HSBC Holdings plc

Annual Report and Accounts 1997

A WORLD OF FINANCIAL SERVICES

HSBC

Financial Highlights

1996		1997	*1997*	*1997*
£m	**For the year**	**£m**	*HK$m*	*US$m*
4,524	Profit before tax	**4,971**	*63,046*	*8,143*
3,112	Profit attributable	**3,355**	*42,550*	*5,495*
1,090	Dividends	**1,337**	*16,957*	*2,190*
	At year-end			
15,187	Shareholders' funds	**16,442**	*209,817*	*27,080*
23,486	Capital resources	**25,236**	*322,024*	*41,562*
169,179	Customer accounts and deposits by banks	**202,268**	*2,581,142*	*333,136*
236,553	Total assets	**286,391**	*3,654,636*	*471,686*
153,488	Risk-weighted assets	**177,283**	*2,262,308*	*291,985*
Pence	**Per share**	**Pence**	*HK$*	*US$*
117.61	Earnings	**125.70**	*15.94*	*2.06*
115.42	Headline earnings	**124.96**	*15.85*	*2.05*
41.00	Dividends	**50.00**	*6.32**	*0.82**
570.73	Net asset value	**614.42**	*78.41*	*10.12*
	Number of ordinary shares in issue at year-end			
1,791m	HK$10	**1,802m**		
870m	£0.75	**874m**		
%	**Ratios**	**%**		
21.3	Return on average shareholders' funds	**20.7**		
1.45	Post-tax return on average assets	**1.37**		
	Capital ratios			
15.3	— total capital	**14.2**		
9.9	— tier 1 capital	**9.3**		
52.9	Cost:income ratio	**54.0**		

* *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 HK249.45 cents per share. The second interim dividend of 30 pence per share will, where required, be converted into Hong Kong dollars at the exchange rate on 17 April 1998.*

Five-Year Comparison

At year-end *(£m)*	1993	1994	1995	1996	**1997**
Share capital	2,111	2,090	2,124	2,014	**2,068**
Shareholders' funds	9,334	10,790	13,387	15,187	**16,442**
Capital resources	16,510	18,098	21,324	23,486	**25,236**
Customer accounts	128,843	128,707	142,121	151,149	**178,621**
Loans and advances to customers	97,753	98,795	109,373	114,353	**145,975**
Total assets	207,447	201,518	226,818	236,553	**286,391**
For the year *(£m)*					
Operating profit before provisions	3,588	3,060	3,772	4,519	**5,222**
Provisions for bad and doubtful debts	(1,158)	(275)	(416)	(384)	**(615)**
Pre-tax profit	2,584	3,166	3,672	4,524	**4,971**
Profit attributable to shareholders	1,806	2,053	2,462	3,112	**3,355**
Dividends	(594)	(703)	(843)	(1,090)	**(1,337)**
HK$/£ average exchange rate	11.582	11.853	12.203	12.078	**12.683**
Per ordinary share *(pence)*					
Earnings	71.13	79.60	94.01	117.61	**125.70**
Headline earnings	68.77	76.84	93.89	115.42	**124.96**
Dividends	23.50	27.00	32.00	41.00	**50.00**

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Group Chairman's Statement

Satisfactory results in challenging markets characterised the 1997 financial performance of HSBC Holdings. Profit attributable to you, our shareholders, rose by 8 per cent to £3,355 million (HK$42,550 million).

Pre-tax profit rose by 10 per cent to £4,971 million (HK$63,046 million, or 15 per cent), and growth in operating profit before provisions was strong at 16 per cent.

Your Directors declared a second interim dividend (in lieu of a final dividend) of 30 pence per ordinary share. With the 20 pence per share first interim dividend, the total distribution for 1997 of 50 pence represents an annual increase of 22 per cent (24 per cent in Hong Kong dollar terms at the exchange rate in effect on 31 December 1997). The dividend is payable on 29 April 1998 in cash, in sterling or Hong Kong dollars, with a scrip alternative.

Our commercial banking businesses in the United Kingdom, North America and the Middle East produced results well ahead of 1996, while business in Asia was affected by turbulent currency and market conditions.

In Asia, these economic difficulties have dominated the second half of 1997 and the first quarter of 1998. The instability, brought about by dramatically weakening exchange rates, attracted increased customer deposits to our branches in the region and a larger volume of customer business to our treasury dealing rooms.

The coincidence of weak exchange rates, lower stock exchange levels and high interest rates led to a deterioration in credit quality, the full impact of which is only now being felt. Reflecting this unusual level of uncertainty, the Group set aside £175 million in the form of a special general provision. Additionally, other general provisions were increased by £116 million, to £1,052 million.

Our investment banking business weakened in the second half of 1997; however, it remained profitable against a backdrop of significant changes and volatile earnings within the industry. In treasury and capital markets, dealing profits rose as business increased and margins widened in unstable markets. Growth in foreign exchange earnings more than offset a weak performance in debt securities and equities trading.

Over the course of the year, the Group's total assets rose by 21 per cent, to £286 billion. Integration of the acquisitions made in 1997 has begun, and their performance has been satisfactory. Although 1997 brought significant goodwill write-offs on acquisitions and adjustments in respect of local currency weakness in Asian markets, our total capital remained strong at 14.2 per cent, with tier one capital at 9.3 per cent at 31 December. Our cost-to-income ratio rose slightly, to 54 per cent, largely due to our acquisitions in Brazil and Argentina.

Exchange rates again had an impact on our reported results: at constant exchange rates, growth in attributable profit of 8 per cent would have been higher, at 12 per cent. Since the US dollar and currencies closely linked to it form the main currency bloc in which the Group's business is transacted, our Board has decided that in future the Company will report its results in US dollars. In 1998, dividends will be declared in US dollars; however, shareholders will continue to be entitled to receive payment alternatively in sterling or Hong Kong dollars or as scrip.

In 1997, the HSBC Group received the coveted 'Best Bank' designation from *Euromoney*; was named 'Asian Bank of the Year' by *International Financing Review*; and was ranked the world's largest and most profitable bank by *Institutional Investor*. Some of the awards received by individual Group members are highlighted by the Group Chief Executive.

Acquisitions and investments dominated the first half of 1997, when the Group embarked on an ambitious expansion programme in the Americas to capitalise on growing intra-regional and international trade flows. Banco HSBC Bamerindus was established in Brazil in March, operating the country's second-largest private branch network, a significant insurance business, and leasing and securities businesses. Its progress was noteworthy, generating a profit in its first period of operation and attracting nearly 1.5 million new accounts, with deposit growth of more than 50 per cent.

In Argentina, the Roberts Group, in which we had previously held a minority banking interest, was acquired in August and renamed HSBC Roberts. It, too, made a small contribution to the Group's operating profit in 1997. Elsewhere in Latin America, the Group acquired 10 per cent of Banco del Sur del Peru and raised our equity investment in Banco Santiago in Chile to 6.99 per cent. In addition, at the year-end we acquired a 19.9 per cent stake in Grupo Financiero Serfin of Mexico, whose principal banking subsidiary, Banca Serfin, is the country's third-largest bank.

The integration of Marine Midland Bank's acquisition of First Federal Savings and Loan and J P Morgan's US dollar-clearing business enhanced our performance, and the Group formed a strategic

Group Chairman's Statement *(continued)*

alliance to market financial services globally with North Carolina's Wachovia Corporation, the United States' 20th-largest bank holding company. Our joint venture, Wells Fargo HSBC Trade Bank (HSBC Group interest: 40 per cent), now ranks among the leading trade finance providers in the western United States.

Hongkong Bank of Canada was the first Group member to launch an Internet securities trading service, *NetTrader*. Since the year-end, it agreed in principle to acquire the banking business of National Westminster Bank of Canada, while HSBC James Capel Canada Inc. announced plans to acquire Moss, Lawson Holdings Limited, a Toronto-based investment firm.

In the UK, Midland Bank had a record year and its subsidiary, Forward Trust, acquired a major rail rolling-stock leasing company, which was subsequently renamed Forward Trust Rail.

Members of the Group opened new branches or offices in Asia, the Middle East, Europe and the Americas, including Dhaka, Bangladesh; Almaty, Kazakhstan; Lahore, Pakistan; and Bilbao, Spain. In China, HongkongBank received approval to upgrade its representative office in Wuhan to a branch, opened new premises in Shanghai, Dalian and Beijing and relocated its card centre to Shanghai, while Hang Seng Bank opened a branch in Shanghai and new premises in Guangzhou and applied to open a representative office in Beijing.

HSBC Investment Bank raised its investment in the South African stockbroker, HSBC Simpson McKie (Pty) Limited, to 89.8 per cent, and purchased the remaining equity in March 1998. Investment banking services were offered for the first time in India through HSBC Capital Markets India Private Limited.

The value of the HSBC brand grew in 1997 as we enhanced its visibility and Group members sought a closer identification with it. With Midland adopting the Group's corporate identity, all wholly-owned subsidiaries now share the corporate symbol, the hexagon, enabling our customers around the world — from Hong Kong to Hamilton, Buffalo to Brisbane, and São Paulo to Saipan — to identify their bank with ease. Additionally, in April 1998 HSBC Investment Banking will complete its rebranding, designating its equities business 'HSBC Securities'. The private bank, Samuel Montagu, and James Capel Investment Management will retain the names of their founders.

The HSBC-sponsored Stewart-Ford Formula One Team achieved an impressive second-place finish at the prestigious Monaco Grand Prix, and although the Team experienced technical difficulties in its first season, the HSBC brand reached hundreds of millions, building our name recognition, and stimulating new business in a variety of markets. Stewart Grand Prix helped with the Group's charitable endeavours, participating in Go-Karting in the City of London to raise funds for the Lord Mayor's Appeal for the Cancer Research Campaign.

The HSBC Money Gallery at the British Museum attracted millions of visitors after its formal opening in January 1997. A 'Resource Pack for Teachers' was created to help teach the history and value of money to students; and, to facilitate distance learning for those unable to visit the Gallery, a CD-ROM, *The World of Money*, will be released in June 1998. The book, *Money: A History*, will soon be available in Korean, Japanese, French and German, and the children's book, *The Story of Money*, is being reissued in paperback and in Danish.

New advertising campaigns by most Group members — all displaying the Group hexagon — are building customer awareness of the many products and services on offer. In 1998, HSBC Global Payments and Cash Management and HSBC Trade Services will undertake major brand-building exercises in all of their markets.

Reinforcing our key Asia-Pacific relationships, the Group was a major sponsor of the Asia-Pacific Economic Co-operation Forum in Vancouver, and in support of our newly-forged links in Latin America, we sponsored trade promotion conferences focusing on Brazil and Argentina.

A commitment to education remained the Group's philanthropic priority, with a particular emphasis on language skills. HSBC expanded its sponsorship of specialist language colleges in the UK to a third school. We sponsored the English Speaking Union's International Public Speaking Competition and a volunteer English teacher through the Voluntary Service Overseas' Partners in China Programme. An essay in this *Annual Report* by the Group Chief Executive highlights some of our educational initiatives around the world.

HSBC was the first bank to sign the revised United Nations Environment Programme Statement by Financial Institutions on the Environment and Sustainable Development, signalling our ongoing commitment to the environment. A new policy statement was posted to shareholders with this *Annual Report*. As in past years, Group members sponsored a wide array of environmental initiatives around the world, ranging from conservation to education.

The Group and its staff continued to help people in crisis and need, supporting the victims of floods and earthquakes in China, of a typhoon in Vietnam, and of ice storms in Canada and New York State. HongkongBank's many years of charitable work were acknowledged by a special Hong Kong Council of Social Service Golden Jubilee Award as Outstanding Philanthropist.

We sponsored Save the Children's Children in Cities Appeal, and Group members around the world helped charities for the homeless, the aged and the handicapped. HSBC Holdings supported the British Red Cross' Victims of Landmines Appeal: a London staff member chaired a fundraiser in the presence of Diana, Princess of Wales and, following her tragic death, a substantial donation was made in her memory to the Appeal.

Our most important asset is our dedicated staff in 79 countries and territories who contribute so much, not only to the Group's success, but to many volunteer programmes in their local communities. On behalf of the Board, I commend and thank them.

In March 1998, we extended a fifth invitation to staff in more than 40 countries to join our award-winning Savings-Related Share Option Scheme.

Dr Q W Lee retired as Adviser to our Board of Directors in December; in February, B H Asher retired from the Board and as Chairman of HSBC Investment Bank; and at our Annual General Meeting in May, Sir Joseph Hotung and C D Mackay will retire as non-executive Directors. We thank all of them for their devoted service to the Group.

Hang Seng Bank's founder and Honorary Chairman, Dr S H Ho, died at the age of 97 in December. He has been succeeded in that role by Dr Q W Lee.

In March 1998, Sir Brian Moffat, Chairman and Chief Executive of British Steel plc, was appointed to our Board and, in May, we hope to be joined by three other non-executive Directors, Lord Butler, Master of University College, Oxford, and former Secretary of the Cabinet and Head of the Home Civil Service in the UK; R K F Ch'ien, Chairman of Inchcape Pacific Limited and a member of the Executive Council in the Hong Kong SAR; and W K L Fung, Group Managing Director of Li & Fung Limited. We also welcome two new executive Directors: S K Green, formerly Group Treasurer, who was appointed Executive Director Investment Banking and Markets on 1 March; and W R P Dalton, formerly President and Chief Executive Officer of Hongkong Bank of Canada, who will be appointed Midland Bank's Chief Executive on 1 April. M J Jacobi, formerly Head of Group Public Affairs, will be appointed an Adviser to the Board on the same date.

We entered 1998 with sound liquidity, strong capital and a conservative balance sheet, attributes which have supported our profitable growth and served us well during weaker economic periods. Our business is well balanced geographically and by product line, and our commitment to cost discipline and profitable growth remains unchanged.

Hong Kong's transition to a Special Administrative Region of the People's Republic of China has been smooth, and we look forward to continuing to develop our business throughout Asia in the years ahead.

At the end of this year's Annual General Meeting I shall retire, with John Bond taking my position as your Group Chairman and Keith Whitson succeeding him as Group Chief Executive. Both have many years of experience and successful service to the Group to guide them as they take up their new duties, and I wish them much good fortune.

It has been my privilege to work with the men and women of HSBC for 44 years. Although I shall retire during an interesting and, perhaps, difficult period, I am confident that their commitment will ensure that the Group continues to seize opportunities and reward shareholders in the challenging years ahead.

Sir William Purves, *Group Chairman*
27 March 1998

Group Chief Executive's Review of Operations

The financial performance of HSBC Holdings plc in 1997 was satisfactory. Operating profit before provisions improved by 16 per cent to £5,222 million, mainly due to 15 per cent growth in net interest income, which accounted for about 59 per cent of our total operating income. This improvement reflected growth in both average interest-earning assets and a modest increase in net interest margin. Net fees and commissions grew by 21 per cent, reflecting growth in all regions, as well as the contributions for the first time of HSBC Bamerindus and HSBC Roberts.

The geographic distribution of our assets was broadly unchanged from that of 1996, except for the Americas where assets increased by 4 per cent to 19 per cent as a result of acquisitions.

We retained over 60 per cent of net profits to support future business growth and invest in new sources of income. Earnings per share rose by 7 per cent to 126 pence.

The 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 five years. During the same period, earnings per share averaged an annual increase of about 15 per cent.

It is HSBC Holdings' policy for our subsidiaries to derive benefits both from the centre and from each other. We do this centrally, for instance, by managing our risk on a Group basis, and also by co-ordinating those parts of our business that operate across national borders. Increasingly, we are branding these businesses to derive benefits from the growing visibility of the HSBC name. In 1997, HSBC Global Payments and Cash Management joined HSBC Trade Services and HSBC Financial Institutions as global business brands. In every subsidiary, chief executive officers are tasked with, and measured on, delivering increased Group referrals or business opportunities.

For our customers, a growing number of whom trade on a global basis, access to our worldwide network provides a competitive advantage.

One particular area where our Group structure has helped members is the 'year 2000' issue, when date-dependent business equipment, ranging from computers to security and building management systems, may have to be converted to recognise the year 2000 and beyond. Many older computer systems were developed to recognise years by the last two digits, so '97' refers to 1997. As a result, in the year 2000, these systems will read the year as '00', which has the potential to cause problems ranging from total system failure to errors in age/date calculations or comparisons. Our Group standard computerised systems for commercial banking, foreign exchange and money markets, credit authorisation and management information were originally designed to be year 2000 compliant, thus reducing the problem for most of our operations. The Group aims to have all its critical banking systems and external interfaces year 2000 compliant by the end of 1998 when testing will be well under way.

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

Attributable profit by subsidiary and by line of business (£m)

	1997	1996
Hang Seng Bank Limited	739	703
Less: minority interests	(283)	(271)
	456	432
HSBC Investment Bank Asia Holdings Limited	(1)	72
HongkongBank and other subsidiaries	1,110	1,092
HongkongBank and subsidiaries	1,565	1,596
Midland Bank plc	1,051	849
Less: preference dividend	(44)	(37)
	1,007	812
HSBC Americas, Inc.	291	245
Less: preference dividend	(1)	(4)
	290	241
The British Bank of the Middle East	79	62
Hongkong Bank Malaysia Berhad	54	84
Hongkong Bank of Canada	61	55
HSBC Latin American operations	42	3
HSBC Holdings sub-group	73	47
Other commercial banking entities	89	92
Less: investment banking profits included above	(37)	(108)
Commercial banking	3,223	2,884
Investment banking	132	228
Group profit	3,355	3,112

Hong Kong Special Administrative Region

Hong Kong's economy performed strongly in the first half of 1997. The resumption of the exercise of sovereignty over Hong Kong by China was successfully completed on 1 July. In the second half, the turmoil in the currency and foreign exchange markets across Asia put pressure on the Hong Kong dollar which, in turn, led to higher interest rates. This caused a fall in the property and stock markets, and a slowdown in the rate of growth in domestic and external demand.

The major effects on the banking sector were a significant reduction in interest spreads, a slowdown in growth of mortgage business in the last quarter of the year, and restraint on trade finance business due to weak export growth.

Operations in Hong Kong contributed 39 per cent, or £1,783 million, of the Group's operating profit for 1997.

Against a background of increased competition, particularly in the mortgage market, the Group's Hong Kong operations reported strong growth in net interest income. This reflected significant increases in advances to customers, despite reductions in interest spreads. Other operating income was higher due to increased fee income and foreign exchange dealing profits. In commercial banking, there was good growth in fees from securities, cards and credit facilities, the latter reflecting strong growth in advances to customers.

The proportion of the Group's total assets invested in Hong Kong remained broadly unchanged at 30 per cent. Advances to customers increased by 32 per cent in HongkongBank and by 25 per cent in Hang Seng Bank, as both banks recorded strong growth in residential mortgages and corporate lending, although this slackened significantly towards the end of the year.

Commercial banking competition remained keen, particularly in personal loans, Hong Kong dollar time deposits and credit cards.

In personal banking, HongkongBank competed vigorously to acquire new business and maintain market share by offering innovations, including the introduction of flexible payment and interest savings features to the mortgage service, such as fortnightly repayment and step-up repayment schemes.

In personal loans, revolving facilities and automatic limit increases were offered to quality credit users. The success of capital-protected investment products led to several further variations being offered. A comprehensive range of unit trust funds was made available, including those of HSBC Asset Management.

HongkongBank won the *Euromoney* 'Best Domestic Bank in Hong Kong' award, and HSBC Investment Bank Asia Limited 'Best Securities Firm'. HSBC Markets was voted number one in both corporate foreign exchange and derivatives by *Asiamoney* and 'Hong Kong Dollar Bond House of 1997' by *International Financing Review*.

Hang Seng Bank (HSBC Group interest: 62.1 per cent) won the *Asiamoney* 'Commercial Bank of the Year' award. It continued to develop its branches into one-stop financial supermarkets offering a 'total package solution' to customers. It also continued to expand investment-related services and launched its personal financial planning service, SmartInvest Services.

HongkongBank maintained its position as the largest issuer and acquirer of credit cards in Hong Kong, and launched a number of co-branded programmes. Hang Seng Bank launched Hang Seng SuperCash, a card offering revolving standby cash and merchant discounts. Hang Seng Bank also extended its credit card range by launching SelectImage MasterCard, a credit card featuring the holder's favourite photograph. It also launched the world's first Forever Friends MasterCard and City Smart, Asia's first dual-chip identity and stored-value 'smart card'.

Hang Seng Life Limited, a joint venture company between Hang Seng Bank and HSBC Life (International) Limited, launched the Education Savings Protection plan, while HSI Services Limited, a wholly-owned subsidiary of Hang Seng Bank, launched the Hang Seng China-Affiliated Corporations Index to track the performance of locally-listed companies with a significant equity interest held by entities in mainland China.

HSBC Investment Bank Asia's strong presence in the Hong Kong SAR enabled it to record growth in advisory and corporate finance fees, particularly from initial public offerings and aviation and structured finance. This success mitigated a significant loss on an underwriting transaction in the first half of the year.

Two major advisory projects in which HSBC Investment Bank Asia participated were the reorganisation of the Cheung Kong Group, and the acquisition of Furama Hotel Enterprises by Lai Sun Development which, at HK$6.9 billion, was one of the largest ever take-overs in Hong Kong.

HongkongBank's Trade Services Division continued to promote a number of new trade initiatives and, as a result, was able to increase its market share in Hong Kong and the rest of the region.

In securities services, a new centre was opened in Hong Kong with an upgraded securities system offering better processing capability and improved customer services. Top-rated status was awarded in the annual *Global Custodian* bank review in 11 Asia-Pacific markets, including top position in Hong Kong for the ninth consecutive year.

HongkongBank sold its interest in Hong Kong International Terminals Group in September.

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

Asia-Pacific

The currency turmoil which arose in mid-1997 changed the outlook for the region's growth prospects. The resulting decline in stock and property markets has adversely affected the region's economies. High domestic interest rates in many countries, combined with reduced government spending, and dampened domestic consumption and investment expenditure, led to a slowdown in economic growth throughout the region in the second half of the year.

Excluding Hong Kong, the region contributed 8 per cent, or £354 million, of the Group's operating profit. We continued to make investments in the region in 1997, which we expect to contribute to growth in operating income achieved from personal banking in the coming years.

The proportion of Group assets in the rest of Asia-Pacific fell slightly in 1997 to 12 per cent. Interest margins rose, due to higher spreads on customer lending, as liquidity tightened in the second half, asset and liability mix improved and treasury earnings increased. An exception was Hongkong Bank Malaysia Berhad where margins decreased due to the faster growth in time deposit rates against the slower rise in base lending rates.

China's GDP grew by 8.8 per cent with inflation at 2.8 per cent in 1997. The Group's presence continued to grow in China, and HongkongBank maintained its position as the country's leading foreign bank with seven branches, one sub-branch and three representative offices. HongkongBank won *Euromoney*'s 'Best Foreign Bank in China' award. Opportunities for business increased in March 1997 with the opening of HongkongBank's branch in the Pudong district of Shanghai, which is licensed to conduct renminbi business in defined sectors.

In Malaysia, net interest income rose by 8 per cent in Hongkong Bank Malaysia, reflecting higher levels of corporate lending, together with increased long-term investments, partly offset by reduced short-term lending to banks. The growth in lending was funded principally by substantial growth in customer deposits, which increased by 31 per cent. Other operating income grew by 26 per cent, including increased customer-driven foreign exchange trading and higher fees and commissions, principally from card products and trade bills. Specific provisions for bad and doubtful debts increased to RM151 million and an additional general provision of RM98 million was set aside to increase the ratio from 1.0 per cent to 1.5 per cent of performing advances.

The Group's expansion in the Asia-Pacific region was reflected by higher staff numbers, notably in Australia, Brunei, mainland China, India, Indonesia, Malaysia, the Philippines, Singapore, Sri Lanka, Thailand and Taiwan. There was an accompanying increase in operating expenses, largely offset by revenue expansion, and improved productivity in the region.

We continued to focus on expanding our personal banking business, partly by extending HongkongBank's AssetVantage service to new areas. AssetVantage is a premium service aimed at professionals, managers and executives, which features a comprehensive range of banking facilities, such as interest-paying current accounts, branded ATM cards and, often, dedicated AssetVantage counters within branches.

In Singapore and Taiwan, the bank opened Select Personal Financial Centres to enhance customer service. HongkongBank's ATM networks were extended in India, Brunei and Mauritius to provide better service to our customers. In Indonesia and Korea, the bank signed ATM network-sharing agreements to improve banking access for our customers.

Personal lending products continued to be developed across the region. These included personal instalment loans, home equity loans, car loans and other specially-tailored loan packages appealing to personal banking and corporate relationship customers.

New insurance and unit trust services were introduced in New Zealand, Macau, Mauritius, Singapore and Taiwan.

A personal telephone banking service was established in Australia, India, the Philippines, Taiwan and Thailand. PC banking trials were conducted in Australia, Brunei, India, Indonesia, the Philippines, Singapore, Sri Lanka and Thailand. In several areas, this was supplemented by an automated telephone banking service.

A major sales and service training programme was developed for staff. It was first piloted in New Zealand, Thailand and Taiwan and will be rolled out across the region in 1998.

Four more securities centres in the region (Bangkok, Jakarta, Seoul and Shanghai) were upgraded to the Group's global securities system, bringing the total number of converted sites to seven.

HongkongBank won *Euromoney*'s 'Best Bank in Asia' award for excellence and the 'Best Foreign Bank' award in Singapore. In Malaysia, Hongkong Bank Malaysia was also named 'Best Foreign Bank' by *Euromoney* and 'Best Foreign Commercial Bank' by *Finance Asia*.

Middle East and Africa

The Gulf States, except Qatar, experienced slower GDP growth due to weaker oil prices. Qatar remained buoyant as developments in the gas sector stimulated growth and offset the impact of falling oil prices.

The British Bank of the Middle East recorded good profit growth with improved contributions from most areas, particularly the United Arab Emirates (UAE) and Qatar, and from the offshore banking unit in Bahrain and the Middle East Finance Company.

Net interest income rose as a result of growth in average interest-earning assets, while the net interest margin decreased slightly. Other operating income grew due to increased trade finance-related fee income and foreign exchange dealing profits in the UAE. Despite strong growth in business volumes, costs were contained, leading to an improvement of 5 percentage points in the cost-to-income ratio. The bank restructured its capital by replacing its subordinated loan liabilities with additional equity and preference share capital totalling £225 million.

BritishBank continued to focus strongly on its personal banking business, resulting in strong growth in customer lending and deposits. Network service centres were established in Oman, Qatar and the UAE to handle back-office functions and allow branches to concentrate on customer service. The bank also piloted a personal telephone banking scheme, tested a loan product for the self-employed in the UAE and created a cash management capability within the electronic banking department.

British Arab Commercial Bank Limited (HSBC Group interest: 46.51 per cent) recorded satisfactory profit growth and implemented a new strategic plan to reduce overheads and increase operating income. It launched a Trade Finance Agency which seeks to link its origination capacity with the distribution capability of HSBC's global network.

Elsewhere in the Middle East, our associate, The Saudi British Bank (HSBC Group interest: 40 per cent), reported good profit growth despite an increasingly competitive environment. The bank focused on improving services to high-net-worth individuals and increased its loan portfolio, partly as a result of advertising its personal instalment loan.

A new investment product, SABBInvest, was launched; the bank's ATM network was increased to 109 machines with further expansion planned; the JCB Gold Card and co-branded Visa/MasterCards were introduced, as well as a special edition MasterCard that commemorated the FIFA Confederations Cup in December. The bank completed a joint advisory assignment with HSBC Investment Banking and continued to develop investment banking expertise.

Egyptian British Bank S.A.E. (HSBC Group interest: 40 per cent) recorded good profit growth. The bank became a founder member of the first ATM-sharing network in Egypt. It also established HSBC Investment Company Egypt S.A.E. and HSBC James Capel Egypt S.A.E. (to be renamed HSBC Securities Egypt S.A.E.), both joint ventures with HSBC Investment Banking.

HSBC Equator Bank plc, the HSBC Group's trade finance and investment bank in sub-Saharan Africa, advised the government of Côte d'Ivoire on its privatisation of the state-owned sugar company. It was also an adviser, with HSBC Investment Banking, in the toll road linking South Africa with Mozambique, for which they successfully structured and arranged finance for the 'Trac Consortium'.

United Kingdom and Continental Europe

The United Kingdom's GDP growth rate was strong at 3.5 per cent in 1997. The consumer sector benefited from an estimated £35 billion of windfalls from demutualising financial institutions. Inflation pressures remained subdued, unemployment continued to fall and sterling appreciated, particularly against the deutschmark.

The British banking sector continued to be extremely competitive with additional pressures on current accounts, savings and mortgages. Midland Bank plc achieved strong growth at operating and profit levels. Results posted by the personal and corporate banking activities in the UK were again highly satisfactory.

In continental Europe, GDP growth of 2.6 per cent was the strongest for some years and, at 2 per cent, inflation was at its lowest level since the 1960s. Average unemployment rose slightly to 12.6 per cent, as economic policies were pursued to achieve the Maastricht convergence criteria for European economic and monetary union (EMU).

Europe's contribution to the Group's operating profit was, at 39 per cent, or £1,779 million, 7 per cent higher than in 1996. The UK's contribution to this was £1,655 million. Results for France, the Channel Islands and Turkey improved significantly. Corporate banking profits in Greece were enhanced by the acquisition of a shipping portfolio. In Germany, higher fee income was offset by lower dealing profits. The proportion of Group assets in the UK and continental Europe was broadly unchanged at 39 per cent.

In the UK, Midland's net interest income increased, reflecting strong customer recruitment and continued growth in lending, particularly mortgages and deposit balances. Within operating income, net fees and commissions also grew, mainly in personal and business lending and insurance, and operating lease income rose. Operating costs continued to be tightly controlled, rising by less than 3 per cent in spite of business expansion. The net effect of increased income and controlled costs was an improvement in the cost-to-income ratio of 4.7 percentage points.

Midland Bank adopted the Group hexagon as its corporate symbol in 1997. Over 1,000 branches had the new signs by the year-end, and all branches will bear the new identity by mid-1998.

Midland continued to focus on growing its current account and deposit bases, as well as cross-selling mortgages, life insurance, pensions and investment products. It was market leader for student accounts for the second year running, and it was the UK's 11th-largest mortgage lender, with a book of £11 billion and a growth rate three times the market average.

In cards, Midland launched 'Solo', a pre-authorised debit card for young people and higher credit-risk customers. 'Smart card' trials started in Northampton as part of an industry-wide, anti-fraud initiative.

First Direct maintained its position as the UK's leading telephone banking service, attracting 150,000 new customers, making a total of 800,000. It successfully tested PC banking and will launch a full service in 1998.

In partnership with Wm. Morrison Supermarkets, Midland launched nine in-store outlets which operate supermarket hours, including Saturdays, Sundays and public holidays.

Forward Trust Group Limited's portfolio of leased assets grew and its invoice and debt management services continued to expand.

HSBC MIDLAND's dealing profits improved, principally due to foreign exchange trading. Overall dealing profits, however, were in line with 1996 as dealing profits from international operations were lower due to difficult bond market conditions.

Midland corporate banking had lead roles in the two largest UK financings of 1997, ICI and BAT. HSBC Investment Bank plc originated and executed several corporate finance mandates during the year, including co-leading the privatisation of OTE, the Greek telecoms company, and won the brokerships of British Energy plc and National Power plc. In equities, the investment bank's UK and continental European operations were merged to offer a pan-European product in preparation for EMU. Midland also made systems preparations for introduction of the European single currency, with seminars for customers emphasising Midland's preparedness to handle fresh business requirements.

An internal reorganisation to improve management and reporting lines saw Midland's interests in Trinkaus & Burkhardt KGaA in Germany and Guyerzeller Bank AG in Switzerland transferred to other Group members. The Swiss private banking subsidiary of Trinkaus was transferred to Guyerzeller in return for a minority interest. Both banks produced satisfactory results.

HSBC Investment Bank and Trinkaus & Burkhardt launched a joint initiative for German-speaking Europe under the HSBC Trinkaus brand. This encompassed strategic advisory services and primary and secondary market equity activities. HSBC Private Equity opened an office in Düsseldorf.

The Cyprus Popular Bank Limited (HSBC Group interest: 21.96 per cent) produced good growth in operating profit despite a recessionary domestic environment. The bank expanded its overseas branch network to six in the UK and 10 in Greece, and opened four new representative offices, in New York, Belgrade, Moscow and Montreal. Its ATM network, the largest in Cyprus, increased to 53 machines.

Americas

Economic growth in the United States was strong in 1997 at 3.8 per cent. New York State, where most of the Group's US operations are concentrated, grew more slowly.

The Canadian economy achieved growth of 3.8 per cent, and inflation of 1.6 per cent. Interest rates declined and unemployment fell to 9.2 per cent.

Latin America enjoyed its best economic performance for two decades, with growth for the region averaging 5.5 per cent, although this may slow down, due to a knock-on effect of the turbulence in Asia. Inflation for the region as a whole averaged 11 per cent.

The contribution to Group operating profit of operations in the Americas improved to £628 million, or 14 per cent. The proportion of the Group's total assets in the Americas increased to 19 per cent.

HSBC Americas, Inc. successfully integrated First Federal Savings and Loan, which increased its New York State market share to 5.3 per cent. J P Morgan's US dollar clearing business was also successfully integrated and improved HSBC Americas' presence in this business. Marine Midland Bank, HSBC Americas' main operating subsidiary, also acquired the loans and business of the corporate banking unit of Midland's New York branch in November 1997.

HSBC Americas' average interest-earning assets increased, and there was also growth in the core consumer and commercial lending portfolios. Changes in the asset and liability mixes as a result of acquisitions led to a lower net interest margin. Increases in operating expenses were also primarily due to acquisitions and related integration expenses. Moreover, tight cost control elsewhere resulted in a slight improvement of the cost-to-income ratio. There was an increase in the charge for bad and doubtful debts due to a substantial increase in consumer loan provisions.

Marine Midland opened a new mortgage centre in Buffalo, piloted a telephone bill-payment service and introduced Brokerage Talk, a 24-hour automated telephone service for trading equity securities.

Hongkong Bank of Canada's net interest income increased as the result of continued growth in commercial loans and residential mortgages. The net interest margin fell in response to competitive pressures. The expansion of financial services offered by the bank resulted in an increase in other operating income, primarily in corporate finance, retail brokerage commissions and mutual fund fees. Other operating expenses increased, reflecting a headcount increase and costs related to new financial services.

Hongkong Bank of Canada introduced a personal financial services initiative, incorporating branch redesign, new merchandising material and staff training, which aimed to improve the delivery of retail services. By year-end, 31 branches had been converted, with 85 to follow in 1998.

In Brazil, the first nine months of operation of HSBC Bamerindus was spent stabilising the business, establishing a control environment consistent with Group standards, and completing the process of due diligence. The Head Office is in Curitiba; however, corporate and regional operations moved to a new building in São Paulo. More than 400 branches have been refurbished with new signage under the trading name 'HSBC Bamerindus'.

As a result of the Group's increased direct investment in Latin America, Midland Bank disposed of most of its Argentinian and Brazilian Brady Bonds, leading to bad debt recoveries of £59 million.

Global Businesses

The HSBC Group devotes considerable efforts to developing those parts of its business which benefit most from wide geographic exposure.

Investment Banking

HSBC Investment Bank, 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 most of the private banking and trustee activities of the Group.

Despite the impact of falling Asian equity markets in the second half of the year, HSBC Asset Management's funds under management were up slightly, at US$45.7 billion.

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

Treasury and Capital Markets

The Group had treasury and capital market operations in 48 countries and territories, enabling it to provide a full range of services across all time zones.

The Asian currency turmoil, which started mid-year, increased corporate foreign exchange business and led to wider margins for most Asian businesses. Midland's London foreign exchange desk, specialised derivatives group and emerging markets currency group also benefited. Resultant interest rate volatility, combined with widening credit spreads, led to some securities trading losses.

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. The non-life market was characterised by reducing premium levels in most countries, but improved levels of claims, except for motor insurance. Our life and pensions market share in Hong Kong grew by 8 per cent overall, with individual life sales up 30 per cent.

Midland Bank's life and non-life agency business made a strong contribution, and overall insurance agency was the largest contributor, with sales increasing by 20 per cent. Midland Business Insurance Direct, the joint venture between HSBC Gibbs and Midland Personal Financial Services, performed well, with over 40 per cent of new business accounts at Midland being referred.

New initiatives in Asia with Royal & Sun Alliance for non-life insurance and American International Assurance for life insurance were designed to expand our services in countries where they are not available from the HSBC Group. In the US, Marine Midland offered new life products.

The acquisitions in Brazil and Argentina have given the Group's underwriting business significant critical mass, counter-cyclical revenue streams and improved reinsurance purchasing power. The growing commitment of the Group's commercial banks to selling insurance and investment products raised average penetration rates to over 4 per cent.

Services for Financial Institutions

The Group's business with banks and non-bank financial institutions is marketed as HSBC Financial Institutions. The Group remained the leading sterling and Hong Kong dollar clearer. It is the fifth largest user of the CHIPS payments sytem in New York.

With the introduction of the European single currency expected in January 1999, we began internal training and external marketing initiatives to establish the Group as a leading euro banker for our customers around the world.

The HSBC Group is a founder member of the 'G20' initiative, which established the Continuous Linked Settlement Bank (CLSB) to reduce the risk and volumes associated with foreign exchange trading settlement. The Group will share in the development costs, and market CLSB-related products to our correspondent banking partners.

Global Banking Services

The Group rationalised its range of personal banking products and enhanced PC banking capabilities for worldwide launch in 1998. In credit cards, the Group ended 1997 with some 10 million issued globally, an increase of 15 per cent during the year.

The HSBC Global Payments and Cash Management name was adopted for our business which meets the growing requirements of corporate and institutional customers. Preparations were made for the launch of euro-denominated services, which will extend our leading position in sterling payments into continental Europe.

HSBC Trade Services had another successful year. It was named 'Best Trade Finance Documentation Bank' in 1997 for the second year running by *Project and Trade Finance* magazine.

Asia-Pacific Securities Services and Midland Securities Services won substantial new business and were ‘top-rated’ by leading market surveys in several Asia-Pacific markets, as well as in the UK.

Preparations were made for an integrated Islamic banking capability to be launched in 1998.

Further investment was made in common Group processing systems to improve the quality of service in all businesses, with a number of strategic upgrades to functionality across the network.

Strategic Outlook

The Group’s capital ratios remain strong, which is appropriate given the challenges and opportunities the Group faces. The principles of sound liquidity and strong capital remain embedded within our strategic thinking. Earnings from volatile business areas will be kept low as a proportion of total earnings and dividend policy will be set to maximise total shareholder return, recognising the potential utilisation of retained capital within our businesses.

In Hong Kong, we anticipate GDP growth will slow in 1998, although its underlying economic fundamentals should see this rebound ahead of the rest of the region. So far, mainland China has been insulated from the Asian turmoil and its growth will continue steadily, which will benefit Hong Kong. The banking environment will remain intensely competitive.

Elsewhere in Asia-Pacific, it is clear that we are entering a period of slower growth and the pace of our expansion into personal banking will depend on the economic situation in each country. As a result of the economic turmoil experienced by some countries, it is likely that we will see further financial deregulation and a ‘flight to quality’ by some investors. Both these factors should benefit the HSBC Group.

In the UK and continental Europe, Midland will continue to focus on growing its market share based on straightforward products, value for money and first-class customer service.

In North America, Hongkong Bank of Canada and Marine Midland will continue to expand the range of products available to their core customer bases. Wealth management services and insurance will widen customer choice, and services will be delivered by new channels, such as the telephone, PC and Internet.

In Latin America, the integration of HSBC Bamerindus and HSBC Roberts into the Group will continue. This will involve significant staff training, introducing new products and services, focusing on customer service, and targeting areas such as insurance and trade services where Group strengths can be brought to bear.

We will continue to seize opportunities which offer long-term shareholder value, especially where we can build on our global network, financial strength or Group synergies.

Growing personal banking within our commercial banks remains a principal objective. The Group aims to broaden the range of personal banking products available in all key territories and extend penetration of our core customer account base.

We shall build an investment banking capability in all markets where we have competitive strengths and focus that capability on working closely with our commercial banks to develop corporate, institutional and private client relationships on a durable and profitable basis.

Insurance is an increasingly important business for us, focusing on developing opportunities provided by our commercial banking networks.

For a Group like ours to provide value to our shareholders, we must give our customers around the world the best possible value and service. Our talented and hard-working staff continued to do this, and I thank them for their efforts during the year.

On a personal note, I would like to record my thanks to Sir William Purves for his immense contribution to the HSBC Group during more than 40 years’ distinguished service; we shall miss him but we shall continue to take HSBC forward.

J R H Bond, *Group Chief Executive*
27 March 1998

The HSBC Group and Education

Group Chief Executive John Bond describes the rationale behind the HSBC Group's commitment to education.

The Group supports hundreds of educational projects and programmes around the globe as the main thrust of its community affairs policy. The scope of our activities is enormous, but the rationale is simple.

We believe in supporting the development of communities where we make profits and we believe education is the life-blood of our business; therefore we support it at many levels. As an employer, the HSBC Group is a 'consumer' of education from at least 79 different education systems around the world and we recognise that we can succeed only if our staff are better educated and better trained than those of our competitors.

The HSBC Group believes international competition demands highly-trained employees with world-class skills to develop, promote and deliver products and services. We also recognise that, in today's global markets, a country needs to offer internationally-competitive standards of education to create or attract jobs.

In a changing world, education and training are investments that pay off many times over. These investments benefit everyone: business, the wider community and young people themselves.

To achieve high educational standards, we believe there needs to be a working partnership among educators, parents and business. Business needs to work more closely with schools and teachers. Business should articulate more forcefully its needs and experience. And parents need to work with teachers and employers to make sure that education equips their children for the challenges they will face in their working lives.

In 1997, the HSBC Group supported many types of educational initiatives, with contributions ranging from a few hundred pounds to more than a million.

Primary and secondary education

Our involvement begins with primary and secondary education. The type of support we offer depends on the particular community involved but, generally, it focuses on those most in need.

Disadvantaged children across the globe benefited from many educational initiatives undertaken by the Group in 1997. In Taiwan, for instance, HongkongBank sponsored a school library, but its main focus remained on educational facilities for the underprivileged, as it did in New Zealand where its Books-in-Homes scheme supplied free books for disadvantaged primary schoolchildren.

Projects for deprived and disabled children in India included financial support for a school in Mumbai; Child Relief and You, an organisation involved in primary education for children of Banjara fisherfolk; and Future Hope, a Calcutta charity which takes care of street children. And half of the running costs of the School of Hope, which provides free primary education to Bangladeshi children from deprived backgrounds, were met by HongkongBank's recently-opened Dhaka branch.

HSBC Gibbs announced plans to make bursaries available to schoolchildren suffering financial hardship in the UK. In New York State, HSBC Americas, Inc. continued Jumpstart, a joint project of Marine Midland and Buffalo's Riverside High School. Last year alone, over 400 students benefited from this programme to provide computer hardware and software, sponsor educational and team-building activities, to create business internships and encourage employees to participate in mentoring and training. Marine Midland also provided scholarships and educational programmes in Buffalo, Rochester, Syracuse and New York City for children from low-to-moderate income families.

Elsewhere, HSBC Equator Bank endowed a place at the Starehe Boys Centre in Kenya and The Cyprus Popular Bank began a three-year educational games programme to teach Cypriot history and archaeology to primary schoolchildren on the Island.

Graduate and postgraduate education

Students in many countries reaped the rewards from HSBC Group participation in graduate and postgraduate education in 1997, including more than 100 in the Hong Kong Special Administrative Region who received scholarships to continue their education either locally or overseas. This scheme is funded by the Hongkong Bank Foundation, which also continued to support student and teacher exchanges between the SAR and the Mainland.

Hang Seng Bank provided 32 scholarships for students at Hong Kong tertiary institutions and at the Hong Kong Academy for Performing Arts, and awarded four scholarships to Hong Kong and

Mainland students to study at Harvard and Princeton universities in the United States.

Elsewhere in Asia, Hongkong Bank Malaysia awarded three scholarships to the University of Malaya and, under the British High Commission/ HongkongBank Award, supplied a stipend for living expenses to a Malaysian postgraduate student in the UK. HongkongBank also provided two university scholarships in Sri Lanka.

In the Middle East, the BritishBank Foundation provided two Lebanese students with MBA scholarships to the American University of Beirut, while in Saudi Arabia, The Saudi British Bank introduced a scheme to provide scholarships for Saudi nationals studying for MBAs at British universities.

The Chevening Scholarship Scheme, which promotes higher-level education through the British Council, received support from The Saudi British Bank in Saudi Arabia, the Egyptian British Bank in Egypt and the British Arab Commercial Bank in the Sudan.

In Europe, Trinkaus & Burkhardt supported the Banking and Finance Department at the European Business School near Frankfurt, Germany, while more than 50 undergraduates from ethnic minorities in the UK took part in the Midland Fellowship programme, which provides valuable work experience and encourages them to apply for positions within the bank.

In North America, Hongkong Bank of Canada doubled its staff's voluntary donations to post-secondary educational establishments and contributed to several Canadian universities and tertiary institutions.

Languages

In the competitive environment of international finance and trade, increasing emphasis is placed on the value of linguistic skills and the Group is an avid supporter of language tuition.

As English is the international language of business, the Group encourages its teaching around the world. This was clearly demonstrated when 38 competitors from 23 countries converged on London for the final of the English-Speaking Union's 1997 International Public Speaking Competition, sponsored by HSBC Holdings. It was won by a Latvian student.

Elsewhere, an English-language quiz for schools in Brunei was sponsored by HongkongBank, and through the BritishBank Foundation, an English-language competition was organised with the help of the British Council to identify 14 United Arab Emirates students to study English for two months in the UK. BritishBank was also the largest single sponsor of an English-language laboratory at the Institute of Foreign Languages in Baku, Azerbaijan.

But our support for language tuition is by no means confined to English. In Hong Kong, for instance, HongkongBank sponsors a popular radio programme in Putonghua (Mandarin), the official spoken language of China, and HongkongBank of Australia has co-sponsored two children's Putonghua-speaking competitions organised by the Chinese Language Teachers' Association of Victoria. And Hongkong Bank Malaysia promotes Bahasa Malaysia (Malay) through sponsorship of an educational radio programme called *Understand the National Language*.

HSBC Holdings continued its programme of financial support for two schools in the UK which teach Asian languages: the Royal Grammar School in High Wycombe and Levenshulme School in Manchester. A third, Shireland High School, near Birmingham, will benefit in 1998.

Vocational and other educational initiatives

The HSBC Group provided support for many other types of educational initiatives, including the Hongkong Bank Foundation School of Nursing at Hong Kong's Haven of Hope Hospital, which it helped establish, an Education and Resource Centre for the Blind Union, also in Hong Kong, and a school for the blind in Vietnam, which was helped with money the bank saved by not sending greetings cards.

Business education is supported by many members of the Group. Hang Seng Bank's School of Commerce in Hong Kong, set up in 1980 with donations from the bank and its directors, continued to receive a high level of support. The school prepares secondary pupils for careers in business, and so far over 4,600 have graduated from it.

HSBC Holdings sponsored Heads, Teachers & Industry, a UK organisation which places teachers in businesses for up to one year to enhance their leadership and management skills and promote a better understanding of the workplace. Midland Bank funded an administrator for this organisation.

The HSBC Group and Education *(continued)*

HSBC Holdings was a founding donor of the School for Social Entrepreneurs in London, which aims to teach entrepreneurial skills to those working in the not-for-profit sector.

Midland Bank is the largest corporate sponsor of Young Enterprise, a UK business-education partnership which encourages young people to set up and run their own companies while remaining in full-time education. The bank also provides more than 850 staff volunteers as advisers and area board members. Keith Whitson, Group Chief Executive designate, is Chairman of Young Enterprise.

Midland now has more than 1,100 Midbanks — mini-banks run by young people — in UK schools and colleges and, during the 1997 ‘Pupils into Midland’ day, more than 1,000 children of staff members visited over 100 Midland offices to explore aspects of working life.

Hongkong Bank Malaysia aligned support for education with concern for the environment. During 1997, it sponsored a Marine Education Kit as a schools’ teaching aid and produced school videos and posters for the Turtle Awareness Campaign.

Theatre was used by HongkongBank as an educational tool in Singapore when it sponsored *Go Green!*, a play with an environmental message which was performed 80 times during a three-month school tour, and Midland Bank funded *Ooh Ah Showab Khan*, a play about racism, which began a 10-month school tour in September 1997. It will eventually be seen by about 60,000 children.

HSBC Investment Banking combined its support for education with the arts through Shakespeare’s Globe Educational Programme and the Whitechapel Art Gallery Education Programme. And in conjunction with the Arts Development Council, HongkongBank launched a new arts programme in secondary schools in Hong Kong.

Sponsorship of the HSBC Money Gallery at the British Museum included a significant educational component in the form of two books and a CD-ROM. As the first international permanent collection dedicated to money, the Gallery serves as a valuable resource for academics and researchers.

This is just a glimpse of the wide range of activities supported by the HSBC Group and underscores the importance of education to us. As a business, we prosper in successful economic environments. And, as education is the ultimate determinant of economic success, our continuing support for it will underpin our own long-term growth.

Board of Directors and Group General Managers

Directors

Sir William Purves, CBE, DSO, *Group Chairman (retiring on 29 May 1998)*
Age 66. An executive Director and Group Chairman since 1990. Joined HongkongBank in 1954; an executive Director of HongkongBank since 1982 and Chairman and Group Chief Executive Officer from 1986 to 1992. A Director of Midland Bank plc since 1987 and Chairman from 1994 to December 1997. 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 and senior non-executive Director*
Age 58. Executive Director of John Swire & Sons Limited and a Director of Swire Pacific Limited, Christie's International plc and The General Electric Company p.l.c. A non-executive Director since 1990 and a non-executive Deputy Chairman since 1992. A non-executive Director of HongkongBank from 1981 to 1996. Former senior member of the Hong Kong Executive Council and Legislative Council.

*Sir Peter Walters, *Deputy Chairman and senior non-executive Director*
Age 67. Deputy Chairman of EMI Group plc, non-executive Chairman of SmithKline Beecham plc and a non-executive Director of Saatchi & Saatchi plc. A non-executive Director since 1992 and a non-executive Deputy Chairman since 1993. Chairman of Midland Bank plc from 1991 to 1994.

J R H Bond
Age 56. Group Chief Executive. Group Chairman (designate). An executive Director since 1990. Joined HongkongBank in 1961; an executive Director of HongkongBank from 1988 to 1992. Chairman of Midland Bank plc, Marine Midland Bank, HSBC Americas, Inc. and The British Bank of the Middle East. A Director of HongkongBank and The Saudi British Bank and a non-executive Director of the London Stock Exchange and Orange plc.

*Lord Butler, GCB, CVO *(appointed on 2 May 1998)*
Age 60. Master, University College, Oxford. Secretary of the Cabinet and Head of the Home Civil Service in the United Kingdom from 1988 to January 1998.

*R K F Ch'ien, CBE *(appointed on 2 May 1998)*
Age 46. A Director of Inchcape plc and Chairman of Inchcape Pacific Limited. A member of the first Executive Council of the Hong Kong SAR. Chairman of the Industry & Technology Development Council, the Hong Kong Industrial Technology Centre Corporation and the Hong Kong/Japan Business Co-operation Committee and a Director of Tianjin Development Holdings Limited. A non-executive Director of HongkongBank since 1997.

*D E Connolly, OBE
Age 66. Chartered Accountant. A Director of Kowloon-Canton Railway Corporation. A non-executive Director since 1990 and a non-executive Director of HongkongBank from 1985 to May 1997.

W R P Dalton *(appointed on 1 April 1998)*
Age 54. An executive Director of the Company, Director and Chief Executive, Midland Bank plc and Chairman of Forward Trust Group Limited with effect from 1 April 1998. Joined Hongkong Bank of Canada in 1981. President and Chief Executive Officer, Hongkong Bank of Canada from 1992 to December 1997.

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

D J Flint

Age 42. Group Finance Director. An executive Director since 1995. A Director of HSBC Investment Bank Holdings plc, Hongkong Bank Malaysia Berhad and HSBC Roberts S.A. de Inversiones. A member of the Urgent Issues Task Force of the Accounting Standards Board. A former partner of KPMG.

*W K L Fung, OBE *(appointed on 2 May 1998)*

Age 49. Group Managing Director of Li & Fung Limited. Past Chairman of the Hong Kong General Chamber of Commerce. A member of the Economic Advisory Committee to the Financial Secretary of the Hong Kong SAR and Chairman of the Hong Kong Committee for Pacific Economic Co-operation. A non-executive Director of HongkongBank since 1995.

S K Green *(appointed on 1 March 1998)*

Age 49. Executive Director Investment Banking and Markets. Joined HongkongBank in 1982. Group Treasurer from 1992 to February 1998. Chairman of HSBC Investment Bank Holdings plc and a Director of Midland Bank plc.

*Sir Joseph Hotung *(retiring on 29 May 1998)*

Age 67. A Director of Hongkong Electric Holdings Limited from 1984 to 1997. A non-executive Director since 1991 and a non-executive Director of HongkongBank from 1991 to 1996.

*C D Mackay *(retiring on 29 May 1998)*

Age 57. Non-executive Deputy Chairman of Thistle Hotels Plc, a non-executive Director of Eurotunnel plc and Eurotunnel SA and a Member of the Supervisory Board of Gucci Group NV. A non-executive Director 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 64. Chairman of British Airways Plc and Inchcape plc and Deputy Chairman of British Telecommunications plc and Siebe 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 Midland Bank plc from 1989 to 1994.

*C Miller Smith

Age 58. Chief Executive of Imperial Chemical Industries plc. A non-executive Director since 1996. A former Director of Unilever plc and Unilever N.V. and a non-executive Director of Midland Bank plc from 1994 to 1996.

*Sir Brian Moffat, OBE *(appointed on 27 March 1998)*

Age 59. Chairman and Chief Executive of British Steel plc. A non-executive Director of Delta plc and Enterprise Oil plc.

*M Murofushi

Age 66. Chairman of ITOCHU Corporation. A non-executive Director since 1992. Chairman of the Japan Foreign Trade Council. Special Advisor to the Chairman of the Japan Chamber of Commerce and Industry. Vice Chairman of the Tokyo Chamber of Commerce and Industry. Chairman of the Japan-Brazil Economic Committee of Keidanren (Japan Federation of Economic Organizations). A member of the Foreign Investment Advisory Council of the Russian Federation.

*Sir Wilfrid Newton, CBE

Age 69. 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 66. A Director and former Chairman and Chief Executive of Wells Fargo & Company. A non-executive Director since 1996. A Director of Ford Motor Company.

*H Sohmen, OBE

Age 58. Chairman of World-Wide Shipping Agency Limited, World-Wide Shipping Group Limited, World Maritime Limited, World Shipping and Investment Company Limited, World Finance International Limited and N&T Argonaut AB. A non-executive Director since 1990. A non-executive Director of HongkongBank since 1984 and Deputy Chairman since 1996.

J E Strickland

Age 58. Chairman of HongkongBank since 1996. Joined HongkongBank in 1971 (previous service 1966-69). An executive Director since 1989. A Director of Midland Bank plc from 1993 to 1996. A Director of Marine Midland Bank from 1994 to 1996. Vice-Chairman of Hang Seng Bank Limited and Chairman of Hongkong Bank Malaysia Berhad.

*Sir Adrian Swire

Age 66. Executive Director and Honorary President 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 55. Group Chief Executive (designate). An executive Director since 1994. A Director of Midland Bank plc since 1992, Chief Executive from 1994 to 31 March 1998 and Deputy Chairman since January 1998. Joined HongkongBank in 1961. Deputy Chairman of the Supervisory Board of Trinkaus & Burkhardt KGaA. A Director of HSBC Investment Bank Holdings plc, Hongkong Bank of Canada and HSBC Roberts S.A. de Inversiones. 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 68. Former Deputy Chairman of HongkongBank. Chairman of Wallem Group Limited and a non-executive Director of Baxter International Inc and Edinburgh Dragon Trust plc.

M J Jacobi *(appointed 1 April 1998)*

Age 46. Joined Marine Midland Bank as Senior Vice President Group Public Affairs USA in 1990. Head of Group Public Affairs, HSBC Holdings plc, from 1993 to 31 March 1998. Former Assistant Secretary of Commerce of the United States; former executive Director, Drexel Burnham Lambert; and former Special Assistant to the President of the United States.

Secretary

R G Barber

Age 47. Group Company Secretary since 1990. Joined HongkongBank as Assistant Secretary in 1980; Corporation Secretary from 1986 to 1992. Company Secretary of Midland Bank from 1994 to 1996.

Group General Managers

D Beath

Age 59. General Manager and Group Audit Controller. Joined HongkongBank in 1960.

R E T Bennett

Age 46. General Manager and Group Legal Adviser. Joined HongkongBank in 1979.

I M Burnett

Age 50. Chief Executive Officer, HSBC Americas and President and Chief Executive Officer, Marine Midland Bank. Joined HongkongBank in 1966.

V H C Cheng, OBE

Age 49. Executive Director, HongkongBank. Joined HongkongBank in 1978.

A Dixon, OBE

Age 53. Deputy Chairman, The British Bank of the Middle East. Joined HongkongBank in 1965.

D G Eldon

Age 52. Chief Executive Officer, HongkongBank. Joined HongkongBank in 1968.

M F Geoghegan

Age 44. President and Chief Executive Officer of Banco HSBC Bamerindus. Joined HongkongBank in 1973.

A P Hope

Age 51. General Manager Group Insurance. Joined Antony Gibbs & Sons Insurance in 1971.

H H Jacobi

Age 63. Chairman of the Managing Partners, Trinkaus & Burkhardt. Joined Midland Bank in 1981.

A W Jebson

Age 48. Group General Manager Technical Services. Joined HongkongBank in 1978.

C P Langley, OBE

Age 53. General Manager, HongkongBank. Joined HongkongBank in 1961.

M B McPhee

Age 56. Group General Manager Credit and Risk. Joined Hongkong Bank of Canada in 1984.

A Mehta

Age 51. General Manager International, HongkongBank. Joined HongkongBank in 1968.

T W O'Brien

Age 50. Deputy Chairman and Chief Executive Officer, Hongkong Bank Malaysia. Joined HongkongBank in 1969.

R M J Orgill

Age 59. Deputy Chief Executive, Midland Bank. Joined HongkongBank in 1958.

J C S Rankin

Age 56. General Manager and Chief Executive Officer Singapore, HongkongBank. Joined HongkongBank in 1960.

P E Selway-Swift

Age 53. Deputy Chairman of HSBC Investment Bank and Chairman of HSBC Investment Bank Asia Holdings. Joined HongkongBank in 1962.

R A Tennant

Age 55. General Manager Group Human Resources. Joined Midland Bank in 1960.

Report of the Directors

Results for 1997

The Group profit for the year attributable to shareholders of the Company was £3,355 million, an increase of 8 per cent.

A first interim dividend of 20 pence per ordinary share was paid on 8 October 1997 and the Directors have declared a second interim dividend of 30 pence per ordinary share, payable on 29 April 1998, making a total distribution for the year of £1,337 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 17 April 1998, with a scrip dividend alternative. The reserves available for distribution before accounting for the second interim dividend of £803 million are £3,689 million.

Further information about the results is given in the accompanying consolidated profit and loss account on page 49.

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 5,500 offices in 79 countries and territories 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 6 to 13.

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

Connected Transactions

The following constitute connected transactions under the rules of The Stock Exchange of Hong Kong.

In May 1997, Hang Seng Bank Limited, a subsidiary, entered into an agreement to sell its property 4/F Wing On House, 71 Des Voeux Road Central, Hong Kong to Hung On Investments Limited, a company indirectly controlled by Dr Lee Quo-Wei, its then Chairman, for a consideration of HK$115 million.

In December 1997, HSBC Investment Bank Holdings BV, a subsidiary, acquired 1,193,169 ordinary shares and Rand 11,025,000 subordinated loan stock of HSBC Simpson McKie (Proprietary) Limited, also a subsidiary, from 21 directors and employees of HSBC Simpson McKie (Proprietary) Limited, for a total consideration of Rand 161 million.

Capital and Reserves

The following events occurred during the year:

1. 1,005,502 ordinary shares of 75p and 7,768,306 ordinary shares of HK$10 each were issued on 30 April 1997 at par in lieu of the 1996 second 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 1,478.65p.
2. 370,477 ordinary shares of 75p and 3,215,656 ordinary shares of HK$10 each were issued on 8 October 1997 at par in lieu of the 1997 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 2,113.9p.
3. Options over 1,344,850 ordinary shares of 75p each were awarded at nil consideration on 24 March 1997 under the Executive Share Option Scheme. The options are exercisable between the third and tenth anniversaries of the award at a price of 1,504.8p per share, the market value at the date of the award.
4. Options over 11,750 ordinary shares of 75p each were awarded at nil consideration on 12 August 1997 under the Executive Share Option Scheme. The options are exercisable between the third and tenth anniversaries of the award at a price of 2,339.5p per share, the market value at the date of the award.

5. Options over 6,574,794 ordinary shares of 75p each were awarded at nil consideration on 9 April 1997 to Group employees resident in 38 countries under the Savings-Related Share Option Scheme. 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 1997 at a price of 1,356.18p per share, a 15 per cent discount to market value at the date of the award.
6. Options over 445,199 ordinary shares of 75p each were awarded at nil consideration on 12 August 1997 under the Savings-Related Share Option Scheme (USA Section). 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 July 1997 at a price of 1,955.6p per share, a 15 per cent discount to market value at the date of the award.
7. 508,727 ordinary shares of 75p each were issued at prices ranging from 541.8p to 1,356.18p per share in connection with the exercise of options under the Savings-Related Share Option Scheme and options over 1,756,663 ordinary shares of 75p each lapsed.
8. 581,391 ordinary shares of 75p each were issued at prices ranging from 651.8p to 1,504.8p in connection with the exercise of options under the Executive Share Option Scheme and options over 85,001 ordinary shares of 75p each lapsed.
9. 1,107,401 ordinary shares of 75p each were issued at prices ranging from 118.43p to 237.12p in connection with the exercise of options under the Midland Bank Savings-Related and Executive Share Option Schemes and options over 32,623 ordinary shares of 75p each 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 of between 30 and 50 years, were revalued in November 1997 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 decreased by £75 million.

Further details are included in Note 20 of the 'Notes on the Accounts'.

Directors

The Directors who served during the year were Sir William Purves, Baroness Dunn, Sir Peter Walters, B H Asher, J R H Bond, D E Connolly, D J Flint, Sir Joseph Hotung, C D Mackay, Sir Colin Marshall, C Miller Smith, M Murofushi, Sir Wilfrid Newton, C E Reichardt, H Sohmen, J E Strickland, Sir Adrian Swire and K R Whitson.

B H Asher will retire on 28 February 1998.

Baroness Dunn, Sir Joseph Hotung, C D Mackay, Sir William Purves and J E Strickland will retire by rotation at the Annual General Meeting. Baroness Dunn and J E Strickland will offer themselves for re-election; Sir Joseph Hotung, C D Mackay and Sir William Purves will not seek re-election.

Directors appointed since the last Annual General Meeting, W R P Dalton (with effect from 1 April 1998), S K Green (with effect from 1 March 1998) and Sir Brian Moffat (with effect from 27 March 1998), will retire at the forthcoming Annual General Meeting and will offer themselves for election.

Brief biographical notes of the Directors are set out on pages 17 to 19.

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 operative 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 1997 and the subsequent period up to 23 February 1998 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 48. KPMG Audit Plc has reported that in its opinion these statements: (i) provide the disclosures required by the London Stock Exchange Listing Rules; and (ii) are not inconsistent with the information of which it is aware from its audit work on 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 I M Burnett, D G Eldon, S K Green, A W Jebson, M B McPhee and A Mehta, who are Group General Managers. B H Asher will retire on 28 February 1998 and W R P Dalton will become a member of the Committee upon his appointment as an executive Director with effect from 1 April 1998.

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, individual remuneration awards, 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 performance-related 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. The Group has a long history of paying close attention to its customers in order to provide value for its shareholders. This has been achieved by ensuring that the interests of the Group and its staff are aligned with those of its shareholders, and that the Group's approach to risk management serves the interests of all.

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

Long-Term Share Awards

The Restricted Share Plan is intended 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 29 to 31.

Executive Directors and Group General Managers are eligible to receive a conditional award under the Restricted Share Plan, but may no longer participate in the Executive Share Option Scheme, although options granted in prior years will remain valid.

Executive Directors are eligible to participate in the Savings-Related Share Option Scheme on the same terms as 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 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 arrangements for J E Strickland are provided under the HSBC International Staff Retirement Benefits Scheme. 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 participated 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.

Report of the Directors *(continued)*

	Accrued annual pension at 31 December 1997 (£000)	*Increase in accrued pension during 1997, excluding any increase for inflation (£000)*	*Personal contributions towards pension (£000)*	*Transfer value relating to increase in accrued pension* (£000)*
J R H Bond	73	14	—	207
J E Strickland	159	10	10	7
K R Whitson	57	10	—	141

* *The transfer value represents a liability of the Group's pension funds and not a sum paid or due to the individual; it cannot meaningfully be added to annual remuneration.*

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 fixed terms not exceeding three years.

J E Strickland, 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 six months' notice to be given by either party.

S K Green and W R P Dalton, who have been appointed Directors with effect from 1 March and 1 April 1998 respectively, will stand for election at the forthcoming Annual General Meeting. They are both employed on contracts which provide for 12 months' notice to be given by either party.

Directors' Individual Remuneration and Interests

Particulars of 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.

Directors' Interests

According to the registers of Directors' interests maintained by the Company pursuant to 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 1997	At 31 December 1997 Personal	Family	Corporate	Other	Total
Ordinary Shares of HK$10						
B H Asher	2,100	2,100	—	—	—	2,100
J R H Bond	17,776	18,259	—	—	—	18,259
D E Connolly	195,707	15,855	—	—	—	15,855
Baroness Dunn	20,000	20,000	—	—	—	20,000
D J Flint	—	1,000	—	—	—	1,000
Sir Joseph Hotung	703,754	—	—	816,123[1]	—	816,123
Sir Wilfrid Newton	3,767	3,869	—	—	—	3,869
Sir William Purves	36,903	37,907	—	—	—	37,907
H Sohmen	646,393	—	120,666	699,771[1]	—	820,437
J E Strickland	30,168	29,952	1,035	—	—	30,987
Sir Adrian Swire	60,000	—	—	—	98,000[2]	98,000
K R Whitson	1,709	1,755	—	—	—	1,755
Ordinary Shares of 75p						
J R H Bond	—	—	—	—	7,884[3]	7,884
Baroness Dunn	—	—	—	—	8,000[2]	8,000
D J Flint	—	—	—	—	4,931[3]	4,931
C D Mackay	7,500	3,750	3,750	—	—	7,500
Sir Colin Marshall	2,066	2,122	—	—	—	2,122
Sir Wilfrid Newton	2,000	2,000	—	—	—	2,000
Sir William Purves	1,471	1,511	—	—	320[2]	1,831
J E Strickland	10,090	10,364	—	—	5,917[3]	16,281
Sir Adrian Swire	109	—	—	—	8,000[2]	8,000
Sir Peter Walters	13,005	13,005	—	—	—	13,005
K R Whitson	—	—	—	—	5,917[3]	5,917
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	359	—	—	—	359[2]	359
Sir Peter Walters	6,500	6,500	—	—	—	6,500

1 *Interests held by private investment companies.*

2 *Non-beneficial.*

3 *Shares conditionally awarded under the Restricted Share Plan in 1997 together with additional shares arising from scrip dividends. The monetary value of the shares awarded during 1997 was: J R H Bond £120,000; D J Flint £75,000; J E Strickland £90,000; and K R Whitson £90,000. For these shares to vest in 2000 or 2001, in whole or in part, performance tests described in the Report of the Remuneration Committee in the 1996* Annual Report and Accounts *must be satisfied.*

Share Options

At 31 December 1997, the undernamed Directors held options to acquire the number of 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 Savings-Related Share Option Scheme are exercisable at a 15 per cent discount to the market value at the date of award. 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 1997 was 1,571 pence. The highest and lowest market values during the year were 2,347 pence and 1,273 pence. Market value is the mid-market price quoted on the London Stock Exchange on the relevant date.

Report of the Directors *(continued)*

	Options held at 1 January 1997	*Options awarded during year*	*Options exercised during year*	*Options held at 31 December 1997*	*Exercise price in pence*	*Date of award*	*Exercisable from[4]*	*Exercisable until[4]*
B H Asher	12,613	—	12,613[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
	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
	—	1,271	—	1,271[1]	1,356.18	9 Apr 1997	1 Aug 2002	31 Jan 2003
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	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
	—	1,271	—	1,271[1]	1,356.18	9 Apr 1997	1 Aug 2002	31 Jan 2003
K R Whitson	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 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 (30 April 1997) was 1,620 pence.*

4 *May be advanced to an earlier date in certain circumstances, e.g. retirement.*

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 he held throughout 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, was 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 from 31 December 1997 to the date of this report. Any subsequent changes up to the last practicable date before the publication of the Notice of Annual General Meeting will be set out in the notes to that Notice.

Directors' Emoluments

The emoluments of the Directors of the Company for 1997 were as follows:

	Fees *£000*	*Salary and other remuneration* *£000*	*Benefits in kind* *£000*	*Discretionary bonuses*[2] *£000*	*Total 1997* *£000*	*Total 1996*[3] *£000*
Executive Directors						
Sir William Purves	25	531	25	150	731	726
— waived	(20)				(20)	(16)
J E Strickland[1]	20	320	618	—	958	672
— waived	(25)				(25)	(20)
J R H Bond	25	449	2	150	626	615
— waived	(20)				(20)	(16)
B H Asher	25	415	8	150	598	578
K R Whitson	25	325	28	100	478	433
D J Flint	25	333	7	85	450	409
Non-executive Directors						
Sir Wilfrid Newton	50	10	—	—	60	47
D E Connolly	33	8	—	—	41	41
Sir Joseph Hotung	25	8	—	—	33	28
Baroness Dunn	25	8	—	—	33	24
Sir Peter Walters	25	5	—	—	30	23
H Sohmen	20	5	—	—	25	20
— waived	(25)	(5)			(30)	(23)
C D Mackay	25	—	—	—	25	20
Sir Colin Marshall	25	—	—	—	25	20
C Miller Smith	25	—	—	—	25	20
M Murofushi	25	—	—	—	25	20
Sir Adrian Swire	25	—	—	—	25	20
C E Reichardt	25	—	—	—	25	16
Total	473	2,417	688	635	4,213	3,732

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 *These discretionary bonuses are in respect of 1997 and will be paid in 1998.*

3 *Restated to exclude employer pension contributions.*

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.

1998 Conditional Awards under the Restricted Share Plan

The Committee has decided that conditional awards under the Restricted Share Plan should be made in 1998 and that the Trustee to the Plan should be provided with funds to acquire ordinary shares of 75p each between 23 and 27 February 1998. The 1998 conditional awards of shares to executive Directors and Group General Managers in respect of 1997 will have an aggregate value at the date of award of £1.41 million and will include conditional awards of shares to the following values to executive Directors:

	£000
J R H Bond	150
D J Flint	100
K R Whitson	120
Total	370

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 tangible fixed assets, subsidiary undertakings, interests in associated undertakings and other participating interests and provisions for permanent diminution in the value of fixed assets.

To illustrate how the Restricted Share Plan is 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 1998 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 of the 1998 awards to be achieved in whole or in part, the following tests must be satisfied.

Test 1 Earnings per share in the year 2001 (the fourth year of the performance period) must be greater than earnings per share in 1997 (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, 1998 to 2001 inclusive, must exceed an aggregate figure calculated by compounding 1997 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 1997 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 1998 to 2001, the same tests will be applied over the years 1999 to 2002. 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 example, if the composite rate of inflation were 5 per cent per annum over the period 1998-2001, 50 per cent of the conditional awards would be released if the following had been achieved:

1. earnings per share for the year 2001 exceeded US$2.68;
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 1998-2001 exceeded US$9.70.

For the maximum number of shares to vest, the cumulative earnings per share over the four years 1998-2001 would have to exceed us$11.19.

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

Employees' Emoluments
Set out below is information in respect of the five individuals, who are not Directors of the Company, 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 1997.

	£000
Basic salaries, allowances and benefits in kind	1,053
Pension contributions	416
Bonuses paid or receivable	5,300
Amounts paid as inducements to join or on joining the Group	1,256
Total	8,025

Their emoluments are within the following bands:

	Number of employees
£1,400,001 – £1,500,000	2
£1,500,001 – £1,600,000	1
£1,700,001 – £1,800,000	1
£1,800,001 – £1,900,000	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 40,000 Group employees in 38 countries and territories worldwide now participating in the Savings-Related Share Option Scheme.

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.

Report of the Directors *(continued)*

It is Company practice to organise payment to its suppliers through a central purchasing unit operated by Midland Bank plc, a subsidiary of HSBC Holdings plc. Included in the balance with Midland Bank plc is the amount due to trade creditors which at 31 December 1997 represents 18 days' average daily purchases of goods and services received from such creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

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	5.29 per cent
The Prudential Corporation Group of Companies	4.76 per cent
Legal & General Group	3.63 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

With the exception of HSBC Investment Bank plc, which for the purposes of the Companies Act 1985 is an intermediary in securities in London in the shares of the Company, neither the Company nor any subsidiary undertaking bought or sold any shares of the Company during the year.

Donations

During the year, the Group made charitable donations totalling £10,146,000. Of this amount, £2,585,000 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, 29 May 1998 at 11.00 a.m.

Auditor

At the Annual General Meeting on 31 May 1996, KPMG resigned 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* 23 February 1998

Summary of Financial Performance

Group profit

The HSBC Group made a profit before tax of £4,971 million in 1997, an increase of £447 million, or 10 per cent, over 1996. In Hong Kong dollar terms, pre-tax profit grew by 15 per cent from HK$54,641 million to HK$63,046 million.

Net interest income of £6,680 million was £859 million, or 15 per cent, higher than 1996. Other operating income rose by £912 million, or 24 per cent, to £4,679 million.

The Group's cost:income ratio increased to 54.0 per cent from 52.9 per cent in 1996. The inclusion of Banco HSBC Bamerindus and HSBC Roberts added 2.8 per cent to the cost:income ratio.

The charge for bad and doubtful debts was £615 million, which was £231 million, or 60 per cent, higher than 1996. General provisions were augmented by £291 million, compared with £78 million in 1996, and included a special general provision charge of £175 million as a precautionary measure in view of the uncertain conditions within Asia.

The gains on disposal of investments were £341 million, in line with 1996.

Profit attributable to shareholders was £3,355 million (HK$42,550 million) in 1997, an increase of 8 per cent (13 per cent in Hong Kong dollar terms).

Shareholder ratios

Earnings per share increased by 7 per cent, from 117.6 pence to 125.7 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 10 pence, or 8 per cent. The headline earnings per share excluded profit on the sale of tangible fixed assets, subsidiaries and associates and provisions for permanent diminution in value of other participating interests.

The return on average shareholders' funds, at 20.7 per cent, decreased from 21.3 per cent in 1996.

Shareholders' funds rose by a net £1,255 million to £16,442 million, including the retention of £2,018 million of Group profits, and the take-up of scrip dividends and shares issued under options totalling £216 million in aggregate. These were partly offset by a goodwill charge of £735 million in respect of Latin American and other acquisitions.

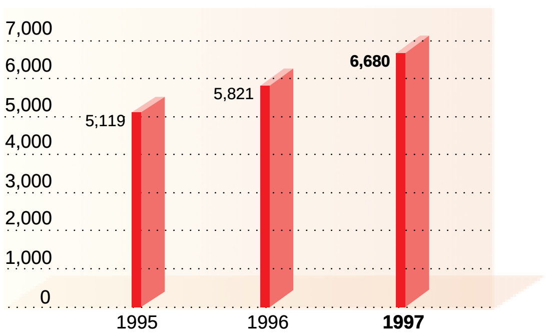
The Directors have declared a second interim dividend of 30 pence per ordinary share (in lieu of a final dividend), which, together with the first interim dividend of 20 pence, will make a total distribution for the year of 50 pence (1996: 41 pence), an increase of 22 per cent. The dividend is covered 2.5 times by attributable profit (1996: 2.9 times).

Net interest income

The improvement in the Group's net interest income reflected both growth in average interest-earning assets and a modest improvement in net interest margin in 1997. With the exception of continental Europe, income levels rose in all regions, with acquisition-driven growth of 60 per cent in the Americas. Excluding acquisitions, the rate of increase in the Group's net interest income reduced in the second half of the year, as average interest-earning assets grew more slowly and competitive pressures, together with actions taken by central banks to defend their countries' currencies, resulted in a decline in the interest spread in the latter part of the year.

Average interest-earning assets increased by £28 billion, or 14 per cent, to £230 billion in 1997. The growth was principally in customer advances and debt securities and was financed mainly by increased customer deposits.

Net interest income (£m)



Financial Review *(continued)*

The modest improvement in the Group's net interest margin to 2.91 per cent reflected a change in mix with margin pressures in most of the Group's principal areas of operation, particularly in Hong Kong, being offset by the inclusion of the new higher-margin business in Latin America.

In the UK, Midland Bank's domestic margin fell as the benefits of improved spreads on savings products and mortgages in the branch network were more than offset by the adverse effect of the funding costs of the expansion of the operating leased assets business and narrower spreads on treasury assets as short-term funding rates rose. Growth of £8.1 billion in average interest-earning assets reflected higher corporate customer and residential mortgage lending and debt securities, the latter partly due to the placement of surplus funds generated from customer deposits in the branch network.

In continental Europe, Midland's margin rose by 3 basis points, whilst the increase in the second half in average interest-earning assets reflected the acquisition of a Greek shipping loan portfolio.

In Hong Kong, HongkongBank's margin deteriorated due to increased price competition in the residential mortgage market, which persisted until August, exacerbated by a narrowing of the gap between best lending rate and interbank rates in the second half and a shift in funding mix. These pressures were mitigated by an improved asset mix and a higher contribution from net free funds. Hang Seng Bank's margin remained constant, as changes in asset mix and higher levels of net free funds offset margin pressures. The growth in average interest-earning assets principally reflected increased lending to corporates and for residential mortgages.

The improvement in the net interest margin in the Asia-Pacific operations of the HongkongBank Group was mainly due to higher spreads on customer lending, as liquidity tightened in the second half of 1997, improved asset and liability mix and higher treasury earnings in the principal countries of operation within the region.

Hongkong Bank Malaysia's margin was lower as spreads tightened as the economy faced considerable pressure on its currency and a reduced contribution was made from lower levels of net free funds. The margin in The British Bank of the Middle East fell because a favourable change in asset-mix, as funds were switched out of interbank placements to customer lending, was more than offset by increased levels of interest suspended and foregone and a smaller contribution from net free funds.

In the Americas, acquisitions resulted in a significant increase in net interest income. HSBC Americas, Inc.'s lower margin was principally attributable to a change in both asset and liability mix. The First Federal Savings acquisition increased the proportion of lower-yielding residential mortgages. Additionally, the credit card portfolio was lower during 1997, which, while lowering the proportion of higher-yielding balances, also reduced credit exposure to this sector. In Hongkong Bank of Canada, the margin narrowed as competitive pressures on pricing of retail mortgages and deposit products reduced spreads.

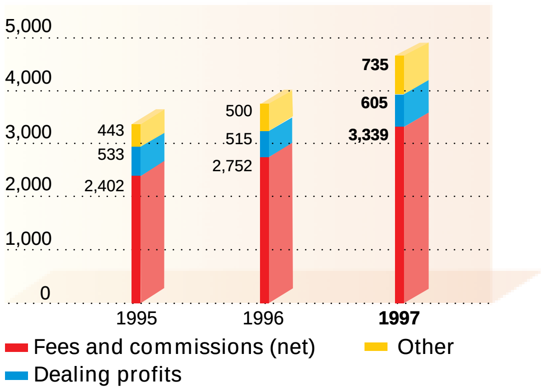
Banco HSBC Bamerindus reported a net interest margin of 9.37 per cent on average interest-earning assets of BRL10,348 million since it was established in March 1997.

Non-interest income

Non-interest income of £4,679 million was £912 million, or 24 per cent, higher than 1996, mainly due to a substantial increase in net fees and commissions. Income levels were higher in all geographic regions. There was particularly strong growth in the Americas (105 per cent) mainly as a result of acquisitions, the rest of Asia-Pacific (14 per cent) and Hong Kong (11 per cent). Excluding net fees and commissions, other operating income rose by £325 million, or 32 per cent, from £1,015 million in 1996 to £1,340 million in 1997.

Net fees and commissions increased by £587 million, or 21 per cent, with growth recorded in all regions. Banco HSBC Bamerindus and HSBC Roberts contributed £210 million of the increase.

Non-interest income (£m)



Analysis of income from dealing in financial instruments (£m)	**1997** Dealing profits	**1997** Dividend and net interest income	**1997** Total	1996 Dealing profits	1996 Dividend and net interest income	1996 Total
Foreign exchange	**609**	**20**	**629**	354	26	380
Interest rate derivatives	**48**	**22**	**70**	53	10	63
Debt securities	**(37)**	**115**	**78**	61	98	159
Equities and other trading	**(15)**	**43**	**28**	47	30	77
	605	**200**	**805**	515	164	679

Corporate finance, advisory and structured finance activities in Asia and Europe performed well, generating higher fees. Increased volumes in most markets led to larger equities securities commission revenues. Within commercial banking, good growth was achieved in insurance, account services and card products. Trade finance grew modestly.

Dealing profits, which exclude net interest income attributable to dealing activities and dividend income on trading equities, increased by £90 million over 1996. Asian currency volatility led to better foreign exchange earnings resulting from increased customer business volumes and wider spreads. Debt securities trading losses were sustained in Germany and in a number of other locations as the uncertain outlook for Asian government and corporate bond issuers resulted in wider credit spreads. Losses in equities and other trading were sustained in equity underwriting activity and equity trading in Hong Kong.

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, and the cost of associated staff and other administrative expenses. The table above 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.

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. Higher operating lease rental income from the acquisition of Eversholt Leasing and a contribution of £102 million (before commissions and operating expenses) from the insurance business in Brazil contributed to the increase in other operating income.

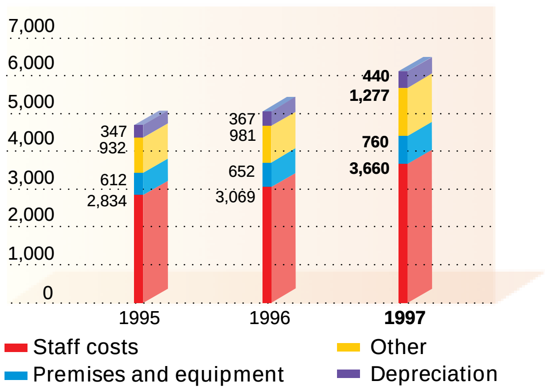
Operating expenses

Operating expenses increased by £1,068 million, or 21 per cent, to £6,137 million in 1997. The acquisitions and investments made in the Americas, mainly in Latin America, and the further business expansion in Asia have increased the Group's cost base. The investments in Latin America added 2.8 percentage points to the Group's cost:income ratio, 24,440 to the Group headcount and accounted for two-thirds of the increase in costs.

In the UK, costs continued to be tightly controlled. In Asia, the Group's commercial banks invested to develop their core businesses and opened new branches. Outside of Hong Kong, staff complement increased, notably in Taiwan, Indonesia, Sri Lanka, India, the Philippines, mainland China, Australia, Brunei, Singapore, Malaysia and Thailand.

Staff costs were up by £591 million, or 19 per cent, compared with 1996. Total staff costs in Midland were unchanged. Although salary increases within the HongkongBank Group were held broadly in line with inflation, staff costs rose due to an increase of 1,680 in headcount.

Operating expenses (£m)



Premises and equipment costs rose by £108 million, or 17 per cent, over 1996.

Financial Review *(continued)*

Staff numbers	Full-time equivalent **1997**	1996	1995
HongkongBank	**24,038**	22,468	21,953
Hang Seng Bank	**8,048**	7,960	7,926
Other HongkongBank Group	**3,426**	3,404	3,346
Midland Bank	**42,601**	43,019	43,572
Banco HSBC Bamerindus	**21,292**	—	—
HSBC Americas, Inc.	**8,995**	7,985	8,012
Hongkong Bank Malaysia	**4,474**	4,160	4,093
Hongkong Bank of Canada	**4,094**	3,816	3,373
HSBC Roberts	**3,148**	—	—
The British Bank of the Middle East	**2,856**	2,570	2,397
Other	**9,313**	7,088	6,398
Total staff numbers	**132,285**	102,470	101,070

The **charge for depreciation** increased by 20 per cent to £440 million, mainly attributable to the higher carrying values of properties following the 1996 property revaluation.

The Group's **cost:income ratio** increased to 54.0 per cent from 52.9 per cent in 1996.

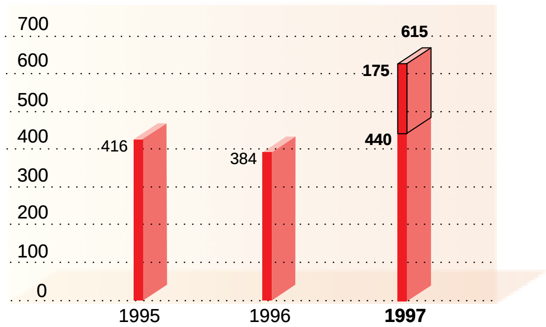
Bad and doubtful debts

The charge for bad and doubtful debts of £615 million was £231 million higher than 1996. New specific customer provisions were £24 million higher notwithstanding the non-recurrence of the individually-significant provisioning requirements in 1996 on one relationship in each of the UK and Hong Kong. In the UK, credit quality remained good and non-performing loans declined. Higher charge-offs for consumer credit card advances were recorded in HSBC Americas, Inc. The general bad debt charge rose to reflect growth in advances and, as a precautionary measure to take account of the emerging credit difficulties in Asia, a special general provision charge of £175 million was made. This special general provision will be utilised should specific provisions be required and will be replenished, if appropriate, as circumstances become clearer during 1998. Excluding this special general provision, general provisions held at 31 December 1997 stood at £1,052 million and covered 0.74 per cent of gross advances.

The charge in Midland Bank of £129 million was lower than 1996 following improved recoveries as a result of higher release of provisions from sales of LDC debt. New specific provisions fell from £357 million to £340 million. Releases and recoveries rose from £206 million to £248 million, of which £101 million related to LDC debt. The general provision charge was £16 million higher than 1996 reflecting growth in customer advances.

The charge in HSBC Americas, Inc. was higher than 1996 due to a substantial increase in consumer loan provisions. This was partially offset by recoveries of commercial loans previously written off. The increased level of consumer bankcard bad debts was in line with general industry experience in the US.

Charge for bad and doubtful debts (£m)



The net charge in the HongkongBank Group of HK$4,546 million was HK$3,103 million higher than 1996. The general bad debt charge was raised to reflect growth in customer advances and more particularly as a precautionary measure to take account of emerging credit problems arising from the severe economic downturn in Asia. The general provision charge for 1997 was increased by HK$1,600 million in excess of the normal coverage held within the HongkongBank Group to reflect the emerging credit difficulties in Asia.

Gains on disposal of investments

The Group's gains on disposal of investment securities of £341 million were £18 million higher than 1996 and included HongkongBank's profit on the disposal of its investment in Hong Kong International Terminals. Hang Seng Bank recorded gains on the sale of listed equity investments of £47 million (1996: £41 million). HSBC Private Equity Europe reported £107 million (1996: £82 million) of gains from venture capital investment disposals.

Taxation

The 1997 effective rate of tax was 25.3 per cent, compared with 23.7 per cent in 1996. The effective tax rate was below the average standard rate of UK corporation tax of 31.5 per cent (1996: 33 per cent) mainly because of lower rates of tax in major subsidiaries overseas, albeit this benefit was eroded by the fall in the year of the UK corporation tax rate. Likewise the recognition of previously unrecognised tax losses was lower in 1997, mainly as a result of lower realised capital gains in the UK in 1997. Furthermore, unlike 1996, tax-free gains in Hong Kong in 1997 were negated by unrelieved losses and general provisions.

Analysis of overall tax charge (£m)	**1997**	1996
Taxation at UK corporation tax rate of 31.5 per cent (1996: 33 per cent)	**1,566**	1,493
Impact of differently taxed overseas profits in principal locations	**(209)**	(346)
Utilisation of previously unrecognised tax losses	**(65)**	(104)
Other items	**(34)**	30
Overall tax charge	**1,258**	1,073

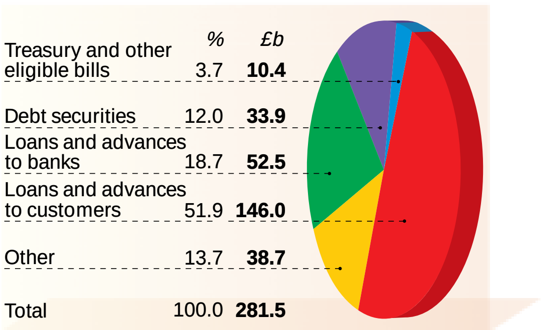
Assets

The growth in assets of £50 billion was predominantly in loans and advances to customers. Acquisitions contributed £14 billion of the increase in total assets. Customer lending growth was strongest in Hong Kong, where increased corporate lending and the demand for residential mortgages remained high, although it slackened significantly towards the end of the year. In the UK, Midland grew its personal, residential mortgage and corporate lending books. In the Asia-Pacific region, there were increases in corporate lending, particularly in Japan, China, Taiwan and Malaysia. The increase in the Americas reflected the contribution of First Federal Savings to the residential mortgage portfolio and the new businesses in Argentina and Brazil.

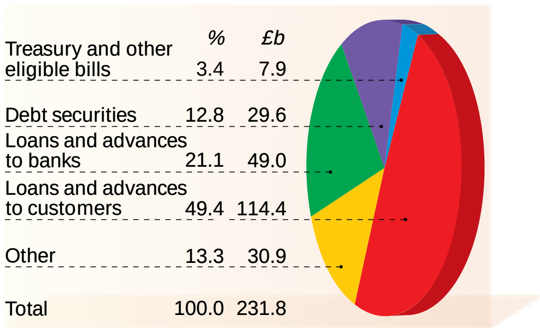
The debt securities held in accrual books showed an unrecognised gain, net of off-balance-sheet hedges, of £87 million compared with a net gain of £144 million at December 1996.

Equity shares included £634 million (December 1996: £757 million) held on investment account, on which there was an unrealised gain of £455 million (December 1996: £720 million).

*Assets **1997** (excluding Hong Kong Government certificates of indebtedness)*



Assets 1996 (excluding Hong Kong Government certificates of indebtedness)



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. The UK Government has announced that responsibility for banking supervision is to be transferred from the Bank of England to the Financial Services Authority and this is currently scheduled to come into effect on 1 June 1998. 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 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. Since 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 opposite page (top) sets out the analysis of regulatory capital at the end of 1997 and 1996.

During 1997, the Group's total capital ratio decreased from 15.3 per cent to 14.2 per cent and its tier 1 capital ratio decreased from 9.9 per cent to 9.3 per cent.

Tier 1 capital increased by £1,420 million from the level at the end of 1996, mainly due to retained earnings of £2,018 million and the take-up of scrip dividends and shares issued under options totalling £216 million in aggregate. This was offset by a goodwill charge of £735 million in respect of Latin American and other acquisitions and other movements of £79 million.

Tier 2 capital increased by £686 million mainly as a result of issues previously made by HSBC Americas, Inc. and HSBC Banco Roberts which have become eligible on a Group basis. General provisions excluded those which did not meet local regulatory criteria for tier 2 capital. Capital deductions increased, mainly due to investments in banks in Chile, Peru and Mexico.

The Group's risk-weighted assets increased by £23.8 billion due to increased customer lending and acquisitions in Latin America.

Overall, the impact of acquisitions lowered the tier 1 ratio by 0.9 per cent and the total capital ratio by 1.1 per cent.

£m	**1997**	1996
Composition of capital		
Tier 1:		
Shareholders' funds	**16,442**	15,187
Minority interests	**2,730**	2,695
Less: property revaluation reserves	**(2,587)**	(2,700)
intangibles/other	**(21)**	(38)
Total qualifying tier 1 capital	**16,564**	15,144
Tier 2:		
Property revaluation reserves	**2,587**	2,700
General provisions	**1,084**	943
Perpetual subordinated debt	**1,987**	1,783
Term subordinated debt	**4,064**	3,552
Minority interests (in tier 2 preference shares)	**—**	58
Total qualifying tier 2 capital	**9,722**	9,036
Unconsolidated investments	**(681)**	(551)
Investments in other banks	**(294)**	(131)
Other deductions	**(75)**	(12)
Total capital	**25,236**	23,486
Total risk-weighted assets	**177,283**	153,488
Capital ratios (per cent)		
Total capital/risk-weighted assets	**14.2**	15.3
Tier 1 capital/risk-weighted assets	**9.3**	9.9

The banking book risk-weighted assets increased by £23.2 billion, as a result of increased customer lending and acquisitions in Latin America. The increase of £0.6 billion in trading book notional risk-weighted assets arose principally in HongkongBank due to increased customer-driven business volumes in Asian markets.

Deployment of shareholders' funds

The shareholders' funds of HSBC Holdings plc are deployed mainly in investments in its subsidiaries. At 31 December 1997 the major investments of shareholders' funds, compared with the previous year, were:

£m	**1997**	1996
Hang Seng Bank — 62.10% owned (1996: 61.51%)	**2,422**	2,257
HongkongBank and other subsidiaries	**4,722**	4,083
HongkongBank and subsidiaries	**7,144**	6,340
Midland Bank plc	**3,922**	3,491
HSBC Americas, Inc.	**983**	1,102
Hongkong Bank Malaysia Berhad	**251**	335
Hongkong Bank of Canada	**286**	267
The British Bank of the Middle East	**333**	164
HSBC Investment Bank plc	**306**	298
Holding company and non-trading subsidiaries	**758**	2,136
Banco HSBC Bamerindus	**288**	—
Other subsidiaries	**1,905**	803
Associates	**266**	251
	16,442	15,187

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 1997, 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 1997 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.

The increase in shareholders' funds deployed in other subsidiaries and the offsetting reduction in funds deployed within the holding company principally reflect the transfer of Midland's overseas operations to other parts of the Group and investments in other entities in Latin America.

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 Group standards, 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 larger credit exposures; the control of the Group's cross-border exposures as well as those to banks and financial institutions; 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 large credit exposures, 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 24.4 per cent of the overall portfolio, having increased by £9,982 million, or 38 per cent, during 1997. 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 and Marine Midland in the US, the latter mainly as a result of the First Federal acquisition. Loan loss experience in this sector remains very good. Other personal banking advances increased by 18 per cent during 1997, to £17,490 million.

Commercial, industrial and international trade loans increased by £5,251 million, or 16 per cent, to £37,982 million.

Commercial real estate advances increased by £2,669 million, or 21 per cent, to £15,267 million and other property related advances increased by £837 million, or 21 per cent, to £4,907 million.

Advances to financial institutions other than banks increased by £7,234 million, or 126 per cent.

Other commercial advances increased by £3,320 million, or 16 per cent.

Gross loans and advances to customers by industry exposure

	1997		1996	
	£m	**%**	£m	%
Personal banking:				
Residential mortgages	**36,431**	**24.4**	26,449	22.5
Other personal*	**17,490**	**11.7**	14,772	12.6
Total personal banking	**53,921**	**36.1**	41,221	35.1
Commercial:				
Commercial, industrial and international trade	**37,982**	**25.4**	32,731	27.8
Commercial real estate	**15,267**	**10.2**	12,598	10.7
Other property related	**4,907**	**3.3**	4,070	3.5
Non-bank financial institutions	**12,971**	**8.7**	5,737	4.9
Other commercial	**24,416**	**16.3**	21,096	18.0
Total commercial	**95,543**	**63.9**	76,232	64.9
Total	**149,464**	**100.0**	117,453	100.0

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

Bad debt provisions

Total provisions against loans and advances to customers amounted to £3,116 million at 31 December 1997 and represented 2.2 per cent of lending, compared with 2.4 per cent at the end of 1996.

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 £58 million, or 2 per cent, to £3,283 million. Non-performing loans amounted to 2.2 per cent of total loans and advances to customers, compared with 2.9 per cent at the end of December 1996. The decrease in Midland Bank was partly offset by small increases in other Group entities.

Specific provisions against loans and advances to banks of £52,561 million (1996: £49,011 million) amounted to £28 million (1996: £31 million). Non-performing loans to banks remained at £37 million.

Country risk and cross-border exposure (£b)

	Indonesia	South Korea	Thailand
As at 31 December 1997			
In-country local currency obligations	**0.2**	**0.2**	**0.6**
In-country foreign currency obligations	**0.5**	**0.5**	**0.4**
Net cross-border obligations	**0.3**	**1.7**	**0.4**
	0.8	**2.2**	**0.8**
Claims under contracts in financial derivatives	**0.1**	**0.1**	**0.3**
Total	**1.1**	**2.5**	**1.7**

The in-country risk exposure and cross-border exposure figures in the table are for the three Asian countries that are in discussion with the International Monetary Fund. They are prepared in accordance with the Bank of England Country Exposure Report (Form C1) guidelines. On this basis, the figures exclude accrued interest and intra-Group exposures.

Customer loans and advances (£m)	**1997**	1996
Gross loans and advances	**149,464**	117,453
Suspended interest	**(373)**	(334)
	149,091	117,119
Provisions	**(3,116)**	(2,766)
Net loans and advances	**145,975**	114,353

Provisions to customer loans and advances (%)	**1997**	1996
Specific provisions	**1.3**	1.6
General provisions:		
— held against Asian risks	**0.1**	—
— other	**0.8**	0.8
Total provisions	**2.2**	2.4

Non-performing customer loans and provisions (£m)	**1997**	1996
Non-performing loans	**3,283**	3,341
Provisions	**3,116**	2,766
Total provisions cover as a percentage of non-performing loans and advances	**94.7**	82.8

In-country obligations represent local offices' on-balance sheet exposures to local residents.

Net cross-border obligations are on-balance sheet exposures based on the country of residence of the borrower or guarantor of ultimate risk, irrespective of whether such exposures are in local or foreign currency.

Cross-border obligations are controlled centrally through a well-developed system of country limits, which are frequently reviewed to avoid concentrations of transfer, economic or political risks.

Market Risk Management

Market risk

Market risk is the risk that interest rates, foreign exchange rates or equities and commodity prices will move and result in 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, equities 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.

Financial Review *(continued)*

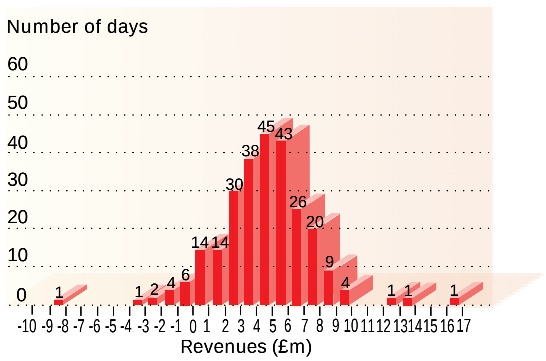
Risk limits are determined for each location and within location, for each portfolio. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set. Only those offices within major subsidiaries with sufficient derivative product expertise 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 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 portfolios caused by movements in market rates and prices. 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.

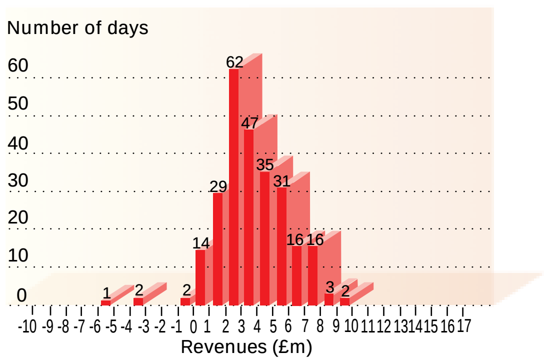
Value at risk measurement techniques have been applied in respect of treasury activities throughout the year.

The average daily revenue earned from market risk-related treasury activities in 1997, including accrual book net interest income and funding related to dealing positions, was £4.3 million compared with £3.7 million in 1996. The standard deviation of these daily revenues was £2.7 million (£2.1 million for 1996). An analysis of the frequency distribution of daily revenues shows a maximum daily loss of £8 million, with only 14 out of 260 days showing losses. The most frequent result was a daily revenue of between £4 million and £5 million, with 45 occurrences. The highest daily revenue was £16 million.

*Daily distribution of market risk revenues **1997***
Group Treasury centres



Daily distribution of market risk revenues 1996
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 1997 was £2.9 million (£2.3 million at 31 December 1996) and the average for 1997 was £3.0 million, with a maximum of £4.7 million and a minimum of £1.8 million in the year. The average one-day foreign exchange trading profit for 1997 was £2.3 million (£1.4 million for 1996). 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. These foreign currency investments amounted to the foreign currency equivalent of £10,906 million (66 per cent of shareholders' funds) at 31 December 1997, an increase from £9,856 million (65 per cent of shareholders' funds) at 31 December 1996. Gains or losses on structural foreign currency exposures are taken to reserves.

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 capital being denominated 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.

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 1997 related to interest rate exposures, including interest rate risk related to accrual book positions, was £16.9 million (£11.2 million at 31 December 1996) and the average for 1997 was £12.2 million, the maximum was £37.9 million and the minimum £6.0 million. The average daily revenues earned from treasury-related interest rate activities for 1997 was £2.0 million (£2.3 million for 1996).

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.

Equities exposure

The Group's equities exposure comprises trading equities forming the basis of value at risk, and long term equities investments. The latter are reviewed annually by the Group Executive Committee and regularly monitored by the subsidiaries' asset and liability management committees.

Value at risk related to equities dealing positions as at 31 December 1997 was £2.1 million.

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.

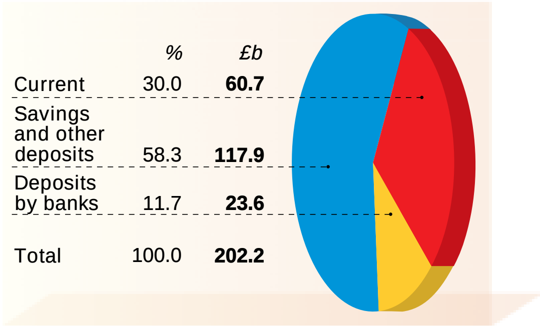
Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of the Group's overall funding. Considerable importance is attached to the stability of this core deposit base, achieved through the Group's diverse geographical retail banking activities. 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 1997, customer accounts totalled £178.6 billion, an increase of 18 per cent from 31 December 1996. Deposits by banks increased by 31 per cent to £23.6 billion at 31 December 1997.

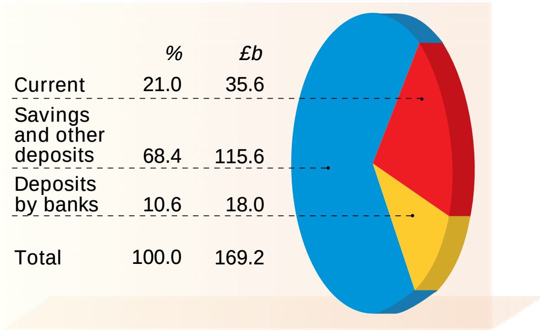
Customer current, deposit and savings accounts accounted for 88.3 per cent of the Group's deposit base at 31 December 1997, compared with 89.4 per cent at 31 December 1996. As at 31 December 1997, 81.7 per cent of the Group's customer accounts were deployed in loans and advances to customers, compared with 75.7 per cent at 31 December 1996.

Cash and balances at central banks, treasury bills and other eligible bills, and loans and advances to banks accounted for 22.6 per cent of total assets and 32.0 per cent of deposits at 31 December 1997, compared with 24.8 per cent and 34.7 per cent, respectively, at 31 December 1996.

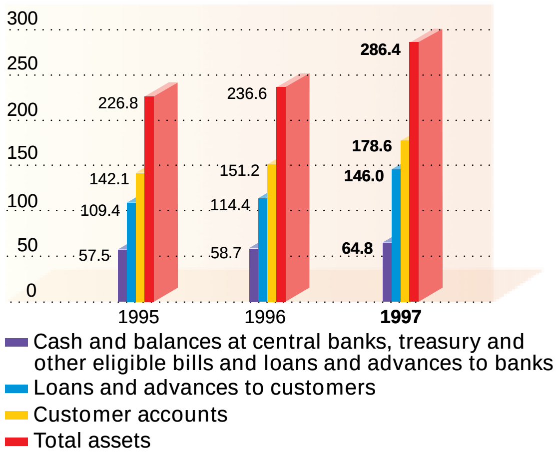
Customer accounts and deposits by banks ***1997***



Customer accounts and deposits by banks 1996



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 1996 and 31 December 1997. Contract amounts shown indicate the volume of transactions outstanding; they do not represent values at risk.

Derivatives contracts with third parties (£m)

	1997		1996	
	Contract amount	Replace-ment cost	Contract amount	Replace-ment cost
Exchange rate contracts	**453,533**	**8,666**	404,332	4,804
Interest rate contracts	**526,136**	**3,143**	481,441	4,325
Equities contracts	**13,336**	**1,225**	6,884	601
Total	**993,005**	**13,034**	892,657	9,730

At 31 December 1997, the total notional principal of outstanding contracts with third parties was £993 billion, compared with a value of £893 billion at 31 December 1996. The net increase of £100 billion, or 11 per cent, is primarily due to a £49 billion increase in exchange rate contracts and a £45 billion rise in interest rate contracts. The increase of £6 billion in equities contracts resulted from increased transaction levels. The increase in exchange rate contracts arose across all types of instruments and is mainly in HSBC MIDLAND in London and in Hong Kong. The most significant growth was noted in forward foreign exchange contracts, resulting from greater activity in Asian currencies, and in increased

	1997			
	Contract amounts		Mark-to-market values*	
Total derivatives contracts outstanding (£m)	Trading*	Non-Trading†	Positive	Negative
Spot and forward foreign exchange	**365,873**	**26,834**	**6,678**	**(6,165)**
Currency swaps, futures and options purchased	**49,329**	**1,606**	**1,933**	**(1,211)**
Currency options written	**33,584**	**—**	**—**	**(751)**
Other contracts	**1,543**	**—**	**55**	**(95)**
Total exchange rate contracts	**450,329**	**28,440**	**8,666**	**(8,222)**
Less: not recognised in the balance sheet			**(29)**	**48**
Balance sheet values			**8,637**	**(8,174)**
Interest rate swaps	**267,488**	**53,030**	**2,706**	**(2,845)**
Interest rate futures, forward rate agreements and options purchased	**197,654**	**6,103**	**437**	**(67)**
Interest rate options written	**37,836**	**—**	**—**	**(299)**
Total interest rate contracts	**502,978**	**59,133**	**3,143**	**(3,211)**
Less: not recognised in the balance sheet			**(104)**	**105**
Balance sheet values			**3,039**	**(3,106)**
Equities, futures and options purchased	**5,172**	**394**	**1,224**	**(2)**
Equities options written	**7,602**	**—**	**—**	**(1,336)**
Other contracts	**444**	**—**	**1**	**(185)**
Total equities contracts	**13,218**	**394**	**1,225**	**(1,523)**
Less: not recognised in the balance sheet			**(1)**	**—**
Balance sheet values			**1,224**	**(1,523)**

* *Third party only.*
† *Including internal deals.*

currency options business in London. The rise in interest rate contracts relates primarily to interest rate futures used to hedge interest rate swaps and increased volume of interest rate swaps.

The replacement cost amount increased from £10 billion at 31 December 1996 to £13 billion at 31 December 1997. £4 billion of this increase related to exchange rate contracts, reflecting increased business in forward foreign exchange contracts in Asia and higher Asian currency volatility. Other significant factors in the overall rise were noted in currency swaps and equity options purchased, where the rise in the replacement cost arose from market volatility. The £1 billion fall in the positive mark-to-market value of interest rate contracts reflects the effect of increased netting of £750 million in HSBC MIDLAND London and a reduction in the mark-to-market value of interest rate swaps in London due to interest rate movements.

The table at the bottom of the previous page provides an analysis of derivatives by product at 31 December 1997, 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. The mark-to-market values are amounts outstanding on contracts with third parties that are included within the balance sheet under 'Other assets' and 'Other liabilities'.

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 third party exchange rate, interest rate and equities contracts with positive mark-to-market gains, after netting where possible, by maturity and by category of counterparty at 31 December 1997 and 31 December 1996. The table shows that the replacement cost of derivatives is predominantly with banks and under five years.

	Residual maturity				
	1997				1996
£m	Less than 1 year	1-5 years	Over 5 years	Total	Total
Governments	**45**	**42**	**30**	**117**	40
Banks	**6,974**	**2,479**	**601**	**10,054**	7,751
Non-bank financial institutions					
— exchanges*	**62**	**8**	**—**	**70**	35
— other	**944**	**291**	**82**	**1,317**	326
Other sectors	**997**	**331**	**148**	**1,476**	1,578
Total **1997**	**9,022**	**3,151**	**861**	**13,034**	
Total 1996	5,594	3,077	1,059		9,730

** Exchanges with margining requirements.*

£m	1997 Less than 1 year	1997 1-5 years	1997 Over 5 years	1997 Total	1996 Total
Exchange rate, interest rate and equities contracts					
— exchanges*	**73,481**	**21,782**	**30**	**95,293**	58,056
— other contracts	**663,690**	**192,818**	**41,204**	**897,712**	834,601
Total	**737,171**	**214,600**	**41,234**	**993,005**	
Total 1996	671,880	188,414	32,363		892,657

** Exchanges with margining requirements.*

The maturity profile of the notional principal values of third party derivative contracts outstanding as at 31 December 1997 and 31 December 1996 above shows that the vast majority of contracts are executed over the counter and mature within one year.

Financial Reporting

The accounting policies used in the preparation of the 1997 financial accounts are consistent with the previous year.

During the year, the Group adopted the guidance issued by the Accounting Standards Board on the application of the Statement of Standard Accounting Practice ('SSAP') 8, 'The treatment of taxation under the imputation system in the accounts of companies', to the presentation of dividend income following the corporation tax changes enacted in the Finance (No. 2) Act 1997. Accordingly, from July 1997, for financial traders and other entities taxed on the cash dividend received as trading income, dividend income is no longer grossed up for any tax credit.

Since the US dollar and currencies closely linked to it form the main currency bloc in which the Group's business is transacted, the Group will report its results in US dollars commencing in 1998. Sterling and Hong Kong dollar equivalent figures will be given for the profit and loss account and balance sheet for information only.

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 below, 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 49 to 92, 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 — 23 February 1998
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 49 to 92. We have also examined the amounts disclosed relating to emoluments, share options, Restricted Share Plan awards and pension entitlements of the Directors, which form part of the 'Report of the Directors' on pages 26 to 29.

Respective responsibilities of Directors and Auditors
As described above, 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 1997 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 — 23 February 1998
Chartered Accountants/Registered Auditor
London

Consolidated Profit and Loss Account for the Year Ended 31 December 1997

1996 £m		Note	1997 £m	1997 *HK$m*	1997 *US$m*
	Interest receivable				
	— interest receivable and similar				
1,770	income arising from debt securities		**2,062**	*26,152*	*3,378*
	— other interest receivable and				
12,525	similar income		**15,433**	*195,737*	*25,279*
(8,474)	Interest payable		**(10,815)**	*(137,167)*	*(17,715)*
5,821	**Net interest income**		**6,680**	*84,722*	*10,942*
103	Dividend income	*3*	**95**	*1,205*	*156*
3,171	Fees and commissions receivable		**4,041**	*51,252*	*6,619*
(419)	Fees and commissions payable		**(702)**	*(8,903)*	*(1,150)*
515	Dealing profits		**605**	*7,673*	*991*
397	Other operating income		**640**	*8,117*	*1,048*
9,588	**Operating income**	*5*	**11,359**	*144,066*	*18,606*
	— continuing operations		**10,358**		
	— acquisitions		**1,001**		
(4,702)	Administrative expenses	*4,5*	**(5,697)**	*(72,255)*	*(9,332)*
(367)	Depreciation and amortisation	*20*	**(440)**	*(5,581)*	*(720)*
4,519	**Operating profit before provisions**		**5,222**	*66,230*	*8,554*
	Provisions				
(384)	— provisions for bad and doubtful debts	*14*	**(615)**	*(7,800)*	*(1,007)*
	— provisions for contingent liabilities				
(7)	and commitments	*27*	**(34)**	*(431)*	*(56)*
	Amounts written off fixed				
(48)	asset investments		**(29)**	*(368)*	*(48)*
4,080	**Operating profit**	*5*	**4,544**	*57,631*	*7,443*
	— continuing operations		**4,400**		
	— acquisitions		**144**		
	Gains on disposal of				
323	— investments		**341**	*4,324*	*559*
33	— tangible fixed assets		**17**	*216*	*28*
88	Income from associated undertakings		**69**	*875*	*113*
4,524	**Profit on ordinary activities before tax**	*5*	**4,971**	*63,046*	*8,143*
(1,073)	Tax on profit on ordinary activities	*6*	**(1,258)**	*(15,955)*	*(2,061)*
3,451	**Profit on ordinary activities after tax**		**3,713**	*47,091*	*6,082*
	Minority interests				
(298)	— equity		**(313)**	*(3,970)*	*(513)*
(41)	— non-equity		**(45)**	*(571)*	*(74)*
	Profit for the financial year				
3,112	**attributable to shareholders**		**3,355**	*42,550*	*5,495*
(1,090)	Dividends	*8*	**(1,337)**	*(16,957)*	*(2,190)*
2,022	**Retained profit for the year**		**2,018**	*25,593*	*3,305*
Pence			**Pence**	*HK$*	*US$*
117.61	**Earnings per ordinary share**	*9*	**125.70**	*15.94*	*2.06*
115.42	**Headline earnings per ordinary share**	*9*	**124.96**	*15.85*	*2.05*
41.00	**Dividends per ordinary share**	*8*	**50.00**	*6.34*	*0.82*

Movements in reserves are set out in Note 31.

Consolidated Balance Sheet at 31 December 1997

1996 £m		Note	**1997 £m**	*1997 HK$m*	*1997 US$m*
	ASSETS				
1,814	Cash and balances at central banks		**1,798**	*22,944*	*2,961*
2,653	Items in the course of collection from other banks		**3,442**	*43,923*	*5,669*
7,944	Treasury bills and other eligible bills	*10*	**10,433**	*133,136*	*17,183*
4,731	Hong Kong SAR Government certificates of indebtedness	*11*	**4,944**	*63,084*	*8,143*
48,980	Loans and advances to banks	*12*	**52,533**	*670,374*	*86,522*
114,353	Loans and advances to customers	*13*	**145,975**	*1,862,787*	*240,421*
29,550	Debt securities	*16*	**33,858**	*432,062*	*55,764*
1,676	Equity shares	*17*	**1,960**	*25,012*	*3,228*
519	Interests in associated undertakings	*18*	**546**	*6,968*	*899*
43	Other participating interests	*19*	**194**	*2,476*	*320*
6,238	Tangible fixed assets	*20*	**7,914**	*100,991*	*13,034*
15,878	Other assets	*22*	**20,191**	*257,658*	*33,255*
2,174	Prepayments and accrued income		**2,603**	*33,221*	*4,287*
236,553	Total assets		**286,391**	*3,654,636*	*471,686*
	LIABILITIES				
4,735	Hong Kong SAR currency notes in circulation	*11*	**4,944**	*63,084*	*8,143*
18,030	Deposits by banks	*23*	**23,647**	*301,759*	*38,947*
151,149	Customer accounts	*24*	**178,621**	*2,279,383*	*294,189*
1,573	Items in the course of transmission to other banks		**2,456**	*31,341*	*4,045*
10,040	Debt securities in issue	*25*	**16,846**	*214,972*	*27,745*
24,894	Other liabilities	*26*	**30,162**	*384,903*	*49,676*
1,997	Accruals and deferred income		**2,830**	*36,114*	*4,661*
	Provisions for liabilities and charges	*27*			
393	— deferred taxation		**570**	*7,274*	*939*
455	— other provisions for liabilities and charges		**1,295**	*16,525*	*2,133*
	Subordinated liabilities	*28*			
1,768	— undated loan capital		**1,970**	*25,139*	*3,245*
4,207	— dated loan capital		**4,421**	*56,416*	*7,281*
	Minority interests				
1,599	— equity		**1,671**	*21,324*	*2,752*
526	— non-equity	*29*	**516**	*6,585*	*850*
2,014	Called up share capital	*30*	**2,068**	*26,390*	*3,406*
299	Share premium account	*31*	**297**	*3,790*	*489*
26	Reserves	*31*	**—**	*—*	*—*
2,697	Revaluation reserves	*31*	**2,588**	*33,025*	*4,262*
10,151	Profit and loss account	*31*	**11,489**	*146,612*	*18,923*
15,187	Shareholders' funds		**16,442**	*209,817*	*27,080*
236,553	Total liabilities		**286,391**	*3,654,636*	*471,686*
	MEMORANDUM ITEMS				
	Contingent liabilities	*33*			
2,162	— acceptances and endorsements		**2,923**	*37,300*	*4,814*
14,389	— guarantees and assets pledged as collateral security		**12,485**	*159,321*	*20,563*
167	— other contingent liabilities		**63**	*804*	*104*
16,718			**15,471**	*197,425*	*25,481*
72,001	Commitments	*33*	**82,749**	*1,055,960*	*136,288*

W Purves, *Group Chairman*

Company Balance Sheet at 31 December 1997

1996 £m		Note	1997 £m	1997 HK$m	1997 US$m
	FIXED ASSETS				
9	Tangible assets	20	**3**	*38*	*5*
	Investments	21			
14,230	— shares in Group undertakings		**15,650**	*199,709*	*25,776*
912	— loans to Group undertakings		**443**	*5,653*	*730*
244	— other investments other than loans		**243**	*3,101*	*400*
15,395			**16,339**	*208,501*	*26,911*
	CURRENT ASSETS				
	Debtors				
1,851	— money market deposits with Group undertakings		**1,451**	*18,516*	*2,390*
659	— other amounts owed by Group undertakings		**1,240**	*15,824*	*2,042*
222	— amounts owed by Group undertakings (falling due after more than 1 year)		**222**	*2,833*	*366*
6	— other debtors		**4**	*51*	*7*
2,738			**2,917**	*37,224*	*4,805*
	Cash at bank and in hand				
144	— balances with Group undertakings		**252**	*3,216*	*415*
2,882			**3,169**	*40,440*	*5,220*
	CREDITORS: amounts falling due within one year				
(807)	Amounts owed to Group undertakings		**(659)**	*(8,409)*	*(1,085)*
(118)	Other creditors		**(119)**	*(1,519)*	*(196)*
(259)	Taxation		**(323)**	*(4,122)*	*(532)*
(693)	Proposed dividend	8	**(803)**	*(10,247)*	*(1,323)*
(1,877)			**(1,904)**	*(24,297)*	*(3,136)*
1,005	**NET CURRENT ASSETS**		**1,265**	*16,143*	*2,084*
16,400	**TOTAL ASSETS LESS CURRENT LIABILITIES**		**17,604**	*224,644*	*28,995*
	CREDITORS: amounts falling due after more than one year				
	Subordinated liabilities	28			
(806)	— owed to third parties		**(811)**	*(10,348)*	*(1,336)*
(205)	— owed to Group undertakings		**(211)**	*(2,693)*	*(348)*
(133)	Amounts owed to Group undertakings		**(133)**	*(1,697)*	*(219)*
	PROVISIONS FOR LIABILITIES AND CHARGES				
(69)	Deferred taxation	27	**(7)**	*(89)*	*(12)*
15,187	**NET ASSETS**		**16,442**	*209,817*	*27,080*
	CAPITAL AND RESERVES				
2,014	Called up share capital	30	**2,068**	*26,390*	*3,406*
299	Share premium account	31	**297**	*3,790*	*489*
9,783	Revaluation reserve	31	**11,191**	*142,809*	*18,432*
3,091	Profit and loss account	31	**2,886**	*36,828*	*4,753*
15,187			**16,442**	*209,817*	*27,080*

W Purves, *Group Chairman*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 1997

	1997	1996
	£m	£m
Profit for the financial year attributable to shareholders	**3,355**	*3,112*
Unrealised (deficit)/surplus on revaluation of investment properties		
— subsidiaries	**(2)**	*9*
— associates	**8**	*12*
Unrealised (deficit)/surplus on revaluation of land and buildings (excluding investment properties)	**(67)**	*639*
Exchange and other movements	**(183)**	*(960)*
Total recognised gains and losses for the year	**3,111**	*2,812*

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 1997

	1997	1996
	£m	£m
Profit for the financial year attributable to shareholders	**3,355**	*3,112*
Dividends	**(1,337)**	*(1,090)*
	2,018	*2,022*
Other recognised gains and losses relating to the year	**(244)**	*(300)*
New share capital subscribed	**10**	*13*
Arising on shares issued in lieu of dividends	**206**	*190*
Goodwill written back on disposal	**—**	9
Goodwill on acquisition of subsidiary and associated undertakings	**(735)**	*(134)*
Net addition to shareholders' funds	**1,255**	*1,800*
Shareholders' funds at 1 January	**15,187**	*13,387*
Shareholders' funds at 31 December	**16,442**	*15,187*

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 1997

	Note	1997 £m	1996 £m
Net cash inflow from operating activities	*34*	**8,726**	*8,787*
Returns on investments and servicing of finance:			
Dividends received from associated undertakings		**39**	*49*
Interest paid on finance leases and similar hire purchase contracts		**(18)**	*(13)*
Interest paid on subordinated loan capital		**(442)**	*(385)*
Dividends paid to minority interests			
— equity		**(192)**	*(226)*
— non-equity		**(40)**	*(32)*
Net cash (outflow) from returns on investments and servicing of finance		**(653)**	*(607)*
Taxation paid		**(897)**	*(713)*
Capital expenditure and financial investment:			
Purchase of investment securities		**(19,307)**	*(13,486)*
Proceeds from sale of investment securities		**18,182**	*10,615*
Purchase of tangible fixed assets		**(826)**	*(651)*
Proceeds of sale of tangible fixed assets		**207**	*167*
Net cash (outflow) from capital expenditure and financial investments		**(1,744)**	*(3,355)*
Acquisitions and disposals			
Net cash (outflow) from acquisition of and increase in stake in subsidiary undertakings		**(573)**	*(29)*
Net cash inflow from disposal of subsidiary undertakings		**18**	*33*
Purchase of interest in associated undertakings and other participating interests		**(74)**	*(53)*
Proceeds from disposal of associated undertakings and other participating interests		**15**	*87*
Net cash (outflow)/inflow from acquisitions and disposals		**(614)**	*38*
Equity dividends paid		**(1,021)**	*(807)*
Net cash inflow before financing		**3,797**	*3,343*
Financing:			
Issue of ordinary share capital		**10**	*13*
Issue of preference share capital		**30**	*124*
Redemption of preference share capital		**(60)**	—
Subordinated loan capital issued		**453**	*1,005*
Subordinated loan capital repaid		**(195)**	*(90)*
Net cash inflow from financing	*35*	**238**	*1,052*
Increase in cash	*36*	**4,035**	*4,395*

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 has adopted the guidance issued by the Accounting Standards Board on the application of the Statement of Standard Accounting Practice ('SSAP') 8, 'The treatment of taxation under the imputation system in the accounts of companies', to the presentation of dividend income following the corporation tax changes enacted in the Finance (No. 2) Act 1997. Accordingly, from July 1997, for financial traders and other entities taxed on the cash dividend received as trading income, dividend income is no longer grossed up for any tax credit.

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 Hongkong Bank of Canada, which has a 31 October year-end. In the case of the principal banking and insurance subsidiaries of HSBC Roberts, whose accounts are made up to 30 June annually to comply with local regulations, the Group uses audited interim accounts, drawn up to 31 December annually. 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.

Within these accounts, the Hong Kong Special Administrative Region of China has been referred to as 'Hong Kong'.

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 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 'Gains on disposal of 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'.

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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 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 their net assets.

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.

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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.

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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.

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.

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.

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.

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

	1997 £m	1996 £m
Income from equity shares	**90**	98
Income from participating interests other than associated undertakings	**5**	5
	95	103

4 Administrative expenses

a

	1997 £m	1996 £m
Staff costs		
— wages and salaries	**3,137**	2,663
— social security costs	**224**	138
— other pension costs (Note 4b below)	**299**	268
	3,660	3,069
Premises and equipment (excluding depreciation)	**760**	652
Other administrative expenses	**1,277**	981
	5,697	4,702

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

	1997 Number	1996 Number
Commercial banking	**126,554**	103,542
Investment banking	**6,415**	5,756
	132,969	109,298

b *Retirement benefits*

The Group operates some 114 pension schemes throughout the world, covering 87% of the Group's employees, with a total pension cost of £299 million (1996: £268 million), of which £136 million (1996: £145 million) relates to overseas schemes. Of the overseas schemes, £21 million (1996: £17 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 75% 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 £253 million (1996: £252 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.

In the UK, the Midland Bank Pension Scheme covers employees of Midland Bank and certain other employees of the Group. This scheme comprises a funded defined benefit scheme ('the Principal Scheme') and a defined contribution scheme which was established on 1 July 1996 for new employees. The latest valuation of the Principal Scheme was made at 31 December 1996 by C G Singer, Fellow of the Institute of Actuaries, of Watson Wyatt Partners. At that date, the market value of the Principal Scheme's assets was £4,463 million. The actuarial value of the assets represented 107% of the benefits accrued to members, after allowing for expected future increases in earnings, and the resulting surplus amounted to £301 million. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 7.6% per annum, salary increases of 4.5% per annum, equity dividend increases and rental growth of 3.5% per annum, and post-retirement pension increases of 3.0% per annum.

4 Administrative expenses *(continued)*

As a result of the Finance (No. 2) Act 1997, which came into force in July 1997, pension schemes are no longer able to claim a tax credit on UK equity dividend income. The actuaries have estimated that the effect on the Principal Scheme will be largely to offset the surplus shown by the 31 December 1996 valuation and this has been accounted for over the average remaining service lives of the employees in the Principal Scheme in accordance with Urgent Issues Task Force Abstract number 18.

In consultation with the actuaries, it has been decided to maintain contributions at 16.1% of pensionable salaries until the next actuarial valuation. The next actuarial valuation is due as at 31 December 1999.

For the principal non-UK scheme, The Hongkong and Shanghai Banking Corporation Limited Local Staff Retirement Benefits Scheme, the latest valuation was made at 31 December 1997 and was performed by E Chiu, Fellow of the Society of Actuaries of the United States of America, of HSBC Life (International) Limited, a subsidiary of the Group. At that date, the market value of the scheme's assets was £326 million. On an ongoing basis, the actuarial value of the scheme's assets represented 92% of the benefits accrued to members, after allowing for expected future increases in salaries, and the resulting deficit amounted to £27 million. On a wind-up basis, the actuarial value of the scheme's assets represents 103% of the members' vested benefits, based on current salaries, and the resulting surplus amounted to £9 million. The actuarial method used is the projected unit credit 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 Local Staff Retirement Benefits Scheme cover 40% (1996: 48%) of the Group's employees.

The pension cost for defined contribution schemes, which cover 12% (1996: 9%) of the Group's employees, was £22 million (1996: £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 £24 million for the year (1996: £23 million). The latest actuarial review as at 31 December 1997 estimated the present value of the accumulated post-retirement benefit obligation at £170 million (1996: £188 million), of which £91 million (1996: £76 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 1997 are price inflation at 3% per annum, health-care claims cost escalation of 8.5% per annum and a discount rate of 7% per annum.

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:

	1997	1996
	£000	£000
Fees	**473**	452
Salaries and other emoluments	**3,105**	3,220
Discretionary bonuses	**635**	585
	4,213	4,257
Gains on the exercise of share options	**113**	100

In addition, there were annual commitments under retirement benefit agreements with former Directors of £103,509 (1996: £143,000). The provision as at 31 December 1997 in respect of unfunded pension obligations to a former Director amounted to £1,656,500 (1996: £1,496,000).

During the year, aggregate contributions to pension schemes in respect of Directors were £178,000 (1996: £187,000).

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 31). The cost of the conditional awards is recognised through an annual charge based on the likely level of vesting of shares, apportioned over the period of service to which the award relates.

4 Administrative expenses *(continued)*

Four Directors waived the right to receive emoluments totalling £95,000 (1996: five Directors £83,000). Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 29.

d *Auditors' remuneration*

Auditors' remuneration amounted to £10.9 million (1996: £9.7 million). In addition, £12.5 million (1996: £4.2 million) was paid by Group companies to the auditors and their associates for non-audit work as analysed below:

	1997	1996
	£m	£m
Regulatory work	**2.1**	1.7
Tax services	**1.3**	0.7
Consultancy	**1.5**	0.8
Acquisition services	**6.7**	—
Other	**0.9**	1.0
	12.5	4.2

In 1997, the auditors provided extensive support in the due diligence and integration of Banco HSBC Bamerindus S.A. The cost of this support constituted substantially all of the amount disclosed above under 'Acquisition services'.

Of fees paid to auditors for non-audit work, £4.9 million were capitalised as part of the cost of acquisitions made during 1997.

5 Profit on ordinary activities before tax

a Profit on ordinary activities before tax is stated after:	**1997**	1996
	£m	£m
i *Income*		
Aggregate rentals receivable, including capital repayments, under		
— finance leases	**2,307**	2,019
— operating leases	**253**	133
Income from listed investments	**1,201**	1,408
Profits less losses on debt securities and equities dealing	**(53)**	121
Gains on disposal of investment securities	**333**	246
ii *Charges*		
Charges incurred with respect to subordinated liabilities	**460**	426
Finance charges in respect of finance leases and similar hire purchase contracts	**16**	10
Hire of plant and machinery	**46**	59
Rentals payable on premises held under operating leases	**266**	252

Gains on the disposal of investments and tangible fixed assets attracted a tax charge of £57 million (1996: £43 million). Of the after tax amount, £19 million (1996: £15 million) is attributable to minority interests.

Notes on the Accounts *(continued)*

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

b The impact of acquisitions on operating profit was as follows:

	1997
	£m
Operating income	**1,001**
Administrative expenses	**(786)**
Depreciation and amortisation	**(44)**
	171
Provisions	
— provisions for bad and doubtful debts	**(25)**
— provisions for contingent liabilities and commitments	**(2)**
Operating profit	**144**

6 Tax on profit on ordinary activities

The charge for taxation comprises:	**1997**	1996
	£m	£m
United Kingdom corporation tax charge	**587**	513
Relief for overseas taxation	**(91)**	(107)
	496	406
Overseas taxation	**678**	598
Deferred taxation (Note 27)	**79**	58
	1,253	1,062
Associated undertakings	**5**	11
	1,258	1,073

The Company and its subsidiary undertakings in the UK provide for UK corporation tax at 31.5% (1996: 33%). Overseas tax includes Hong Kong profits tax of £266 million (1996: £250 million). Subsidiary undertakings in Hong Kong provide for Hong Kong profits tax at the rate of 16.5% (1996: 16.5%) on the profits for the year assessable in Hong Kong. Other overseas subsidiary undertakings and overseas branches provide for taxation at the appropriate rates in the countries in which they operate.

7 Profit of the Company

The profit of the Company for the year is £926 million (1996: £807 million).

8 Dividends

	1997		1996	
	Pence per share	**£m**	Pence per share	£m
First interim	**20.00**	**534**	15.00	397
Second interim	**30.00**	**803**	26.00	693
	50.00	**1,337**	41.00	1,090

Of the first interim dividend for 1997, £76 million (1996: £89 million) was settled by the issue of shares. Of the second interim dividend for 1996, £130 million (1995 final dividend: £101 million) was settled by the issue of shares in 1997.

9 Earnings per ordinary share

Earnings per ordinary share is calculated by dividing the earnings of £3,355 million (1996: £3,112 million) by the weighted average number of ordinary shares in issue in 1997 of 2,669 million (1996: 2,646 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:

	1997	1996
	Pence	Pence
Earnings per ordinary share	**125.70**	117.61
Adjustments:		
Profit on sale of tangible fixed assets	**(0.64)**	(1.06)
Profit on disposal of subsidiary undertaking	**(0.22)**	(1.10)
Profit on sale of interest in associated undertaking	**(0.07)**	(1.47)
Provision for permanent diminution in value of other participating interests	**0.19**	1.44
Headline earnings per ordinary share	**124.96**	115.42

10 Treasury bills and other eligible bills

	1997	1996
	£m	£m
Treasury bills and similar securities	**8,403**	6,755
Other eligible bills	**2,030**	1,189
	10,433	7,944

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

11 Hong Kong SAR currency notes in circulation

	1997	1996
	£m	£m
Authorised note issue	**—**	4
Excess note issue (HK$63,084 million)	**4,944**	4,731
	4,944	4,735

In 1996, the authorised note issue was secured by the deposit of investments having a market value of HK$70 million. In 1997, the entire note issue and in 1996, the excess note issue, was secured by the deposit of funds in respect of which the Government of the Hong Kong Special Administrative Region certificates of indebtedness are held.

12 Loans and advances to banks

	1997	1996
	£m	£m
Remaining maturity		
— repayable on demand	**10,806**	7,066
— 3 months or less but not repayable on demand	**38,483**	36,775
— 1 year or less but over 3 months	**2,307**	3,748
— 5 years or less but over 1 year	**427**	421
— over 5 years	**538**	1,001
Specific bad and doubtful debt provisions (Note 14)	**(28)**	(31)
	52,533	48,980

12 Loans and advances to banks *(continued)*

	1997 £m	1996 £m
Amounts include:		
Due from associated undertakings		
— unsubordinated	**19**	62

13 Loans and advances to customers

	1997 £m	1996 £m
Remaining maturity		
— repayable on demand or at short notice	**22,101**	32,548
— 3 months or less but not repayable on demand or at short notice	**29,353**	9,212
— 1 year or less but over 3 months	**18,517**	13,425
— 5 years or less but over 1 year	**41,219**	32,481
— over 5 years	**37,901**	29,453
General and specific bad and doubtful debt provisions (Note 14)	**(3,116)**	(2,766)
	145,975	114,353
Amounts include:		
Subordinated	**80**	68
Securitised advances not qualifying for linked presentation under Financial Reporting Standard ('FRS') 5	**92**	117
Due from associated undertakings		
— unsubordinated	**211**	132
Due from other undertakings in which the Group has a participating interest		
— unsubordinated	**—**	3

14 Provisions for bad and doubtful debts

	Provisions against advances			*Suspended*
	Specific	*General*	*Total*	*interest*
	£m	**£m**	**£m**	**£m**
At 1 January 1997	**1,873**	**924**	**2,797**	**394**
Amounts written off	**(457)**	**—**	**(457)**	**(46)**
Recoveries of advances written off in previous years	**105**	**—**	**105**	**—**
Charge to profit and loss account	**324**	**291**	**615**	**—**
Interest suspended during the year	**—**	**—**	**—**	**154**
Suspended interest recovered	**—**	**—**	**—**	**(61)**
Exchange and other movements	**72**	**12**	**84**	**(15)**
At 31 December 1997	**1,917**	**1,227**	**3,144**	**426**

Included in:	
Loans and advances to banks (Note 12)	**28**
Loans and advances to customers (Note 13)	**3,116**
	3,144

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

	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

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

	1997	1996
	£m	£m
Gross	**1,967**	1,991
Net of specific provisions	**732**	777

15 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 1997	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Residential mortgages	**11,561**	**56**	**14,792**	**1,356**	**8,666**	**36,431**
Other personal	**5,712**	**503**	**5,463***	**1,935**	**3,877**	**17,490**
Commercial, industrial and international trade	**15,766**	**1,403**	**7,254**	**8,782**	**4,777**	**37,982**
Commercial real estate	**3,483**	**216**	**6,329**	**2,222**	**3,017**	**15,267**
Other property related	**1,096**	**132**	**1,560**	**1,067**	**1,052**	**4,907**
Non-bank financial institutions	**3,142**	**239**	**3,208**	**991**	**5,391**	**12,971**
Other commercial	**9,719**	**1,648**	**4,828**	**3,436**	**4,785**	**24,416**
	50,479	**4,197**	**43,434**	**19,789**	**31,565**	**149,464**

Notes on the Accounts *(continued)*

15 Concentrations of exposure *(continued)*

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

* *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.

16 Debt securities

	1997		1996	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	£m	£m
Issued by public bodies				
Investment securities				
— government securities	**9,439**	**9,549**	8,602	8,675
— other public sector securities	**613**	**623**	689	702
	10,052	**10,172**	9,291	9,377
Other securities				
— government securities	**4,984**		4,859	
— other public sector securities	**451**		213	
	15,487		14,363	
Issued by other bodies				
Investment securities				
— bank and building society certificates of deposit	**2,311**	**2,350**	1,597	1,596
— other debt securities	**4,405**	**4,379**	4,403	4,495
	6,716	**6,729**	6,000	6,091
Other securities				
— bank and building society certificates of deposit	**6,426**		3,578	
— other debt securities	**5,229**		5,609	
	18,371		15,187	
	33,858		29,550	

16 Debt securities *(continued)*

	1997		1996	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	£m	£m
Due within 1 year	**15,427**		9,954	
Due 1 year and over	**18,431**		19,596	
	33,858		29,550	
Amounts include:				
Subordinated debt securities	**77**		134	
Unamortised net (discounts) on investment securities	**(17)**		(19)	
Investment securities				
— listed on a recognised UK exchange	**3,665**	**3,682**	4,023	4,028
— listed in Hong Kong	**292**	**283**	386	390
— listed elsewhere	**5,243**	**5,361**	5,352	5,463
— unlisted	**7,568**	**7,575**	5,530	5,587
	16,768	**16,901**	15,291	15,468
Other debt securities				
— listed on a recognised UK exchange	**1,859**		1,795	
— listed in Hong Kong	**390**		184	
— listed elsewhere	**6,347**		6,335	
— unlisted	**8,494**		5,945	
	33,858		29,550	

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 £16,855 million (1996: £15,435 million).

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
At 1 January 1997	**15,309**	**(18)**	**15,291**
Additions	**19,237**	**—**	**19,237**
Acquisitions of subsidiaries	**506**	**—**	**506**
Disposals and amounts repaid	**(17,651)**	**—**	**(17,651)**
Transfers	**7**	**—**	**7**
Provisions made	**—**	**(6)**	**(6)**
Amortisation of discounts and premiums	**22**	**—**	**22**
Exchange movements	**(636)**	**(2)**	**(638)**
At 31 December 1997	**16,794**	**(26)**	**16,768**

Notes on the Accounts *(continued)*

17 Equity shares

	1997		1996	
	Book value	*Market valuation*	*Book value*	*Market valuation*
	£m	**£m**	£m	£m
Investment securities				
— listed on a recognised UK exchange	**27**	**81**	47	104
— listed in Hong Kong	**216**	**423**	261	695
— listed elsewhere	**125**	**231**	181	257
— unlisted	**266**	**354**	268	421
	634	**1,089**	757	1,477
Other securities				
— listed on a recognised UK exchange	**672**		549	
— listed in Hong Kong	**49**		77	
— listed elsewhere	**499**		269	
— unlisted	**106**		24	
	1,960		1,676	

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 249,440 (1996: 907,712) shares in the Company held by subsidiary undertakings as equity market-makers.

Investment securities:

	Cost	*Provisions*	*Book value*
	£m	**£m**	**£m**
At 1 January 1997	**820**	**(63)**	**757**
Additions	**70**	**—**	**70**
Acquisitions of subsidiaries	**80**	**—**	**80**
Disposals	**(204)**	**6**	**(198)**
Other transfers	**(35)**	**1**	**(34)**
Provisions made	**—**	**(28)**	**(28)**
Provisions released	**—**	**10**	**10**
Provisions written off	**(1)**	**1**	**—**
Exchange movements	**(21)**	**(2)**	**(23)**
At 31 December 1997	**709**	**(75)**	**634**

18 Interests in associated undertakings

	1997
	£m
At 1 January 1997	**519**
Additions	**12**
Acquisitions of subsidiaries	**28**
Retained profits	**17**
Disposals	**(10)**
Transfer to subsidiaries	**(51)**
Transfer from subsidiaries	**8**
Surplus on revaluation of property	**14**
Exchange and other movements	**9**
At 31 December 1997	**546**

18 Interests in associated undertakings *(continued)*

		1997	1996
		£m	£m
a	Shares in banks	**341**	361
	Other	**205**	158
		546	519
	Listed shares (all listed outside the UK and Hong Kong)	**248**	224
	Unlisted shares	**298**	295
		546	519

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*
Barrowgate Limited	31.12.97	Hong Kong	Property	25%	*
British Arab Commercial Bank Limited	31.12.97	England	Banking	47%	US$81m £32m fully paid, £5m nil paid
The Cyprus Popular Bank Limited	31.12.97	Cyprus	Banking	22%	C£75m
Egyptian British Bank S.A.E.	31.12.97	Egypt	Banking	40%	E£101m
Máxima S.A. A.F.J.P.	30.6.97	Argentina	Pension fund management	35%	ARS98m
Mondex UK Limited	31.12.97	England	Electronic cash	50%	†
The Saudi British Bank	31.12.97	Saudi Arabia	Banking	40%	SR1,250m
Wells Fargo HSBC Trade Bank, N.A.	31.12.97	United States	Trade finance	20%	¶
World Finance International Limited	30.6.97	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 which operates 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; Barrowgate Limited which has HK$845 million of loan capital in which the Group has a 25% interest; and The Cyprus Popular Bank Limited which has issued C£15 million of convertible debentures in which the Group has a 43.5% 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. The Group has a 40% economic interest in Wells Fargo HSBC Trade Bank, N.A. by virtue of the joint agreement under which the Group's equity capital and preferred stock interests are held.

Notes on the Accounts *(continued)*

19 Other participating interests

	1997	1996
	£m	£m
Listed other than on a recognised UK exchange or in Hong Kong	**3**	3
Unlisted	**191**	40
	194	43
Market value of listed securities	**5**	6
Other participating interests in banks	**177**	24

	Cost	*Provisions*	*Carrying value*
	£m	**£m**	**£m**
At 1 January 1997	**95**	**(52)**	**43**
Additions	**157**	**—**	**157**
Acquisitions of subsidiaries	**4**	**—**	**4**
Disposals	**(3)**	**—**	**(3)**
Provisions made	**—**	**(5)**	**(5)**
Provisions written off	**(38)**	**38**	**—**
Exchange and other movements	**(3)**	**1**	**(2)**
At 31 December 1997	**212**	**(18)**	**194**

20 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 1997	**1,151**	**3,316**	**1,031**	**1,847**	**512**	**7,857**
Additions	**92**	**8**	**74**	**398**	**254**	**826**
Acquisitions of subsidiaries	**256**	**—**	**3**	**93**	**1,458**	**1,810**
Disposals	**(35)**	**(41)**	**(33)**	**(144)**	**(173)**	**(426)**
Reclassifications	**—**	**(845)**	**747**	**98**	**—**	**—**
Transfer of accumulated depreciation arising on revaluation	**(23)**	**(9)**	**(51)**	**—**	**—**	**(83)**
Surplus/(deficit) on revaluation	**22**	**(155)**	**58**	**—**	**—**	**(75)**
Exchange and other movements	**(50)**	**106**	**35**	**(59)**	**(2)**	**30**
Cost or valuation at 31 December 1997	**1,413**	**2,380**	**1,864**	**2,233**	**2,049**	**9,939**
Accumulated depreciation at 1 January 1997	**—**	**—**	**(310)**	**(1,175)**	**(134)**	**(1,619)**
Acquisitions of subsidiaries	**(5)**	**—**	**—**	**—**	**(272)**	**(277)**
Disposals	**5**	**—**	**22**	**131**	**78**	**236**
Reclassifications	**—**	**—**	**70**	**(70)**	**—**	**—**
Transfer of accumulated depreciation arising on revaluation	**23**	**9**	**51**	**—**	**—**	**83**
Charge for the year	**(19)**	**(12)**	**(59)**	**(243)**	**(107)**	**(440)**
Exchange and other movements	**(4)**	**3**	**(38)**	**29**	**2**	**(8)**
Accumulated depreciation at 31 December 1997	**—**	**—**	**(264)**	**(1,328)**	**(433)**	**(2,025)**
Net book value at 31 December 1997	**1,413**	**2,380**	**1,600**	**905**	**1,616**	**7,914**
Net book value at 31 December 1996	1,151	3,316	721	672	378	6,238

Notes on the Accounts *(continued)*

20 Tangible fixed assets *(continued)*

b *Company*

	Freehold land and buildings	*Equipment, fixtures and fittings*	*Total*
	£m	**£m**	**£m**
Cost or valuation at 1 January 1997	**9**	**—**	**9**
Transfer from another Group company	**—**	**2**	**2**
Deficit on revaluation	**(3)**	**—**	**(3)**
Exchange and other movements	**(4)**	**—**	**(4)**
Cost or valuation at 31 December 1997	2	2	4
Accumulated depreciation at 1 January 1997	**—**	**—**	**—**
Transfer from another Group company	**—**	**(1)**	**(1)**
Accumulated depreciation at 31 December 1997	—	(1)	(1)
Net book value at 31 December 1997	2	1	3
Net book value at 31 December 1996	9	—	9

c *Valuations*

	Group		*Company*	
	1997	1996	**1997**	1996
	£m	£m	**£m**	£m
Cost or valuation of freehold and long and short leasehold land and buildings (excluding investment properties):				
At 1997 valuation (1996: at 1996 valuation)	**4,760**	4,630	**2**	9
At cost	**448**	423	**—**	—
	5,208	5,053	**2**	9
On the historical cost basis, freehold and long and short leasehold land and buildings would have been included as follows (excluding investment properties):				
Cost	**2,955**	2,822	**—**	1
Accumulated depreciation	**(471)**	(430)	**—**	—
	2,484	2,392	**—**	1

The Group values its non-investment properties on an annual basis. In November 1997, the Group's freehold and long leasehold properties, together with properties in Hong Kong with an unexpired lease term of 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) decreased by £76 million. A deficit of £67 million (net of minority interest of £9 million) was charged to reserves at 31 December 1997.

20 Tangible fixed assets *(continued)*

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 1997	**423**	**(268)**
Additions	**59**	**—**
Disposals	**(25)**	**22**
Charge for the year	**—**	**(28)**
Exchange and other movements	**(9)**	**2**
At 31 December 1997	**448**	**(272)**
Net book value at 31 December 1997 (1996: £155 million)	**176**	

The property of the Company was also valued by an independent, professionally qualified valuer on an existing use basis. The deficit on revaluation of £3 million has been charged to reserves at 31 December 1997.

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:

	1997		1996	
	At valuation	At cost	At valuation	At cost
	£m	£m	£m	£m
Freehold land and buildings	**25**	**25**	10	12
Short and long leasehold land and buildings	**424**	**60**	435	73
	449	**85**	445	85

Investment properties are valued on an open market value basis at 31 December annually by professional valuers. Of the Group's investment properties at valuation, 89% were valued by Wayfoong Property Limited, a subsidiary of HongkongBank, and 11% were valued by independent professionally qualified valuers. As a result of the revaluation, the net book value of investment properties has increased by £1 million (1996: surplus of £13 million). A deficit of £2 million, net of minority interests of £3 million, has been charged to reserves at 31 December 1997.

The Company had no investment properties at 31 December 1997 or 1996.

e *Group properties leased to customers*

Group properties leased to customers, none of which was held by the Company, included £420 million at 31 December 1997 (1996: £360 million) let under operating leases, net of accumulated depreciation of £13 million (1996: £7 million).

f *Land and buildings occupied for own activities*

	1997	1996
	£m	£m
Net book value	**4,786**	4,525

There were no such assets in the Company at 31 December 1997 or 1996.

Notes on the Accounts *(continued)*

21 Investments

a

	Shares in Group undertakings	*Loans to Group undertakings*	*Other investments other than loans*	*Total*
	£m	**£m**	**£m**	**£m**
At 1 January 1997	**14,230**	**912**	**244**	**15,386**
Additions	**70**	**40**	**1**	**111**
Repayments and redemptions	**—**	**(546)**	**—**	**(546)**
Amortisation of discounts and premiums	**—**	**—**	**(2)**	**(2)**
Write-up of subsidiary undertakings to net asset value (Note 31)	**1,453**	**—**	**—**	**1,453**
Provisions for diminution in value	**(103)**	**—**	**—**	**(103)**
Exchange movements	**—**	**37**	**—**	**37**
At 31 December 1997	**15,650**	**443**	**243**	**16,336**

'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.

Included within 'Other investments other than loans' is £1 million of the Company's own shares purchased in 1997 and held in trust for the purposes of conditional awards under the Restricted Share Plan, details of which are provided in the 'Report of the Directors' on pages 27 and 29 to 31. At 31 December 1997, the trust held 69,097 shares (1996: nil) of nominal value 75p with a market value at that date of £1,077,913 (1996: £ nil) in respect of these conditional awards.

'Other investments other than loans' also includes the Company's holdings of investments in UK Government stock listed on a recognised UK exchange of £242 million (1996: £244 million). The market value of these investments at 31 December 1997 was £249 million (1996: £241 million).

	1997	1996
	£m	£m
On the historical cost basis, shares in Group undertakings would have been included as follows:		
Cost less provisions of £103 million (1996: £ nil)	**14,355**	14,388

b The principal subsidiary undertakings of the Company are:

	Country of incorporation or registration	*Principal activity*	*Issued equity capital*
UK			
The British Bank of the Middle East	England	Banking	£125m
Forward Trust Group Limited (formerly Forward Trust Limited)	England	Finance	£265m
HSBC Gibbs Limited	England	Insurance	£3m
HSBC Greenwell	England	Capital markets	£30m
HSBC Investment Bank plc	England	Investment banking	£180m
Midland Bank plc	England	Banking	£797m
Midland Life Limited	England	Insurance	£14m
Samuel Montagu & Co. Limited	England	Private banking	£112m
Continental Europe			
Guyerzeller Bank AG (71% owned)	Switzerland	Banking	SFr5m
Trinkaus & Burkhardt KGaA (partnership limited by shares, 73% owned)	Germany	Banking	DM131m

21 Investments *(continued)*

	Country of incorporation or registration	*Principal activity*	*Issued equity capital*
Hong Kong			
Hang Seng Bank Limited (62.10% owned)	Hong Kong	Banking	HK$9,566m
The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	Banking	HK$16,254m
HSBC Insurance Limited (82.5% owned)	Hong Kong	Insurance	HK$125m
HSBC Investment Bank Asia Limited	Hong Kong	Investment banking	HK$770m
Wayfoong Finance Limited	Hong Kong	Finance	HK$300m
Rest of Asia-Pacific			
HongkongBank of Australia Limited	Australia	Banking	A$500m
Hongkong Bank Malaysia Berhad	Malaysia	Banking	M$100m
Americas			
Banco HSBC Bamerindus S.A.	Brazil	Banking	BRL1,018m
HSBC Banco Roberts S.A. (99.85% owned)	Argentina	Banking	ARS175m
Hongkong Bank of Canada	Canada	Banking	C$75m
HSBC Americas, Inc.	United States	Holding company	—*
HSBC Asset Management Asia Pacific Limited	Bahamas	Asset management	—*
HSBC Bamerindus Seguros S.A. (65.06% owned)	Brazil	Insurance	BRL244m
HSBC Securities, Inc.	United States	Investment banking	—*
La Buenos Aires Compañia Argentina de Seguros S.A. (98.03% owned)	Argentina	Insurance	ARS44m
Marine Midland Bank	United States	Banking	US$185m

** 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.

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 HSBC Roberts, whose accounts are made up to 30 June annually.

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.

c *Acquisitions*

The Group made the following acquisitions of subsidiary undertakings or net assets and operations in 1997, which are accounted for on an acquisitions basis:

i On 19 February 1997, Forward Trust Group Limited, a wholly-owned subsidiary undertaking of the Group, acquired 100% of the issued share capital of Forward Trust Rail Services Limited (formerly Eversholt Holdings Limited) for a consideration of £464 million. The consideration comprised cash of £422 million and loan notes of £42 million. No goodwill arose on this acquisition.

ii On 1 March 1997, Marine Midland Bank, a wholly-owned subsidiary undertaking of the Group, acquired 100% of the issued share capital of First Federal Savings and Loan Association of Rochester for a cash consideration of £417 million. Goodwill of £139 million arose on this acquisition.

iii On 26 March 1997, following the intervention of the Central Bank of Brazil, Banco HSBC Bamerindus S.A. capitalised at BRL1,018 million (£589 million), a wholly-owned subsidiary of the Group, assumed selected assets, liabilities and subsidiaries, together with a significant part of the activities of Banco Bamerindus do Brasil for a cash consideration of £226 million. Goodwill of £297 million arose on this acquisition. The fair values of the assets and liabilities acquired have been determined only on a provisional basis at 31 December 1997, pending completion of the intervention period on 25 March 1998.

Notes on the Accounts *(continued)*

21 Investments *(continued)*

iv On 12 August 1997, HSBC Latin America B.V., a wholly-owned subsidiary of the Group, acquired 100% of the issued share capital of Roberts S.A. de Inversiones and 100% of the issued share capital of Roberts Meynell S.A. de Inversiones (together, with their respective subsidiaries and associated companies, 'HSBC Roberts'). The 29.9% of the issued share capital of Banco Roberts S.A. already owned by Midland Bank plc was also transferred to HSBC Latin America B.V. The consideration for the acquisition of HSBC Roberts comprised cash of £374 million and additional deferred contingent consideration in the form of loan notes of up to US$80 million. The deferred contingent consideration is dependent on the determination of net asset value at the date of acquisition and the performance of HSBC Roberts in the year ending 30 June 1998.

At 31 December 1997, no deferred consideration had been provided. Goodwill of £297 million arose on this acquisition.

v Midland Bank plc also acquired a shipping loan portfolio on 21 July 1997, for consideration of £26 million, on which goodwill of £7 million arose.

vi HSBC Investment Bank Holdings B.V., a wholly-owned subsidiary of the Group, increased its stake in HSBC Simpson McKie Pty Limited on 31 December 1997 from 51.00% to 89.84% for cash consideration of £18 million, and goodwill of £16 million arose. This acquisition is not included in the table below because it represents an increase in stake in an existing subsidiary undertaking. There were no fair value adjustments arising on this acquisition.

The assets and liabilities at the dates of acquisition and the total consideration paid are set out in the following table.

	Book value	*Revaluations*	*Accounting policy alignments*	*Fair value*
	£m	£m	£m	£m
At the date of acquisition:				
Cash and balances at central banks	**450**	**—**	**—**	**450**
Items in the course of collection from other banks	**361**	**—**	**—**	**361**
Treasury bills and other eligible bills	**803**	**—**	**—**	**803**
Loans and advances to banks	**3,479**	**—**	**—**	**3,479**
Loans and advances to customers	**6,901**	**22**	**—**	**6,923**
Debt securities and equity shares	**933**	**3**	**—**	**936**
Tangible fixed assets	**1,298**	**308**	**(73)**	**1,533**
Other asset categories	**602**	**29**	**(77)**	**554**
Items in the course of transmission to other banks	**(350)**	**—**	**—**	**(350)**
Deposits by banks	**(1,970)**	**(6)**	**—**	**(1,976)**
Customer accounts	**(7,408)**	**(7)**	**—**	**(7,415)**
Debt securities in issue	**(2,691)**	**(3)**	**—**	**(2,694)**
Provision for liabilities and charges	**(916)**	**(45)**	**37**	**(924)**
Other liability categories	**(806)**	**(39)**	**—**	**(845)**
	686	**262**	**(113)**	**835**
Less: minority interests	**(47)**	**15**	**9**	**(23)**
Less: carrying value of the Group's existing interest in HSBC Roberts (Note iv above)	**(45)**	**—**	**—**	**(45)**
Net assets acquired	**594**	**277**	**(104)**	**767**
Goodwill written off against reserves (Note 31)				**740**
Total consideration including costs of acquisition				**1,507**

21 Investments *(continued)*

The fair value adjustments in the above table represent the following:

i Revaluations, reflecting the recognition of
- — the market value of acquired properties;
- — the fair value of train rolling stock acquired;
- — UK basis actuarial provisions for general insurance businesses acquired (included in provisions for liabilities and charges);
- — the fair value of financial instruments acquired and in issue;
- — deferred and current tax liabilities not previously recognised; and
- — the fair value of lessee obligations assumed.

ii Accounting policy alignments reflecting
- — the Group's criteria for the recognition of intangible assets, capitalised costs and deferred tax assets;
- — compliance with Urgent Issues Task Force Abstract 16 'Income and expenses subject to non-standard rates of tax' (issued February 1997).

22 Other assets

	1997	1996
	£m	£m
Bullion	**197**	133
Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	**13,157**	9,578
Current taxation recoverable	**70**	63
Deferred taxation (Note 27)	**58**	52
Long-term assurance assets attributable to policyholders (Note 26)	**4,093**	3,383
Other accounts	**2,616**	2,669
	20,191	15,878

Included in the above are 2,458,506 (1996: 2,392,214) 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:

	1997	1996
	£m	£m
Loans and advances to banks — with Group companies	**180**	351
Debt securities	**1,615**	1,086
Equity shares	**1,526**	1,593
Other assets	**1,428**	888
Prepayments and accrued income	**24**	12
Other liabilities	**(680)**	(547)
	4,093	3,383

Notes on the Accounts *(continued)*

23 Deposits by banks

	1997 £m	1996 £m
Repayable on demand	**6,981**	5,271
With agreed maturity dates or periods of notice, by remaining maturity:		
— 3 months or less but not repayable on demand	**13,265**	11,319
— 1 year or less but over 3 months	**2,913**	1,191
— 5 years or less but over 1 year	**425**	171
— over 5 years	**63**	78
	23,647	18,030
Amounts include:		
Due to associated undertakings	**48**	16

24 Customer accounts

	1997 £m	1996 £m
Repayable on demand	**81,960**	78,586
With agreed maturity dates or periods of notice, by remaining maturity:		
— 3 months or less but not repayable on demand	**85,172**	64,881
— 1 year or less but over 3 months	**8,563**	5,743
— 5 years or less but over 1 year	**2,100**	1,726
— over 5 years	**826**	213
	178,621	151,149
Amounts include:		
Due to associated undertakings	**24**	6

25 Debt securities in issue

	1997 £m	1996 £m
Bonds and medium-term notes, by remaining maturity:		
— within 1 year	**668**	29
— between 1 and 2 years	**284**	51
— between 2 and 5 years	**1,823**	182
— over 5 years	**140**	175
	2,915	437
Other debt securities in issue, by remaining maturity:		
— 3 months or less	**6,638**	4,688
— 1 year or less but over 3 months	**4,519**	2,470
— 5 years or less but over 1 year	**2,714**	2,376
— over 5 years	**60**	69
	16,846	10,040

26 Other liabilities

	1997 £m	1996 £m
Short positions in securities:		
Treasury bills and other eligible bills	**1,050**	1,576
Debt securities		
— government securities	**4,348**	3,914
— other public sector securities	**24**	32
— other debt securities	**576**	230
Equity shares	**492**	305
	6,490	6,057
Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market	**13,333**	9,637
Current taxation	**1,145**	1,008
Obligations under finance leases	**178**	50
Dividend payable by the Company	**803**	693
Long-term assurance liabilities attributable to policyholders (Note 22)	**4,093**	3,383
Other liabilities	**4,120**	4,066
	30,162	24,894
Obligations under finance leases fall due as follows:		
— within 1 year	**13**	18
— between 1 and 5 years	**6**	17
— over 5 years	**159**	15
	178	50

27 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 £m	*Company* £m
At 1 January 1997	**341**	**69**
Charge/(credit) to profit and loss account (Note 6)	**79**	**(42)**
Acquisitions of subsidiaries	**147**	**—**
Exchange and other movements	**(55)**	**(20)**
At 31 December 1997	**512**	**7**

27 Provisions for liabilities and charges *(continued)*

	Group		*Company*	
	1997	1996	**1997**	1996
	£m	£m	**£m**	£m
Included in 'Provisions for liabilities and charges'	**570**	393	**7**	69
Included in 'Other assets' (Note 22)	**(58)**	(52)	**—**	—
Net deferred taxation provision	**512**	341	**7**	69
Comprising:				
Short-term timing differences	**18**	21	**—**	3
Leasing transactions	**541**	368	**—**	—
Relief for tax losses	**(7)**	(15)	**—**	—
Advance corporation tax on dividends proposed	**(201)**	(173)	**(201)**	(173)
Provision for additional UK tax on profit remittances from overseas	**141**	170	**141**	170
Other items	**20**	(30)	**67**	69
	512	341	**7**	69

There is no material 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, £141 million remained at 31 December 1997 (1996: £170 million). Of the £29 million decrease in this provision in the year ended 31 December 1997 (1996: £18 million), £6 million was utilised and £23 million was released to the profit and loss account as a result of the reduction in the rate of UK corporation tax to 31%.

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.

iv At 31 December 1997, there were potential future tax benefits of approximately £250 million (1996: £210 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.

b *Other provisions for liabilities and charges*

	Provisions for pension and other post-retirement obligations	*Provisions for contingent liabilities and commitments*	*Insurance and other provisions*	*Total*
	£m	**£m**	**£m**	**£m**
At 1 January 1997	**163**	**90**	**202**	**455**
Acquisitions of subsidiaries	**—**	**166**	**611**	**777**
Charge to the profit and loss account	**42**	**34**	**68**	**144**
Provisions utilised	**(23)**	**(31)**	**(51)**	**(105)**
Exchange and other movements	**16**	**45**	**(37)**	**24**
At 31 December 1997	**198**	**304**	**793**	**1,295**

27 Provisions for liabilities and charges *(continued)*

Provisions assumed on the acquisition of subsidiaries principally related to general insurance businesses, and contingent liabilities and commitments in respect of acquisitions made in 1997 (Note 21c).

None of the above provisions relates to the Company (1996: £ nil).

28 Subordinated liabilities

	1997 £m	1996 £m
Undated subordinated loan capital:		
— the Company	**—**	—
— other Group	**1,970**	1,768
	1,970	1,768
Dated subordinated loan capital:		
— the Company	**811**	806
— other Group	**3,610**	3,401
	4,421	4,207
Total subordinated liabilities:		
— the Company	**811**	806
— other Group	**5,580**	5,169
	6,391	5,975
Dated subordinated loan capital is repayable:		
— within 1 year	**40**	73
— between 1 and 2 years	**357**	155
— between 2 and 5 years	**916**	781
— over 5 years	**3,108**	3,198
	4,421	4,207

		1997 £m	1996 £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	**152**	147
		811	806
Amounts owed to Group undertakings:			
US$350m	7.525% subordinated loan 2003 — HSBC Finance Nederland B.V.	**211**	205
		1,022	1,011

	1997 £m	1996 £m
The Company's dated subordinated loan capital is repayable:		
— between 2 and 5 years	**413**	—
— over 5 years	**609**	1,011
	1,022	1,011

28 Subordinated liabilities *(continued)*

At 31 December 1997, the following other Group subordinated borrowings were £100 million or over:

		1997	1996
		£m	£m
US$1,200m	Primary capital subordinated undated floating rate notes	**729**	705
US$750m	Undated floating rate primary capital notes	**455**	441
US$500m	Undated floating rate primary capital notes	**304**	294
US$500m	7.625% subordinated notes 2006	**304**	294
£250m	Subordinated unsecured floating rate notes 2001	**250**	250
US$400m	8.625% subordinated notes 2004	**241**	233
HK$3,000m	Subordinated collared (7% to 9%) floating rate notes 2003	**235**	228
US$350m	7.4% subordinated guaranteed notes 2003	**213**	206
£200m	9% subordinated notes 2005	**200**	200
US$300m	Undated floating rate primary capital notes (Series 3)	**181**	176
US$300m	6.95% subordinated notes 2011	**181**	176
US$300m	7.65% subordinated notes 2025	**181**	176
US$300m	7% fixed rate subordinated notes 2006	**181**	176
£150m	9.25% Step-up undated subordinated notes	**150**	150
£150m	8.625% Step-up undated subordinated notes*	**150**	—
£150m	Subordinated Step-up coupon floating rate notes 2007*	**149**	—
US$200m	7.808% capital securities 2026	**122**	118
US$200m	8.38% capital securities 2027†	**122**	—
US$200m	Guaranteed floating rate notes 1999	**122**	118
US$200m	Floating rate subordinated notes 2000	**122**	118
¥24.8b	Fixed rate (5.0% to 5.5%) subordinated loans 2004	**115**	125
£100m	14% subordinated unsecured loan stock 2002/07	**100**	100
DM300m	Guaranteed floating rate notes 1986/98	**—**	114
	Other subordinated liabilities less than £100m	**773**	771
		5,580	5,169

* *The proceeds of the issue of 8.625% Step-up Undated Subordinated Notes and Subordinated Step-up Coupon Floating Rate Notes 2007 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 8.38% capital securities 2027 during the year were added to the general funds of HSBC Americas, Inc. and are available for general corporate purposes.*

Subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, generally with the consent of the Bank of England, 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%.

29 Minority interests — non-equity

Preference shares issued by subsidiaries:

		1997	1996
		£m	£m
US$98m	Perpetual preference shares	**—**	58
US$875m	Non-cumulative preference shares	**516**	468
		516	526

During 1997, Midland Bank issued US$50 million Series 1 non-cumulative preference shares to strengthen its capital base and HSBC Americas, Inc. redeemed US$98 million perpetual preference shares.

30 Called up share capital

Authorised:

The authorised ordinary share capital of the Company at 31 December 1997 and 1996 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 1997 and 1996, the authorised preference share capital of the Company is £500 million divided into 500 million non-cumulative preference shares of £1 each.

	Number of HK$10 shares	*Number of 75p shares*	**£m**
Issued:			
At 1 January 1997	1,790,628,607	870,556,852	**2,014**
Shares issued under option schemes	—	2,197,519	**2**
Shares issued in lieu of dividends	10,983,962	1,375,979	**10**
Exchange movements	—	—	**42**
At 31 December 1997	1,801,612,569	874,130,350	**2,068**

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 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 1997	**43,496,592**	**1998 to 2007**	**£1.1843 to £23.395**
31 December 1996	38,376,784	1997 to 2006	£1.1843 to £10.00

31 Reserves

	Group	*Company*	*Associated undertakings*
	£m	**£m**	**£m**
Share premium account:			
At 1 January 1997	**299**	**299**	**—**
Shares issued under option schemes	**8**	**8**	**—**
Shares issued in lieu of dividends and associated issue costs	**(10)**	**(10)**	**—**
At 31 December 1997	**297**	**297**	**—**
Reserves:			
— Merger reserve			
At 1 January 1997	**26**	**—**	**—**
Goodwill written off on acquisition	**(26)**	**—**	**—**
At 31 December 1997	**—**	**—**	**—**

Notes on the Accounts *(continued)*

31 Reserves *(continued)*

	Group	Company	Associated undertakings
	£m	£m	£m
Revaluation reserves:			
— Investment property revaluation reserve			
At 1 January 1997	**313**	**—**	**54**
Unrealised surplus on revaluation of land and buildings	**6**	**—**	**8**
Transfer to revaluation reserve	**(5)**	**—**	**—**
Realisation on disposal of properties	**(7)**	**—**	**—**
Exchange and other movements	**6**	**—**	**1**
At 31 December 1997	**313**	**—**	**63**
— Revaluation reserve			
At 1 January 1997	**2,384**	**9,783**	**3**
Realisation on disposal of properties	**(18)**	**—**	**—**
Unrealised deficit on revaluation of Group properties	**(67)**	**(3)**	**—**
Transfer of depreciation from profit and loss account reserve	**(34)**	**—**	**—**
Transfer from investment property revaluation reserve	**5**	**—**	**—**
Net increase in attributable net assets of subsidiary undertakings	**—**	**1,453**	**—**
Exchange and other movements	**5**	**(42)**	**2**
At 31 December 1997	**2,275**	**11,191**	**5**
Total revaluation reserves	**2,588**	**11,191**	**68**
Profit and loss account:			
At 1 January 1997	**10,151**	**3,091**	**94**
Retained profit/(deficit) for the year	**2,018**	**(411)**	**17**
Goodwill written off on acquisitions	**(709)**	**—**	**—**
Transfer of depreciation to revaluation reserve	**34**	**—**	**—**
Realisation on disposal of properties	**25**	**—**	**—**
Arising on shares issued in lieu of dividends	**206**	**206**	**—**
Exchange and other movements	**(236)**	**—**	**(12)**
At 31 December 1997	**11,489**	**2,886**	**99**

Goodwill amounting to £3,086 million (1996: £2,351 million) has been charged against reserves in current and prior years in respect of acquisitions of subsidiaries. In 1997, goodwill written off on acquisition includes a write-back of £21 million in respect of deferred consideration on the acquisition of J P Morgan's domestic US dollar clearing business.

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 27 above, the remittance of reserves may result in further taxation liabilities.

32 Analysis of total assets and total liabilities

	1997 £m	1996 £m
a *Assets and liabilities denominated in foreign currency*		
Denominated in sterling	**80,940**	65,389
Denominated in currencies other than sterling	**205,451**	171,164
Total assets	**286,391**	236,553
Denominated in sterling	**97,064**	77,164
Denominated in currencies other than sterling	**189,327**	159,389
Total liabilities	**286,391**	236,553

b *Assets subject to sale and repurchase transactions*	1997 £m	1996 £m
Total assets subject to sale and repurchase transactions	**6,135**	4,200

c *Assets leased to customers*	1997 £m	1996 £m
Loans and advances to customers	**4,654**	4,292
Tangible fixed assets — equipment on operating leases (Note 20a)	**1,616**	378
	6,270	4,670

The cost of assets acquired during 1997 for letting to customers under finance leases and hire purchase contracts by the Group amounted to £2,718 million (1996: £2,568 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	
	1997 £m	1996 £m
Deposits by banks	**242**	415
Customer accounts	**1,205**	598
Debt securities in issue	**683**	531
Other liabilities	**1,002**	1,081
	3,132	2,625

The amount of assets pledged to secure these amounts is £8,309 million (1996: £8,432 million). This is mainly made up of items included in ‘Debt securities’ and ‘Treasury bills and other eligible bills’ of £6,255 million (1996: ‘Debt securities’ £6,775 million).

Notes on the Accounts *(continued)*

33 Memorandum items

a *Group*

	1997			1996		
	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	**2,923**	**2,124**	**2,054**	2,162	1,588	1,581
Guarantees and assets pledged as collateral security:						
— guarantees and irrevocable letters of credit	**12,485**	**9,466**	**8,371**	14,389	11,675	8,553
Other contingent liabilities	**63**	**63**	**48**	167	27	26
	15,471	**11,653**	**10,473**	16,718	13,290	10,160
Commitments:						
Documentary credits and short-term trade-related transactions	**5,098**	**1,413**	**1,060**	5,075	1,333	1,070
Forward asset purchases and forward forward deposits placed	**721**	**587**	**270**	450	450	307
Undrawn note issuing and revolving underwriting facilities	**90**	**45**	**45**	139	70	70
Undrawn formal standby facilities, credit lines and other commitments to lend:						
— over 1 year	**16,003**	**7,996**	**7,427**	14,766	7,383	6,485
— 1 year and under	**60,837**	**—**	**—**	51,571	—	—
	82,749	**10,041**	**8,802**	72,001	9,236	7,932

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.

33 Memorandum items *(continued)*

Exchange rate, interest rate and equities contracts

	1997		1996	
	Contract amount	*Replacement cost*	*Contract amount*	*Replacement cost*
	£m	**£m**	£m	£m
Exchange rate contracts	**453,533**	**8,666**	404,332	4,804
Interest rate contracts	**526,136**	**3,143**	481,441	4,325
Equities contracts	**13,336**	**1,225**	6,884	601

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

Included in the above table, which excludes contracts made with other Group counterparties, there are £450,329 million (1996: £399,821 million) contract amount of exchange rate contracts, £502,978 million (1996: £452,740 million) contract amount of interest rate contracts and £13,218 million (1996: £6,762 million) contract amount of equities contracts which were made for trading purposes. The remaining exchange rate, interest rate and equities 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 45.

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 no contingent liabilities (1996: £39 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 and is determined on the basis set out in Note 40:

Contract amounts

	UK	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas*	*Total*
Contingent liabilities:	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
1997	**6,076**	**1,459**	**2,217**	**3,856**	**1,863**	**15,471**
1996	7,347	1,302	1,971	4,069	2,029	16,718
Commitments:	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
1997	**29,507**	**2,787**	**25,272**	**11,487**	**13,696**	**82,749**
1996	27,986	2,535	21,484	9,167	10,829	72,001

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

	1997	1996
	£m	£m
Operating profit	**4,544**	4,080
Change in prepayments and accrued income	**(437)**	364
Change in accruals and deferred income	**817**	(360)
Interest on finance leases and similar hire purchase contracts	**16**	10
Interest on subordinated loan capital	**460**	426
Depreciation and amortisation	**440**	367
Provisions for bad and doubtful debts	**615**	384
Loans written off net of recoveries	**(352)**	(492)
Provisions for liabilities and charges	**144**	105
Provisions utilised	**(105)**	(49)
Amounts written off fixed asset investments	**29**	48
Net cash inflow from trading activities	**6,171**	4,883
Change in items in the course of collection from other banks	**(428)**	4
Change in treasury bills and other eligible bills	**(1,686)**	4,822
Change in loans and advances to banks	**3,131**	(2,306)
Change in loans and advances to customers	**(25,088)**	(4,672)
Change in other securities	**(2,916)**	(3,507)
Change in other assets	**(3,779)**	1,387
Change in deposits by banks	**3,641**	(2,663)
Change in customer accounts	**20,057**	9,028
Change in items in the course of transmission to other banks	**533**	207
Change in debt securities in issue	**4,112**	1,390
Change in other liabilities	**4,295**	(162)
Elimination of exchange differences*	**683**	376
Net cash inflow from operating activities	**8,726**	8,787

** 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.*

35 Changes in financing during the year

	Subordinated loan capital	*Preference shares**	*Ordinary shares*	*Share premium*
	£m	**£m**	**£m**	**£m**
Balance at 1 January 1997	**5,975**	**526**	**2,014**	**299**
Shares issued in lieu of dividends	**—**	**—**	**10**	**(10)**
Acquisition of subsidiaries	**99**	**—**	**—**	**—**
Issued during the year	**453**	**30**	**2**	**8**
Repaid during the year	**(195)**	**(60)**	**—**	**—**
Net cash inflow from financing	**258**	**(30)**	**2**	**8**
Exchange and other movements	**59**	**20**	**42**	**—**
Balance at 31 December 1997	**6,391**	**516**	**2,068**	**297**

** Preference shares in issue are in subsidiary undertakings (Note 29).*

36 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 1997, these amounted to £1,838 million (1996: £933 million).

b *Changes in cash during the year*

	1997	1996
	£m	£m
Balance at 1 January	**8,880**	5,182
Net cash inflow before the effect of foreign exchange movements	**4,035**	4,395
Effect of foreign exchange movements	**(311)**	(697)
Balance at 31 December	**12,604**	8,880

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

	1997	1996
	£m	£m
Cash and balances at central banks	**1,798**	1,814
Loans and advances to banks	**10,806**	7,066
	12,604	8,880

37 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.

38 Capital commitments

	1997	1996
	£m	£m
Expenditure contracted for	**99**	142
Expenditure authorised by Directors but not contracted for	**75**	82
	174	224

There were no capital commitments in respect of the Company (1996: £ nil).

39 Lease commitments

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

	1997	1996
	£m	£m
Leasehold land and buildings		
Operating leases which expire:		
— within 1 year	**23**	18
— between 1 and 5 years	**88**	75
— over 5 years	**74**	102
	185	195
Equipment		
Operating leases which expire:		
— within 1 year	**5**	1
— between 1 and 5 years	**10**	3
	15	4

The Company had no commitments under operating leases at 31 December 1997 (1996: none).

40 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. 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. Common costs are included in segments on the basis of the actual recharges made.

The allocation of intra-sector recharges between operating income and operating expenses has been revised in order to reflect the nature of these items more appropriately. Comparative data have been restated for this change in presentation.

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 1997**		At 31 December 1996	
	£m	**%**	£m	%
UK	**98,088**	**34.9**	86,157	37.2
Continental Europe	**10,340**	**3.7**	9,852	4.2
Hong Kong	**85,127**	**30.2**	72,029	31.1
Rest of Asia-Pacific	**34,806**	**12.4**	29,364	12.7
Americas*	**53,086**	**18.8**	34,420	14.8
	281,447	**100.0**	231,822	100.0
Add: Hong Kong SAR Government certificates of indebtedness	**4,944**		4,731	
Total assets	**286,391**		236,553	

40 Segmental analysis *(continued)*

Net assets:

	At 31 December 1997		At 31 December 1996	
	£m	**%**	£m	%
UK	**4,858**	**29.6**	5,334	35.1
Continental Europe	**1,058**	**6.4**	665	4.4
Hong Kong	**7,016**	**42.7**	5,879	38.7
Rest of Asia-Pacific	**1,337**	**8.1**	1,579	10.4
Americas	**2,173**	**13.2**	1,730	11.4
Total net assets	**16,442**	**100.0**	15,187	100.0

Profit on ordinary activities before tax:

	UK	*Continental Europe*	*Hong Kong*	*Rest of Asia-Pacific*	*Americas**	*Total*
Year ended 31 December 1997	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Interest receivable	**5,579**	**580**	**5,629**	**2,357**	**4,084**	**18,229**
Interest payable	**(3,378)**	**(446)**	**(3,520)**	**(1,582)**	**(2,623)**	**(11,549)**
Net interest income	**2,201**	**134**	**2,109**	**775**	**1,461**	**6,680**
Dividend income	**37**	**10**	**36**	**2**	**10**	**95**
Fees and commissions receivable	**1,880**	**234**	**758**	**467**	**767**	**4,106**
Fees and commissions payable	**(376)**	**(52)**	**(87)**	**(68)**	**(184)**	**(767)**
Dealing profits	**232**	**25**	**124**	**195**	**29**	**605**
Other operating income	**364**	**—**	**180**	**22**	**189**	**755**
Operating income	**4,338**	**351**	**3,120**	**1,393**	**2,272**	**11,474**
Operating expenses	**(2,639)**	**(225)**	**(1,169)**	**(657)**	**(1,562)**	**(6,252)**
Operating profit before provisions	**1,699**	**126**	**1,951**	**736**	**710**	**5,222**
Provisions for bad and doubtful debts	**(50)**	**8**	**(136)**	**(372)**	**(65)**	**(615)**
Provisions for contingent liabilities and commitments	**(4)**	**(10)**	**(7)**	**(7)**	**(6)**	**(34)**
Amounts written off fixed asset investments	**10**	**—**	**(25)**	**(3)**	**(11)**	**(29)**
Operating profit	**1,655**	**124**	**1,783**	**354**	**628**	**4,544**
Gains on disposal of investments and tangible fixed assets	**156**	**8**	**182**	**4**	**8**	**358**
Income from associated undertakings	**(3)**	**11**	**19**	**45**	**(3)**	**69**
Profit on ordinary activities before tax	**1,808**	**143**	**1,984**	**403**	**633**	**4,971**

** In the Americas region, included within profit on ordinary activities before tax and total assets are £78 million and £12,973 million respectively in relation to businesses acquired during 1997.*

Notes on the Accounts *(continued)*

40 Segmental analysis *(continued)*

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

	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)	152	48	80	595
Operating income	3,974	344	2,916	1,244	1,308	9,786
Operating expenses	(2,546)	(259)	(1,125)	(564)	(773)	(5,267)
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
Gains on disposal of investments and tangible fixed assets	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

Total interest receivable and total interest payable include intra-Group interest of £734 million (1996: £983 million). Fees and commissions receivable and fees and commissions payable include intra-Group items of £65 million in 1997. Other operating income and operating expenses include intra-Group items of £115 million (1996: £198 million).

b *By class of business*

	Commercial banking		*Investment banking*		*Total*	
	1997	1996	**1997**	1996	**1997**	1996
	£m	£m	**£m**	£m	**£m**	£m
Profit on ordinary activities before tax	**4,755**	4,252	**216**	272	**4,971**	4,524
Total assets	**274,356**	225,694	**12,035**	10,859	**286,391**	236,553
Net assets	**15,523**	14,433	**919**	754	**16,442**	15,187

41 Subsequent events

On 2 February 1998, Hongkong Bank of Canada announced that, subject to regulatory approval, it had reached an agreement with National Westminster Bank Plc to acquire all of the corporate and commercial banking business of National Westminster Bank of Canada.

42 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:

	1997		1996	
	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 (1996: £37,000) and £31,593,000 in guarantees (1996: £1,609,000))	**62**	**388**	58	153
Officers: Loans and credit card transactions (including £60,000 in credit card transactions (1996: £31,000) and £ nil in guarantees (1996: £82,000))	**19**	**6**	16	3

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

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 18: interests in associated undertakings; principal associated undertakings and interests in loan capital
- Notes 23 and 24: amounts due to associated undertakings.

Pension funds

At 31 December 1997, £6.7 billion (1996: £6.2 billion) of Group pension fund assets were under management by Group companies of which £511 million (1996: £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 (1996: £11 million). The Group's pension funds had deposits of £93 million (1996: £101 million) with banking subsidiaries within the Group.

43 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 1997 and the closing rate at that date respectively. These were as follows:

	Average rate	*Closing rate*
£1.00 = HK$	12.683	12.761
£1.00 = US$	1.638	1.647

44 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’.

45 Approval of accounts

These accounts were approved by the Board of Directors on 23 February 1998.

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 European Economic Area national. 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 1996 second interim dividend and the 1997 first interim dividend was set out in the Secretary's letters to shareholders of 27 March and 1 September 1997. 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 £14.7865 for the 1996 second interim dividend and £21.139 for the 1997 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 5,500 offices in 79 countries and territories:

Asia-Pacific	Offices		Offices
Australia	44	Malaysia	46
Bangladesh	1	Myanmar (Burma)	1
Brunei Darussalam	12	New Zealand	8
China	15	Pakistan	4
Hong Kong Special Administrative Region	436	Philippines	7
India	30	Singapore	31
Indonesia	9	Sri Lanka	7
Japan	8	Taiwan	8
Kazakhstan	1	Thailand	9
Korea, Republic of	4	Vietnam	2
Macau	6		
Europe			
Armenia	1	Italy	3
Austria	1	Luxembourg	2
Azerbaijan	1	Malta	1
Channel Islands	26	Netherlands	1
Cyprus	148	Poland	2
Czech Republic	2	Russia	3
France	3	Spain	5
Germany	14	Sweden	2
Greece	4	Switzerland	4
Hungary	1	Turkey	2
Ireland	4	United Kingdom	1,792
Isle of Man	4		
Americas			
Argentina	178	Guam	1
Bahamas	6	Mexico	2
Bermuda	1	Panama	4
Brazil	2,006	Peru	47
Canada	124	Saipan	1
Cayman Islands	4	United States of America	450
Chile	1	Uruguay	1
Colombia	2	Venezuela	1
Middle East and Africa			
Angola	2	Oman	5
Bahrain	6	Palestinian Autonomous Area	1
Egypt	8	Qatar	3
Ghana	1	Saudi Arabia	63
Jordan	5	South Africa	6
Kenya	1	Uganda	1
Lebanon	6	United Arab Emirates	15
Mauritius	14	Zambia	1
Mozambique	1	Zimbabwe	4
Namibia	1		

Associated companies are included in the network of offices.

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Stock number 91295-6

Chinese translation

A Chinese translation of this *Annual Report and Accounts* is available on request from:
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