**	**—**	**54**
— Revaluation reserve:			
At 1 January 1996	**1,878**	**7,772**	**2**
Exchange and other movements	**(135)**	**120**	**—**
Realisation on disposal of properties	**(1)**	**—**	**—**
Unrealised surplus on revaluation of Group properties	**639**	**—**	**1**
Transfer of permanent diminution in value of land and buildings to the profit and loss reserve	**8**	**—**	**—**
Transfer of depreciation from profit and loss account reserve	**(34)**	**—**	**—**
Transfer from investment property revaluation reserve	**29**	**—**	**—**
Net increase in attributable net assets of subsidiary undertakings	**—**	**1,891**	**—**
At 31 December 1996	**2,384**	**9,783**	**3**
Total revaluation reserves	**2,697**	**9,783**	**57**
Profit and loss account:			
At 1 January 1996	**8,590**	**3,184**	**93**
Exchange and other movements	**(676)**	**—**	**(3)**
Retained profit/(deficit) for the year	**2,022**	**(283)**	**4**
Goodwill written off on acquisition	**(12)**	**—**	**—**
Goodwill written back on part disposal of associated undertakings	**9**	**—**	**—**
Transfer of depreciation to revaluation reserve	**34**	**—**	**—**
Transfer of permanent diminution in value of land and buildings from revaluation reserve	**(8)**	**—**	**—**
Realisation on disposal of properties	**2**	**—**	**—**
Arising on shares issued in lieu of dividends	**190**	**190**	**—**
At 31 December 1996	**10,151**	**3,091**	**94**

Goodwill amounting to £2,351 million (1995: £2,217 million) has been charged against reserves in current and prior years in respect of acquisitions of subsidiaries, and includes £29 million in respect of deferred consideration on the acquisition of J P Morgan’s domestic dollar clearing business.

32 Reserves *(continued)*

Many of the Group's banking subsidiary and associated undertakings operate under local regulatory jurisdictions which could potentially restrict the amount of reserves which can be remitted to the Company in order to maintain local regulatory capital ratios. In addition, as stated in Note 28 above, the remittance of reserves may result in further taxation liabilities.

33 Analysis of total assets and total liabilities

a *Assets and liabilities denominated in foreign currency*

	1996 £m	1995 £m
Denominated in sterling	**65,389**	68,783
Denominated in currencies other than sterling	**171,164**	158,035
Total assets	**236,553**	226,818
Denominated in sterling	**77,164**	71,546
Denominated in currencies other than sterling	**159,389**	155,272
Total liabilities	**236,553**	226,818

b *Assets subject to sale and repurchase transactions*

	1996 £m	1995 £m
Total assets subject to sale and repurchase transactions	**4,200**	4,445

c *Assets leased to customers*

	1996 £m	1995 £m
Loans and advances to customers	**4,292**	3,961
Tangible fixed assets — equipment on operating leases (Note 21a)	**378**	280
	4,670	4,241

The cost of assets acquired during 1996 for letting to customers under finance leases and hire purchase contracts by the Group amounted to £2,568 million (1995: £1,956 million).

d *Assets charged as security for liabilities*

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

	Amount of liability secured	
	1996 £m	1995 £m
Deposits by banks	**415**	1,357
Customer accounts	**598**	1,075
Debt securities in issue	**531**	177
Other liabilities	**1,081**	216
	2,625	2,825

The amount of assets pledged to secure these amounts is £8,432 million (1995: £7,741 million) and is mainly made up of items included in 'Debt securities' £6,775 million (1995: 'Debt securities' £6,799 million).

Notes on the Accounts *(continued)*

34 Memorandum items

a *Group*

	1996			1995		
	Contract amount	*Credit equivalent amount*	*Risk-weighted amount*	*Contract amount*	*Credit equivalent amount*	*Risk-weighted amount*
	£m	**£m**	**£m**	£m	£m	£m
Contingent liabilities:						
Acceptances and endorsements	**2,162**	**1,588**	**1,581**	2,076	1,519	1,466
Guarantees and assets pledged as collateral security:						
— guarantees and irrevocable letters of credit	**14,389**	**11,675**	**8,553**	13,769	11,083	8,259
Other contingent liabilities	**167**	**27**	**26**	180	15	14
	16,718	**13,290**	**10,160**	16,025	12,617	9,739
Commitments:						
Documentary credits and short-term trade-related transactions	**5,075**	**1,333**	**1,070**	5,223	1,327	1,091
Forward asset purchases and forward forward deposits placed	**450**	**450**	**307**	451	451	343
Undrawn note issuing and revolving underwriting facilities	**139**	**70**	**70**	107	54	54
Undrawn formal standby facilities, credit lines and other commitments to lend:						
— over 1 year	**14,766**	**7,383**	**6,485**	14,428	7,214	6,027
— 1 year and under	**51,571**	**—**	**—**	48,975	—	—
	72,001	**9,236**	**7,932**	69,184	9,046	7,515

The table above gives the nominal principal amounts, credit equivalent amounts and risk-weighted amounts of off-balance-sheet transactions. The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Bank of England's guidelines which implement the Basle agreement on capital adequacy and depend on the status of the counterparty and the maturity characteristics.

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

34 Memorandum items *(continued)*

Exchange rate and interest rate contracts

	1996		1995	
	Contract amount	*Replacement cost*	*Contract amount*	*Replacement cost*
	£m	**£m**	£m	£m
Exchange rate contracts	**411,216**	**5,405**	376,018	4,916
Interest rate contracts	**481,441**	**4,325**	608,922	7,014

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

Included in the above table, which excludes contracts made with other Group counterparties, there are £406,583 million (1995: £368,414 million) contract amount of exchange rate contracts and £452,740 million (1995: £585,107 million) contract amount of interest rate contracts which were made for trading purposes. The remaining exchange and interest rate contracts were made for non-trading purposes. Non-trading contracts are also made with Group counterparties and further analysis of the Group's trading and non-trading contracts is provided in the 'Financial Review' on page 44.

The notional or contractual amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

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

b *Company*

The Company had contingent liabilities of £39 million (1995: £50 million). In addition, the Company enters into guarantees and letters of support on behalf of other Group undertakings in the normal course of business.

c *Concentrations of contingent liabilities and commitments*

The Group has the following concentrations of exposure to contingent liabilities and commitments:

Contract amounts

	UK	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
Contingent liabilities:	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
1996	**7,347**	**1,302**	**1,971**	**4,069**	**2,029**	**16,718**
1995	6,206	1,518	1,779	3,983	2,539	16,025
Commitments:						
1996	**27,986**	**2,535**	**21,484**	**9,167**	**10,829**	**72,001**
1995	24,808	3,418	21,931	8,693	10,334	69,184

Notes on the Accounts *(continued)*

35 Reconciliation of operating profit to net cash flow from operating activities

	1996	1995
	£m	£m
Operating profit	**4,080**	3,364
Change in prepayments and accrued income	**364**	(562)
Change in accruals and deferred income	**(360)**	247
Interest on finance leases and similar hire purchase contracts	**10**	11
Interest on subordinated loan capital	**426**	399
Depreciation and amortisation	**367**	347
Provisions for bad and doubtful debts	**384**	416
Loans written off net of recoveries	**(492)**	(659)
Provisions for liabilities and charges	**105**	111
Provisions utilised	**(49)**	(102)
Amounts written off fixed asset investments	**48**	16
Net cash inflow from trading activities	**4,883**	3,588
Change in items in the course of collection from other banks	**4**	(461)
Change in treasury bills and other eligible bills	**4,822**	(3,468)
Change in loans and advances to banks	**(2,306)**	(1,017)
Change in loans and advances to customers	**(4,672)**	(10,654)
Change in other securities	**(3,507)**	(1,643)
Change in other assets	**1,387**	(4,516)
Change in deposits by banks	**(2,663)**	1,566
Change in customer accounts	**9,028**	13,414
Change in items in the course of transmission to other banks	**207**	384
Change in debt securities in issue	**1,390**	(132)
Change in other liabilities	**(162)**	6,206
Elimination of exchange differences*	**376**	(92)
Net cash inflow from operating activities	**8,787**	3,175

* *Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line by line basis, as it cannot be determined without unreasonable expense.*

36 Changes in financing during the year

	Subordinated loan capital	*Preference shares**	*Ordinary shares*	*Share premium*
	£m	**£m**	**£m**	**£m**
Balance at 1 January 1996	**5,539**	**452**	**2,124**	**307**
Shares issued in lieu of dividends	**—**	**—**	**15**	**(15)**
Issued during the year	**1,005**	**124**	**6**	**7**
Repaid during the year	**(90)**	**—**	**—**	**—**
Net cash inflow from financing	**915**	**124**	**6**	**7**
Exchange and other movements	**(479)**	**(50)**	**(131)**	**—**
Balance at 31 December 1996	**5,975**	**526**	**2,014**	**299**

* *Preference shares in issue are in subsidiary undertakings (Note 30).*

37 Analysis of cash

a The Group is required to make deposits with central banks as a result of government regulations in the territories in which it operates. As at 31 December 1996, these amounted to £933 million (1995: £1,084 million).

b *Changes in cash during the year*

	1996	1995
	£m	£m
Balance at 1 January	**5,182**	5,219
Net cash inflow/(outflow) before the effect of foreign exchange movements	**4,395**	(154)
Effect of foreign exchange movements	**(697)**	117
Balance at 31 December	**8,880**	5,182

c *Analysis of the balances of cash as classified in the consolidated balance sheet*

	1996	1995
	£m	£m
Cash and balances at central banks	**1,814**	1,806
Loans and advances to banks	**7,066**	3,376
	8,880	5,182

38 Litigation

The Group, through a number of its subsidiary undertakings, is named in and is defending legal actions in various jurisdictions arising from its normal business. No material adverse impact on the financial position of the Group is expected to arise from these proceedings.

39 Capital commitments

	1996	1995
	£m	£m
Expenditure contracted for	**142**	123
Expenditure authorised by Directors but not contracted for	**82**	150
	224	273

There were no capital commitments in respect of the Company (1995: £ nil).

40 Lease commitments

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

	1996	1995
	£m	£m
Leasehold land and buildings		
Operating leases which expire:		
— within 1 year	**18**	19
— between 1 and 5 years	**75**	76
— over 5 years	**102**	101
	195	196
Equipment		
Operating leases which expire:		
— within 1 year	**1**	1
— between 1 and 5 years	**3**	5
	4	6

The Company had no commitments under operating leases at 31 December 1996 (1995: none).

Notes on the Accounts *(continued)*

41 Segmental analysis

As the Group is not required to disclose turnover, no segmental analysis of turnover is included. Turnover of non-banking businesses is included in other operating income above. Common costs are included in segments on the basis of the actual recharges made. The allocation of earnings reflects the benefit of shareholders' funds to the extent that these are actually allocated to businesses in the segment by way of intra-Group capital and funding structures.

a *By geographic region*

Geographical information has been classified by the location of the principal operations of the subsidiary undertaking, or in the case of HongkongBank, Midland and The British Bank of the Middle East operations, by the location of the branch responsible for reporting the results or for advancing the funds. Due to the nature of the Group structure, the analysis of profits and net assets shown below includes intra-Group items between geographic regions. The 'Rest of Asia-Pacific' geographical segment includes the Middle East, India and Australasia.

Total assets:	**At 31 December 1996**		At 31 December 1995	
	£m	**%**	£m	%
UK	**86,157**	**37.2**	78,264	35.2
Continental Europe	**9,852**	**4.2**	13,417	6.1
Hong Kong	**72,029**	**31.1**	68,965	31.1
Rest of Asia-Pacific	**29,364**	**12.7**	29,630	13.4
Americas	**34,420**	**14.8**	31,444	14.2
	231,822	**100.0**	221,720	100.0
Add: Hong Kong Government certificates of indebtedness	**4,731**		5,098	
Total assets	**236,553**		226,818	

Net assets:	**£m**	**%**	£m	%
UK	**5,334**	**35.1**	4,503	33.6
Continental Europe	**665**	**4.4**	503	3.8
Hong Kong	**5,879**	**38.7**	5,399	40.4
Rest of Asia-Pacific	**1,579**	**10.4**	1,479	11.0
Americas	**1,730**	**11.4**	1,503	11.2
Total net assets	**15,187**	**100.0**	13,387	100.0

41 Segmental analysis *(continued)*

Profit on ordinary activities before tax:

	UK	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
Year ended 31 December 1996	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Interest receivable	**5,017**	**567**	**5,017**	**2,193**	**2,484**	**15,278**
Interest payable	**(2,950)**	**(432)**	**(3,014)**	**(1,489)**	**(1,572)**	**(9,457)**
Net interest income	**2,067**	**135**	**2,003**	**704**	**912**	**5,821**
Dividend income	**57**	**1**	**32**	**6**	**7**	**103**
Fees and commissions receivable	**1,596**	**169**	**684**	**413**	**309**	**3,171**
Fees and commissions payable	**(213)**	**(19)**	**(84)**	**(56)**	**(47)**	**(419)**
Dealing profits	**151**	**59**	**129**	**129**	**47**	**515**
Other operating income	**316**	**(1)**	**227**	**48**	**80**	**670**
Operating income	**3,974**	**344**	**2,991**	**1,244**	**1,308**	**9,861**
Operating expenses	**(2,546)**	**(259)**	**(1,200)**	**(564)**	**(773)**	**(5,342)**
Operating profit before provisions	**1,428**	**85**	**1,791**	**680**	**535**	**4,519**
Provisions for bad and doubtful debts	**(180)**	**(6)**	**(143)**	**(20)**	**(35)**	**(384)**
Provisions for contingent liabilities and commitments	**1**	**—**	**—**	**(9)**	**1**	**(7)**
Amounts written off fixed asset investments	**(41)**	**—**	**(6)**	**(1)**	**—**	**(48)**
Operating profit	**1,208**	**79**	**1,642**	**650**	**501**	**4,080**
Profit on disposal of fixed assets and investments	**212**	**—**	**116**	**17**	**11**	**356**
Income from associated undertakings	**16**	**9**	**21**	**35**	**7**	**88**
Profit on ordinary activities before tax	**1,436**	**88**	**1,779**	**702**	**519**	**4,524**

Notes on the Accounts *(continued)*

41 Segmental analysis *(continued)*

	UK	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
	£m	£m	£m	£m	£m	£m
Year ended 31 December 1995						
Interest receivable	4,864	743	4,750	1,890	1,923	14,170
Interest payable	(2,982)	(593)	(3,090)	(1,306)	(1,080)	(9,051)
Net interest income	1,882	150	1,660	584	843	5,119
Dividend income	27	1	31	9	4	72
Fees and commissions receivable	1,451	149	571	299	274	2,744
Fees and commissions payable	(180)	(17)	(50)	(47)	(48)	(342)
Dealing profits	186	68	108	121	50	533
Other operating income	262	9	203	33	56	563
Operating income	3,628	360	2,523	999	1,179	8,689
Operating expenses	(2,484)	(232)	(1,041)	(442)	(718)	(4,917)
Operating profit before provisions	1,144	128	1,482	557	461	3,772
Provisions for bad and doubtful debts	(163)	(30)	(25)	(65)	(133)	(416)
Provisions for contingent liabilities and commitments	31	—	1	(6)	(2)	24
Amounts written off fixed asset investments	(9)	1	(5)	(1)	(2)	(16)
Operating profit	1,003	99	1,453	485	324	3,364
Profit/(loss) on disposal of fixed assets and investments	110	(1)	94	—	29	232
Income from associated undertakings	14	8	11	37	6	76
Profit on ordinary activities before tax	1,127	106	1,558	522	359	3,672

Total interest receivable and total interest payable include intra-Group interest of £983 million (1995: £986 million). Other operating income and operating expenses include intra-Group items of £273 million (1995: £192 million).

b *By class of business*

	Commercial banking		*Investment banking*		*Total*	
	1996	1995	**1996**	1995	**1996**	1995
	£m	£m	**£m**	£m	**£m**	£m
Segment result before exceptional items	**4,252**	3,425	**272**	222	**4,524**	3,647
Release of provision in respect of British & Commonwealth Holdings plc litigation	—	—	—	25	—	25
Profit on ordinary activities before tax	**4,252**	3,425	**272**	247	**4,524**	3,672
Total assets	**225,694**	216,943	**10,859**	9,875	**236,553**	226,818

41 Segmental analysis *(continued)*

	Commercial banking		*Investment banking*		*Total*	
	1996	1995	**1996**	1995	**1996**	1995
	£m	£m	**£m**	£m	**£m**	£m
Net assets	**14,433**	12,600	**754**	787	**15,187**	13,387

The 1995 figures have been restated to reflect the sale of HSBC Life Limited from an investment banking to a commercial banking subsidiary.

42 Subsequent events

On 19 February 1997, Forward Trust Limited, a wholly-owned subsidiary undertaking, acquired the issued share capital of Eversholt Holdings Limited for a consideration of £726.5 million, including the repayment of net debt of £273.1 million. Eversholt Holdings Limited, through its subsidiary undertaking, Eversholt Leasing Limited, provides passenger rolling stock under operating leases to train operators in the United Kingdom. The acquisition forms part of a strategy to develop and expand Forward Trust's asset finance and operating lease business.

The acquisition by HSBC Americas, Inc. of First Federal Savings and Loan Association of Rochester, which was announced in August 1996, was completed on 1 March 1997. The consideration amounted to US$620 million.

43 Related party transactions

a *Transactions, arrangements and agreements involving Directors and others*

Particulars of transactions, arrangements and agreements entered into by subsidiary undertakings of the Company with Directors and connected persons and companies controlled by them and with officers of the Company disclosed pursuant to Section 232 of the Companies Act 1985 are as follows:

	1996		1995	
	Number	**£m**	Number	£m
Directors and connected persons and companies controlled by them:				
Loans and credit card transactions (including £37,000 in credit card transactions (1995: £45,000) and £1,609,000 in guarantees (1995: £1,023,000))	**58**	**153**	64	176
Officers:				
Loans and credit card transactions (including £31,000 in credit card transactions (1995: £49,000) and £82,000 in guarantees (1995: £82,000))	**16**	**3**	15	4

Particulars of Directors' transactions are recorded in a register held at the Registered Office of the Company which is available for inspection by members.

Notes on the Accounts *(continued)*

43 Related party transactions *(continued)*

b *Transactions with other related parties of the Group*

Associated undertakings

Information relating to associated undertakings can be found in the 'Notes on the Accounts' where the following are disclosed:

— Notes 12 and 13: amounts due from associated undertakings
— Note 19: investments in associated undertakings; principal associated undertakings and interests in loan capital
— Notes 24 and 25: amounts due to associated undertakings.

Pension funds

At 31 December 1996, £6.2 billion of Group pension fund assets were under management by Group companies of which £510 million is included in the Group's balance sheet under 'Other assets' in 'Long-term assurance assets attributable to policyholders'. Fees to Group companies in connection with such management amounted to £11 million. The Group's pension funds had deposits of £101 million with banking subsidiaries within the Group.

44 Foreign currency amounts

The Hong Kong and United States dollar figures shown in the consolidated profit and loss account and the balance sheets are for information only. They are translated from sterling at the average rate of exchange for the year ended 31 December 1996 and the closing rate at that date respectively. These were as follows:

	Average rate	*Closing rate*
£1.00 = HK$	12.078	13.160
£1.00 = US$	1.562	1.701

45 UK and Hong Kong accounting requirements

The financial statements have been prepared in accordance with UK accounting requirements; there would be no material differences had they been prepared in accordance with Hong Kong accounting standards other than in the presentation of the cash flow statement which has been prepared in accordance with Financial Reporting Standard 1 (revised 1996) 'Cash Flow Statements' rather than Hong Kong Statement of Standard Accounting Practice 15 'Cash Flow Statements'.

46 Approval of accounts

These accounts were approved by the Board of Directors on 3 March 1997.

Taxation of Shares and Dividends

1. Cash Dividends

Since 1 January 1993, when the Company became UK resident for UK taxation purposes, HSBC Holdings plc has had to account to the UK Inland Revenue for advance corporation tax when the Company pays a dividend.

For individual shareholders who are resident in the United Kingdom for taxation purposes and liable to UK income tax at the basic rate, no further tax liability will arise. Individual shareholders who are liable to UK income tax at the higher rate of 40 per cent will be taxed on the dividend, including the tax credit of 20 per cent. The tax credit will then be available for set-off against the higher rate liability. Individual UK-resident shareholders whose income falls within the lower rate band of income tax charged at 20 per cent will not be entitled to any tax credit repayment. Other UK-resident shareholders who are exempt from tax on their investment income will be entitled to repayment by the UK Inland Revenue of the tax credit in respect of dividends at the rate of 20 per cent.

Non-UK-resident shareholders are generally not entitled to any payment of the tax credit in respect of any dividend received. However, some shareholders who are not resident in the United Kingdom may be entitled to a cash payment from the Inland Revenue of a proportion of the tax credit in respect of dividends received. Such entitlement depends in general either upon the provisions of any double taxation agreement between the country of residence and the United Kingdom, or upon the shareholder being a Commonwealth citizen or a citizen of the Republic of Ireland. In the 1996 Finance Act, with effect from 6 April 1996 such entitlement has been extended to all European Economic Area nationals. The UK Inland Revenue has confirmed that after 30 June 1997, Hong Kong residents will continue to be treated as Commonwealth citizens if registered as British Nationals (Overseas) or otherwise classified as British Overseas citizens.

Dividends paid by HSBC Holdings plc are generally not subject to tax in Hong Kong.

2. Scrip Dividends

Information on the taxation consequences of the HSBC Holdings plc scrip dividends offered in lieu of the 1995 final dividend and the 1996 first interim dividend was set out in the Secretary's letters to shareholders of 19 April and 3 September 1996. The market value of the scrip dividend shares on the first day of dealing was not substantially different from the cash dividend forgone and, accordingly, the price of both classes of the Company's ordinary shares for income and capital gains tax purposes is £9.978 for the 1995 final dividend and £11.47 for the 1996 first interim dividend. Shareholders should contact their professional advisers to obtain further information.

3. UK Capital Gains Tax

The computation of the capital gains tax liability arising on disposals of shares in the Company by shareholders subject to UK capital gains tax can be complex, partly dependent on whether the shares were purchased since April 1991, acquired in April 1991 in exchange for shares in The Hongkong and Shanghai Banking Corporation Limited, or acquired in July 1992 in acceptance of the offer for shares in Midland Bank plc.

Whilst it is not possible to give specific guidance on the tax calculation, it may be helpful to note that the market value of the relevant shares as at 31 March 1982 (before any adjustment to take account of subsequent rights and capitalisation issues) was:

The Hongkong and Shanghai Banking Corporation Limited	£1.36
Midland Bank plc	£3.23

For capital gains tax purposes, the acquisition cost for ordinary shares is adjusted to take account of subsequent rights and capitalisation issues. Further adjustments may be necessary where a shareholder has chosen to receive shares instead of cash dividends. Any capital gain arising on a disposal will also be adjusted to take account of indexation allowance.

If in doubt, shareholders are recommended to consult their professional advisers.

International Network

Services are provided by more than 5,000 offices in 78 countries:

Asia-Pacific	*Offices*		*Offices*
Australia	*42*	Malaysia	*50*
Bangladesh	*1*	Myanmar (Burma)	*1*
Brunei Darussalam	*12*	New Zealand	*7*
China	*14*	Pakistan	*4*
Cook Islands	*2*	Philippines	*7*
Hong Kong	*433*	Singapore	*31*
India	*29*	Sri Lanka	*6*
Indonesia	*8*	Taiwan	*7*
Japan	*8*	Thailand	*9*
Korea, Republic of	*4*	Vietnam	*2*
Macau	*7*		
Europe			
Armenia	*1*	Italy	*3*
Austria	*1*	Luxembourg	*2*
Azerbaijan	*1*	Malta	*1*
Channel Islands	*26*	Netherlands	*1*
Cyprus	*136*	Poland	*2*
Czech Republic	*1*	Russia	*2*
France	*3*	Spain	*4*
Germany	*14*	Sweden	*2*
Greece	*4*	Switzerland	*4*
Hungary	*1*	Turkey	*2*
Ireland	*4*	United Kingdom	*1,792*
Isle of Man	*4*		
Americas			
Argentina	31	Guam	1
Bahamas	6	Mexico	3
Bermuda	1	Panama	4
Brazil	2,004	Peru	*47*
Canada	122	Saipan	1
Cayman Islands	4	United States of America	452
Chile	3	Venezuela	1
Colombia	2		
Middle East and Africa			
Angola	*2*	Oman	*5*
Bahrain	*6*	Palestinian Autonomous Area	*1*
Egypt	*6*	Qatar	*2*
Ghana	*1*	Saudi Arabia	*63*
Jordan	*5*	South Africa	*4*
Kenya	*1*	Uganda	*1*
Lebanon	*5*	United Arab Emirates	*15*
Mauritius	*14*	Zambia	*1*
Mozambique	*1*	Zimbabwe	*4*
Namibia	*1*		

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