



HSBC Holdings plc
Annual Report and Accounts 1998

HSBC Holdings plc
10 Lower Thames Street, London EC3R 6AE, United Kingdom

The HSBC Group

Headquartered in London, HSBC Holdings plc is one of the largest banking and financial services organisations in the world. The HSBC Group's international network comprises more than 5,000 offices in 79 countries and territories, operating in the Asia-Pacific region, Europe, the Americas, the Middle East and Africa.

With primary listings on the London and Hong Kong stock exchanges, shares in HSBC Holdings plc are held by some 170,000 shareholders in more than 90 countries and territories. In the United States, HSBC Holdings plc offers investors a sponsored American Depositary Receipt programme.

Through a global network linked by advanced technology, the Group provides a comprehensive range of financial services: personal, commercial, investment and private banking; trade services; cash management; treasury and capital markets services; insurance; consumer and business finance; pension and investment fund management; trustee services; and securities and custody services.

HSBC HOLDINGS PLC

*Incorporated in England with limited liability
Registered in England: number 617987*

REGISTERED OFFICE AND GROUP HEAD OFFICE

10 Lower Thames Street
London EC3R 6AE
United Kingdom
Telephone: 44 0171 260 0500
Facsimile: 44 0171 260 0501
Web: www.hsbc.com

REGISTRARS

Principal Register
Computershare Services PLC
PO Box 435, Owen House
8 Bankhead Crossway North
Edinburgh EH11 4BR
United Kingdom
Telephone: 44 0131 523 6666

Hong Kong Overseas Branch Register
Central Registration Hong Kong Limited
Rooms 1901-5, Hopewell Centre
183 Queen's Road East
Hong Kong
Telephone: 852 2862 8628

STOCKBROKERS

Cazenove & Co.
12 Tokenhouse Yard
London EC2R 7AN
United Kingdom

HSBC Securities
Thames Exchange
10 Queen Street Place
London EC4R 1BL
United Kingdom

ADR DEPOSITARY

HSBC Issuer Services
HSBC Bank USA
140 Broadway
New York
New York 10005
USA

Annual Report and Accounts 1998

Financial Highlights

| 1997 | | 1998 | 1998 | 1998 |
|---------|---|----------------|--------------|--------------|
| US\$m | For the year | US\$m | <i>£m</i> | <i>HK\$m</i> |
| 8,130 | Profit before tax | 6,571 | 3,962 | 50,899 |
| 5,487 | Profit attributable | 4,318 | 2,604 | 33,447 |
| 2,206 | Dividends | 2,495 | 1,505 | 19,326 |
| | At year-end | | | |
| 27,080 | Shareholders' funds | 27,402 | 16,523 | 212,256 |
| 41,562 | Capital resources | 41,092 | 24,778 | 318,299 |
| 333,136 | Customer accounts and deposits by banks | 343,252 | 206,981 | 2,658,829 |
| 471,686 | Total assets | 483,128 | 291,326 | 3,742,309 |
| 291,985 | Risk-weighted assets | 301,950 | 182,076 | 2,338,905 |
| US\$ | Per share | US\$ | <i>Pence</i> | <i>HK\$</i> |
| 2.06 | Basic earnings | 1.61 | 97.1 | 12.47 |
| 2.04 | Diluted earnings | 1.59 | 95.9 | 12.31 |
| 2.04 | Headline earnings | 1.60 | 96.5 | 12.39 |
| 0.830† | Dividends | 0.925 | 55.4* | 7.17* |
| 10.12 | Net asset value | 10.15 | 612.0 | 78.62 |
| | Number of ordinary shares in issue at year-end | | | |
| 1,802m | HK\$10 | 1,816m | | |
| 874m | £0.75 | 883m | | |
| % | Ratios | % | | |
| 20.7 | Return on average shareholders' funds | 15.5 | | |
| 1.37 | Post-tax return on average assets | 0.98 | | |
| 2.17 | Post-tax return on average risk-weighted assets | 1.60 | | |
| | Capital ratios | | | |
| 14.2 | — total capital | 13.6 | | |
| 9.3 | — tier 1 capital | 9.7 | | |
| 54.0 | Cost:income ratio | 54.9 | | |

* The second interim dividend of US\$0.555 per share is translated at the closing rate. Where required, the dividend will be converted into sterling or Hong Kong dollars at the exchange rate on 16 April 1999.

† US dollar amounts have been calculated at the exchange rate on the dividend payment dates.

Annual Report and Accounts 1998

Five-Year Comparison

| At year-end (US\$m) | 1994 | 1995 | 1996 | 1997 | 1998 |
|---------------------------------------|---------|---------|---------|---------|----------------|
| Share capital | 3,265 | 3,296 | 3,426 | 3,406 | 3,443 |
| Shareholders' funds | 16,854 | 20,776 | 25,833 | 27,080 | 27,402 |
| Capital resources | 28,269 | 33,095 | 39,950 | 41,562 | 41,092 |
| Customer accounts | 201,040 | 220,572 | 257,104 | 294,189 | 308,910 |
| Loans and advances to customers | 154,318 | 169,747 | 194,514 | 240,421 | 235,295 |
| Total assets | 314,771 | 352,022 | 402,377 | 471,686 | 483,128 |
| For the year (US\$m) | | | | | |
| Operating profit before provisions | 4,694 | 5,952 | 7,054 | 8,553 | 9,051 |
| Provisions for bad and doubtful debts | (422) | (657) | (604) | (1,014) | (2,637) |
| Pre-tax profit | 4,857 | 5,794 | 7,052 | 8,130 | 6,571 |
| Profit attributable to shareholders | 3,149 | 3,885 | 4,852 | 5,487 | 4,318 |
| Dividends | (1,078) | (1,330) | (1,738) | (2,206) | (2,495) |
| Per ordinary share (US\$) | | | | | |
| Basic earnings | 1.22 | 1.48 | 1.83 | 2.06 | 1.61 |
| Headline earnings | 1.18 | 1.48 | 1.80 | 2.04 | 1.60 |
| Dividends | 0.43 | 0.49 | 0.66 | 0.83 | 0.925 |

For comparative purposes, the sterling data previously reported have been translated for balance sheet data at the closing rates, and for profit and loss account data at the average rates.

Contents

| | | | |
|----|---|-----|--|
| 1 | Financial Highlights | 56 | Statement of Directors' Responsibilities in Relation to Financial Statements |
| 2 | Five-Year Comparison | 57 | Report of the Auditors |
| 2 | Contents | 58 | Accounts |
| 3 | Group Chairman's Statement | 63 | Notes on the Accounts |
| 6 | Group Chief Executive's Review of Operations | 102 | Taxation of Shares and Dividends |
| 16 | Managing for Value | 103 | Shareholder Information |
| 19 | HSBC: Business Principles and Values | 105 | HSBC International Network |
| 22 | Board of Directors and Group General Managers | 106 | HSBC Principal Offices |
| 26 | Report of the Directors | | |
| 41 | Financial Review | | |

Group Chairman's Statement



We want to be the world's leading financial services company. That is our vision. To achieve this, we have a new strategy called 'Managing for Value' which you can read about on pages 16 to 18. The strategy is designed to place you, our shareholders, at the centre of everything we do. HSBC has always been about shareholder value. US\$100 invested in HSBC at the beginning of 1974, with dividends reinvested, would be worth over US\$11,000 at the beginning of 1999, a compound annual growth rate of over 20 per cent. The strategy simply reinforces our commitment to shareholders and gives us a focus.

We have adopted this strategy from a position of strength. The strength of the Group was widely recognised during the year, including being rated the world's strongest bank by *The Banker* magazine and the 'best bank in Asia' by *Euromoney*. *Forbes* magazine rated us number 2 in its 'Super 50' league table of global companies. We are building from that strength: this strategy is evolutionary, not revolutionary.

Operating Environment

In a number of our major markets, 1998 saw the toughest economic conditions for many years, with some 40 per cent of those markets in recession. Profit attributable to you, our shareholders, was US\$4,318 million, down 21 per cent. That the Group was able to report increased operating profits before provisions of US\$9,051 million, a return on shareholders' funds of 15.5 per cent and declare dividends of US\$0.925 per share reflects the spread and robustness of our businesses and our ability to generate revenues and hold down costs.

Inevitably, the results of the commercial banking members of the Group reflected to a considerable degree the economic environment of the countries in which they operate. In 1998, these conditions varied

markedly. The United States, Canada, the Middle East and the United Kingdom remained relatively buoyant and our subsidiaries in those countries reported satisfactory results. Our core UK banking business did particularly well. In contrast, a number of Asian economies contracted sharply and some in Latin America faltered. We responded to the changed economic circumstances by focusing new lending on preferred economies and customers, enhancing liquidity and maintaining our strong capital position. Our financial standing enabled us to grow our share of deposits in many of our major markets including, in particular, the Hong Kong Special Administrative Region of China.

Much has been written about the events in Asia. Our faith in the region's long-term prospects remains undiminished. There is no one Asian model. But there are some common denominators, some fundamentals, which help to explain the region's success. First, talented people: across Asia, there are hard-working entrepreneurial people dedicated to improving their life and the lives of their families. Second, there is also a strong commitment to basic education at the primary and secondary levels, and excellent universities. Third, countries throughout the region also have very high savings rates which lead naturally to high levels of investment. Fourth, labour costs across Asia compare favourably with those in OECD countries.

Of course, there are well-documented problems. In some cases, the financial and economic infrastructure did not keep pace with the dynamic growth enjoyed by many Asian countries over 30 years. But these issues are being addressed and when that has been done, Asia will return to the high growth rates that have characterised the region for so long. The current problems experienced by some countries should be seen in the context of 30 years of economic success.

We also see excellent long-term potential in Latin America, despite the difficulties experienced by some countries in 1998. We are encouraged by the progress made in integrating our businesses there into the HSBC Group.

In our operations in OECD countries, we see strong potential to conduct more business with our excellent customer base, and our strategy highlights the areas we shall focus on.

Old Values

As well as more information on our new strategy in this report, we are also publishing for the first time a

Group Chairman's Statement (continued)

statement on the principles which underpin our business. Again, this is an evolutionary step. Our values are old values; only the publication of them is new.

One aspect of our conduct deserves special mention. HSBC plays a full part in the communities in which we operate. Our priority continues to be education: we supported some 236 projects in 1998. We also sponsor measures to protect the environment and to help the underprivileged. HSBC Holdings plc undertook many initiatives in these three areas, including four specialist language colleges, Earthwatch, the Royal Geographical Society, Save the Children, Asia House, Voluntary Service Overseas, the English Speaking Union and the British Museum's Money Gallery. The HSBC-sponsored Millennium Bridge in London is our means of marking the millennium.

Our subsidiaries continued to be heavily involved in local initiatives. Among many other activities, the Hongkong Bank Foundation funded over a hundred scholarships and bursaries for Hong Kong students and continued to promote exchange programmes with mainland China. The BritishBank Foundation supported several educational projects in its first full year of operation.

Young Enterprise, Shelter, Age Concern and Children in Need were just four of the charities helped by Midland Bank. Banco HSBC Bamerindus focused on helping the poorest areas of Brazil, with support for education and health services, as well as for orphanages in Curitiba. In the United States, our successful Project Jumpstart with Buffalo's Riverside High School went from strength to strength and meeting former students who are now employees was one of the highlights of my year. We contributed towards the founding of a college of higher education in Saudi Arabia. Group members backed environmental initiatives in many countries, including Canada, Malaysia, Australia and Singapore.

Colleagues' Contributions

I should also record my thanks to the many colleagues who devoted considerable time and effort to supporting their communities.

It would be remiss of me if I did not also thank them for the contribution they make to HSBC's business success. It is commonplace to commend staff in an annual report. Nevertheless, I should like to say 'thank you' to my many talented colleagues around the world, who have contributed so much to the achievements of HSBC. While it is invidious to single out any particular

group, this year I acknowledge my colleagues in Indonesia who did a marvellous job in very difficult circumstances.

The photographs in this *Annual Report* show some of our staff at work. For us to create shareholder value, we need satisfied customers. To satisfy our customers, we need committed and capable staff. It is the job of management to build and maintain this virtuous circle.

During 1998, we made the decision to bring together some 8,000 staff in a new headquarters building at London's Canary Wharf. We will start occupying the building in 2002. It is being constructed under a fixed-price contract and the effect over time will be cost neutral, which is why we decided to proceed. We expect to realise benefits from bringing business units closer together.

At the end of 1998, John Strickland retired from the Board and as Chairman of The Hongkong and Shanghai Banking Corporation Limited. John was succeeded by David Eldon. Sir Wilfrid Newton will retire at this year's Annual General Meeting in May. I thank John and Sir Wilfrid for their services to your Board.

New York Stock Exchange Listing

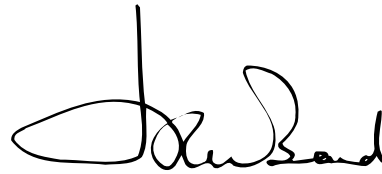
You may be aware already that we plan to seek a listing on the New York Stock Exchange to supplement our existing listings in London and Hong Kong. Given the size and nature of the Group, your Board thought it appropriate that HSBC should have access to the widest range of international capital markets, and we felt that a listing in New York should also stimulate international demand for HSBC shares. To facilitate this, we will ask your approval to simplify the existing share structure by creating a new class of 50 US cent ordinary shares. If approved, shareholders will receive three new shares for each existing share they hold, whether 75p or HK\$10. We also seek your authority for the ability to buy back shares. Full details of our proposals are set out in the 'Notice of the Annual General Meeting' circular which is enclosed with this report.

The year ahead promises to be very challenging. Much will depend on the performance of the US economy and its ability to continue a remarkable record of sustained growth. Some Asian economies are expected to begin to recover; others are still experiencing a severe downturn and we do not rule out the possibility of further setbacks. In the first three months of 1999, we have already made progress in a number of areas.

In February, we purchased for a total consideration of US\$57.6 million a further 14 per cent equity interest in three Argentine financial services companies in which we already held minority interests. We also signed a memorandum of understanding with the Korean Government with respect to the acquisition of a controlling interest in Seoul Bank. The exact terms of the transaction are being negotiated at the time of writing. If the outcome is successful, the acquisition will add significant weight to our presence in South Korea, an OECD country, and give us some 3.5 million customers there.

We have entered 1999 confident in our strength to withstand further volatility and in our ability to build on the strengths of the Group to deliver further value to shareholders. We have many strengths: sound liquidity, strong capital and a conservative balance sheet. We have an excellent customer base, the envy of our competitors. We have strength in depth in our

management team. (The 22 executive Directors and general managers of your Group have a combined length of service of some 600 years, averaging 27 years of service each.) And we have more than 130,000 dedicated members of staff across 79 countries and territories. The task before our team is to marshal our resources and unlock the massive further potential in the HSBC Group. I look forward to reporting to you on our progress.

A handwritten signature in black ink, appearing to read 'John Bond', with a stylized, cursive script.

John Bond, *Group Chairman*
26 March 1999

Group Chief Executive's Review of Operations



This year's 'Review of Operations' has been organised differently from that in previous years. In line with our new strategy, it describes the Group's activities in a way that reflects the relative economic importance of our operations worldwide. We have divided our operations into three categories. First, we have four large businesses, each with more than one million customers: the UK, the Hong Kong SAR and mainland China, Brazil and the United States. Second, we have seven major businesses, each with more than 200,000 customers. Third, we have other international businesses which support our large and major businesses, and some of which we hope will become our major businesses of tomorrow.

Aligned with these is our Corporate and Institutional Banking business which, by its nature, often crosses geographical borders and is increasingly co-ordinated globally. We have also included other businesses which are global or supra-regional in nature.

An analysis of our results by subsidiary and by line of business is shown in the table opposite.

HSBC's Large Businesses

United Kingdom

The core UK banking business grew strongly in 1998. Despite the impact of a gradual economic slowdown, operating profit rose by 15 per cent to US\$1,912 million. Wealth management activities, which include the sale of investment, insurance and private banking products, showed strong growth.

Improvements were made to Midland Bank plc's personal products range, including a relaunch of the bank's savings accounts, which provided better terms for 1.5 million customers. Service enhancements included access to products over the telephone, such as savings, mortgages and loans.

Our telephone banking division, First Direct, established nearly 10 years ago, continued to be very popular, attracting on average over 10,000 new cheque accounts a month. With 880,000 customers today, we expect First Direct to take on its one-millionth customer in the year 2000.

We also continued to develop new ways of delivering banking services. PC banking was launched at First Direct, and has attracted 68,000 users. A service will be launched for Midland customers during 1999. We opened more outlets at Wm Morrison Supermarkets plc, taking the total to 21, and offering the banking public an alternative way to reach us. Development of a TV banking proposition also continued through Open...., the marketing name of British Interactive Broadcasting.

In our business market, specific initiatives included a two-year free banking package to start up businesses and the establishment of a business innovation and

Attributable profit by subsidiary and by line of business

| US\$m | 1998 | 1997 |
|--|-------|-------|
| Hang Seng Bank | 876 | 1,210 |
| Less: minority interests | (332) | (463) |
| | 544 | 747 |
| HSBC Investment Bank Asia Holdings | 59 | (2) |
| The Hongkong and Shanghai Banking Corporation and other subsidiaries | 789 | 1,812 |
| The Hongkong and Shanghai Banking Corporation and subsidiaries | 1,392 | 2,557 |
| Midland Bank | 1,726 | 1,719 |
| Less: preference dividend | (71) | (69) |
| | 1,655 | 1,650 |
| HSBC Americas | 527 | 471 |
| Less: preference dividend | — | (3) |
| | 527 | 468 |
| The British Bank of the Middle East | 141 | 129 |
| HSBC Bank Malaysia | (91) | 88 |
| Hongkong Bank of Canada* | 122 | 100 |
| HSBC Latin American operations | 147 | 66 |
| HSBC Holdings sub-group | | |
| — Canary Wharf vacant space provisions | (158) | — |
| — Other | 28 | 122 |
| Other commercial banking entities | 229 | 92 |
| UK GAAP adjustments | 161 | 60 |
| Less: investment banking profits included above† | (101) | (87) |
| Commercial banking | 4,052 | 5,245 |
| Investment banking | 266 | 242† |
| Group profit | 4,318 | 5,487 |

* 1998 figures for Hongkong Bank of Canada are based on the 14-month period to 31 December 1998. The attributable profit arising in the additional two-month period was US\$16 million.

† Restated to include Guyerzeller Bank, which was transferred from Midland Bank to HSBC Investment Bank on 31 December 1997.

growth unit. Five new South Asian banking units were opened in the UK, bringing to 11 the total number of offices serving the needs of the South Asian business community.

Our asset-based financing businesses performed well, with new business growth contributing to increased operating profit.

Several factors had an adverse impact on the overall results. A provision of US\$99 million was raised to cover the extension of the pension review in the UK. Provisions for bad and doubtful debts increased, due mainly to lower Latin American debt recoveries.

Exceptional market volatility affected operating profits at HSBC MIDLAND, which fell to US\$63 million, although foreign exchange, money markets and sterling bond issues recorded a sound year.

Hong Kong SAR and Mainland China

The economic and financial turmoil of the last 18 months inevitably affected the performance of The Hongkong and Shanghai Banking Corporation and its subsidiaries. Despite the downturn, the bank was able to generate a level of operating profit before provisions similar to 1997. Provisions for bad and doubtful debts rose significantly, however, as credit quality deteriorated and non-performing loans increased, leading to a fall in attributable profit.

These difficult times also provided opportunities. Most notably, we gained new business and new customers. The bank also benefited from the reduction in liquidity that affected the ability of some competitors to meet customer requirements and from increased spreads on corporate lending, as pricing more accurately reflected increased credit risks, although margins were affected by the rise in non-performing loans.

Although competition in the retail market intensified, reflecting economic conditions, the bank was able to maintain or grow market share in all core product sectors, including customer deposits, residential mortgages (including the Hong Kong SAR Government's Home Ownership Scheme), and other personal loans. We continued to expand and improve our products and services while controlling costs through streamlined operations. A downturn in unit trust sales was offset by increased sales of insurance products, which more than doubled compared with 1997. Credit card receivables continued to grow. Although write-off and delinquency rates rose slightly, they remained below the industry average.

The focus in 1999 will be to seek out new business

growth opportunities, maintain strict control of credit quality and costs, and improve customer relationships by offering corporate and personal customers a wider range of products and services. In particular, in personal banking, the focus will be on deepening customer relationships by increasing the number of products sold to our large personal customer base. Existing products will be made more easily available through new delivery channels, such as enhanced telephone and electronic banking services.

The bank's soundness, financial standing and strong revenue-generating capability means that it is well placed to take advantage of appropriate business opportunities and to benefit from improved market conditions when economic recovery takes place.

Hang Seng Bank (HSBC Group interest: 62.14 per cent) focused on investment-related and insurance products, including launching the Hang Seng Investment Series as the umbrella brand for the bank's managed portfolios; opening Hong Kong's first automated securities phone-trading service and first automated mobile phone messaging service for securities customers; and launching a number of credit cards, including the Hang Seng MasterCard Corporate Card and Hang Seng Platinum MasterCard (in January 1999).

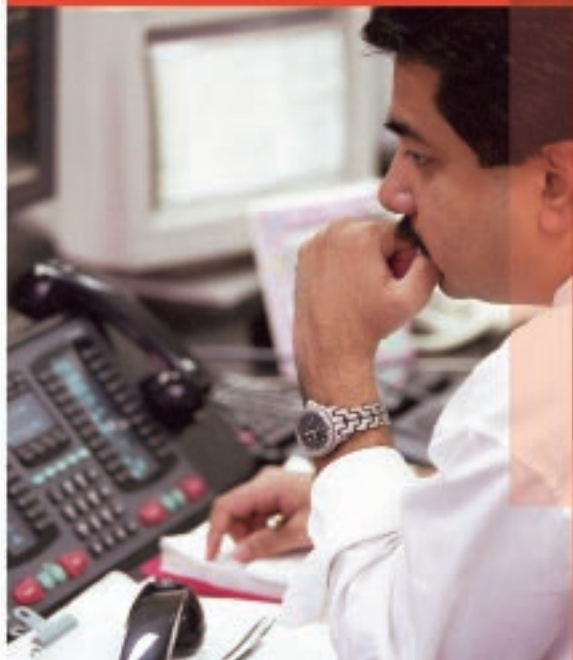
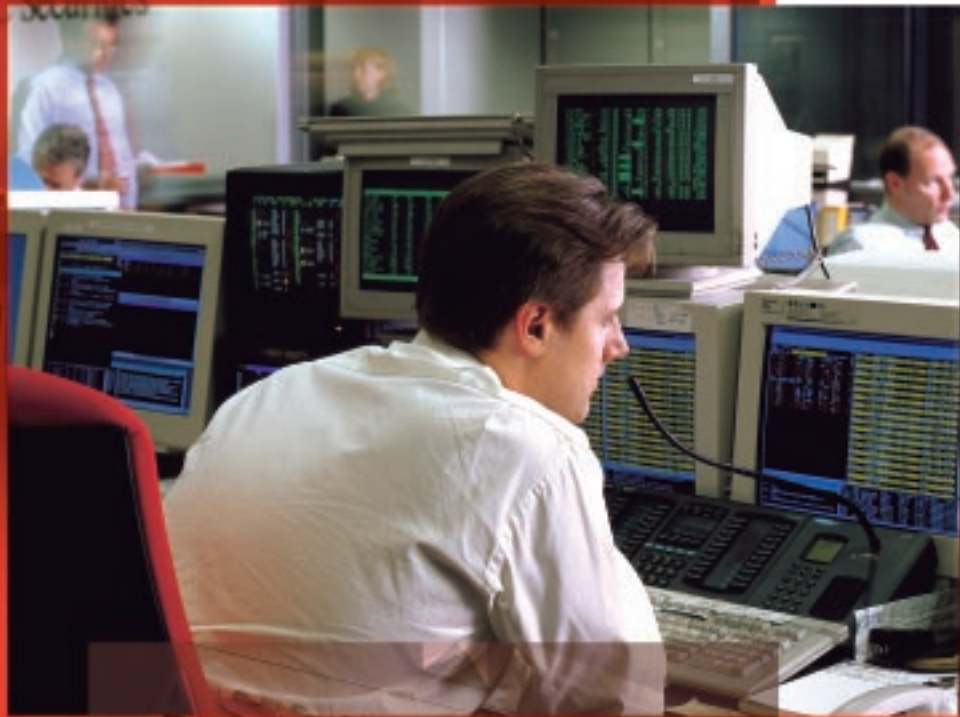
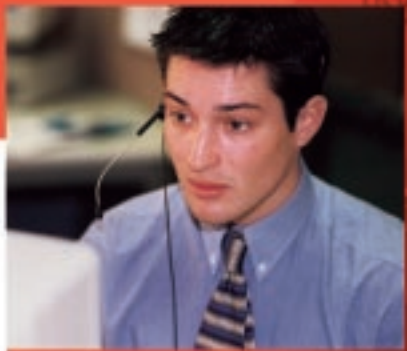
Joint initiatives between The Hongkong and Shanghai Banking Corporation and Hang Seng Bank included the launch of an interbank fund transfer function on our automated teller machines (ATMs) in June and the introduction of utility bill payments via ATMs.

In mainland China, The Hongkong and Shanghai Banking Corporation upgraded its Wuhan representative office to a branch in April and, since the year-end, has opened a representative office in Chongqing, bringing the bank's total network up to eight branches, one sub-branch and three representative offices. Permission was also obtained to undertake renminbi banking in Shenzhen, the second bank location to be granted this status. Hang Seng's Beijing representative office was opened in December.

Brazil

HSBC's Brazilian operations generated attributable profit of US\$165 million in its first full year of operation. This represents a 16.2 per cent return on equity in local currency terms, compared with 6.9 per cent in 1997.

Banco HSBC Bamerindus S.A. also took several new initiatives to increase market share, such as the premier branches, a totally new concept of service in



the country. The first premier branch was opened in Curitiba, where our Brazilian headquarters are located. More will be opened in 1999.

During the year, two new business units were launched: Auto Finance and Real Estate. Auto Finance, focusing on car loans for personal customers, began operations in five major cities and is preparing to open in 10 others in 1999. Auto Finance offers quick finance, often enabling customers to purchase cars on the spot. The Real Estate unit provides property-related services to large corporate customers, developing specific solutions for residential, commercial and industrial projects.

Funds under management rose by 22 per cent to US\$3.87 billion, serving 216,000 clients. Several funds reported excellent performances, with some of them receiving industry awards in recognition.

The process of establishing a control culture and an environment consistent with Group standards continued, with the implementation of further controls of costs and expenses. Banco HSBC Bamerindus also invested US\$25 million to establish a back-up site for its data-processing activities.

USA

HSBC Americas saw record profits for the sixth consecutive year. Profit before tax in 1998 rose by 15 per cent to US\$765 million and attributable profit increased by 12 per cent to US\$527 million. The results benefited from a settlement with the US Internal Revenue Service on Brazilian tax credits disallowed in the 1980s, which contributed US\$33 million pre-tax, and reduced taxes by a net amount of US\$10 million. Other operating income was enhanced by a US\$28 million gain from the sale of credit card portfolios. A return on average shareholders' funds of 25 per cent and a cost-to-income ratio of 48 per cent on a local basis continued to place HSBC Americas among the top performing regional banks in the United States.

In 1998, as part of a five-year strategic plan, HSBC Americas set a new challenge to ensure customer satisfaction: 'Superior customer service, every time'. A new management structure was established with a single head of personal banking and a focus on wealth management. The range of wealth management products available to customers was expanded, with the introduction of life and long-term care insurance, and the launch of a platinum credit card, one of the fastest-growing card products in the US market-place. Telephone bill payment and PC-

banking services were introduced in partnership with NYCE Corporation.

HSBC Americas announced the acquisition of First Commercial Bank of Philadelphia, Pennsylvania, which fits with the bank's strategy of attracting Asian communities in the United States.

In the fourth quarter of the year, the commercial loans of the US branches of The Hongkong and Shanghai Banking Corporation were acquired by HSBC Americas, completing the consolidation of the HSBC Group's commercial banking activities in the United States.

HSBC's Major Businesses

Argentina

HSBC Roberts made a disappointing pre-tax loss of US\$13 million in 1998. A strategic plan was completed and approved in June. This sets the direction for HSBC Roberts' banking and insurance companies up to the year 2000. The focus in 1998 was primarily on introducing HSBC standards across the business and operational areas. Work also began on consolidating the product range, client base and management skills in order to create a highly competitive financial services business in 1999. The bank will actively cross-sell its products and those of the insurance and health care businesses. There is a large untapped domestic market and, with the spread of products and services available through HSBC Roberts, the bank is well placed to provide a comprehensive financial service to clients.

HSBC Group practices are steadily being implemented. The Group treasury system was installed in the fourth quarter of 1998; a single administration and payments system was introduced; a communications policy implemented; and further investment was made in staff training.

Canada

Hongkong Bank of Canada's net interest income increased in 1998, primarily as a result of strong growth in commercial loans and residential mortgages. This was assisted by new business gains arising from previously proposed consolidations in the Canadian financial services industry. Other operating income improved due to growth in our investment businesses, which increased brokerage commissions and mutual fund fees, and higher trading income. An additional provision for credit losses equivalent to US\$22 million was recorded during the 14 months from October 1997 to December 1998, as the bank increased its general loan loss reserves in anticipation of new industry-wide guidelines.

Group Chief Executive's Review of Operations (continued)

The acquisitions of National Westminster Bank of Canada and Moss, Lawson Holdings Limited, a Canadian retail brokerage company, were completed during 1998. The purchase agreement for Gordon Capital Corporation, a leading Canadian institutional investment dealer, was concluded in early January 1999. This acquisition will greatly enhance the strengths and capabilities of our existing securities business.

We continued to focus on personal financial services and wealth management initiatives. HSBC InvestDirect Canada implemented the first internet-based discount brokerage businesses in Canada.

India

HSBC's operations in India performed satisfactorily in 1998. In personal banking, loan demand grew by over 10 per cent, and the range of asset products was extended to provide greater choice. Growth in the number of credit cards issued was particularly strong, despite keen competition from both local and foreign banks. India is now our third most important credit card centre in Asia, after Hong Kong and Taiwan.

During the year, two new branches were opened by Group members to improve the availability of services to customers. A programme to refurbish existing branches in conjunction with the adoption of the HSBC brand and the introduction of a standard presentation for the Group's worldwide network of branches is being implemented.

A further investment of US\$7 million was a new Central Services Centre in Mumbai, which has allowed us to bring together on one site our back-office operations for credit cards and custodian services, our training and technical services staff, and our network services management team.

Continued growth was seen in the corporate banking business. In the course of the year, we created a factoring capability and established an integrated payments and cash management unit. Growing awareness within Asia-Pacific of the importance of cash management techniques has led to a significant rise in the volume of new business. A special debt-recovery team was created to monitor developments in local industry and tighten credit procedures.

Malaysia

In the face of economic uncertainties, HSBC Bank Malaysia Berhad (formerly Hongkong Bank Malaysia Berhad) adopted a conservative stance.

The bank's operating profit before provisions was up 31.1 per cent in local currency terms, although

adverse currency movements resulted in an 8 per cent fall in US dollar terms. Significantly increased provisioning resulted in a pre-tax loss of US\$90.2 million. Included in this was a strengthening of the general provision, which the bank considered prudent to mitigate against further deterioration in asset quality.

The bank is investing to support its personal banking business and, at the same time, driving business more aggressively through the branch network. A major project to streamline back-office functions and create dedicated sales and services outlets through the branches has been undertaken. A unit has been set up to market payment and cash management services to corporate customers.

The bank is pursuing a selective asset growth strategy. Cross-selling opportunities to increase non-interest income and non-credit risk business are receiving emphasis.

The bank also participated in the US\$1.35 billion financing recently arranged for the Malaysian Government.

HSBC Finance (Malaysia) Berhad's business was transferred to the bank in November 1998 and its licence surrendered. At the same time, the bank was given permission to relocate four branches.

HSBC Bank Malaysia changed its legal name in February 1999, the first in the Group to do so under our initiative to establish a global brand.

Singapore

The regional financial turmoil, and consequent slowing of Singapore's domestic economy, had a significant impact on our business. During the year, in preparation for an eventual upturn in the economy, a new management structure and revised work processes were put in place for personal banking. The effect of these changes has been to create a more sales- and customer-driven culture ahead of the anticipated deregulation of the retail banking sector.

In corporate banking, other operating income saw a marginal improvement over 1997, but results were depressed by provisioning and the influence of cross-border exposures to more severely affected economies in the region. The bank was well positioned to meet the increased demand for domestic and regional cash management services and trade-related facilities. Securities services also performed well.

The bank's treasury and capital markets business also had a successful year, despite the economic difficulties. Further progress was made in establishing



Group Chief Executive's Review of Operations (continued)

HSBC Markets as a leading player in the Singapore bond and derivatives market. To cope with the increased volumes of business and to ensure closer co-ordination between HSBC Markets, HSBC Securities and HSBC Futures, a new dealing room employing the latest technology was opened in July. In November, HSBC Markets successfully arranged and placed S\$100 million seven-year negotiable certificates of deposit for HSBC in Singapore.

Saudi Arabia

The 1998 net profit of The Saudi British Bank (HSBC Group interest: 40 per cent) amounted to US\$163 million, an increase of 13 per cent over 1997. This was primarily due to improved net interest income, and higher returns from banking services and foreign exchange trading.

The Corporate Banking Division enhanced and rebranded its increasingly important import and export business as 'SABB Trade Services'. Personal banking continued to restructure management reporting lines; this had a positive effect on business, especially on the cards and loan portfolios.

Products aimed at three new customer segments were introduced: Al Mutamiyah (Ladies') Account, Al Mustaqbal (Future) Account for college students, and Islamic loans and trade funds. The branch and ladies' section network has been expanded to 75, with the opening of four new outlets. The ATM network has, meanwhile, risen to 124 machines.

Depressed oil prices will result in reduced spending and higher fiscal deficits this year in the oil-producing states of the Arabian Gulf. Growth in the private non-oil sector is likely to diminish, liquidity will be tight, and public sector investment restrained.

Middle Eastern operations of The British Bank of the Middle East

Despite depressed oil prices and the downturn in trade originating from the former Soviet Union, The British Bank of the Middle East achieved a 9 per cent increase in attributable profit.

With the exception of the newly opened branch in Ramallah in the Palestinian Autonomous Area, all branch networks produced operating profits, including the branch in Azerbaijan which is in only its second year of operation. Record results in Qatar were supported by improved contributions from the United Arab Emirates, Oman and Bahrain.

The cost-to-income ratio improved by over 3 per cent and the opening during the year of network service

centres — centralising processing and other administrative functions — in the United Arab Emirates, Lebanon and Bahrain, and the extension of the existing centre in Qatar, can be expected to continue this trend. Income increased from trade finance, personal and private banking activities and there was strong growth in income from the card business. The latter was underpinned by an award-winning promotion campaign focusing on the football World Cup. Personal banking continued to expand, and a range of targeted new products was launched by branch networks in the region.

In addition to the extension of its geographical reach with the new office in Ramallah, the bank opened new branches in existing networks in Qatar and India. Work commenced on the new headquarters buildings in Doha, Qatar, and Beirut, Lebanon.

HSBC's International Businesses

With HSBC operating in 79 countries and territories, it is not possible to cover every area in this review. However, there were some notable highlights around the world which deserve recognition.

January 1999 saw the introduction of the European single currency, the euro, in 11 countries. Preparations had been under way since 1994 and the conversion of our systems to the euro was completed successfully, thanks to the commitment of over 500 staff working around the clock over the new year holiday. Our branches in France, Italy and Spain have successfully joined their local clearing systems, and branches will be opened in Belgium, Ireland and the Netherlands in 1999 to extend our payments and cash management capabilities.

HSBC's operations in the Channel Islands, Turkey, Greece and France reported significantly improved results, and efforts are being made to expand the fund management business across Europe.

In Germany, Trinkaus & Burkhardt KGaA (HSBC Group interest: 73.47 per cent), which is soon to be renamed HSBC Trinkaus & Burkhardt KGaA, aligned its operations more closely with our investment banking and markets operations, and has full local clearing capabilities. In Switzerland, we purchased 25 per cent of the shares of our Swiss private bank, Guyerzeller Bank AG, bringing the Group's interest to 95.80 per cent. The bank is to be renamed HSBC Guyerzeller Bank AG soon.

Egyptian British Bank (HSBC Group interest: 40 per cent) enjoyed strong growth, with net profit before tax up by 39 per cent to US\$13 million.

British Arab Commercial Bank Limited (HSBC Group interest: 46.51 per cent) recorded a 14 per cent increase in attributable profit to US\$24 million.

The Cyprus Popular Bank Limited (HSBC Group interest: 21.96 per cent) increased operating profit by US\$17 million or 19.7 per cent. During the year, it launched the first internet banking service in Cyprus and, in January 1999, it purchased a life and general insurance group.

In other countries of Asia, the economic downturn adversely affected our operations. Most countries, in particular Indonesia and Thailand, experienced a deterioration in asset quality and increased provisioning was required, although this was lower in the second half of the year.

In March, HSBC was one of a group of international banks that exchanged Korean short-term credits for sovereign-guaranteed loans with maturities of one to three years. The sovereign rating of Korea has now returned to investment grade.

Australia, Indonesia, Korea and the Philippines all contributed strong operating profit before provisions, with a particularly good net result recorded in Korea. Customer assets showed limited growth in a few areas but, in most cases, were lower than in 1997.

Personal banking was launched in Korea with the opening of the first personal banking branch in Seoul in October. New branches were also opened in Bangladesh, Sri Lanka and Taiwan. Towards the end of the year, approval was received to establish a 100 per cent-owned subsidiary in Kazakhstan, HSBC Bank Kazakhstan, which opened for business in January 1999.

Good growth in personal banking portfolios was recorded in a number of countries, notably Australia, Indonesia, Sri Lanka and Taiwan. The focus in 1999 will be on further increasing our personal banking and credit cards market penetration, increasing deposits and sales of insurance and asset management products. In Australia, our recently introduced discount broking capability has been very well received and will be further promoted.

Corporate and Institutional Banking

As our major corporate customers operate internationally, we must serve them internationally. To achieve this objective, in the second half of the year we brought together the following functional units under a top Group executive to enable us to present a cohesive structure to our clients.



Group Chief Executive's Review of Operations (continued)

Financial Institutions

The Group's management of relations with bank and non-bank financial institutions, marketed as HSBC Financial Institutions, focused in 1998 on the cross-border selling of the Group's euro services. To help reduce interbank settlement risk, we will be making preparations in 1999 to deliver Continuous Linked Settlement solutions to financial institutions in 2000.

Trade Services

Despite the downturn in trade volumes in some of our major markets in 1998, our business continued to grow and was named 'best trade documentation bank' by *Trade Finance* magazine for the third successive year.

Global Payments and Cash Management

Continued investment in 1998 has positioned HSBC competitively, with particular strengths in euro clearing and pan-Asian services.

Securities Services

Our global custody business continued to expand its client base, especially in the UK and continental Europe. In the UK, we launched a fund administration service. In Asia, we remained the top-rated regional sub-custodian service provider.

Investment Banking and Markets

HSBC Investment Banking and Markets has responsibility for the Group's treasury, capital markets, advisory, equity securities origination and distribution, trading and research, asset management, merchant banking and the private banking and trustee activities of the Group.

Attributable profit from investment banking increased by 10 per cent over 1997 in spite of major market turbulence which adversely affected many investment banks. However, new issue and advisory activity in Europe was buoyant and the Group's market position improved. Equity commissions were lower in Asia, but this was compensated by a strong performance in European business. The Project and Export Finance division performed strongly in a difficult economic climate and maintained a broad spread of business. HSBC Loan Syndication retained its leading market position, arranging and distributing syndicated finance for Group clients. Declining Asian market values adversely affected HSBC Asset Management, but this was partially offset by continued strong investment performance.

HSBC Equator Bank plc (HSBC Group interest: 60 per cent) continued to strengthen its trade finance

business and increased its investment banking activity in several African markets.

HSBC Private Equity had another strong year and disposed of a number of investments from its portfolio.

Private banking accounted for the largest share of profits in our investment banking operations, with increased earnings in all geographical locations.

The Group continued to provide a full range of treasury and capital markets services in all areas. A focus on customer-driven business, combined with sound risk management practices, helped to achieve a significant growth in income in 1998.

As Asian currency fluctuations continued in the first half of 1998, wide margins and high volumes continued to underpin foreign exchange earnings. At the same time, the Group's policy of maintaining high levels of liquidity enabled it to benefit from interest rate movements in Asia and South America. Although Asian currencies began to stabilise in the second half of 1998, core customer-driven businesses remained buoyant and proved resilient in the face of market pressures.

Insurance

HSBC continues to develop a wide range of insurance protection and investment products. Our activities encompass underwriting, broking and agency activities in both the life and general insurance sectors. Insurance now accounts for over 8 per cent of Group profit.

Considerable effort was devoted to integrating our insurance capability with commercial banking to improve cross-sales and to take advantage of our existing distribution networks. HSBC now offers insurance in 27 countries and territories, with 1.5 million customers having purchased an insurance product or service from us.

In 1998, total premiums increased by 25 per cent and revenues by more than 30 per cent. The number of personal banking customers acquiring insurance increased from 4 to 7 per cent.

The UK contributed the majority of insurance profits, with the balance coming mainly from Latin America and South-East Asia. Strong growth was recorded in Hong Kong, particularly in life products.

Strategic Outlook

In 1999, we will concentrate on implementing our new strategic plan throughout the Group. All our senior executives will attend a training programme in the first half of 1999 on 'Managing for Value'. We have a wealth

of experience and a wide range of expertise in our businesses around the world. Successful implementation of the strategy will be accelerated by taking the opportunities available to us to transfer our best practices across the Group. We will be arranging a number of conferences for colleagues from around the world in comparable lines of business to exchange experience and ideas, and to work together on shared developments.

In our retail banks, we will concentrate on personal wealth management — unlocking the potential for deepening customer relationships in all our principal markets for personal business — and on increasing our commercial business. Corporate and Institutional Banking will be more closely aligned with our Investment Banking and Markets operation to sharpen our focus on the entirety of the global needs of our largest customers.

We will continue the process of creating a global brand for the HSBC Group, using HSBC and our hexagon symbol everywhere, and aim to have effectively completed this process by 1 January 2000. This major initiative is designed to achieve full recognition for HSBC as one of the world's largest and most successful financial services organisations. We want HSBC to become a strong consumer brand

synonymous with integrity, trust and excellent customer service. The brands of the wholly owned commercial banks have now been changed. During 1999, to execute the brand strategy, we are seeking regulatory approval to change the legal names of most of our wholly owned commercial banks as well as subsidiaries involved in a number of other businesses.

HSBC will be ready for the challenge of the year 2000 issue and preparations are in hand to ensure that our systems do not produce any disruptions to either our customers or to our own operations. We will also be converting our global communications networks to internet-compatible technology.

This will be a challenging year, but one which I am confident will see us continuing to build on the strengths of the Group.

A handwritten signature in black ink, appearing to read 'K. Whitson', written in a cursive style.

Keith Whitson, *Group Chief Executive*
26 March 1999

Managing for Value

We believe HSBC is an excellent company, but we also believe that we can do better.

Over a generation, we have provided superior returns to our shareholders. We have many strengths and, today, HSBC is a well-capitalised business with an excellent customer base, geographically diverse earnings and strong management.

But there is always room to improve. In 1998, HSBC was one of the top 10 banks in the world by market capitalisation. If we want to stay that way, we must continue to deliver sustained and profitable growth. To do this, we have been through a process of internal consultation, research and planning involving management and the Board. What has emerged is a strategy — ‘Managing for Value’ — to see us through the next five years (1999-2003). With this new strategy, we are sharpening our focus and articulating it more clearly. There is nothing new about managing for value in the HSBC Group. This plan is evolutionary, not revolutionary; it clearly builds on our existing strengths.

What We Aim to Do

We have one aim, which we call our governing objective. It is to beat the average total shareholder returns (TSR) performance of a peer group of financial institutions, with a minimum objective to double shareholder returns over a five-year period. We measure TSR as the increase in our share price with dividends assumed to be reinvested.

The objective has two measures: one relative and one absolute. It has a relative measure because TSR is dependent on a company’s stock-market valuation and stock-markets are subject to external influences. So it is no good us increasing value by 20 per cent if our competitors do so by 40 per cent. We must aim to do better than our peer group. We use an absolute measure because our shareholders entrust their money to us and we ought to reward that trust with a return superior to the cost of their capital, by at least doubling their investment every five years.

Our Vision

To achieve this, we need a vision of what we want to be. And what we want to be is the world’s leading financial services company. The verdict of the market, and also of management at HSBC, is that today we are a contender, not yet the champion. We aim to change that.

Our other vision is to balance our earnings between the OECD countries and the emerging markets. This is

what makes HSBC unique to its shareholders. No other financial services institution derives half its profit from stable, mature economies and half from the faster-growing, albeit more volatile, emerging markets. HSBC will preserve this balance as a truly global organisation.

What We Stand For

As part of our review, we looked at what HSBC stood for. We found five sets of values in the Group that we aim to live by. First and foremost, we believe in long-term ethical service for our customers. You will see our statement of principles on pages 19 to 21. We also aim for high productivity through our teamwork, something which is reflected in our cost-to-income ratio.

We are confident and we are ambitious. We need to be: this strategy is ambitious. We are truly international in character with a conservative orientation, as you would expect from an organisation that has long experience of operating successfully in volatile markets. And we have the potential to be capable of creativity and strong marketing. The potential is there; the challenge for management is to realise that potential. These values are the glue that holds us together around the world, making all our businesses recognisably HSBC.

What We Will Do

To do what we want to do, we will need to focus relentlessly on those parts of our business where we can create value. We see some real opportunities.

We will concentrate on delivering ‘wealth management’ to our key markets around the world. By wealth management, we mean deepening relationships with our personal customers to give them much more than a bank account. We mean offering them the full range of financial services, including savings, pensions, investments and insurance. Competition will be strong, both from traditional providers and also new entrants to the business. But nowhere is this business fully mature and we see strong growth prospects.

To deliver wealth management, we need to offer the right products and unlock the potential in our relationships with existing personal and business clients. This is an area in which HSBC lags behind the best of its competitors in some countries: we need to provide better products and build a more effective sales capability.

As well as personal wealth management, we will grow our commercial business. This market consists



of a wide range of businesses, including major companies, trading enterprises, professional practices, charities, entrepreneurs and smaller businesses. We have been very successful in this market and we aim to build on our strengths, in particular by making sure our customers have access to our full range of products and services.

To take advantage of the opportunities we see, we will allocate our resources, including capital, management time, human resources and information technology, according to the contributions made by each country or territory.

We will enhance our risk-adjusted cost of capital methodology, based on a measure called economic profit. Capital entrusted to HSBC by its shareholders has a cost that is not shown in its accounts. HSBC prices that cost of capital internally and the difference between that cost and post-tax profit is the amount of economic profit created.

We first started measuring costs of capital over 20 years ago. This further refinement not only allows us to measure at the Group level, but it also allows us to drive the measure much deeper into our lines of business. It will be used by management to decide the allocation of resources where they will be most productive.

Today, we have four large personal and commercial banking businesses: the UK, the Hong Kong SAR and mainland China, Brazil and the USA. For these businesses, we will concentrate on personal wealth management and developing our commercial business.

We also have seven major financial services businesses: Argentina, Canada, India, Malaysia, Singapore, Saudi Arabia and the Middle Eastern countries covered by The British Bank of the Middle East. These businesses conduct personal and commercial banking. We will continue to grow these areas.

The third category comprises our international businesses. These act as platforms for cross-border Group business and some are tomorrow's major businesses. We will focus on growing those with potential and serving our international customers.

Combined with these will be a functional tier — corporate and investment banking — which will oversee corporate banking for our largest customers, including cash management, financial institutions and parts of trade services. At the moment, our largest corporate customers deal with us through both our commercial banks and also our investment banking

Managing for Value (continued)

operations. We will align corporate and investment banking much more closely. Increasingly, we will focus on a customer's entire business with the Group, to both their and our advantage.

We will continue to position HSBC as a global brand. The name HSBC and the Group's hexagon symbol are the most visible signs of the new strategy. A brand is more than simple name recognition. It is a promise of performance that will help HSBC win repeat business. Most of the wholly owned commercial banking subsidiaries have adopted HSBC and our hexagon symbol as their brand. Building the brand is a continuous process; changing the name across the world by 1 January 2000 is a major step in developing it.

To succeed in our strategy, we need to attract, retain and motivate the very best people. It is a truism that a company can only be as good as its staff and we have excellent staff. We intend to align the interests of staff and shareholders ever more closely. We aim to reward

staff, particularly those who deal face to face with customers, with a wider stock and options programme, and to match compensation with sales performance, where appropriate.

It is rare to read an annual report these days that does not affirm management's commitment to creating shareholder value. But HSBC's strategy is far more than just lip service. It gives a clear, explicit commitment to our shareholders of what management intends to do and where their company is headed. It is a continuous process. And implementing and monitoring the strategy will be key to its successful delivery. In future, we will keep you updated of our progress through the *Annual Report* and other communications.

This is an exciting time for HSBC. The Group is strong and has immense potential. If we can realise that potential, then HSBC will indeed be the world's leading financial services organisation.

HSBC: Business Principles and Values

Introduction

HSBC is a global banking and financial services organisation headquartered in the United Kingdom.

We are owned by approximately 170,000 shareholders in over 90 countries and territories. We conduct business in a wide variety of social and business cultures and in a broad range of political environments.

As a commercial organisation, our governing objective is to provide a satisfactory return on our shareholders' capital. We do this by having a talented and motivated staff who offer our customers competitive services and products. We meet our financial obligations, we invest to develop our business for the future; our investments are made primarily on a financial basis, but with regard to the principles and values set out in this document.

HSBC has always striven to maintain the highest ethical standards; this statement explains our approach. However, it cannot cover every eventuality.

HSBC's policy is not to make contributions to political parties or partisan organisations. HSBC works co-operatively with host governments and regulators while remaining politically neutral in all jurisdictions.

HSBC codifies its key business principles and values in its *Group Standards Manual* which is in force throughout our operations. The opening page reads as follows:

Group Business Principles and Values

The HSBC Group is committed to five Core Business Principles:

- *outstanding customer service;*
- *effective and efficient operations;*
- *strong capital and liquidity;*
- *conservative lending policy;*
- *strict expense discipline;*

through loyal and committed employees who make lasting customer relationships and international teamwork easier to achieve.

HSBC also operates according to certain Key Business Values:

- *the highest personal standards of integrity at all levels;*
- *commitment to truth and fair dealing;*
- *hands-on management at all levels;*

- *openly esteemed commitment to quality and competence;*
- *a minimum of bureaucracy;*
- *fast decisions and implementation;*
- *putting the Group's interests ahead of the individual's;*
- *the appropriate delegation of authority with accountability;*
- *fair and objective employer;*
- *a merit approach to recruitment/selection/promotion;*
- *a commitment to complying with the spirit and letter of all laws and regulations wherever we conduct our business;*
- *the promotion of good environmental practice and sustainable development and commitment to the welfare and development of each local community.*

HSBC's reputation is founded on adherence to these principles and values. All actions taken by a member of HSBC or staff member on behalf of a Group company should conform with them.

Additionally, we have Codes of Conduct for staff in all operations.

Customer Care and Business Integrity

Looking after our customers is basic to all our business relationships. We promise only what we can deliver and we strive never to mislead our customers.

We have strict rules against staff accepting from customers any material personal benefits, including gifts, favours, services, loans or fees, and we actively discourage customers from offering any personal benefits to our staff.

In conducting business with due skill, care and diligence, HSBC seeks always to comply with both the letter and the spirit of relevant laws, rules, regulations, codes and standards of good market practice.

We address any irregularities that arise promptly, we seek to resolve them promptly in a way that protects our reputation and minimises financial loss. We believe in transparency in our financial and regulatory reporting with swift disclosure of any breaches.

We co-operate with supervisors and regulators to attain and maintain the highest operating standards to safeguard the interests of our customers, our

HSBC: Business Principles and Values (continued)

shareholders, our staff and the communities where we operate.

HSBC supports the general policies set out in the OECD Guidelines for Multinational Enterprises, which are designed to ensure that we operate in harmony with the policies of the countries in which we operate.

We support and comply with the Statement of Principles issued by the Basle Committee on Banking Regulations and Supervisory Practices.

We support the policies and procedures of the Vienna and Strasbourg Conventions against drug-trafficking and money-laundering, and also the various United Nations conventions and resolutions combatting terrorism.

Responsible Financing

Wherever we operate, we play a constructive, responsible role in aligning our objectives with those of the local community.

HSBC believes that personal freedom flourishes best in an environment of economic growth and opportunity. We support free trade and investment because they are avenues for the creation of jobs and for the improvement of living standards. Every country and territory where we operate has its own character, history and aspirations; a single standard for their progress would be difficult to devise.

HSBC retains a pioneering spirit, promoting international trade and constructive engagement through its business activities.

We take a careful and limited approach to the financing of sales of defence equipment. We ensure that the vendor's government and other relevant authorities have granted the necessary licences and approvals. Every potential transaction is considered on individual merit and in consultation with colleagues in the country and region where the equipment may be destined.

We do not participate in financing the manufacture or export of landmines. We have assisted organisations which support the victims of anti-personnel landmines. It is not possible, however, for any financial institution involved in commercial lending to give an absolute assurance that none of its customers is an indirect supplier of component parts of landmines or other military equipment.

Specific lending and investment policies are confidential but comply with these standards.

Members of Staff

The welfare of our staff is a fundamental concern.

We recruit and promote employees solely on merit and suitability; we encourage staff to realise their full potential. While we recognise and reward individual performance, we foster teamwork in our working environment as well as encouraging initiative and innovation.

Our members of staff receive and must abide by Codes of Conduct, which call for honesty, integrity, openness and teamwork for the benefit of customers, shareholders and the communities we serve.

We are committed to providing equality of opportunity to all staff, regardless of sex, race, nationality, age, disability, ethnic origin or status, on the basis of merit and suitability.

We believe in maintaining effective employee relations, and we are willing to work with and through recognised staff representative bodies.

HSBC in the Community

We are involved in the well-being of the communities where we operate through philanthropy and sponsorship.

Education, particularly for those less fortunate in society, and the environment are our two principal causes. Members of HSBC are expected to allocate 75 per cent of their donations and non-commercial sponsorship budgets to these activities, with the greater emphasis on educational initiatives which include:

- primary and secondary schooling for under-privileged children or support for schools in economically deprived areas;
- programmes to promote international understanding among young people;
- activities that promote interest in and sensitivity to other cultures;
- language programmes, particularly the learning of Asian languages;
- programmes which encourage youth to have a greater understanding of business and finance.

These activities are supplemented by direct support for other good causes. We encourage our staff to help raise money for charity and to do volunteer work.

The Environment

HSBC believes that sound business management should take account of the effects that business has on the environment, with a view to minimising detrimental impact. The pursuit of economic growth and a healthy environment are linked; governments, businesses and individuals all have a role to play in achieving sustainable development.

HSBC was among the original signatories of the United Nations Environment Programme Statement by Financial Institutions; we play a leadership role in its ongoing development.

We seek to adopt good environmental practices in respect of our premises, equipment and consumption of resources. We incorporate environmental considerations into credit and risk analysis, and we expect borrowers to comply with legal and regulatory requirements.

We support environmental projects in different parts of the world, including local scientific research, conservation, recycling and ecology programmes. Our staff are involved as volunteers in some of these programmes.

We publish a separate brochure explaining our Environmental Policy.

Implementation

These principles and values, which apply throughout the Group's operations, were affirmed by the Board of Directors of HSBC Holdings plc at its meeting on 26 March 1999. Senior managers of Group companies are responsible for ensuring conformity with these principles and values through employee awareness programmes, Codes of Conduct and operating procedures.

Board of Directors and Group General Managers

Directors



J R H Bond, *Group Chairman*

Age 57. An executive Director since 1990; Group Chief Executive from 1993 to May 1998. Joined the HSBC Group in 1961; an executive Director of The Hongkong and Shanghai Banking Corporation from 1988 to 1992. Chairman of Midland Bank plc, HSBC Bank USA (formerly Marine Midland Bank), HSBC Americas, Inc. and The British Bank of the Middle East. A Director of The Hongkong and Shanghai Banking Corporation and The Saudi British Bank and a non-executive Director of the London Stock Exchange and Orange Plc. Chairman of the Institute of International Finance and a member of the Banking Advisory Group of the International Finance Corporation.



* **Baroness Dunn**, *DBE, Deputy Chairman and senior non-executive Director*

Age 59. Executive Director of John Swire & Sons Limited and a Director of Swire Pacific Limited 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 The Hongkong and Shanghai Banking Corporation 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 68. 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.



K R Whitson

Age 56. Group Chief Executive. An executive Director since 1994. A Director of Midland Bank plc since 1992, Chief Executive from 1994 to March 1998 and Deputy Chairman since January 1998. Joined the HSBC Group in 1961. Deputy Chairman of the Supervisory Board of Trinkaus & Burkhardt KGaA. A Director of The Hongkong and Shanghai Banking Corporation, HSBC Americas, Inc., Hongkong Bank of Canada and HSBC Roberts S.A. de Inversiones. A non-executive Director of the Financial Services Authority.



* **Lord Butler**, *GCB, CVO*

Age 61. Master, University College, Oxford. A non-executive Director since May 1998. 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*

Age 47. A Director of Inchcape plc and Chairman of Inchcape Pacific Limited. A non-executive Director since May 1998. Chairman of HSBC Private Equity Management Limited and Co-Chairman of Beijing CAST Information System Technology Co., Ltd. A member of the 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 member of the Economic Advisory Committee to the Financial Secretary of the Hong Kong SAR. A Director of Hsin Chong Construction Group Ltd., Kader Holdings Company Limited and Tianjin Development Holdings Limited. A non-executive Director of The Hongkong and Shanghai Banking Corporation since 1997.



* **D E Connolly**, *OBE*

Age 67. Chartered Accountant. A Director of Kowloon-Canton Railway Corporation. A non-executive Director since 1990 and a non-executive Director of The Hongkong and Shanghai Banking Corporation from 1985 to May 1997.



W R P Dalton

Age 55. An executive Director since April 1998. 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 1980. President and Chief Executive Officer, Hongkong Bank of Canada from 1992 to December 1997. A Director of HSBC Investment Bank Holdings plc. A non-executive Director of MasterCard International Inc. and a non-executive Director and Chairman of Young Enterprise Limited.

**D G Eldon**

Age 53. An executive Director of the Company since 1 January 1999. Joined the HSBC Group in 1968. Appointed an executive Director and Chief Executive Officer of The Hongkong and Shanghai Banking Corporation in 1996; Chairman since 1 January 1999. Non-executive Chairman of Hang Seng Bank Limited and a non-executive Director of Swire Pacific Limited.

**D J Flint**

Age 43. Group Finance Director. An executive Director since 1995. A Director of HSBC Investment Bank Holdings plc, HSBC Bank Malaysia Berhad (formerly Hongkong Bank Malaysia Berhad), HSBC Roberts S.A. de Inversiones and HSBC Bank USA. A member of the Urgent Issues Task Force of the Accounting Standards Board. A former partner in KPMG.

*** W K L Fung, OBE**

Age 50. Group Managing Director and Chief Executive Officer of Li & Fung Limited. A non-executive Director since May 1998. 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 The Hongkong and Shanghai Banking Corporation since 1995.

**S K Green**

Age 50. Executive Director Investment Banking and Markets. Joined The Hongkong and Shanghai Banking Corporation in 1982. Group Treasurer from 1992 to February 1998. Chairman of HSBC Investment Bank Holdings plc and a Director of Midland Bank plc and Guyerzeller Bank AG.

*** Lord Marshall**

Age 65. Chairman of British Airways Plc, Inchcape plc and BTR Siebe plc. Deputy Chairman of British Telecommunications plc. A non-executive Director since 1993. Deputy 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 59. 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**

Age 60. Chairman of British Steel plc. A non-executive Director since March 1998. A non-executive Director of Enterprise Oil plc.

Board of Directors and Group General Managers (continued)



*** M Murofushi**

Age 67. 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 (retiring on 28 May 1999)

Age 70. Chairman of Raglan Properties plc, Jacobs Holdings PLC and Mountcity Holdings 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 The Hongkong and Shanghai Banking Corporation from 1986 to 1992. A non-executive Director of Midland Bank plc since 1992.



*** C E Reichardt**

Age 67. 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 59. 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 The Hongkong and Shanghai Banking Corporation since 1984 and Deputy Chairman since 1996.



*** Sir Adrian Swire**

Age 67. 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. Former Chairman of the International Chamber of Shipping and former President of the General Council of British Shipping.

** Independent non-executive Directors*

Advisers to the Board



M J Jacobi

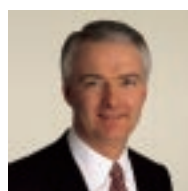
Age 47. Joined HSBC Bank USA as Senior Vice President Group Public Affairs USA in 1990. Head of Group Public Affairs, HSBC Holdings plc, from 1993 to 31 March 1998. Former Assistant Secretary of Commerce of the United States; former executive Director, Drexel Burnham Lambert; former Special Assistant to the President of the United States; and former Member, US Presidential Advisory Committee on Trade Negotiations.



D J Shaw

Age 52. An Adviser to the Board since June 1998. Solicitor. A partner in Norton Rose from 1973 to May 1998. A Director of HSBC Investment Bank Holdings plc.

Secretary



R G Barber

Age 48. Group Company Secretary since 1990. Joined the HSBC Group in 1980; Corporation Secretary of The Hongkong and Shanghai Banking Corporation from 1986 to 1992. Company Secretary of Midland Bank from 1994 to 1996.

Group General Managers

D Beath

Age 60. General Manager and Group Audit Controller. Joined the HSBC Group in 1960.

R E T Bennett

Age 47. General Manager and Group Legal Adviser. Joined the HSBC Group in 1979.

I M Burnett

Age 51. Chief Executive, HSBC Americas, and President and Chief Executive, HSBC Bank USA. Joined the HSBC Group in 1966.

V H C Cheng, OBE

Age 50. Executive Director, The Hongkong and Shanghai Banking Corporation and Chief Executive Officer, Hang Seng Bank. Joined the HSBC Group in 1978.

A Dixon, OBE

Age 54. Deputy Chairman, The British Bank of the Middle East. Joined the HSBC Group in 1965.

M F Geoghegan

Age 45. President and Chief Executive Officer, Banco HSBC Bamerindus. Joined the HSBC Group in 1973.

A P Hope

Age 52. General Manager Group Insurance. Joined Antony Gibbs & Sons Insurance in 1971.

A W Jebson

Age 49. Group General Manager Technical Services. Joined the HSBC Group in 1978.

C P Langley, OBE

Age 54. Executive Director, The Hongkong and Shanghai Banking Corporation. Joined the HSBC Group in 1961.

M B McPhee

Age 57. Group General Manager Credit and Risk. Joined Hongkong Bank of Canada in 1984.

A Mehta

Age 52. Chief Executive Officer, The Hongkong and Shanghai Banking Corporation. Joined the HSBC Group in 1968.

Y A Nasr

Age 44. President and Chief Executive Officer, Hongkong Bank of Canada. Joined HSBC Bank USA in 1976.

T W O'Brien

Age 51. Deputy Chairman and Chief Executive Officer, HSBC Bank Malaysia. Joined the HSBC Group in 1969.

R M J Orgill

Age 60. Group General Manager and Global Head of Corporate and Institutional Banking. Joined the HSBC Group in 1958.

J C S Rankin

Age 57. General Manager and Chief Executive Officer Singapore, The Hongkong and Shanghai Banking Corporation. Joined the HSBC Group in 1960.

R A Tennant

Age 56. General Manager Group Human Resources. Joined Midland Bank in 1960.

Report of the Directors

Results for 1998

The Group reported operating profits before provisions up 6 per cent to US\$9,051 million. As a result of an increased provision for bad and doubtful debts, the Group's profit for the year attributable to shareholders of the Company was US\$4,318 million, which represented a return of 15.5 per cent on shareholders' funds but was 21 per cent lower than 1997.

A first interim dividend of US\$0.37 per ordinary share was paid on 8 October 1998. The Directors have declared a second interim dividend of US\$0.555 per ordinary share, making a total distribution for the year of US\$2,495 million. The second interim dividend will be payable on 28 April 1999 in cash in United States dollars, or in sterling or Hong Kong dollars at exchange rates to be fixed on 16 April 1999, with a scrip dividend alternative. The reserves available for distribution before accounting for the second interim dividend of US\$1,499 million are US\$5,412 million.

Further information about the results is given in the consolidated profit and loss account on page 58.

Principal Activities and Business Review

Through its subsidiary and associated undertakings, the Group provides a comprehensive range of banking and related financial services through an international network of more than 5,000 offices in 79 countries and territories in the Asia-Pacific region, Europe, the Americas, the Middle East and Africa. Taken together, the five largest customers of the Group do not account for more than 1 per cent of the Group's income.

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 15.

Following a widespread review in 1998 of the Group's operations, a new five-year strategy designed to focus the Group on shareholder value was adopted. An account of the strategy 'Managing for Value' can be found on pages 16 to 18.

Capital and Reserves

The following events occurred during the year:

1. 5,326,641 ordinary shares of 75p and 10,574,613 ordinary shares of HK\$10 each were issued at par on 29 April 1998 to shareholders who elected to receive new shares in lieu of the 1997 second interim dividend. The value per share used to calculate shareholders' entitlements to new shares was 1,787.1p.
2. 1,065,564 ordinary shares of 75p and 3,921,208 ordinary shares of HK\$10 each were issued at par on 8 October 1998 to shareholders who elected to receive new shares in lieu of the 1998 first interim dividend. The value per share used to calculate shareholders' entitlements to new shares was US\$21.348, being the United States dollar equivalent of 1,303.3p.
3. Options over 1,498,550 ordinary shares of 75p each were awarded at nil consideration on 16 March 1998 under the Executive Share Option Scheme. The options are exercisable between the third and tenth anniversaries of the award at a price of 1,883p per share, the market value at the date of the award.
4. Options over 6,130,370 ordinary shares of 75p each were awarded at nil consideration on 6 April 1998 to 27,097 Group employees resident in 41 countries and territories under the Savings-Related Share Option Scheme. The options are exercisable within six months following the fifth anniversary of the commencement of the relevant savings contract on 1 August 1998 at a price of 1,566.38p per share, a 15 per cent discount to the market value at the date of the award.
5. Options over 805,567 ordinary shares of 75p each were awarded at nil consideration on 24 August 1998 for the benefit of 4,694 US resident Group employees under the Savings-Related Share Option Scheme (USA Section). The options are exercisable within six months following the fifth anniversary of the commencement of the relevant savings contract on 1 July 1998 at a price of 1,133.05p per share, a 15 per cent discount to the market value at the date of the award.

6. 520,421 ordinary shares of 75p each were issued at prices ranging from 541.8p to 1,566.38p per share in connection with the exercise of options under the Savings-Related Share Option Scheme and options over 3,277,524 ordinary shares of 75p each lapsed.
7. 731,196 ordinary shares of 75p each were issued at prices ranging from 651.8p to 1,505p per share in connection with the exercise of options under the Executive Share Option Scheme and options over 55,500 ordinary shares of 75p each lapsed.
8. 1,175,426 ordinary shares of 75p each were issued at prices ranging from 118.43p to 222.68p per share in connection with the exercise of options under the Midland Bank Savings-Related and Executive Share Option Schemes and options over 40,329 ordinary shares of 75p each lapsed.

Valuation of Freehold and Leasehold Land and Buildings

The Group's freehold and long leasehold properties, together with all leasehold properties in the Hong Kong SAR, were revalued in November 1998 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 US\$2,294 million.

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

Board of Directors

The objectives of the management structures within the Group, headed by the Board of Directors and led by the Group Chairman, are to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the Group Executive Committee under the leadership of the Group Chief Executive.

The Board meets regularly and between meetings Directors receive information about the activities of committees and developments in the Group's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The Directors who served during the year were J R H Bond, Baroness Dunn, Sir Peter Walters, K R Whitson, B H Asher, Lord Butler, R K F Ch'ien, D E Connolly, W R P Dalton, D J Flint, W K L Fung, S K Green, Sir Joseph Hotung, C D Mackay, Lord Marshall, C Miller Smith, Sir Brian Moffat, M Murofushi, Sir Wilfrid Newton, Sir William Purves, C E Reichardt, H Sohmen, J E Strickland and Sir Adrian Swire.

B H Asher retired on 28 February 1998; Sir William Purves, Sir Joseph Hotung and C D Mackay retired on 29 May 1998; and J E Strickland retired on 31 December 1998.

S K Green was appointed a Director on 1 March 1998; Sir Brian Moffat on 27 March 1998; W R P Dalton on 1 April 1998; and Lord Butler, R K F Ch'ien and W K L Fung were appointed Directors on 2 May 1998.

D G Eldon was appointed a Director on 1 January 1999. Having been appointed since the last Annual General Meeting, he will retire at the forthcoming Annual General Meeting and offers himself for election.

J R H Bond, D J Flint, Lord Marshall, C Miller Smith, M Murofushi, Sir Wilfrid Newton, C E Reichardt and Sir Peter Walters will retire by rotation at the Annual General Meeting. With the exception of Sir Wilfrid Newton, who will retire, they offer themselves for re-election.

Brief biographical particulars for each Director are set out on pages 22 to 24.

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.

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 Group Executive Committee are K R Whitson (Chairman), J R H Bond,

Report of the Directors (continued)

W R P Dalton, D G Eldon, D J Flint and S K Green, all of whom are executive Directors, and I M Burnett, A P Hope, A W Jebson, M B McPhee, A Mehta and R M J Orgill, all of whom are Group General Managers.

Group Audit Committee

The Group Audit Committee meets regularly with the Group's senior financial, internal audit and compliance management and the external auditor to consider the Company's financial reporting, 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, Sir Brian Moffat and C E Reichardt, all of whom are non-executive Directors.

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

Nomination Committee

The Nomination Committee carries out the process of nominating candidates to fill vacancies on the Board of Directors. Nominations are considered by the Board. All Directors are subject to election by shareholders at the Annual General Meeting following their appointment and to re-election at least every three years. The members of the Nomination Committee are the members of the Remuneration Committee, together with the Group Chairman.

Corporate Governance

The Group is committed to high standards of corporate governance. The Company has complied throughout the year with the provisions of Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong and with the best practice provisions of the Combined Code on corporate governance introduced by the London Stock Exchange in June 1998, save that the level of proxies lodged in respect of resolutions at the Annual General Meeting held in May were not announced at the meeting, but were available to shareholders on request in accordance with the Company's policy at that time.

Internal Control

The Directors are responsible for internal 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 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, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; 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 such internal 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 reporting and the adequacy of the internal control structure.
- Annual reviews of the systems of internal control throughout the Group are conducted against a detailed checklist which covers internal controls from both a financial and non-financial perspective, and their effectiveness is reported on to the appropriate audit committee.

The Group Audit Committee has reviewed the effectiveness of the overall system of internal control throughout 1998 and the subsequent period up to 22 February 1999 when the financial statements were signed. The review has been undertaken before formal guidance has been issued as to the scope of such a review and the procedures to be undertaken and may, therefore, require some amendment once guidance has been received.

Communication with Shareholders

Communication with shareholders is given high priority. Extensive information about the Group's activities is provided in the *Annual Report and Accounts* and the *Interim Report* which are sent to shareholders. There is regular dialogue with institutional investors and enquiries from individuals on matters relating to their shareholdings and the business of the Group are welcomed and are dealt with in an informative and timely manner. All shareholders are encouraged to attend the Annual General Meeting or the informal meeting of shareholders held in Hong Kong to discuss the progress of the Group.

Remuneration

Policy

Within the authority delegated by the Board of Directors, the Remuneration Committee is responsible for determining the remuneration policy of the Group, including the terms of bonus schemes, share option schemes and other long-term incentive schemes, and for determining the individual remuneration packages of executive Directors and other senior Group employees. No Directors are involved in deciding their own remuneration.

The Remuneration 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 Company's shareholders. The Remuneration 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 Remuneration Committee considers the practices and levels of remuneration in appropriate comparator companies which operate in similar industry sectors and territories to those in

Report of the Directors (continued)

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.

As part of the recent review of the Group's five-year strategy, it has been decided to extend the use of the existing share schemes so that more employees are able to participate in the success they help to create. The vesting of all awards will be subject to the attainment of total shareholder return targets.

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. Closer alignment with the interests of shareholders is intended to be achieved by extending employee participation in the existing share schemes.

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 predetermined total shareholder return targets.

Executive Directors and Group General Managers have been eligible to receive conditional awards under the Restricted Share Plan since 1996. The Restricted Share Plan will be extended to other senior executives from 1999. Participants in the Restricted Share Plan are not eligible to participate in the Executive Share Option Scheme, although options previously granted remain valid.

Participants in the Restricted Share Plan are also eligible to participate in the Savings-Related Share Option Scheme on the same terms as other eligible employees.

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 R H Bond, who is to retire by rotation and stand for re-election at the forthcoming Annual General Meeting, is employed on a contract which requires 12 months' notice to be given by either party.

D J Flint, who is to retire by rotation and stand for re-election at the forthcoming Annual General Meeting, is employed on a contract which requires 12 months' notice to be given by the Company and nine months' notice to be given by Mr Flint.

D G Eldon, who was appointed a Director on 1 January 1999, will stand for election at the forthcoming Annual General Meeting. He is employed on a contract which requires three months' notice to be given by either party.

Directors' emoluments

The emoluments of the Directors of the Company for 1998 were as follows:

| | <i>Fees</i> | <i>Salary and other remuneration</i> | <i>Benefits in kind</i> | <i>Discretionary bonuses¹</i> | <i>Total 1998</i> | <i>Total 1997</i> |
|---------------------------------|-------------|--|-----------------------------|--|-----------------------|-----------------------|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Executive Directors | | | | | | |
| B H Asher ² | 4 | 103 | 14 | — | 121 | 598 |
| J R H Bond | 25 | 494 | 1 | 135 | 655 | 626 |
| — waived | (20) | | | | (20) | (20) |
| W R P Dalton ³ | 19 | 296 | — | 100 | 415 | — |
| D J Flint | 25 | 356 | 7 | 77 | 465 | 450 |
| S K Green ⁴ | 21 | 293 | 4 | 80 | 398 | — |
| Sir William Purves ⁵ | 10 | 267 | 21 | 100 | 398 | 731 |
| — waived | (8) | | | | (8) | (20) |
| J E Strickland ⁶ | 20 | 336 | 578 | — | 934 | 958 |
| — waived | (25) | | | | (25) | (25) |
| K R Whitson | 25 | 377 | 34 | 90 | 526 | 478 |
| — waived | (20) | | | | (20) | — |
| Non-executive Directors | | | | | | |
| Lord Butler ⁷ | 17 | — | — | — | 17 | — |
| R K F Ch'ien ⁷ | 92 | — | — | — | 92 | — |
| D E Connolly | 33 | — | — | — | 33 | 41 |
| Baroness Dunn | 33 | — | — | — | 33 | 33 |
| W K L Fung ⁷ | 30 | — | — | — | 30 | — |
| Sir Joseph Hotung ⁵ | 14 | — | — | — | 14 | 33 |
| C D Mackay ⁵ | 10 | — | — | — | 10 | 25 |
| Lord Marshall | 25 | — | — | — | 25 | 25 |
| C Miller Smith | 25 | — | — | — | 25 | 25 |
| Sir Brian Moffat ⁸ | 23 | — | — | — | 23 | — |
| M Murofushi | 25 | — | — | — | 25 | 25 |
| Sir Wilfrid Newton | 60 | — | — | — | 60 | 60 |
| C E Reichardt | 25 | — | — | — | 25 | 25 |
| H Sohmen | 25 | — | — | — | 25 | 25 |
| — waived | (30) | | | | (30) | (30) |
| Sir Adrian Swire | 25 | — | — | — | 25 | 25 |
| Sir Peter Walters | 30 | — | — | — | 30 | 30 |
| Total (£) | 641 | 2,522 | 659 | 582 | 4,404 | 4,213 |
| Total (US\$) | 1,063 | 4,182 | 1,093 | 965 | 7,303 | 6,907 |

¹ These discretionary bonuses are in respect of 1998 and will be paid in 1999.

² Retired on 28 February 1998.

³ Appointed on 1 April 1998.

⁴ Appointed on 1 March 1998.

⁵ Retired on 29 May 1998.

⁶ The emoluments of J E Strickland include housing and other expatriate benefits in kind which are normal within the location in which he was employed. J E Strickland retired on 31 December 1998.

⁷ Appointed on 2 May 1998.

⁸ Appointed on 27 March 1998.

Report of the Directors (continued)

Executive Directors who are also Directors of The Hongkong and Shanghai Banking Corporation Limited may elect to receive a fee from either the Company or The Hongkong and Shanghai Banking Corporation Limited. H Sohmen has elected to waive any fees payable to him by the Company.

1999 conditional awards under the Restricted Share Plan

The Remuneration Committee has decided that conditional awards under the Restricted Share Plan should be made in 1999 and that the Trustee to the Plan should be provided with funds to acquire ordinary shares of 75p each between 22 February and 5 March 1999. The 1999 awards to executive Directors and Group General Managers in respect of 1998 will have an aggregate value at the date of award of £3.025 million and will include awards to the following values to executive Directors:

| | <u>£000</u> |
|--------------|--------------|
| J R H Bond | 300 |
| W R P Dalton | 175 |
| D G Eldon | 175 |
| D J Flint | 175 |
| S K Green | 175 |
| K R Whitson | 250 |
| Total | <u>1,250</u> |

Purpose

The Restricted Share Plan is intended to reward the delivery of sustained financial growth of the Company. So as to align the interests of Directors and senior employees more closely with those of shareholders, the Restricted Share Plan links the vesting of 1999 awards to the attainment of predetermined total shareholder return (TSR) targets.

TSR is defined as the growth in share value and declared dividend income during the relevant period. In calculating TSR, dividend income is assumed to be reinvested in the underlying shares.

The vesting of previous years' awards was linked to growth in earnings per share. The performance conditions and vesting rules for those awards are as set out in the Report by the Remuneration Committee in the 1996 and 1997 *Annual Report and Accounts*.

To illustrate how the Restricted Share Plan is to be applied for 1999 awards, particulars of the terms are set out below.

Vesting schedule

Having regard to the Company's size and status within the financial sector, a benchmark has been established which takes account of:

1. a peer group of nine banks;
2. the five largest banks from each of the United States, the United Kingdom, continental Europe and the Far East, other than any within 1 above; and
3. the banking sector of the Morgan Stanley Capital International World Index, excluding any within 1 and 2 above.

By combining the above three elements and weighting the average so that 50 per cent is applied to 1, 25 per cent is applied to 2 and 25 per cent is applied to 3, an appropriate market comparator is determined.

For vesting of the 1999 awards to be achieved, the Company's TSR over a three-year period must exceed the mean of the benchmark. The calculation of the share price component within the Company's TSR will be the average market price over the 20 trading days commencing on the day when the annual results are announced, which in 1999 was 22 February. The starting point will be, therefore, the average over the period 22 February to 19 March inclusive. TSR for the benchmark banks will be based on the published share price for 19 March 1999.

If the Company's TSR exceeds the benchmark mean, but is less than the top quartile of the benchmark, the shares will be deemed to have vested in full but will be retained by the Trustee for a further two years with release being

dependent upon the participant remaining with the Company. If the Company's TSR is in the top quartile of the benchmark, an additional award of 20 per cent of the original shares will be added, to be released to the participants two years later, again subject to continued employment. The two-year additional retention period is intended to encourage longer-term shareholding by those concerned.

If the Company's TSR has not exceeded the benchmark mean at the end of year 3, then the test will be applied over a four-year period at the end of year 4; if still not attained, then the test will be applied over a five-year period at the end of year 5. If the test is satisfied in either case, the shares will be released after five years, contingent upon continued employment. If the test has not been satisfied by the end of year 5, then the particular share award will be forfeited. No additional shares will be awarded even where the Company's TSR is in the top quartile where a share award has to rely on the year 4 or year 5 test in order to vest.

The Remuneration Committee retains discretion to allow early release of share awards in the event of termination of employment due to retirement; injury, illness or disability; redundancy or death. Awards will be forfeited if the participant is dismissed or resigns from the Company.

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 Remuneration Committee considers to be anomalous, the right is reserved to the Remuneration Committee to make such adjustments as in its absolute discretion it deems appropriate to make.

Pensions

The pension entitlements earned by the executive Directors during the year are shown below.

The pension arrangements for J R H Bond, S K Green 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 were, and for D G Eldon are, provided under the HSBC International Staff Retirement Benefits Scheme. Pension accrues at a rate of one twenty-seventh of pensionable salary per year of pensionable service.

The pension arrangements for W R P Dalton to contractual retirement age of 60 are provided under the Hongkong Bank of Canada Pension Plan A at an accrual rate of one thirtieth of pensionable salary per year of pensionable service and under the HSBC Holdings Overseas (No.1) Pension Plan on a defined contribution basis, with an employer contribution of £129,000 having been made during 1998.

| | <i>Accrued annual pension at 31 December 1998 £000</i> | <i>Increase in accrued pension during 1998, excluding any increase for inflation £000</i> | <i>Personal contributions towards pension £000</i> | <i>Transfer value relating to increase in accrued pension* £000</i> |
|----------------|--|---|--|---|
| J R H Bond | 103 | 27 | — | 434 |
| W R P Dalton | 218 | — | — | — |
| S K Green | 74 | 22 | — | 254 |
| J E Strickland | 182 | 18 | 11 | 12 |
| K R Whitson | 87 | 27 | — | 402 |

* 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.

In recognition of extended unpensioned UK service, B H Asher, who retired on 28 February 1998, was granted an unfunded pension of £75,000 per annum, subject to annual review, with effect from 1 March 1998.

In recognition of 5½ years of unpensioned service in the UK, Sir William Purves, who retired on 29 May 1998, was granted an unfunded pension of £80,000 per annum, subject to annual review, with effect from 1 June 1998.

Report of the Directors (continued)

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

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 | At 31 December 1998 | | | | Total |
|---|-------------------|---------------------|---------|----------------------|----------------------|---------|
| | 1998 ¹ | Personal | Family | Corporate | Other | |
| Ordinary shares of HK\$10 | | | | | | |
| J R H Bond | 18,259 | 18,390 | 501 | — | — | 18,891 |
| R K F Ch'ien | 7,405 | 7,405 | — | — | — | 7,405 |
| D E Connolly | 15,855 | 16,400 | — | — | — | 16,400 |
| W R P Dalton | 304 | 314 | — | — | — | 314 |
| Baroness Dunn | 20,000 | 22,788 | — | — | — | 22,788 |
| D G Eldon ⁴ | 850 | 850 | — | — | — | 850 |
| D J Flint | 1,000 | 1,730 | — | — | — | 1,730 |
| W K L Fung | 95,834 | 95,834 | — | — | — | 95,834 |
| S K Green | 4,152 | — | 4,221 | — | — | 4,221 |
| Sir Wilfrid Newton | 3,869 | 4,003 | — | — | — | 4,003 |
| C E Reichardt | — | 10,000 | — | — | — | 10,000 |
| H Sohmen | 820,437 | — | 120,666 | 749,771 ² | — | 870,437 |
| J E Strickland | 30,987 | 30,805 | 714 | — | — | 31,519 |
| Sir Adrian Swire | 98,000 | — | — | — | 108,833 ³ | 108,833 |
| K R Whitson | 1,755 | 1,814 | — | — | — | 1,814 |
| Ordinary shares of 75p⁵ | | | | | | |
| Baroness Dunn | 8,000 | — | — | — | 8,000 ³ | 8,000 |
| Lord Marshall | 2,122 | 2,196 | — | — | — | 2,196 |
| Sir Brian Moffat | 1,655 | — | 1,713 | — | — | 1,713 |
| Sir Wilfrid Newton | 2,000 | 4,500 | — | — | — | 4,500 |
| J E Strickland | 10,364 | 13,597 | — | — | — | 13,597 |
| Sir Adrian Swire | 8,000 | — | — | — | 8,000 ³ | 8,000 |
| Sir Peter Walters | 13,005 | 13,005 | — | — | — | 13,005 |
| 11.69% subordinated bonds 2002 of £1 | | | | | | |
| J R H Bond | 500,000 | 500,000 | — | — | — | 500,000 |
| Baroness Dunn | 70,000 | — | — | — | — | — |
| Lord Marshall | 975 | 975 | — | — | — | 975 |
| Sir Wilfrid Newton | 35,000 | — | — | — | — | — |
| Sir Adrian Swire | 359 | — | — | — | — | — |
| Sir Peter Walters | 6,500 | 6,500 | — | — | — | 6,500 |

1 Or at date of appointment if later.

2 Interests held by private investment companies.

3 Non-beneficial.

4 Interests at 1 January 1999, i.e. date of appointment.

5 Details of additional interests in ordinary shares of 75p each under the Share Option Schemes and Restricted Share Plan are set out below.

Share options (ordinary shares of 75p)

At 31 December 1998, 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 1998 was 1,630 pence. The highest and lowest market values during the year were 2,025 pence and 982 pence. Market value is the mid-market price quoted on the London Stock Exchange on the relevant date.

| | <i>Options held at 1 January 1998¹</i> | <i>Options awarded during year</i> | <i>Options exercised during year</i> | <i>Options held at 31 December 1998</i> | <i>Exercise price in pence</i> | <i>Date of award</i> | <i>Exercisable from⁴</i> | <i>Exercisable until⁴</i> |
|------------------------|---|------------------------------------|--------------------------------------|---|--------------------------------|----------------------|-------------------------------------|--------------------------------------|
| 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 ² | 541.80 | 10 Apr 1995 | 1 Aug 2000 | 31 Jan 2001 |
| | 25,000 | — | — | 25,000 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| W R P Dalton | 7,568 | — | — | 7,568 | 721.84 | 12 Oct 1993 | 12 Oct 1996 | 12 Oct 2003 |
| | 10,091 | — | — | 10,091 | 851.27 | 8 Mar 1994 | 8 Mar 1997 | 8 Mar 2004 |
| | 12,000 | — | — | 12,000 | 651.80 | 7 Mar 1995 | 7 Mar 1998 | 7 Mar 2005 |
| | 2,875 | — | — | 2,875 ² | 541.80 | 10 Apr 1995 | 1 Aug 2000 | 31 Jan 2001 |
| | 12,000 | — | — | 12,000 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| D G Eldon ⁵ | 8,577 | — | — | 8,577 | 721.84 | 12 Oct 1993 | 12 Oct 1996 | 12 Oct 2003 |
| | 10,091 | — | — | 10,091 | 851.27 | 8 Mar 1994 | 8 Mar 1997 | 8 Mar 2004 |
| | 12,000 | — | — | 12,000 | 651.80 | 7 Mar 1995 | 7 Mar 1998 | 7 Mar 2005 |
| | 13,500 | — | — | 13,500 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| D J Flint | 12,000 | — | — | 12,000 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| | 1,271 | — | — | 1,271 ² | 1,356.18 | 9 Apr 1997 | 1 Aug 2002 | 31 Jan 2003 |
| S K Green | 8,072 | — | — | 8,072 | 721.84 | 12 Oct 1993 | 12 Oct 1996 | 12 Oct 2003 |
| | 12,108 | — | — | 12,108 | 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 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| | 1,879 | — | — | 1,879 ² | 917.70 | 3 Apr 1996 | 1 Aug 2001 | 31 Jan 2002 |
| 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 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |
| | 1,271 | — | — | 1,271 ² | 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 ² | 541.80 | 10 Apr 1995 | 1 Aug 2000 | 31 Jan 2001 |
| | 20,000 | — | — | 20,000 ³ | 1,000.00 | 1 Apr 1996 | 1 Apr 1999 | 1 Apr 2006 |

1 Or at date of appointment if later.

2 Options awarded under the Savings-Related Share Option Scheme.

3 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.

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

5 Options at 1 January 1999, i.e. date of appointment.

Report of the Directors (continued)

Restricted Share Plan (ordinary shares of 75p)

| | <i>Awards held at 1 January 1998¹</i> | <i>Awards made during year</i> | <i>Monetary value of awards made during year (£000)</i> | <i>Awards vested during year</i> | <i>Awards held at 31 December 1998²</i> | <i>Year in which awards will vest</i> |
|------------------------|--|--------------------------------|---|----------------------------------|--|---------------------------------------|
| J R H Bond | 7,884 | — | — | — | 8,156 | 2001 or 2002 |
| | — | 8,333 | 150 | — | 8,613 | 2002 or 2003 |
| W R P Dalton | 4,931 | — | — | — | 5,101 | 2001 or 2002 |
| | 10,000 | — | — | — | 10,345 ⁴ | 2001 |
| | — | 5,556 ³ | 100 | — | 5,748 | 2002 or 2003 |
| D G Eldon ⁵ | 6,121 | — | — | — | 6,121 | 2001 or 2002 |
| | — | 6,896 | 120 | — | 6,896 | 2002 or 2003 |
| D J Flint | 4,931 | — | — | — | 5,101 | 2001 or 2002 |
| | — | 5,556 | 100 | — | 5,748 | 2002 or 2003 |
| S K Green | 5,917 | — | — | — | 6,121 | 2001 or 2002 |
| | — | 6,666 | 120 | — | 6,896 | 2002 or 2003 |
| J E Strickland | 5,917 | — | — | 3,060 | — | — |
| K R Whitson | 5,917 | — | — | — | 6,121 | 2001 or 2002 |
| | — | 6,666 | 120 | — | 6,896 | 2002 or 2003 |

Unless otherwise indicated, vesting of these shares is subject to the performance tests described in the Report of the Remuneration Committee in the 1996 and 1997 Annual Report and Accounts being satisfied.

1 Or at date of appointment if later.

2 Includes additional shares arising from scrip dividends.

3 Held on date of appointment.

4 Award not subject to performance conditions.

5 Interests at 1 January 1999, i.e. date of appointment.

S K Green has a personal interest in £100,000 of Midland Bank plc 9 per cent subordinated notes 2005, which he held on the date of his appointment and at the end of the year.

H Sohmen has a corporate interest in £1,200,000 of Midland Bank plc 9 per cent 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.

Interests held by D G Eldon at the date of his appointment as a Director, i.e. 1 January 1999, have been included in the above tables.

Sir Adrian Swire acquired a non-beneficial interest in an additional 19,000 ordinary shares of HK\$10 each on 12 February 1999.

There have been no other changes in Directors' interests from 31 December 1998 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.

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.

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 1998.

| | <i>£000</i> |
|---|--------------|
| Basic salaries, allowances and benefits in kind | 1,816 |
| Pension contributions | 160 |
| Bonuses paid or receivable | 6,204 |
| Total | <u>8,180</u> |

Their emoluments are within the following bands:

| | <i>Number of employees</i> |
|-------------------------|----------------------------|
| £800,001 – £900,000 | 1 |
| £1,100,001 – £1,200,000 | 1 |
| £1,500,001 – £1,600,000 | 1 |
| £2,100,001 – £2,200,000 | 1 |
| £2,400,001 – £2,500,000 | 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 45,000 Group employees in 43 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 subscribes to the Better Payment Practice Code for all suppliers, the four principles of which are to agree payment terms at the outset and stick to them; explain payment procedures to suppliers; pay bills in accordance with any contract agreed with the supplier or as required by law; and tell suppliers without delay when an invoice is contested and settle disputes quickly.

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 1998 represented 23 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 are recorded in the register maintained under section 211 of the Companies Act 1985:

| | <i>% of class</i> |
|--|-------------------|
| <i>Interests in ordinary shares of HK\$10 each</i> | |
| Hong Kong Monetary Authority | 13.23 |
| <i>Interests in ordinary shares of 75p each</i> | |
| Standard Life Group | 5.52 |
| The Prudential Corporation Group of Companies | 4.75 |
| Legal & General Group | 3.51 |

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. The Hong Kong Monetary Authority has informed the Company that the disclosure provisions of the Securities (Disclosure of Interests) Ordinance do not apply in respect of its interests. However, it has been publicly announced that the Hong Kong SAR Government holds 8.9 per cent of the Company's total issued ordinary share capital.

Dealings in HSBC Holdings plc Shares

HSBC Investment Bank plc is an intermediary in the shares of the Company in London. In addition, during the year ended 31 December 1998, a subsidiary undertaking of the Company sold 40,000 ordinary shares of HK\$10 each. The aggregate consideration for the sale was HK\$6.4 million.

Connected Transactions

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

In March 1998, HSBC Investment Bank Holdings BV, a wholly owned subsidiary, acquired 312,111 ordinary shares in HSBC Simpson McKie (Proprietary) Limited, being the remaining 10.16 per cent of the issued ordinary share capital it did not already own, from 52 employees, including 14 directors, of HSBC Simpson McKie (Proprietary) Limited for a total consideration of 45 million rand.

In March 1998, HSBC Investment Bank Holdings BV, a wholly owned subsidiary, entered into an agreement with M Murarka and R Agarwal, holders of the 49 per cent of the share capital of HSBC Batlivala & Karani Securities Holdings Private Limited not owned by HSBC Investment Bank Holdings BV, to sell their shareholding to third parties nominated by HSBC Investment Bank Holdings BV for a total consideration of US\$17 million. Each new minority shareholder granted HSBC Investment Bank Holdings BV a call option in relation to their respective holdings.

In March 1998, HSBC Asset Management Asia Pacific Limited, a wholly owned subsidiary, acquired 75,000 ordinary shares in HSBC Private Equity Management Limited and 250 ordinary shares in HSBC Private Equity Management Hong Kong Limited, being the remaining 25 per cent of the issued ordinary share capital of these companies it did not already own, and 1,400 'B' shares in Private Equity Management BVI Limited. The shares were acquired from D F J Paterson, a former director of the three companies, for a total consideration of US\$15 million.

In May 1998, The Hongkong and Shanghai Banking Corporation Limited and Midland Bank plc, both wholly owned subsidiaries, entered into an agreement with JWL Property Finance Limited, a 75 per cent owned subsidiary of Midland Bank plc, to vary existing agreements for a total consideration payable to JWL Property Finance Limited of £8.2 million. In addition, Midland Bank plc sold 3,750 ordinary shares in JWL Property Finance Limited, being 75 per cent of the issued ordinary share capital, to J W Lloyd, the holder of the remaining 25 per cent, for a total consideration of £556,000.

In September 1998, HSBC Insurance (Asia-Pacific) Holdings Limited, a wholly owned subsidiary, acquired 175 ordinary shares in HSBC Non-Life Holdings Limited, representing the remaining 17.5 per cent of the issued ordinary share capital it did not already own, from Actinium Holding Corporation, for a consideration of HK\$160 million. Actinium Holding Corporation was the Trustee of a unit trust in which the family of The Honourable Michael D Kadoorie, who resigned as a non-executive director of HSBC Non-Life Holdings Limited on completion of the acquisition, had an indirect interest.

In December 1998, HSBC Investment Bank Holdings BV, a wholly owned subsidiary, agreed to acquire 2,500 shares, representing the remaining 25 per cent of the issued ordinary share capital not already owned by HSBC Group companies, and approximately 939 *bons de jouissance* (bonus shares) in Guyerzeller Bank AG for a consideration of SFr179.5 million, from Holdingmaatschappij Matron BV. Save for holding the above-mentioned securities, Holdingmaatschappij Matron BV had no connection with the HSBC Group.

Donations

During the year, the Group made charitable donations totalling US\$10,845,000. Of this amount, US\$3,863,000 was given for charitable purposes in the United Kingdom.

No political donations were made during the year.

Year 2000 Readiness

The Group recognises that with the approach of the new millennium the inability of systems around the world to recognise the date change from 31 December 1999 to 1 January 2000 could pose significant issues. The Group has adopted the Year 2000 conformity requirements issued by the British Standards Institution as its definition of Year 2000 compliance.

The Group has assessed the impact of Year 2000 and does not expect either its operations or service to customers to be disrupted as a result of the Group's systems not being Year 2000 compliant. Steering Committees have been formed in all the key business units and progress on the Year 2000 compliance programme ('the Year 2000 Programme') is reported regularly to their Boards of Directors and to the Group Audit and Executive Committees.

The Year 2000 Programme involves testing all the Group's relevant systems to ensure that they are Year 2000 compliant and seeking confirmation from suppliers and service providers that their products and services are Year 2000 compliant. The Group is also assessing its customers' commitment to achieving compliance and is providing information and assistance to help customers understand the risks and issues. Relevant credit and investment policies have been revised and relationship managers trained to ensure that Year 2000 risks are taken account of in credit and investment evaluations.

Substantially all lines of programme code in the Group's computer systems have already been reviewed for Year 2000 compliance and amended or replaced where necessary. The great majority of these systems have been tested and are in use. In addition, the small number of computer systems which remain non-compliant are planned to be replaced by mid-1999 as part of the Group's existing technology development programme and expenditure.

In other areas of information technology (IT), the Group is reviewing its end-user computing applications, networks, centralised data systems, and the desktop environment for Year 2000 compliance. Substantially all of the Group's end-user computing applications and inventory items related to the Group's networks have already been made compliant. Our programme to ensure the hardware and software elements of the Group's data centre systems have been made Year 2000 compliant is on schedule and substantially complete.

The Group has evaluated the potential effect of the Year 2000 on its non-IT systems, including its facilities and other business processes. Substantially all of the Group's facilities and related systems have been investigated and, where not already compliant, are in the process of being made so compliant. Other business processes are similarly being addressed across the Group.

Revisions to Group-wide business contingency plans are being finalised to address the perceived risks associated with the arrival of the Year 2000. These plans include mitigating the effects of any failure to complete remedial work on critical business systems, business resumption contingency plans to address the possibility of systems failure, and

Report of the Directors (continued)

market resumption contingency plans to address the possibility of the failure of systems or processes outside the Group's control. The Group is, however, unable to predict the effect if any of the efforts to address the Year 2000 problem fail.

Lack of readiness on the part of third parties would expose the Group to the potential for loss, impairment of business processes and activities, and disruption of financial markets. The Group is addressing these risks through bilateral and multiparty efforts and participates in industry, country and global initiatives.

For more than a decade parts of the Group have been modifying their systems to be Year 2000 compliant when making other enhancements. The costs of the Year 2000 modifications made as part of such a combined package have not been separately identified. Costs incurred for the year ended 31 December 1998 were US\$113 million (including US\$48 million attributable to incremental external costs). The Group expects that the cost of completing the Year 2000 compliance and testing process will be approximately US\$52 million (including US\$20 million attributable to incremental external costs). Costs relating to major systems changes that are not directly related to the Year 2000 but which address some Year 2000 issues are not included in these costs.

Annual General Meeting

The Annual General Meeting of the Company will be held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 28 May 1999 at 11.00 a.m.

An informal meeting of shareholders will be held at Level 28, 1 Queen's Road Central, Hong Kong on Tuesday, 25 May 1999 at 4.00 p.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 determine its remuneration will be submitted to the forthcoming Annual General Meeting.

On behalf of the Board
R G Barber, *Secretary*

22 February 1999

Financial Review

Summary of Financial Performance

Group profit

The HSBC Group made a profit before tax of US\$6,571 million in 1998, a fall of US\$1,559 million, or 19 per cent, compared with 1997.

Net interest income of US\$11,547 million was US\$603 million, or 6 per cent, higher than 1997. Other operating income rose by US\$843 million, or 11 per cent, to US\$8,508 million.

The Group's cost:income ratio deteriorated marginally to 54.9 per cent from 54.0 per cent in 1997 after taking account of exceptional property costs in the UK as a result of the prospective move to Canary Wharf.

The charge for bad and doubtful debts was US\$2,637

million, which was US\$1,623 million higher than in 1997, reflecting the continuing downturn in Asia and its impact on asset quality in several economies. It included general provisions of US\$10 million, compared with US\$481 million in 1997, which included the special general provision charge of US\$290 million for Asian risk. In view of the continuing unsettled economic environment in Asia, this special general provision has been left intact.

The gains on disposal of investments were US\$222 million, US\$333 million lower than in 1997.

Profit attributable to shareholders was US\$4,318 million in 1998, a fall of 21 per cent.

Shareholder ratios

Basic earnings per share decreased by 22 per cent, from US\$2.06 to US\$1.61. Diluted earnings per share decreased by 22 per cent, from US\$2.04 to US\$1.59.

The headline earnings per share, which is calculated in accordance with the Institute of Investment Management and Research Statement of Investment Practice, decreased by 44 US cents, or 22 per cent. The headline earnings per share excluded profit on the sale of tangible fixed assets and subsidiaries and the charge for amortisation of goodwill.

The return on average shareholders' funds, at 15.5 per cent, was lower than the 20.7 per cent return in 1997.

Shareholders' funds rose by a net US\$322 million to US\$27,402 million, including the retention of US\$1,823 million of Group profits, and the take-up of scrip dividends and shares issued under options totalling US\$601 million in aggregate. These were partly offset by a deficit on the revaluation of Group and investment properties of US\$2,033 million.

The Directors have declared a second interim dividend of US\$0.555 per ordinary share (in lieu of a final dividend) which, together with the first interim dividend of US\$0.370, will make a total distribution for the year of US\$0.925 (1997: US\$0.830), an increase of 11 per cent. The dividend is covered 1.7 times by attributable profit (1997: 2.5 times).

Net interest income

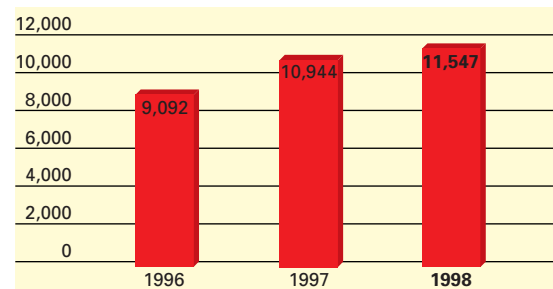
An improvement of 6 per cent in net interest income was achieved in difficult circumstances as the slowdown in a number of regions in which the Group operates resulted in only modest loan demand and increased levels of interest suspended on non-performing loans. Income levels rose in Latin America (61 per cent) due to a full year's contribution from recent acquisitions, in Europe (5 per cent), were slightly higher in Hong Kong, and fell by 1 per cent in the rest of Asia-Pacific and 2 per cent in North America.

Average interest-earning assets increased by US\$30 billion, or 8 per cent, to US\$406 billion for 1998. The growth, principally in customer advances and short-term funds to banks, occurred mainly in Europe, North America and Hong Kong as demand for advances in

the weakening economies of the Asia-Pacific region was modest.

The Group's net interest margin at 2.84 per cent was 7 basis points lower than for 1997. The increased

Net interest income (US\$m)



Financial Review (continued)

contribution from the Group’s higher margin business in Latin America only partially offset the impact of higher levels of interest suspended on non-performing loans, increased funding costs and the reduced contribution from net free funds resulting from the reduction in the ratio of net free funds to average interest-earning assets.

In Europe, Midland Bank’s UK domestic margin fell as the impact of competitive pressures on retail liability products and credit cards resulted in a narrowing in spread. Growth in average interest-earning assets, primarily in finer margin lending to large corporate borrowers and fixed rate mortgage lending, led to a change in asset mix. The growth in the funding costs of operating leased assets and an increase in lower yielding treasury assets also contributed to the lower margin. An increased contribution from higher levels of net free funds partially offset the reduction in spread.

Margins in Hong Kong deteriorated as a result of a combination of higher levels of suspended interest on non-performing loans and the effect of the periodic substantial narrowing of the gap between the best lending rate and the interbank rates. A fall in the average advances-to-deposits ratio resulting from a slowdown in the growth in customer advances in the second half of the year and a change in asset mix as surplus funds were placed in lower yielding short-term funds to banks also reduced margins. The effect of increased competition for customer deposits, resulting in an increase in funding costs, was also detrimental to margins. The fall in Hang Seng Bank’s margin was not as pronounced as for our other banking operations in Hong Kong as the effect of a higher contribution from

net free funds was greater due to Hang Seng Bank’s higher ratio of net free funds to average interest-earning assets.

Margins in the Asia-Pacific operations of The Hongkong and Shanghai Banking Corporation fell as the benefit of widening spreads resulting from the tightening credit environment following the downturn in the region only partially offset the higher levels of interest suspended on non-performing loans.

HSBC Bank Malaysia’s (formerly Hongkong Bank Malaysia) margin was only slightly lower as the effect of higher levels of interest suspended was largely offset by an increased contribution from higher levels of net free funds. The improved margin in The British Bank of the Middle East was principally due to an increased contribution from net free funds as the improved spreads arising from a favourable change in asset mix towards higher yielding personal and consumer lending was offset by the increase in levels of interest suspended on non-performing loans.

In North America, a change in asset mix towards lower yielding treasury assets, mortgage and corporate lending, lower levels of suspended interest recoveries and the effect on short-term lending of a flattening yield curve all contributed to the fall in HSBC Americas, Inc.’s margin. In Hongkong Bank of Canada, a change in asset mix towards lower yielding corporate lending and the effects of the flattening yield curve on short-term lending depressed the margin. In addition, a combination of competitive pressures on deposit pricing in a tighter market and the resulting increase in the use of wholesale funding also contributed to the fall in margin.

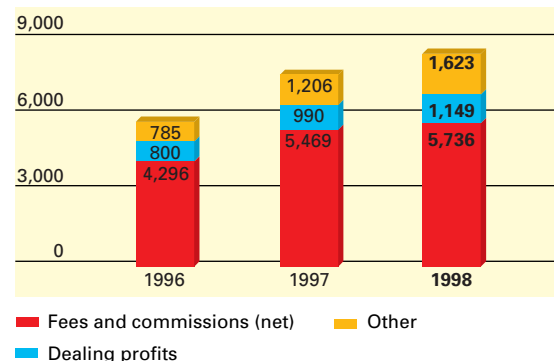
Non-interest income

Non-interest income of US\$8,508 million was US\$843 million, or 11 per cent, higher than 1997, mainly due to increases in net fees and commissions and other operating income. There was strong growth in income levels in North America (21 per cent), Europe (13 per cent) and Latin America (50 per cent) due to full year contributions from the Brazilian and Argentinian operations acquired during 1997. Hong Kong showed a small decline and the rest of Asia-Pacific was unchanged, reflecting the slowdown in economic activity in the region. Excluding net fees and commissions, other operating income rose by US\$576 million, or 26 per cent, from US\$2,196 million in 1997 to US\$2,772 million in 1998.

Net fees and commissions increased by US\$267

million, with significant growth in Europe and Latin America partly offset by a decline in Hong Kong and

Non-interest income (US\$m)



| Analysis of income from dealing in financial instruments (US\$m) | 1998 | | | 1997 | | |
|--|-----------------|----------------------------------|--------------|-----------------|----------------------------------|--------------|
| | Dealing profits | Dividend and net interest income | Total | Dealing profits | Dividend and net interest income | Total |
| Foreign exchange | 953 | 24 | 977 | 998 | 41 | 1,039 |
| Interest rate derivatives | 67 | 2 | 69 | 78 | 36 | 114 |
| Debt securities | 116 | 84 | 200 | (61) | 187 | 126 |
| Equities and other trading | 13 | 77 | 90 | (25) | 71 | 46 |
| | 1,149 | 187 | 1,336 | 990 | 335 | 1,325 |

the rest of Asia-Pacific. The growth in Europe was in insurance, current accounts, mortgages, cards and lending to corporate customers. In Latin America, the growth reflected the development of new customer products, as well as the fact that 1997 included only nine months' trading in Brazil and some five months in Argentina. In Hong Kong and the rest of Asia-Pacific, the decline occurred in most countries and business lines as a result of the current depressed market conditions. Falls were most noticeable in fees from securities, credit facilities and cards and, in investment banking, in corporate finance, underwriting and structured financing.

Dealing profits increased in 1998 as the Asian currency turmoil continued through the first half of 1998 and wide margins and high volumes in customer driven business continued to underpin foreign exchange revenues. Income from debt securities trading improved markedly compared to 1997 as credit spreads in Asian bond markets stabilised. The equities trading business returned to profit after losses in underwriting and trading in Hong Kong in 1997.

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 operating income increased by US\$425 million with the majority of the increase being in Europe and North America. In Europe, other income was boosted by the rentals receivable on operating leased assets following the acquisition of Forward Trust Rail in 1997. Wealth management activities, which include sales of investment, insurance and private banking products, also showed strong growth. In North America, benefit of the settlement with the US Internal Revenue Service on Brazilian tax credits disallowed in the 1980s and gain on disposal of credit card portfolios contributed to the increase, as well as underlying business growth.

Operating expenses

For the Group as a whole, operating expenses increased by US\$948 million, of which about half arose in Europe and half was the result of a full year's operation of Latin American businesses acquired during 1997. A small increase in North America was offset by a similar decrease in Hong Kong and the rest of Asia-Pacific.

Premises and equipment costs increased in Europe as a result of the prospective move to Canary Wharf and the increase in depreciation included the effect of the growth in operating leased assets. Staff costs rose modestly as staff numbers increased.

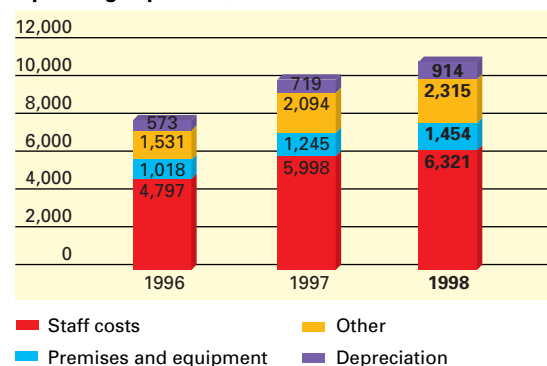
This year saw the first full year of operating expenses for the Latin American operations which were acquired during 1997 and the trend of expenses was flat on an annualised basis.

In Hong Kong and the rest of Asia-Pacific, the decrease in operating expenses was achieved mainly

by administrative cost savings and there was also a decrease in staff costs in both regions.

In North America, the increase in operating expenses was wholly explained by the inclusion of 14 months'

Operating expenses (US\$m)



Financial Review (continued)

Staff numbers

| Full-time equivalent | 1998 | 1997 | 1996 |
|----------------------------|----------------|---------|---------|
| Europe | 49,798 | 48,595 | 47,371 |
| Hong Kong | 24,447 | 25,050 | 24,428 |
| Rest of Asia-Pacific | 21,116 | 19,701 | 17,536 |
| North America | 14,500 | 14,499 | 13,101 |
| Latin America | 26,572 | 24,440 | 34 |
| Total staff numbers | 136,433 | 132,285 | 102,470 |

Bad and doubtful debts

The charge for bad and doubtful debts of US\$2,637 million was US\$1,623 million higher than 1997, reflecting the deterioration in credit quality in the poor economic climate of a number of Asian countries. New specific provisions increased by US\$689 million in Hong Kong, in part due to a decline in asset values particularly in the property market, and by US\$1,059 million in the rest of Asia-Pacific, principally from corporate customer provisions for exposures to Malaysia, Indonesia and Thailand. The continuing economic uncertainty over Asia also impacted on our banking operations in Latin America which, coupled with high domestic interest rates, resulted in credit weakness in Argentina and, to a lesser extent, in Brazil. In Europe, there were lower recoveries achieved on the loan book, in particular from the historical Latin American debt portfolio in Midland Bank. A large proportion of the bad debt charge in Europe related to personal lending in the UK, mainly in consumer finance and credit cards, while corporate credit experience remained stable although with some signs of a weakening outlook. In North America, new specific provisions were broadly in line with 1997.

The lower net charge of US\$10 million in respect of general provisions principally reflected contraction

Gains on disposal of investments

The Group's gains on disposal of investments of US\$222 million were US\$333 million lower than 1997 which included The Hongkong and Shanghai Banking Corporation's profit on the disposal of its investment in Hong Kong International Terminals. Hang Seng Bank

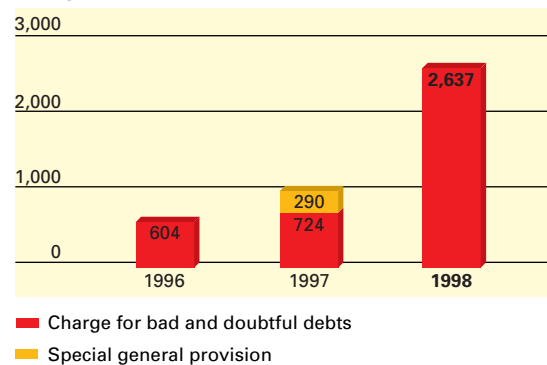
Taxation

The 1998 effective rate of tax was 27.2 per cent, compared with 25.3 per cent in 1997. For both years, the effective rate of tax was below the standard 31 per cent (1997: 31.5 per cent) rate of UK corporation tax mainly because of lower rates of tax in major operations overseas, in particular Hong Kong where profits were

expenses for Hongkong Bank of Canada on its change in financial year-end; otherwise costs were held to the same level as the prior year.

The Group's cost:income ratio deteriorated marginally to 54.9 per cent from 54.0 per cent in 1997 after taking account of exceptional property costs in the UK as a result of the prospective move to Canary Wharf.

Charge for bad and doubtful debts (US\$m)



of the customer loan portfolio, although enhancements to the general provision coverage rates were made in Canada, Malaysia and Brazil. In view of the continuing unsettled economic environment in Asia, the special general provision for Asian risk of US\$290 million booked at the end of 1997 has been left intact.

Non-performing customer advances increased by US\$3,464 million to US\$8,871 million which represented 3.7 per cent of gross customer advances (31 December 1997: 2.2 per cent).

recorded profits on the sale of listed equity investments of US\$8 million (1997: US\$76 million). HSBC Private Equity Europe reported a US\$95 million profit from venture capital investment disposals (1997: US\$175 million).

taxed at a rate of 16.0 per cent (1997: 16.5 per cent). However, this benefit was diluted in 1998 as a result of such less highly taxed overseas operations representing a lower proportion of the Group's 1998 profit. The tax charge for both years was further reduced by partial recognition of previously unrecognised tax benefits, but

increased by new unrecognised potential tax benefits, particularly in 1998 when higher unrelieved trading losses arose in the rest of Asia-Pacific. The benefit of tax-free gains in Hong Kong in 1997 was not repeated in 1998.

| Analysis of overall tax charge (US\$m) | 1998 | 1997 |
|--|--------------|--------------|
| Taxation at UK corporation tax rate of 31 per cent (1997: 31.5 per cent) | 2,037 | 2,561 |
| Impact of differently taxed overseas profits in principal locations | (339) | (466) |
| Net unrecognised tax benefits | 71 | (61) |
| Tax-free gains | — | (47) |
| Other items | 20 | 71 |
| Overall tax charge | 1,789 | 2,058 |

Assets

Total assets increased by US\$11 billion, primarily due to debt securities and treasury bills deploying increased customer deposits. New lending opportunities were limited, as demand for customer loans in Hong Kong and the rest of Asia-Pacific decreased as a result of the contraction in the economies. Balance sheet loans and advances to customers were also reduced by the impact of lower financial market transactions and increased provisions.

Underlying gross lending to customers increased predominantly in Europe as a result of growth in personal lending but this was partly offset by a fall in Hong Kong.

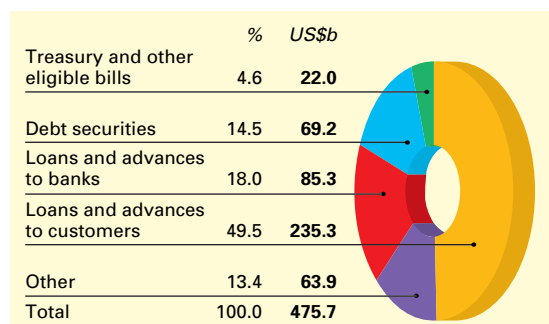
There was a decline in customer loans and advances

balances in North America partly as a result of reduced financial market transactions and the disposal of two national credit card portfolios.

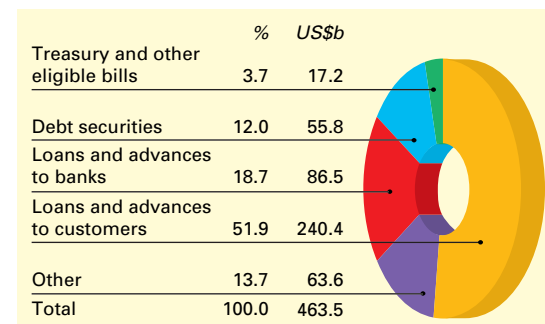
Decreased reverse repo activity with banks in Europe, North America and Latin America accounted for the reduction in loans and advances to banks.

Debt securities held in accrual books showed an unrecognised gain, net of off-balance-sheet hedges, of US\$298 million (December 1997: US\$143 million). Equity shares included US\$1,140 million (December 1997: US\$1,044 million) held on investment account, on which there was an unrecognised gain of US\$589 million (December 1997: US\$749 million).

Assets 1998 (excluding Hong Kong Government certificates of indebtness)



Assets 1997 (excluding Hong Kong Government certificates of indebtness)



Capital Management

Capital measurement and allocation

The Financial Services Authority (FSA) 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. Responsibility for banking supervision was transferred from the Bank of England to the FSA 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 may be subject to supervision and capital requirements of relevant local regulatory authorities. Since 1988, when the governors of the Group of Ten central banks, who form the Basle Committee on Banking Supervision, 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.

Financial Review (continued)

Under the European Union's Own Funds, Solvency Ratio and Consolidated Supervision Directives, the FSA requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets. Since 30 September 1998, the method the FSA 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 Amending Directive (Directive 98/31/EC) to the Capital Adequacy Directive (CAD2). This modification will allow banks to calculate capital requirements for market risk in the trading book using value at risk techniques.

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 a prudent distribution of that capital between the holding company and its 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.

The Group's 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 are made from tier 1 capital in respect of goodwill and intangible assets. Total capital is also reduced by deducting investments in unconsolidated subsidiaries and associates, investments in the capital of banks and other regulatory deductions.

Under CAD2, banking operations are categorised as either trading book (broadly, marked-to-market activities) or banking book (all other 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, taking into account any eligible collateral or guarantees. Banking book off-balance-sheet items giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the product and the category of the counterparty, taking into account any eligible collateral or guarantees. 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 opposite sets out the analysis of regulatory capital at the end of 1998 and 1997.

During 1998, the Group's tier 1 capital ratio increased from 9.3 per cent to 9.7 per cent and its total capital ratio decreased from 14.2 per cent to 13.6 per cent.

Tier 1 capital increased by US\$2,071 million from the level at the end of 1997, mainly due to retained earnings of US\$1,823 million and the take-up of shares issued in lieu of dividends of US\$584 million.

Tier 2 property revaluation reserves decreased due to the deficit arising on revaluation of Group properties. Term subordinated debt decreased, primarily as a result of regulatory amortisation exceeding the issuance of new debt net of redemptions.

Risk-weighted assets increased by US\$10 billion, reflecting balance sheet growth.

| | 1998 US\$m | 1997 US\$m |
|--|----------------|----------------|
| <i>Composition of capital</i> | | |
| Tier 1: | | |
| Shareholders' funds | 27,402 | 27,080 |
| Minority interests | 4,275 | 4,497 |
| Less: property revaluation reserves | (2,121) | (4,261) |
| intangible assets and goodwill | (204) | (35) |
| Total qualifying tier 1 capital | 29,352 | 27,281 |
| Tier 2: | | |
| Property revaluation reserves | 2,121 | 4,261 |
| General provisions | 1,807 | 1,785 |
| Perpetual subordinated debt | 3,276 | 3,273 |
| Term subordinated debt | 6,433 | 6,693 |
| Total qualifying tier 2 capital | 13,637 | 16,012 |
| Unconsolidated investments | (1,266) | (1,122) |
| Investments in other banks | (503) | (485) |
| Other deductions | (128) | (124) |
| Total capital | 41,092 | 41,562 |
| Total risk-weighted assets | 301,950 | 291,985 |
| Capital ratios (per cent) | | |
| Total capital | 13.6 | 14.2 |
| Tier 1 capital | 9.7 | 9.3 |

Structural foreign currency exposure

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. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group's structural foreign currency exposures are managed 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 usually achieved by denominating tier 1 capital broadly in proportion to the corresponding foreign-currency-denominated risk-weighted assets at a subsidiary bank level. HSBC considers hedging structural foreign currency exposures only in limited circumstances, including protecting the tier 1 capital ratio or the US dollar value of capital invested.

As subsidiaries are generally able to balance adequately foreign currency tier 1 capital with foreign currency risk-weighted assets, HSBC's foreign currency structural exposures are usually unhedged, including exposures due to foreign-currency-denominated profits arising during the year. Selective hedges were, however,

transacted during 1998. There was no material effect from foreign currency exchange rate movements on Group or subsidiary tier 1 capital ratios during the year.

Some investments are in underlying currencies which are linked to the US dollar, being primarily Hong Kong dollars, UAE dirhams, Saudi riyals, Argentine pesos and, from September 1998 but not before, Malaysian ringgit. Those foreign currency investments which are not in the US dollar or linked currencies amounted to the foreign currency equivalent of US\$11,053 million (40 per cent of shareholders' funds) at 31 December 1998, an increase from US\$10,960 million (40 per cent of shareholders' funds) at 31 December 1997.

The increase in foreign currency investments mainly reflects profit retentions. This was partly offset by the impact of property revaluations in 1998 as a result of the fall in property values in Hong Kong and Singapore.

The Brazilian real has depreciated significantly since the 1998 year-end. Had the closing balance sheet been retranslated at the rate on 12 February 1999, shareholders' funds would have been reduced by the equivalent of US\$220 million.

Deployment of shareholders' funds

The shareholders' funds of HSBC Holdings plc are deployed mainly in investments in its subsidiaries. At 31 December 1998, the major investments of shareholders' funds by legal entity, compared with the previous year, were as shown in the table.

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, the impact of the property revaluation in 1998 and capital injections to fund expansions in business operations.

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.

| | 1998 US\$m | 1997 US\$m |
|--|---------------|---------------|
| Hang Seng Bank – 62.14% owned (1997: 62.10%) | 3,456 | 3,989 |
| The Hongkong and Shanghai Banking Corporation and other subsidiaries | 6,462 | 7,776 |
| The Hongkong and Shanghai Banking Corporation and subsidiaries | 9,918 | 11,765 |
| Midland Bank plc | 7,059 | 6,459 |
| HSBC Americas, Inc. | 1,857 | 1,621 |
| The British Bank of the Middle East | 625 | 549 |
| HSBC Bank Malaysia Berhad | 333 | 413 |
| Hongkong Bank of Canada | 530 | 471 |
| Banco HSBC Bamerindus | 423 | 475 |
| HSBC Roberts | 339 | 216 |
| HSBC Investment Bank plc | 538 | 504 |
| Holding company and non-trading subsidiaries | 2,133 | 1,248 |
| Other subsidiaries | 3,208 | 2,921 |
| Associates | 439 | 438 |
| | 27,402 | 27,080 |

Financial Review (continued)

Credit and 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 risk 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. Over one-third of loans and advances to customers are to the personal banking sector with the balance to commercial enterprises. Residential mortgages now comprise 26 per cent of the overall portfolio, having increased by US\$2,210 million, or 4 per cent, during 1998. There was strong growth in loans under the Hong Kong SAR Government Home Ownership Scheme, which increased by 36 per cent. Other personal banking advances increased by 6 per cent during 1998, to US\$25,732 million.

Commercial, industrial and international trade loans decreased by US\$1,145 million, or 2 per cent, to US\$61,411 million.

Commercial real estate advances decreased by US\$1,029 million, or 4 per cent, to US\$24,116 million and other property related advances increased by US\$167 million, or 2 per cent, to US\$8,249 million.

Advances to financial institutions other than banks decreased by US\$9,600 million, or 45 per cent,

| Gross loans and advances to customers by industry exposure | 1998 | | 1997 | |
|--|----------------|--------------|----------------|--------------|
| | US\$m | % | US\$m | % |
| Residential mortgages | 62,212 | 25.7 | 60,002 | 24.4 |
| Hong Kong SAR | | | | |
| Government Home Ownership Scheme | 6,291 | 2.6 | 4,631 | 1.9 |
| Other personal | 25,732 | 10.6 | 24,175 | 9.8 |
| Commercial, industrial and international trade | 61,411 | 25.3 | 62,556 | 25.4 |
| Commercial real estate | 24,116 | 9.9 | 25,145 | 10.2 |
| Other property related | 8,249 | 3.4 | 8,082 | 3.3 |
| Government | 5,285 | 2.2 | 4,514 | 1.8 |
| Non-bank financial institutions | 11,763 | 4.9 | 21,363 | 8.7 |
| Settlement accounts | 4,963 | 2.0 | 4,339 | 1.8 |
| Other commercial* | 32,467 | 13.4 | 31,360 | 12.7 |
| Total | 242,489 | 100.0 | 246,167 | 100.0 |

* Other commercial includes advances in respect of agriculture, transport, energy and utilities.

following a substantial reduction in securities trading business by the end of 1998.

Other advances increased by US\$2,502 million, or 6 per cent.

Bad debt provisions

Total provisions against loans and advances to customers amounted to US\$6,627 million at 31 December 1998 and represented 2.77 per cent of gross lending, net of suspended interest and reverse repo transactions, compared with 2.18 per cent at the end of 1997.

Non-performing customer advances increased by US\$3,464 million to US\$8,871 million which represented 3.7 per cent of gross customer advances (December 1997: 2.2 per cent).

Total customer provisions cover as a percentage of non-performing loans and advances decreased from 94.7 per cent at 31 December 1997 to 74.7 per cent at 31 December 1998. This reflected the fact that the most recently categorised non-performing advances included advances which are better collateralised, for example, residential mortgages.

| Customer loans and advances (US\$m) | 1998 | 1997 |
|---|----------------|-------------|
| Gross loans and advances | 242,489 | 246,167 |
| Suspended interest | (567) | (614) |
| | 241,922 | 245,553 |
| Provisions | (6,627) | (5,132) |
| Net loans and advances | 235,295 | 240,421 |
| Provisions to customer loans and advances (%) | 1998 | 1997 |
| Specific provisions | 1.93 | 1.32 |
| General provisions | | |
| — held against Asian risks | 0.12 | 0.12 |
| — other | 0.72 | 0.74 |
| Total provisions | 2.77 | 2.18 |
| Non-performing customer loans and provisions (US\$m) | 1998 | 1997 |
| Non-performing loans | 8,871 | 5,407 |
| Provisions | 6,627 | 5,132 |
| Total provisions cover as a percentage of non-performing loans and advances | 74.7 | 94.7 |

Against loans and advances to banks, net of suspended interest, of US\$85,346 million (1997: US\$86,568 million), specific provisions amounted to US\$31 million (1997: US\$46 million). Non-performing loans to banks were US\$42 million (1997: US\$61 million).

The in-country risk exposure and cross-border exposure figures in the following table are for the three Asian countries that have negotiated arrangements with the International Monetary Fund. They are prepared in accordance with the Bank of England Country Exposure Report (Form C1) guidelines. On this basis,

Country risk and cross-border exposure (US\$b)

| | Indonesia | South Korea | Thailand |
|---|------------|-------------|------------|
| As at 31 December 1998 | | | |
| In-country local currency obligations | 0.2 | 0.5 | 1.2 |
| In-country foreign currency obligations | 0.8 | 0.8 | 0.7 |
| Net cross-border obligations | 0.4 | 2.3 | 0.3 |
| | 1.2 | 3.1 | 1.0 |
| Claims under contracts in financial derivatives | — | — | 0.1 |
| Total at 31 December 1998 | 1.4 | 3.6 | 2.3 |
| Total at 31 December 1997 | 1.8 | 4.1 | 2.8 |

the figures exclude accrued interest and intra-group exposures.

In-country obligations represent local offices' on-balance-sheet exposures to and acceptances given under facilities opened on behalf of local residents.

Net cross-border obligations represent non-local offices' on-balance-sheet exposures to and acceptances given under facilities opened on behalf of customers 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 risk is controlled centrally through a well-developed system of country limits, which are frequently reviewed to avoid concentrations of transfer, economic or political risks.

On 31 March 1998, a loan agreement was signed between a group of international banks (including HSBC Holdings plc) and the Republic of Korea, which was the first stage of the programme to address South Korea's economic problems. The loan agreement facilitated a voluntary exchange of Korean banks' short-term credits to new loans with one, two and three-year maturities guaranteed by the Republic of Korea. Subsequent to the completion of the loan exchange, foreign currency liquidity pressures in South Korea have been considerably eased, and the sovereign rating of the country has been reinstated to investment grade.

On 4 June 1998, an agreement was reached between the Steering Committee of Banks for Indonesia (including HSBC Holdings plc) and the Indonesia Debt Negotiation team with respect to the general terms of a comprehensive programme to address Indonesia's external debt problems. The programme consists of three principal components: (i) the voluntary maintenance of trade finance by foreign banks to the

Financial Review (continued)

Indonesian banking system, effected by the completion of individual agreements between Bank Indonesia (the central bank) and the foreign banks during the second half of 1998; (ii) an exchange offer whereby foreign banks could exchange specified existing exposures to Indonesian banks for loans guaranteed by Bank Indonesia with maturities of one, two, three and four years, which is evidenced by a number of separate loan agreements completed during the second half of 1998; and (iii) 'INDRA', the Government of Indonesia's

voluntary programme for the provision of foreign exchange availability to Indonesian corporate obligors which is applicable on a case by case basis.

Thailand has not entered into any specific arrangements with the foreign banking community to restructure its foreign currency obligations, but has taken positive steps under its IMF programme to recapitalise its financial system.

Market Risk Management

Market risk

Market risk is the risk that interest rates, foreign exchange rates or equity 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, exchange rate and equity derivative instruments, as well as in debt, equities and other securities. Trading risks arise either from customer-related business or from position taking.

The Group manages market risk through risk limits approved by the Group Executive Committee. Group Market Risk, an independent unit within HSBC Holdings, develops risk management policies and measurement techniques, and reviews limit utilisation on a daily basis.

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 with sufficient derivative product expertise and appropriate control systems are authorised to trade derivative products. Limits are set using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk (VAR) limits at a portfolio level. Similarly, option risks are controlled through full revaluation limits in conjunction with limits on the underlying variables that determine each option's value.

VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. The Group VAR, calculated on a variance/covariance basis, 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. The one-day movement in market prices is calculated by reference to market data from the last two years. Aggregation of VAR from different risk types is based upon the assumption of independence between risk types.

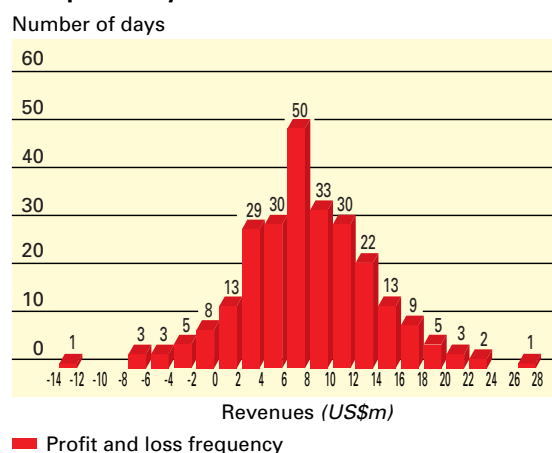
The Group VAR should be viewed in the context of the limitations of the methodology used. These include:

- The model assumes that changes in risk factors follow a normal distribution. This may not be the case in reality and may lead to an underestimation of the probability of extreme market movements.
- The use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This does not fully capture the market risk arising from times of illiquidity, when one-day liquidation or hedging may not be possible.
- The use of a 95 per cent confidence level does not take account of any losses that might occur beyond this level of confidence.
- The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature.
- The assumption of independence between risk types may be incorrect and therefore result in VAR not fully capturing market risk where correlation between variables is exhibited.
- VAR is calculated at the close of business with intra-day exposures not being subject to intra-day VAR calculations.
- VAR does not necessarily capture all of the higher order market risks and as such may underestimate VAR.

The Group VAR should not therefore be viewed as a maximum amount that the Group can lose on its market risk positions. The Group recognises these limitations by augmenting the VAR limits with other position and sensitivity limit structures, as well as with stress testing, both on individual portfolios and on a consolidated basis. The Group's stress testing regime provides senior management with an assessment of the impact of extreme events on the market risk exposures of the Group.

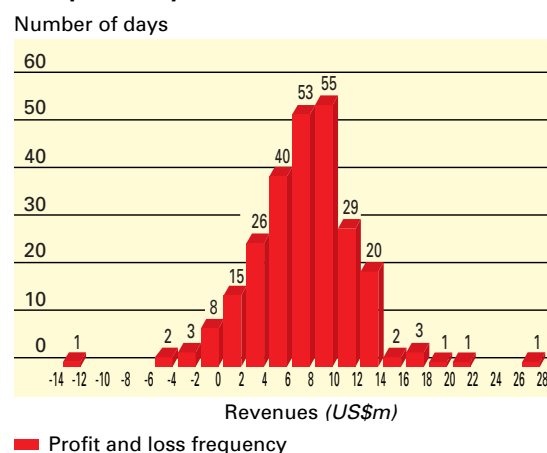
VAR measurement techniques have been applied in respect of treasury activities throughout the year.

Daily distribution of market risk revenues 1998 Group treasury centres



The average daily revenue earned from market risk-related treasury activities in 1998, including accrual book net interest income and funding related to dealing positions, was US\$7.8 million (US\$7.1 million in 1997). The standard deviation of these daily revenues was US\$5.8 million. An analysis of the frequency distribution of daily revenues shows a maximum daily loss of US\$13 million, with only 20 out of 260 days showing losses. The most frequent result was a daily revenue of between US\$6 million and US\$8 million, with 50 occurrences. The highest daily revenue was US\$28 million.

Daily distribution of market risk revenues 1997 Group treasury centres



Foreign exchange exposure

The Group's foreign exchange exposure arises from foreign exchange dealing within the Group's markets businesses 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 1998 was US\$3.2 million (US\$4.8 million at 31 December 1997). The average for 1998 was US\$4.6 million, with a maximum of US\$8.1 million and a minimum of US\$2.9 million in the year. The average one-day foreign exchange revenue in 1998 was US\$4.0 million (US\$3.8 million in 1997). The value at risk and average dealing profit information noted excludes structural foreign currency exposures, since related gains or losses are taken through reserves.

Financial Review (continued)

Interest rate exposure

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

Value at risk at 31 December 1998 related to treasury interest rate risk exposures, including accrual book positions, was US\$27.6 million (US\$27.8 million at 31 December 1997). The average value at risk for 1998 was US\$29.4 million, the maximum was US\$51.7 million and the minimum US\$16.4 million. The average daily revenues earned from treasury-related interest rate activities for 1998 was US\$3.8 million (US\$3.3 million for 1997).

The primary source of interest rate risk originating

in other banking activities arises 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. The Asset and Liability Policy Committee (ALCO) of each major Group subsidiary assesses the 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 ALCO. Where appropriate, 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. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income.

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’ ALCOs.

Value at risk at 31 December 1998 related to equity trading positions was US\$2.3 million (31 December 1997: US\$3.5 million).

Liquidity Management

HSBC requires operating entities to manage the liquidity structure of their assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due.

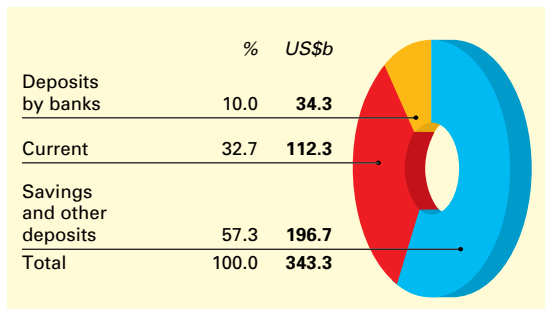
It is the responsibility of local management to ensure compliance with local regulatory and Group Executive Committee requirements. Liquidity is managed on a daily basis by local treasury functions, with the larger regional treasury sites providing support to smaller entities where required.

Compliance with liquidity requirements is

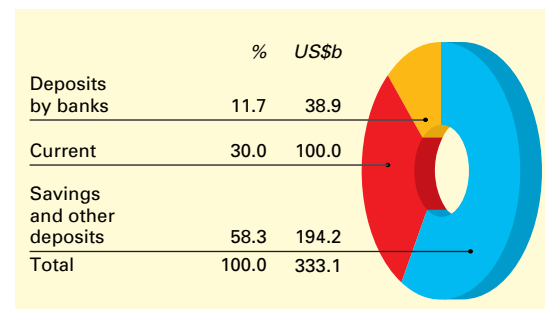
monitored by local ALCOs which report to Group Head Office on a regular basis. This process includes:

- Projecting cash flows by major currency and a consideration of the level of liquid assets in relation thereto;
- Maintenance of balance sheet liquidity ratios;
- Monitoring of depositor concentration both in terms of the overall funding mix and to avoid undue reliance on large individual depositors; and
- Maintenance of liquidity contingency plans.

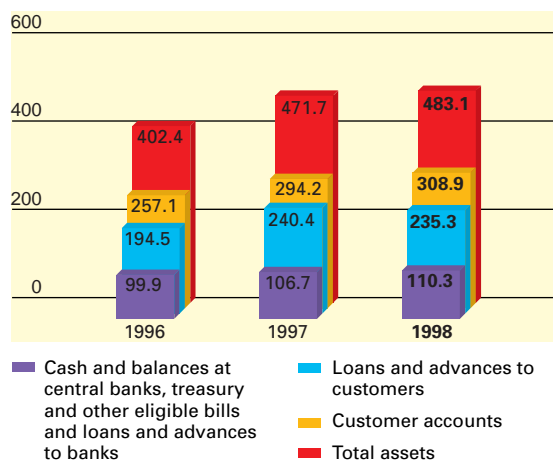
Customer accounts and deposits by banks 1998



Customer accounts and deposits by banks 1997



Assets, deposits and advances (US\$b)



Core retail deposits (current accounts and savings deposits payable on demand or at short notice) form a significant part of HSBC's overall funding. Considerable importance is attached to the stability and growth of this core deposit base, achieved through HSBC's diverse geographical retail banking activities. Core retail deposits accounted for 90.0 per cent of HSBC's deposit base at 31 December 1998, compared with 88.3 per cent at 31 December 1997. As at 31 December 1998, 76.2 per cent of HSBC's customer accounts were deployed in loans and advances to customers, compared with 81.7 per cent at 31 December 1997. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and aligning asset and liability maturities.

Off-Balance-Sheet Financial Instruments

Derivatives

Off-balance-sheet financial instruments, commonly referred to as derivatives, are contracts the characteristics of which 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. Transactions 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

Derivatives contracts with third parties (US\$m)

| | 1998 | | 1997 | |
|-------------------------|------------------|------------------|------------------|------------------|
| | Contract amount | Replacement cost | Contract amount | Replacement cost |
| Exchange rate contracts | 765,665 | 8,899 | 746,969 | 14,273 |
| Interest rate contracts | 1,060,563 | 7,297 | 866,546 | 5,177 |
| Equities contracts | 29,799 | 2,218 | 21,964 | 2,017 |
| Total | 1,856,027 | 18,414 | 1,635,479 | 21,467 |

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 1997 and 31 December 1998. Contract amounts shown indicate the volume of transactions outstanding; they do not represent values at risk.

At 31 December 1998, the total notional principal of outstanding contracts with third parties was US\$1,856 billion, compared with a value of US\$1,635 billion at 31 December 1997. The net increase of US\$221 billion, or 14 per cent, represents a US\$194 billion rise in interest rate contracts, a US\$19 billion increase in exchange rate contracts and a US\$8 billion increase in equities contracts.

The replacement cost amount decreased from US\$21 billion at 31 December 1997 to US\$18 billion at 31 December 1998. An increase of US\$2 billion in interest rate contracts was more than offset by a decrease of US\$5 billion in exchange rate contracts.

The decrease in the replacement cost of exchange

Financial Review (continued)

Total derivatives contracts outstanding (US\$m)

| | 1998 | | | |
|--|------------------|---------------|------------------------|----------------|
| | Contract amounts | | Mark-to-market values* | |
| | Trading* | Non-trading† | Positive | Negative |
| Spot and forward foreign exchange | 604,358 | 67,749 | 6,145 | (6,354) |
| Currency swaps, futures and options purchased | 97,396 | 3,260 | 2,729 | (1,644) |
| Currency options written | 57,034 | — | — | (1,232) |
| Other contracts | 1,937 | — | 25 | (43) |
| Total exchange rate contracts | 760,725 | 71,009 | 8,899 | (9,273) |
| Less: not recognised in the balance sheet | | | (72) | 73 |
| Balance sheet values | | | 8,827 | (9,200) |
| Interest rate swaps | 532,978 | 73,784 | 6,005 | (5,194) |
| Interest rate futures, forward rate agreements and options purchased | 423,432 | 10,601 | 1,292 | (262) |
| Interest rate options written | 76,889 | — | — | (784) |
| Total interest rate contracts | 1,033,299 | 84,385 | 7,297 | (6,240) |
| Less: not recognised in the balance sheet | | | (413) | 299 |
| Balance sheet values | | | 6,884 | (5,941) |
| Equities, futures and options purchased | 11,321 | 724 | 2,205 | (3) |
| Equities options written | 16,341 | — | — | (2,364) |
| Other contracts | 1,813 | 18 | 13 | (472) |
| Total equities contracts | 29,475 | 742 | 2,218 | (2,839) |
| Less: not recognised in the balance sheet | | | (5) | — |
| Balance sheet values | | | 2,213 | (2,839) |

* Third party only.

† Including internal deals.

rate contracts, compared to December 1997, arises mainly in Hong Kong and Singapore and reflects reduced volatility in Asian currencies and an increase of US\$1.2 billion in netting in Hong Kong.

The increase in the replacement cost of interest rate contracts since December 1997 was mainly in interest rate swaps in London, and reflects lower term interest rates in major currencies.

The table above provides an analysis of derivatives by product at 31 December 1998, 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

Replacement cost of derivatives contracts with third parties

| US\$m | Residual maturity | | | | 1997 Total |
|---------------------------------------|---------------------|--------------|-----------------|---------------|---------------|
| | 1998 | | | Total | |
| | Less than 1 year | 1-5 years | Over 5 years | | |
| Governments | 50 | 49 | 101 | 200 | 193 |
| Banks | 7,216 | 4,400 | 1,578 | 13,194 | 16,559 |
| Non-bank financial institutions | | | | | |
| — exchanges* | 272 | 11 | 1 | 284 | 115 |
| — other | 1,359 | 730 | 360 | 2,449 | 2,169 |
| Other sectors | 1,203 | 691 | 393 | 2,287 | 2,431 |
| Total 1998 | 10,100 | 5,881 | 2,433 | 18,414 | |
| Total 1997 | 14,859 | 5,190 | 1,418 | | 21,467 |

* Exchanges with margining requirements.

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

Contract amounts of derivatives contracts with third parties

| US\$m | Residual maturity | | | | 1997 Total |
|--|---------------------|----------------|-----------------|------------------|------------------|
| | 1998 | | | Total | |
| | Less than 1 year | 1-5 years | Over 5 years | | |
| Exchange rate, interest rate and equities contracts | | | | | |
| — exchanges* | 183,499 | 38,557 | 37 | 222,093 | 156,948 |
| — other contracts | 1,178,685 | 359,055 | 96,194 | 1,633,934 | 1,478,531 |
| Total 1998 | 1,362,184 | 397,612 | 96,231 | 1,856,027 | |
| Total 1997 | 1,214,121 | 353,446 | 67,912 | | 1,635,479 |

* Exchanges with margining requirements.

deals only with the most creditworthy counterparties.

The first table above 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 1998 and 31 December 1997. The table shows that the replacement cost of derivatives is predominantly with banks and under five years.

The maturity profile of the notional principal values of third party derivative contracts outstanding as at 31 December 1998 and 31 December 1997 in the second table 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 1998 financial accounts are consistent with the previous year except as noted below.

During the year, the Group adopted Financial Reporting Standards (FRS) 9, 10, 11 and 14 as issued by the Accounting Standards Board. FRS 9, 'Associates and joint ventures', sets out how to identify and account for strategic investments that are not consolidated. FRS 11, 'Impairment of fixed assets and goodwill', details requirements for the identification, measurement and recognition of impairment of all fixed assets and goodwill. FRS 14, 'Earnings per share', states the method for calculating basic and diluted earnings per share.

FRS 10, 'Goodwill and intangible assets', requires goodwill arising on the acquisition of subsidiary or associated undertakings to be capitalised in the balance sheet. For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets' in respect of subsidiary undertakings and

in 'Interests in associated undertakings' in respect of associated undertakings. Capitalised goodwill is amortised over its estimated useful life on a straight-line basis.

In addition, the Group has adopted the British Bankers' Association revised Statement of Recommended Practice, 'Advances'. No change in accounting policy has resulted from the adoption of this revised statement.

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 changed its reporting currency from sterling to US dollars with effect from 1 January 1998. For comparative purposes, the 1997 sterling reported profit and loss account has been translated into US dollars at the applicable quarterly average exchange rates. The 1997 sterling balance sheets have been translated into US dollars at the closing rate.

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the Auditor's statement of its responsibilities set out in its report on page 57, 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 58 to 101, 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
R G Barber, *Secretary*

22 February 1999

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

We have audited the financial statements on pages 58 to 101.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the *Annual Report*, including as described on page 56 of the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions with the Company is not disclosed.

We review whether the statement on pages 28 and 29 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's corporate governance procedures or its internal controls.

We read the other information contained in the *Annual Report*, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit 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 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 the Group as at 31 December 1998 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
Chartered Accountants/Registered Auditor
London

22 February 1999

Consolidated Profit and Loss Account for the Year Ended 31 December 1998

| 1997 US\$m | <i>Note</i> | 1998 US\$m | 1998 £m | 1998 HK\$m |
|---------------|-------------|-----------------|--------------|---------------|
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| 10,944 | | 11,547 | 6,963 | 89,443 |
| 156 | 3 | 148 | 89 | 1,146 |
| 6,622 | | 6,970 | 4,203 | 53,991 |
| (1,153) | | (1,234) | (744) | (9,559) |
| 990 | | 1,149 | 693 | 8,900 |
| 1,050 | | 1,475 | 889 | 11,425 |
| 18,609 | 5 | 20,055 | 12,093 | 155,346 |
| (9,337) | 4,5 | (10,090) | (6,084) | (78,158) |
| | | | | |
| (719) | 21 | (904) | (545) | (7,002) |
| — | 20 | (10) | (6) | (77) |
| 8,553 | | 9,051 | 5,458 | 70,109 |
| | | | | |
| (1,014) | 14 | (2,637) | (1,590) | (20,427) |
| (56) | 28 | (144) | (87) | (1,115) |
| (49) | | (85) | (51) | (658) |
| 7,434 | | 6,185 | 3,730 | 47,909 |
| | | | | |
| 112 | | 136 | 82 | 1,053 |
| | | | | |
| 555 | | 222 | 133 | 1,720 |
| 29 | | 28 | 17 | 217 |
| 8,130 | 5 | 6,571 | 3,962 | 50,899 |
| (2,058) | 6 | (1,789) | (1,078) | (13,858) |
| 6,072 | | 4,782 | 2,884 | 37,041 |
| | | | | |
| (512) | | (393) | (237) | (3,044) |
| (73) | | (71) | (43) | (550) |
| 5,487 | | 4,318 | 2,604 | 33,447 |
| (2,206) | 8 | (2,495) | (1,505) | (19,326) |
| 3,281 | | 1,823 | 1,099 | 14,121 |
| | | | | |
| US\$ | | US\$ | <i>Pence</i> | <i>HK\$</i> |
| 2.06 | 9 | 1.61 | 97.1 | 12.47 |
| 2.04 | 9 | 1.59 | 95.9 | 12.31 |
| 2.04 | 9 | 1.60 | 96.5 | 12.39 |
| 0.830 | 8 | 0.925 | 55.8 | 7.17 |

Movements in reserves are set out in Note 32.

Consolidated Balance Sheet at 31 December 1998

| 1997 US\$m | | Note | 1998 US\$m | 1998 £m | 1998 HK\$m |
|-------------------------|--|------|----------------|----------------|------------------|
| ASSETS | | | | | |
| 2,961 | Cash and balances at central banks | | 3,048 | 1,838 | 23,610 |
| 5,669 | Items in the course of collection from other banks | | 5,911 | 3,564 | 45,787 |
| 17,183 | Treasury bills and other eligible bills | 10 | 21,980 | 13,254 | 170,257 |
| 8,143 | Hong Kong SAR Government certificates of indebtedness | 11 | 7,408 | 4,467 | 57,382 |
| 86,522 | Loans and advances to banks | 12 | 85,315 | 51,445 | 660,850 |
| 240,421 | Loans and advances to customers | 13 | 235,295 | 141,884 | 1,822,593 |
| 55,764 | Debt securities | 16 | 69,185 | 41,719 | 535,907 |
| 3,228 | Equity shares | 17 | 4,221 | 2,545 | 32,696 |
| 899 | Interests in associated undertakings | 18 | 889 | 536 | 6,886 |
| 320 | Other participating interests | 19 | 309 | 186 | 2,394 |
| — | Intangible fixed assets | 20 | 146 | 88 | 1,131 |
| 13,034 | Tangible fixed assets | 21 | 12,108 | 7,301 | 93,789 |
| 33,255 | Other assets | 23 | 32,352 | 19,508 | 250,599 |
| 4,287 | Prepayments and accrued income | | 4,961 | 2,991 | 38,428 |
| 471,686 | Total assets | | 483,128 | 291,326 | 3,742,309 |
| LIABILITIES | | | | | |
| 8,143 | Hong Kong SAR currency notes in circulation | 11 | 7,408 | 4,467 | 57,382 |
| 38,947 | Deposits by banks | 24 | 34,342 | 20,708 | 266,013 |
| 294,189 | Customer accounts | 25 | 308,910 | 186,273 | 2,392,816 |
| 4,045 | Items in the course of transmission to other banks | | 4,206 | 2,536 | 32,580 |
| 27,745 | Debt securities in issue | 26 | 29,190 | 17,602 | 226,106 |
| 49,676 | Other liabilities | 27 | 48,662 | 29,343 | 376,936 |
| 4,661 | Accruals and deferred income | | 4,805 | 2,897 | 37,220 |
| | Provisions for liabilities and charges | 28 | | | |
| 939 | — deferred taxation | | 1,268 | 765 | 9,822 |
| 2,133 | — other provisions for liabilities and charges | | 2,906 | 1,752 | 22,510 |
| | Subordinated liabilities | 29 | | | |
| 3,245 | — undated loan capital | | 3,247 | 1,958 | 25,151 |
| 7,281 | — dated loan capital | | 7,597 | 4,581 | 58,846 |
| | Minority interests | | | | |
| 2,752 | — equity | | 2,315 | 1,396 | 17,932 |
| 850 | — non-equity | 30 | 870 | 525 | 6,739 |
| 3,406 | Called up share capital | 31 | 3,443 | 2,076 | 26,669 |
| 489 | Share premium account | 32 | 480 | 289 | 3,718 |
| 4,262 | Revaluation reserves | 32 | 2,120 | 1,278 | 16,422 |
| 18,923 | Profit and loss account | 32 | 21,359 | 12,880 | 165,447 |
| 27,080 | Shareholders' funds | | 27,402 | 16,523 | 212,256 |
| 471,686 | Total liabilities | | 483,128 | 291,326 | 3,742,309 |
| MEMORANDUM ITEMS | | | | | |
| | Contingent liabilities | 34 | | | |
| 4,814 | — acceptances and endorsements | | 4,032 | 2,431 | 31,232 |
| 20,563 | — guarantees and assets pledged as collateral security | | 23,686 | 14,283 | 183,472 |
| 104 | — other contingent liabilities | | 64 | 39 | 496 |
| 25,481 | Total contingent liabilities | | 27,782 | 16,753 | 215,200 |
| 136,288 | Commitments | 34 | 146,652 | 88,431 | 1,135,966 |

John Bond, *Group Chairman*

Company Balance Sheet at 31 December 1998

| 1997 US\$m | Note | 1998 US\$m | 1998 £m | 1998 HK\$m |
|--|---|---------------|------------|---------------|
| FIXED ASSETS | | | | |
| 5 | Tangible assets | 8 | 5 | 62 |
| | Investments | | | |
| 25,776 | — shares in Group undertakings | 26,935 | 16,242 | 208,639 |
| 730 | — loans to Group undertakings | 1,068 | 644 | 8,273 |
| 400 | — other investments other than loans | 1,097 | 661 | 8,497 |
| 26,911 | | 29,108 | 17,552 | 225,471 |
| CURRENT ASSETS | | | | |
| Debtors | | | | |
| | — money market deposits with Group undertakings | 44 | 27 | 341 |
| 2,390 | — other amounts owed by Group undertakings | 2,395 | 1,444 | 18,552 |
| 2,042 | — amounts owed by Group undertakings (falling due after more than 1 year) | 93 | 56 | 720 |
| 366 | — other debtors | 5 | 3 | 39 |
| 7 | | | | |
| 4,805 | | 2,537 | 1,530 | 19,652 |
| Cash at bank and in hand | | | | |
| 415 | — balances with Group undertakings | 850 | 512 | 6,584 |
| 5,220 | | 3,387 | 2,042 | 26,236 |
| CREDITORS: amounts falling due within 1 year | | | | |
| (1,085) | Amounts owed to Group undertakings | (941) | (568) | (7,290) |
| (187) | Other creditors | (201) | (121) | (1,557) |
| (532) | Taxation | (218) | (131) | (1,689) |
| (1,332) | Proposed dividend | (1,499) | (904) | (11,611) |
| (3,136) | | (2,859) | (1,724) | (22,147) |
| 2,084 | NET CURRENT ASSETS | 528 | 318 | 4,089 |
| 28,995 | TOTAL ASSETS LESS CURRENT LIABILITIES | 29,636 | 17,870 | 229,560 |
| CREDITORS: amounts falling due after more than 1 year | | | | |
| Subordinated liabilities | | | | |
| (1,336) | — owed to third parties | (1,343) | (810) | (10,403) |
| (348) | — owed to Group undertakings | (349) | (210) | (2,703) |
| (219) | Amounts owed to Group undertakings | (221) | (133) | (1,712) |
| PROVISIONS FOR LIABILITIES AND CHARGES | | | | |
| (12) | Deferred taxation | (321) | (194) | (2,486) |
| 27,080 | NET ASSETS | 27,402 | 16,523 | 212,256 |
| CAPITAL AND RESERVES | | | | |
| 3,406 | Called up share capital | 3,443 | 2,076 | 26,669 |
| 489 | Share premium account | 480 | 289 | 3,718 |
| 18,432 | Revaluation reserve | 19,566 | 11,798 | 151,559 |
| 4,753 | Profit and loss account | 3,913 | 2,360 | 30,310 |
| 27,080 | | 27,402 | 16,523 | 212,256 |

John Bond, *Group Chairman*

Statement of Total Consolidated Recognised Gains and Losses for the Year Ended 31 December 1998

| | 1998 | 1997 |
|--|--------------|--------------|
| | US\$m | US\$m |
| Profit for the financial year attributable to shareholders | 4,318 | 5,487 |
| Impairment of land and buildings | (38) | — |
| Unrealised (deficit)/surplus on revaluation of investment properties | | |
| — subsidiaries | (190) | (3) |
| — associates | (56) | 13 |
| Unrealised (deficit) on revaluation of land and buildings (excluding investment properties) | (1,787) | (112) |
| Exchange and other movements | (31) | (1,106) |
| Total recognised gains and losses for the year | <u>2,216</u> | <u>4,279</u> |

Reconciliation of Movements in Consolidated Shareholders' Funds for the Year Ended 31 December 1998

| | 1998 | 1997 |
|---|----------------------|----------------------|
| | US\$m | US\$m |
| Profit for the financial year attributable to shareholders | 4,318 | 5,487 |
| Dividends | (2,495) | (2,206) |
| | <u>1,823</u> | <u>3,281</u> |
| Other recognised gains and losses relating to the year | (2,102) | (1,208) |
| New share capital subscribed | 17 | 17 |
| Amounts arising on shares issued in lieu of dividends | 584 | 337 |
| Goodwill on acquisition of subsidiary and associated undertakings | — | (1,180) |
| | <u>322</u> | <u>1,247</u> |
| Net addition to shareholders' funds | 322 | 1,247 |
| Shareholders' funds at 1 January | <u>27,080</u> | <u>25,833</u> |
| Shareholders' funds at 31 December | <u>27,402</u> | <u>27,080</u> |

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 1998

| | <i>Note</i> | 1998 US\$m | 1997 US\$m |
|---|-------------|----------------------|---------------|
| Net cash inflow from operating activities | 35 | 9,687 | 14,352 |
| Dividends received from associated undertakings | | 82 | 65 |
| Returns on investments and servicing of finance: | | | |
| Interest paid on finance leases and similar hire purchase contracts | | (25) | (29) |
| Interest paid on subordinated loan capital | | (813) | (724) |
| Dividends paid to minority interests | | | |
| — equity | | (339) | (313) |
| — non-equity | | (65) | (65) |
| Net cash (outflow) from returns on investments and servicing of finance | | (1,242) | (1,131) |
| Taxation paid | | (1,893) | (1,476) |
| Capital expenditure and financial investments: | | | |
| Purchase of investment securities | | (59,814) | (31,626) |
| Proceeds from sale of investment securities | | 50,568 | 29,779 |
| Purchase of tangible fixed assets | | (2,537) | (1,355) |
| Proceeds from sale of tangible fixed assets | | 266 | 339 |
| Net cash (outflow) from capital expenditure and financial investments | | (11,517) | (2,863) |
| Acquisitions and disposals: | | | |
| Net cash (outflow) from acquisition of and increase in stake in subsidiary undertakings | | (176) | (990) |
| Net cash inflow from disposal of subsidiary undertakings | | — | 32 |
| Purchase of interest in associated undertakings and other participating interests | | (55) | (120) |
| Proceeds from disposal of associated undertakings and other participating interests | | 18 | 23 |
| Net cash (outflow) from acquisitions and disposals | | (213) | (1,055) |
| Equity dividends paid | | (1,744) | (1,670) |
| Net cash (outflow)/inflow before financing | | (6,840) | 6,222 |
| Financing: | | | |
| Issue of ordinary share capital | | 17 | 17 |
| Issue of preference share capital | | — | 50 |
| Redemption of preference share capital | | — | (98) |
| Subordinated loan capital issued | | 443 | 740 |
| Subordinated loan capital repaid | | (215) | (318) |
| Net cash inflow from financing | 36 | 245 | 391 |
| (Decrease)/Increase in cash | 37 | (6,595) | 6,613 |

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 provisions of Financial Reporting Standards ('FRSs'): FRS 9, 'Associates and joint ventures', FRS 10, 'Goodwill and intangible assets', FRS 11, 'Impairment of fixed assets and goodwill', and FRS 14, 'Earnings per share', together with the British Bankers' Association's revised Statement of Recommended Practice ('SORP'), 'Advances'. The Group has applied the transitional arrangements of FRS 10 and goodwill previously eliminated against reserves has not been reinstated.

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 changed its reporting currency from sterling to US dollars with effect from 1 January 1998.

For comparative purposes, the 1997 sterling reported profit and loss account has been translated into US dollars at the quarterly average exchange rates. The 1997 sterling reported balance sheets have been translated into US dollars at the closing rate.

- 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, including those of Hongkong Bank of Canada, which in previous years has had a 31 October year-end. For Hongkong Bank of Canada, accounts for a period of 14 months have been used in the 1998 consolidated accounts. 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 the People's Republic 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.

Notes on the Accounts (continued)

2 Principal accounting policies (continued)

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 banks' or 'Loans and advances to customers'.

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 arises on the acquisition of subsidiary or associated undertakings when the cost of acquisition exceeds the fair value of the Group's share of separable net assets acquired. For acquisitions made on or after 1 January 1998, goodwill is included in the balance sheet in 'Intangible fixed assets' in respect of subsidiary undertakings and in 'Interests in associated undertakings', in respect of associated undertakings. Capitalised goodwill is amortised over its estimated life on a straight-line basis. For acquisitions prior to 1 January 1998, goodwill was charged against reserves in the year of acquisition.

At the date of disposal of subsidiary or associated undertakings, any unamortised goodwill or goodwill charged directly to reserves is included in the Group's share of net assets of the undertaking in the calculation of the profit or loss on disposal of the undertaking.

e Tangible fixed assets

- i Land and buildings are stated at valuation or cost less depreciation calculated to write off the assets over their estimated useful lives as follows:
 - freehold land and land held on leases with more than 50 years to expiry are not depreciated;
 - land held on leases with 50 years or less to expiry is depreciated over the unexpired terms of the leases; and

2 Principal accounting policies (continued)

- 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 or over the remaining useful lives.
- ii Equipment, fixtures and fittings are stated at cost less depreciation calculated on the straight line basis to write off the assets over their estimated useful lives, which are generally between 5 years and 20 years.
- iii The Group holds certain properties as investments. No depreciation is provided in respect of such properties other than leaseholds with 20 years or less to expiry. Investment properties are included in the balance sheet at their open market value and the aggregate surplus or deficit, where material, is transferred to the investment property revaluation reserve.

f Finance and operating leases

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

Notes on the Accounts (continued)

2 Principal accounting policies (continued)

i Foreign currencies

- i Assets and liabilities denominated in foreign currencies are translated into US dollars at the rates of exchange ruling at the year-end. The results of branches and subsidiary and associated undertakings not reporting in US dollars are translated into US dollars 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 exchange rate, interest rate and equities 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

| | 1998 US\$m | 1997 US\$m |
|--|---------------|---------------|
| Income from equity shares | 138 | 148 |
| Income from participating interests other than associated undertakings | 10 | 8 |
| | <u>148</u> | <u>156</u> |

4 Administrative expenses

| a | 1998 US\$m | 1997 US\$m |
|---|---------------|---------------|
| Staff costs | | |
| — wages and salaries | 5,440 | 5,139 |
| — social security costs | 398 | 368 |
| — other pension costs (Note 4b below) | 483 | 491 |
| | <u>6,321</u> | <u>5,998</u> |
| Premises and equipment (excluding depreciation) | 1,454 | 1,245 |
| Other administrative expenses | 2,315 | 2,094 |
| | <u>10,090</u> | <u>9,337</u> |

4 Administrative expenses (continued)

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

| | 1998 | 1997 |
|--------------------|----------------|----------------|
| | Number | Number |
| Commercial banking | 137,501 | 126,554 |
| Investment banking | 7,020 | 6,415 |
| | <u>144,521</u> | <u>132,969</u> |

b Retirement benefits

The Group operates some 125 pension schemes throughout the world, covering 87% of the Group's employees, with a total pension cost of US\$483 million (1997: US\$491 million), of which US\$223 million (1997: US\$223 million) relates to overseas schemes. Of the overseas schemes, US\$23 million (1997: US\$34 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 71% 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 US\$401 million (1997: US\$416 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 US\$7,351 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 US\$496 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.

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 Hongkong and Shanghai Banking Corporation Limited Local Staff Retirement Benefits Scheme, the latest valuation was made at 31 December 1998 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 US\$635 million. On an ongoing basis, the actuarial value of the scheme's assets represented 101% of the benefits accrued to members, after allowing for expected future increases in salaries, and the resulting surplus amounted to US\$3 million. On a wind-up basis, the actuarial value of the scheme's assets represents 108% of the members' vested benefits, based on current salaries, and the resulting surplus amounted to US\$46 million. The actuarial method used was 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.

In Brazil, the Banco HSBC Bamerindus S.A. Lump Sum Retirement Benefit Scheme provides retirement benefits under an unfunded defined benefit scheme. The latest valuation was made at 31 December 1998 and was performed by Carl de Montigny, Fellow of the Society of Actuaries, of William M Mercer. At that date, the present value of the accumulated benefit obligation amounted to US\$74 million. US\$76 million has been provided in these accounts (Note 28b) and the surplus evidenced by the latest valuation will be spread forward over the expected remaining

Notes on the Accounts (continued)

4 Administrative expenses (continued)

service lives of the current employees. The method adopted for this valuation was the projected unit method and the main assumptions used were a long-term investment return of 5.0% over the rate of inflation per annum, salary increases of 2.0% over the rate of inflation per annum and post-retirement pension increases at the rate of inflation per annum.

The Midland Bank Pension Scheme, The Hongkong and Shanghai Banking Corporation Limited Local Staff Retirement Benefits Scheme and the Banco HSBC Bamerindus S.A. Lump Sum Retirement Benefit Scheme cover 55% (1997: 54%) of the Group's employees.

The pension cost for defined contribution schemes, which cover 16% (1997: 12%) of the Group's employees, was US\$52 million (1997: US\$36 million).

The Group also provides post-retirement health-care benefits under schemes, mainly in the UK and also in the United States, Canada and Brazil. The charge relating to these schemes, which are unfunded, is US\$30 million for the year (1997: US\$39 million). The latest actuarial review estimated the present value of the accumulated post-retirement benefit obligation at US\$357 million (1997: US\$280 million), of which US\$240 million (1997: US\$150 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:

| | 1998 | 1997 |
|--|---------------------|--------------|
| | US\$000 | US\$000 |
| Fees | 1,063 | 775 |
| Salaries and other emoluments | 5,275 | 5,091 |
| Discretionary bonuses | 965 | 1,041 |
| | <u>7,303</u> | <u>6,907</u> |
| Gains on the exercise of share options | <u>—</u> | <u>185</u> |

In addition, there were annual commitments under retirement benefit agreements with former Directors of US\$303,000 (1997: US\$170,000). The provision as at 31 December 1998 in respect of unfunded pension obligations to former Directors amounted to US\$5,856,000 (1997: US\$2,728,000).

During the year, aggregate contributions to pension schemes in respect of Directors were US\$214,000 (1997: US\$292,000).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee. Details of Directors' remuneration are included in the 'Report of the Directors' (see pages 29 to 37). The cost of the conditional awards under the Restricted Share Plan 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.

Five Directors waived the right to receive emoluments totalling US\$171,000 (1997: four Directors US\$156,000).

Details of individual Directors' remuneration are disclosed in the 'Report of the Directors' on page 31.

d Auditors' remuneration

Auditors' remuneration amounted to US\$17.3 million (1997: US\$18.0 million). In addition, US\$8.3 million (1997: US\$20.3 million) was paid by Group companies to the auditors and their associates for non-audit work analysed as follows:

4 Administrative expenses (continued)

| | 1998 | 1997 |
|-----------------------------|------------|-------------|
| | US\$m | US\$m |
| Regulatory work | 3.5 | 3.4 |
| Tax services | 1.4 | 2.1 |
| Consultancy and recruitment | 1.5 | 2.4 |
| US registration | 0.4 | — |
| Acquisition services | — | 10.9 |
| Other | 1.5 | 1.5 |
| | <u>8.3</u> | <u>20.3</u> |

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'.

5 Profit on ordinary activities before tax

| Profit on ordinary activities before tax is stated after: | 1998 | 1997 |
|---|-------|-------|
| | US\$m | US\$m |
| <i>i Income</i> | | |
| Aggregate rentals receivable, including capital repayments, under | | |
| — finance leases and hire purchase contracts | 3,458 | 3,779 |
| — operating leases | 501 | 415 |
| Income from listed investments | 1,987 | 1,965 |
| Profits less losses on debt securities and equities dealing | 190 | (88) |
| Gains on disposal of investment securities | 210 | 543 |
| <i>ii Charges</i> | | |
| Charges incurred with respect to subordinated liabilities | 814 | 753 |
| Finance charges in respect of finance leases and similar hire | | |
| purchase contracts | 26 | 26 |
| Hire of plant and machinery | 92 | 75 |
| Rentals payable on premises held under operating leases | 429 | 436 |

Gains on the disposal of investments and tangible fixed assets attracted a tax charge of US\$45 million (1997: US\$93 million). Of the after-tax amount, US\$3 million (1997: US\$31 million) is attributable to minority interests.

6 Tax on profit on ordinary activities

| The charge for taxation comprises: | 1998 | 1997 |
|---------------------------------------|--------------|--------------|
| | US\$m | US\$m |
| United Kingdom corporation tax charge | 745 | 960 |
| Relief for overseas taxation | (13) | (149) |
| | <u>732</u> | <u>811</u> |
| Overseas taxation | 1,118 | 1,109 |
| Deferred taxation (Note 28) | (71) | 129 |
| | <u>1,779</u> | <u>2,049</u> |
| Associated undertakings | 10 | 9 |
| | <u>1,789</u> | <u>2,058</u> |

The Company and its subsidiary undertakings in the UK provide for UK corporation tax at 31.0% (1997: 31.5%). Overseas tax includes Hong Kong profits tax of US\$293 million (1997: US\$436 million). Subsidiary undertakings in Hong Kong provide for Hong Kong profits tax at the rate of 16.0% (1997: 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.

Notes on the Accounts (continued)

7 Profit of the Company

The profit of the Company for the year was US\$1,072 million (1997: US\$1,520 million).

8 Dividends

| | 1998 | | 1997 | |
|----------------|-------------------|--------------|-------------------|-------|
| | US\$ per share | US\$m | US\$ per share | US\$m |
| First interim | 0.370 | 996 | 0.325 | 874 |
| Second interim | 0.555 | 1,499 | 0.505 | 1,332 |
| | 0.925 | 2,495 | 0.830 | 2,206 |

Of the first interim dividend for 1998, US\$107 million (1997: US\$125 million) was settled by the issue of shares. Of the second interim dividend for 1997, US\$477 million (1996: US\$212 million) was settled by the issue of shares in 1998.

9 Earnings per ordinary share

Basic earnings per ordinary share is calculated by dividing the earnings of US\$4,318 million (1997: US\$5,487 million) by the weighted average number of ordinary shares outstanding in 1998 of 2,689 million (1997: 2,669 million).

Diluted earnings per share is calculated by dividing the basic earnings, which require no adjustment for the effects of dilutive ordinary potential shares, by the weighted average number of shares outstanding plus the weighted average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares in 1998 of 2,708 million (1997: 2,690 million).

Headline earnings per share continues to have widespread acceptance and 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:

| | 1998 US\$ | 1997 US\$ |
|---|---------------|--------------|
| Basic earnings per ordinary share | 1.61 | 2.06 |
| Adjustments: | | |
| Gains on disposal of tangible fixed assets | (0.01) | (0.01) |
| Gains on disposal of subsidiary undertaking | — | (0.01) |
| Headline earnings per ordinary share | 1.60 | 2.04 |

10 Treasury bills and other eligible bills

| | 1998 US\$m | 1997 US\$m |
|---------------------------------------|---------------|---------------|
| Treasury bills and similar securities | 19,553 | 13,840 |
| Other eligible bills | 2,427 | 3,343 |
| | 21,980 | 17,183 |

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

11 Hong Kong SAR currency notes in circulation

| | 1998 | 1997 |
|--|--------------|--------------|
| | US\$m | US\$m |
| Excess note issue (HK\$57,384 million) | <u>7,408</u> | <u>8,143</u> |

The 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

| | 1998 | 1997 |
|---|---------------|---------------|
| | US\$m | US\$m |
| Remaining maturity | | |
| — repayable on demand | 11,155 | 17,795 |
| — 3 months or less but not repayable on demand | 63,986 | 63,382 |
| — 1 year or less but over 3 months | 6,794 | 3,801 |
| — 5 years or less but over 1 year | 2,265 | 703 |
| — over 5 years | 1,146 | 887 |
| Specific bad and doubtful debt provisions (Note 14) | <u>(31)</u> | <u>(46)</u> |
| | <u>85,315</u> | <u>86,522</u> |

| Amounts include: | 1998 | 1997 |
|----------------------------------|-----------|-----------|
| | US\$m | US\$m |
| Due from associated undertakings | | |
| — unsubordinated | <u>82</u> | <u>31</u> |

13 Loans and advances to customers

| | 1998 | 1997 |
|---|----------------|----------------|
| | US\$m | US\$m |
| Remaining maturity | | |
| — repayable on demand or at short notice | 33,832 | 36,400 |
| — 3 months or less but not repayable on demand or at short notice | 39,204 | 48,342 |
| — 1 year or less but over 3 months | 30,251 | 30,497 |
| — 5 years or less but over 1 year | 67,659 | 67,889 |
| — over 5 years | 70,976 | 62,425 |
| General and specific bad and doubtful debt provisions (Note 14) | <u>(6,627)</u> | <u>(5,132)</u> |
| | <u>235,295</u> | <u>240,421</u> |
| Amounts include: | | |
| Subordinated | <u>119</u> | <u>132</u> |
| Securitised advances not qualifying for linked presentation under FRS 5 ('Reporting the substance of transactions') | <u>1,143</u> | <u>152</u> |
| Due from associated undertakings | | |
| — unsubordinated | <u>319</u> | <u>347</u> |

Notes on the Accounts (continued)**14 Provisions for bad and doubtful debts**

| | <i>Provisions against advances</i> | | | <i>Suspended interest</i> |
|--|------------------------------------|---------------------|---------------------|---------------------------|
| | <i>Specific</i> | <i>General</i> | <i>Total</i> | |
| | US\$m | US\$m | US\$m | US\$m |
| At 1 January 1998 | 3,157 | 2,021 | 5,178 | 702 |
| Amounts written off | (1,398) | — | (1,398) | (458) |
| Recoveries of advances written off in previous years | 172 | — | 172 | — |
| Charge to profit and loss account | 2,627 | 10 | 2,637 | — |
| Interest suspended during the year | — | — | — | 647 |
| Suspended interest recovered | — | — | — | (117) |
| Exchange and other movements | 81 | (12) | 69 | (6) |
| At 31 December 1998 | <u>4,639</u> | <u>2,019</u> | <u>6,658</u> | <u>768</u> |
| Included in: | | | | |
| Loans and advances to banks (Note 12) | | | 31 | |
| Loans and advances to customers (Note 13) | | | 6,627 | |
| | | | <u>6,658</u> | |

| | <i>Provisions against advances</i> | | | <i>Suspended interest</i> |
|--|------------------------------------|---------------------|---------------------|---------------------------|
| | <i>Specific</i> | <i>General</i> | <i>Total</i> | |
| | US\$m | US\$m | US\$m | US\$m |
| At 1 January 1997 | 3,186 | 1,572 | 4,758 | 670 |
| Amounts written off | (752) | — | (752) | (75) |
| Recoveries of advances written off in previous years | 173 | — | 173 | — |
| Charge to profit and loss account | 533 | 481 | 1,014 | — |
| Interest suspended during the year | — | — | — | 253 |
| Suspended interest recovered | — | — | — | (100) |
| Exchange and other movements | 17 | (32) | (15) | (46) |
| At 31 December 1997 | <u>3,157</u> | <u>2,021</u> | <u>5,178</u> | <u>702</u> |
| Included in: | | | | |
| Loans and advances to banks (Note 12) | | | 46 | |
| Loans and advances to customers (Note 13) | | | 5,132 | |
| | | | <u>5,178</u> | |

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

| | 1998 | 1997 |
|----------------------------|---------------------|--------------|
| | US\$m | US\$m |
| Gross | 6,435 | 3,240 |
| Net of specific provisions | <u>3,148</u> | <u>1,206</u> |

15 Concentrations of exposure

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

| Total gross advances to customers: | <i>Europe</i> | <i>Hong Kong</i> | <i>Rest of Asia-Pacific</i> | <i>North America</i> | <i>Latin America</i> | <i>Total</i> |
|--|---------------|------------------|-----------------------------|----------------------|----------------------|----------------|
| At 31 December 1998 | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Residential mortgages | 20,716 | 25,051 | 2,746 | 13,059 | 640 | 62,212 |
| Hong Kong SAR | | | | | | |
| Government Home Ownership Scheme | — | 6,291 | — | — | — | 6,291 |
| Other personal | 12,000 | 4,257 | 3,322 | 5,265 | 888 | 25,732 |
| Commercial, industrial and international trade | 28,224 | 10,952 | 13,189 | 6,444 | 2,602 | 61,411 |
| Commercial real estate | 6,418 | 9,420 | 3,601 | 4,615 | 62 | 24,116 |
| Other property related | 2,110 | 2,248 | 2,126 | 1,591 | 174 | 8,249 |
| Government | 3,381 | 551 | 567 | 651 | 135 | 5,285 |
| Non-bank financial institutions | 4,638 | 2,259 | 1,527 | 3,238 | 101 | 11,763 |
| Settlement accounts | 877 | 78 | 231 | 3,734 | 43 | 4,963 |
| Other commercial* | 15,200 | 7,377 | 5,071 | 3,934 | 885 | 32,467 |
| | 93,564 | 68,484 | 32,380 | 42,531 | 5,530 | 242,489 |
| Total gross advances to customers: | | | | | | |
| At 31 December 1997 | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Residential mortgages | 19,133 | 24,364 | 2,233 | 13,858 | 414 | 60,002 |
| Hong Kong SAR | | | | | | |
| Government Home Ownership Scheme | — | 4,631 | — | — | — | 4,631 |
| Other personal | 10,236 | 4,367 | 3,187 | 5,597 | 788 | 24,175 |
| Commercial, industrial and international trade | 28,277 | 11,947 | 14,464 | 5,601 | 2,267 | 62,556 |
| Commercial real estate | 6,092 | 10,424 | 3,660 | 4,955 | 14 | 25,145 |
| Other property related | 2,023 | 2,569 | 1,757 | 1,585 | 148 | 8,082 |
| Government | 3,530 | 120 | 277 | 576 | 11 | 4,514 |
| Non-bank financial institutions | 5,569 | 5,283 | 1,632 | 8,230 | 649 | 21,363 |
| Settlement accounts | 1,248 | 182 | 211 | 2,644 | 54 | 4,339 |
| Other commercial* | 13,943 | 7,649 | 5,171 | 3,811 | 786 | 31,360 |
| | 90,051 | 71,536 | 32,592 | 46,857 | 5,131 | 246,167 |

* Other commercial includes advances in respect of agriculture, transport, energy and utilities.

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

Notes on the Accounts (continued)**16 Debt securities**

| | 1998 | | 1997 | |
|---|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | US\$m | US\$m | US\$m | US\$m |
| Issued by public bodies | | | | |
| Investment securities | | | | |
| — government securities and US government agencies | 21,475 | 21,722 | 17,122 | 17,306 |
| — other public sector securities | 1,520 | 1,566 | 760 | 776 |
| | 22,995 | 23,288 | 17,882 | 18,082 |
| Other securities | | | | |
| — government securities and US government agencies | 13,532 | | 8,208 | |
| — other public sector securities | 336 | | 743 | |
| | 36,863 | | 26,833 | |
| Issued by other bodies | | | | |
| Investment securities | | | | |
| — bank and building society certificates of deposit | 4,963 | 4,957 | 3,806 | 3,871 |
| — other debt securities | 9,536 | 9,671 | 5,929 | 5,883 |
| | 14,499 | 14,628 | 9,735 | 9,754 |
| Other securities | | | | |
| — bank and building society certificates of deposit | 10,159 | | 10,583 | |
| — other debt securities | 7,664 | | 8,613 | |
| | 32,322 | | 28,931 | |
| | 69,185 | | 55,764 | |
| Due within 1 year | 38,202 | | 25,409 | |
| Due 1 year and over | 30,983 | | 30,355 | |
| | 69,185 | | 55,764 | |
| Amounts include: | | | | |
| Subordinated debt securities | 124 | | 127 | |
| Unamortised net premiums/(discounts) on investment securities | 85 | | (28) | |

16 Debt securities (continued)

| | 1998 | | 1997 | |
|--------------------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | US\$m | US\$m | US\$m | US\$m |
| Investment securities | | | | |
| — listed on a recognised UK exchange | 5,675 | 5,722 | 6,036 | 6,064 |
| — listed in Hong Kong | 783 | 821 | 481 | 466 |
| — listed elsewhere | 12,670 | 12,903 | 8,635 | 8,829 |
| — unlisted | 18,366 | 18,470 | 12,465 | 12,477 |
| | 37,494 | 37,916 | 27,617 | 27,836 |
| Other securities | | | | |
| — listed on a recognised UK exchange | 5,721 | | 3,062 | |
| — listed in Hong Kong | 1,004 | | 642 | |
| — listed elsewhere | 11,462 | | 10,454 | |
| — unlisted | 13,504 | | 13,989 | |
| | 69,185 | | 55,764 | |

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 US\$37,792 million (1997: US\$27,760 million).

Investment securities:

| | <i>Cost</i> | <i>Provisions</i> | <i>Book value</i> |
|--|---------------|-------------------|-------------------|
| | US\$m | US\$m | US\$m |
| At 1 January 1998 | 27,660 | (43) | 27,617 |
| Additions | 59,591 | — | 59,591 |
| Disposals and amounts repaid | (50,279) | — | (50,279) |
| Provisions made | — | (19) | (19) |
| Amortisation of discounts and premiums | 53 | — | 53 |
| Exchange and other movements | 535 | (4) | 531 |
| At 31 December 1998 | 37,560 | (66) | 37,494 |

Notes on the Accounts (continued)

17 Equity shares

| | 1998 | | 1997 | |
|--------------------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <i>Book value</i> | <i>Market valuation</i> | <i>Book value</i> | <i>Market valuation</i> |
| | US\$m | US\$m | US\$m | US\$m |
| Investment securities | | | | |
| — listed on a recognised UK exchange | 45 | 84 | 44 | 133 |
| — listed in Hong Kong | 306 | 623 | 356 | 697 |
| — listed elsewhere | 122 | 170 | 206 | 380 |
| — unlisted | 667 | 852 | 438 | 583 |
| | <u>1,140</u> | <u>1,729</u> | 1,044 | <u>1,793</u> |
| Other securities | | | | |
| — listed on a recognised UK exchange | 1,400 | | 1,107 | |
| — listed in Hong Kong | 14 | | 80 | |
| — listed elsewhere | 1,550 | | 822 | |
| — unlisted | 117 | | 175 | |
| | <u>4,221</u> | | <u>3,228</u> | |

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 152,955 (1997: 249,440) shares in the Company held by subsidiary undertakings as equity market-makers.

Investment securities:

| | <i>Cost</i> | <i>Provisions</i> | <i>Book value</i> |
|------------------------------|--------------|-------------------|-------------------|
| | US\$m | US\$m | US\$m |
| At 1 January 1998 | 1,168 | (124) | 1,044 |
| Additions | 223 | — | 223 |
| Disposals | (92) | 13 | (79) |
| Provisions made | — | (68) | (68) |
| Provisions released | — | 6 | 6 |
| Provisions written off | (3) | 3 | — |
| Exchange and other movements | 25 | (11) | 14 |
| At 31 December 1998 | <u>1,321</u> | <u>(181)</u> | <u>1,140</u> |

18 Interests in associated undertakings

| | 1998 |
|------------------------------------|------------|
| | US\$m |
| At 1 January 1998 | 899 |
| Additions | 48 |
| Retained profits | 37 |
| Disposals | (14) |
| Deficit on revaluation of property | (94) |
| Exchange and other movements | 13 |
| At 31 December 1998 | <u>889</u> |

18 Interests in associated undertakings (continued)

| | 1998 | 1997 |
|---|------------|-------|
| | US\$m | US\$m |
| a Shares in banks | 647 | 562 |
| Other | 242 | 337 |
| | 889 | 899 |
| Listed shares (all listed outside the UK and Hong Kong) | 427 | 408 |
| Unlisted shares | 462 | 491 |
| | 889 | 899 |

b The principal associated undertakings of the Group are:

| | <i>Accounts made up to</i> | <i>Country of incorporation</i> | <i>Principal activity</i> | <i>Group's interest in equity capital</i> | <i>Issued equity capital</i> |
|---|--------------------------------|-------------------------------------|------------------------------------|---|--|
| Barrowgate Limited | 31.12.98 | Hong Kong | Property | 25% | * |
| British Arab Commercial Bank Limited | 31.12.98 | England | Banking | 47% | US\$81m £32m fully paid, £5m nil paid |
| British Interactive Broadcasting Limited | 31.12.98 | England | Digital interactive services | 20% | † |
| The Cyprus Popular Bank Limited | 31.12.98 | Cyprus | Banking | 22% | C£75m |
| Egyptian British Bank S.A.E. | 31.12.98 | Egypt | Banking | 40% | E£101m |
| Máxima S.A. A.F.J.P. | 30.6.98 | Argentina | Pension fund management | 35% | ARS98m |
| Mondex Holdings Limited | 31.12.98 | England | Electronic cash | 50% | † |
| The Saudi British Bank | 31.12.98 | Saudi Arabia | Banking | 40% | SR1,600m |
| Wells Fargo HSBC Trade Bank, N.A. | 31.12.98 | United States | Trade finance | 20% | ¶ |
| World Finance International Limited | 30.6.98 | 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\$44.5 million 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**

| | 1998 | 1997 |
|---|--------------|-------|
| | US\$m | US\$m |
| Listed other than on a recognised UK exchange or in Hong Kong | 4 | 5 |
| Unlisted | 305 | 315 |
| | 309 | 320 |
| Market value of listed securities | 6 | 8 |
| Other participating interests in banks | 287 | 292 |

| | <i>Cost</i> | <i>Provisions</i> | <i>Carrying value</i> |
|------------------------------|--------------|-------------------|-----------------------|
| | US\$m | US\$m | US\$m |
| At 1 January 1998 | 350 | (30) | 320 |
| Additions | 7 | — | 7 |
| Disposals | (4) | — | (4) |
| Transfers | (7) | — | (7) |
| Provisions made | — | (4) | (4) |
| Provisions written off | (6) | 6 | — |
| Exchange and other movements | (4) | 1 | (3) |
| At 31 December 1998 | 336 | (27) | 309 |

20 Intangible fixed assets*Goodwill*

| | <i>Cost</i> |
|---------------------------------|--------------|
| | US\$m |
| Cost at 1 January 1998 | — |
| Additions | 160 |
| Exchange movements | (4) |
| Cost at 31 December 1998 | 156 |

| | <i>Accumulated amortisation</i> |
|--|---------------------------------|
| | US\$m |
| Accumulated amortisation at 1 January 1998 | — |
| Charge to the profit and loss account | (10) |
| Accumulated amortisation at 31 December 1998 | (10) |
| Net book value at 31 December 1998 (1997: US\$ nil) | 146 |

Additions represent goodwill arising on acquisitions of subsidiaries during 1998 which is being amortised over periods of between 5 and 15 years.

21 Tangible fixed assets

a Group

| | <i>Freehold land and buildings</i> | <i>Long leasehold land and buildings*</i> | <i>Short leasehold land and buildings</i> | <i>Equipment, fixtures and fittings</i> | <i>Equipment on operating leases</i> | <i>Total</i> |
|---|--|---|---|---|--|----------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Cost or valuation at 1 January 1998 | 2,327 | 3,919 | 3,070 | 3,678 | 3,374 | 16,368 |
| Additions | 119 | 717 | 639 | 603 | 459 | 2,537 |
| Disposals | (101) | (9) | (23) | (382) | (253) | (768) |
| Reclassification | — | 243 | 4 | (247) | — | — |
| Transfer of accumulated depreciation arising on revaluation | (32) | (190) | (55) | — | — | (277) |
| Impairment of land and buildings | (38) | — | — | — | — | (38) |
| Deficit on revaluation | (81) | (1,355) | (858) | — | — | (2,294) |
| Exchange and other movements | 17 | (11) | 1 | 50 | 24 | 81 |
| Cost or valuation at 31 December 1998 | 2,211 | 3,314 | 2,778 | 3,702 | 3,604 | 15,609 |
| Accumulated depreciation at 1 January 1998 | — | — | (435) | (2,187) | (712) | (3,334) |
| Disposals | 6 | 1 | 16 | 340 | 167 | 530 |
| Reclassification | — | (161) | — | 161 | — | — |
| Transfer of accumulated depreciation arising on revaluation | 32 | 190 | 55 | — | — | 277 |
| Charge to the profit and loss account | (41) | (45) | (92) | (501) | (225) | (904) |
| Exchange and other movements | (2) | 15 | (3) | (56) | (24) | (70) |
| Accumulated depreciation at 31 December 1998 | (5) | — | (459) | (2,243) | (794) | (3,501) |
| Net book value at 31 December 1998 | 2,206 | 3,314 | 2,319 | 1,459 | 2,810 | 12,108 |
| Net book value at 31 December 1997 | 2,327 | 3,919 | 2,635 | 1,491 | 2,662 | 13,034 |

* Included in the cost and net book value of long leasehold land and buildings is a payment on account in respect of a long leasehold interest of US\$695 million (1997: US\$ nil).

Notes on the Accounts (continued)

21 Tangible fixed assets (continued)

b Company

| | <i>Freehold land and buildings</i> | <i>Equipment, fixtures and fittings</i> | <i>Total</i> |
|---|--|---|--------------|
| | US\$m | US\$m | US\$m |
| Cost or valuation at 1 January 1998 | 3 | 3 | 6 |
| Additions | — | 2 | 2 |
| Disposals | — | (1) | (1) |
| Surplus on revaluation | 1 | — | 1 |
| Exchange and other movements | 1 | — | 1 |
| Cost or valuation at 31 December 1998 | 5 | 4 | 9 |
| Accumulated depreciation at 1 January 1998 | — | (1) | (1) |
| Disposals | — | 1 | 1 |
| Charge to the profit and loss account | — | (1) | (1) |
| Accumulated depreciation at 31 December 1998 | — | (1) | (1) |
| Net book value at 31 December 1998 | 5 | 3 | 8 |
| Net book value at 31 December 1997 | 3 | 2 | 5 |

c Valuations

| | <i>Group</i> | | <i>Company</i> | |
|---|--------------|--------------|----------------|----------|
| | 1998 | 1997 | 1998 | 1997 |
| | US\$m | US\$m | US\$m | US\$m |
| Cost or valuation of freehold and long and short leasehold land and buildings (excluding investment properties): | | | | |
| At 1998 valuation (1997: at 1997 valuation) | 7,039 | 7,840 | 5 | 3 |
| At cost | 676 | 732 | — | — |
| | 7,715 | 8,572 | 5 | 3 |
| On the historical cost basis, freehold and long and short leasehold land and buildings would have been included as follows (excluding investment properties): | | | | |
| Cost | 6,190 | 4,867 | — | — |
| Accumulated depreciation | (863) | (776) | — | — |
| | 5,327 | 4,091 | — | — |

The Group values its non-investment properties on an annual basis. In November 1998, the Group's freehold and long leasehold properties, together with all leasehold properties in Hong Kong, were revalued on an existing use basis or open market value as appropriate 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 US\$2,005 million. A deficit of US\$1,787 million (net of minority interest of US\$218 million) was charged to reserves at 31 December 1998.

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:

21 Tangible fixed assets (continued)

| | <i>Cost</i> | <i>Accumulated depreciation</i> |
|---|--------------|-------------------------------------|
| | US\$m | US\$m |
| At 1 January 1998 | 738 | (448) |
| Additions | 23 | — |
| Disposals | (120) | 114 |
| Charge for the year | — | (42) |
| Exchange and other movements | 35 | 20 |
| At 31 December 1998 | 676 | (356) |
| Net book value at 31 December 1998 (1997: US\$290 million) | 320 | |

The property of the Company was also valued by an independent, professionally qualified valuer on an existing use basis. The surplus on revaluation of US\$1 million has been credited to reserves at 31 December 1998.

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:

| | 1998 | | 1997 | |
|---|---------------------|----------------|---------------------|----------------|
| | <i>At valuation</i> | <i>At cost</i> | <i>At valuation</i> | <i>At cost</i> |
| | US\$m | US\$m | US\$m | US\$m |
| Freehold land and buildings | 41 | 41 | 41 | 41 |
| Short and long leasehold land and buildings | 546 | 147 | 699 | 99 |
| | 587 | 188 | 740 | 140 |

Investment properties are valued on an open market value basis at 31 December annually by professional valuers. Investment properties in the Hong Kong SAR, Macau and mainland China, which represent 90% by value of the Group's properties subject to revaluation, were valued by C Y Leung & Company Limited. The valuations were carried out by qualified valuers who are members of the Hong Kong Institute of Surveyors. As a result of the revaluation, the net book value of investment properties has decreased by US\$289 million (1997: surplus of US\$2 million). A deficit of US\$190 million (net of minority interests of US\$99 million) has been charged to reserves at 31 December 1998.

The Company had no investment properties at 31 December 1998 or 1997.

e Group properties leased to customers

Group properties leased to customers, none of which was held by the Company, included US\$483 million at 31 December 1998 (1997: US\$692 million) let under operating leases, net of accumulated depreciation of US\$21 million (1997: US\$21 million).

f Land and buildings occupied for own activities

| | 1998 | 1997 |
|----------------|--------------|-------|
| | US\$m | US\$m |
| Net book value | 6,420 | 7,883 |

There were no such assets in the Company at 31 December 1998 or 1997.

Notes on the Accounts (continued)

22 Investments

| a | <i>Shares in Group undertakings</i> | <i>Loans to Group undertakings</i> | <i>Other investments other than loans</i> | <i>Total</i> |
|---|---|--|---|---------------|
| | US\$m | US\$m | US\$m | US\$m |
| At 1 January 1998 | 25,776 | 730 | 400 | 26,906 |
| Additions | 17 | 65 | 1,093 | 1,175 |
| Repayments and redemptions | — | — | (400) | (400) |
| Amortisation of discounts and premiums | — | — | 1 | 1 |
| Transfers | — | 273 | — | 273 |
| Write-up of subsidiary undertakings to net asset value (Note 32) | 1,142 | — | — | 1,142 |
| Exchange movements | — | — | 3 | 3 |
| At 31 December 1998 | 26,935 | 1,068 | 1,097 | 29,100 |

'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 US\$2.8 million, after amortisation, of the Company's own shares (1997: US\$1.6 million) 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 30 and 32 to 33. At 31 December 1998, the trust held 163,329 shares (1997: 69,097 shares) of nominal value 75p with a market value at that date of US\$4,413,494 (1997: US\$1,775,323) in respect of these conditional awards.

'Other investments other than loans' also includes the Company's holdings of investments in unlisted US government agencies discount notes of US\$1,094 million (1997: US\$ nil) and investments in UK government stock listed on a recognised UK exchange of US\$ nil (1997: US\$399 million). The market value of these investments at 31 December 1998 was US\$1,094 million (1997: US\$410 million).

| | 1998 US\$m | 1997 US\$m |
|--|---------------|---------------|
| On the historical cost basis, shares in Group undertakings would have been included as follows: Cost less provisions of US\$170 million (1997: US\$170 million) | 23,659 | 23,643 |

b The principal subsidiary undertakings of the Company are:

| | <i>Country of incorporation or registration</i> | <i>Principal activity</i> | <i>Issued equity capital</i> |
|---|---|-------------------------------|--------------------------------------|
| <i>Europe</i> | | | |
| The British Bank of the Middle East | England | Banking | £150m |
| Forward Trust Group Limited | England | Finance | £265m |
| HSBC Gibbs Limited | England | Insurance | £3m |
| 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 |
| Guyertzeller Bank AG (indirect minority)* | Switzerland | Banking | SF5m |
| Trinkaus & Burkhart KGaA (partnership limited by shares, 73.47% owned) | Germany | Banking | DM131m |

22 Investments (continued)

| | <i>Country of incorporation or registration</i> | <i>Principal activity</i> | <i>Issued equity capital</i> |
|---|---|-------------------------------|--------------------------------------|
| <i>Hong Kong</i> | | | |
| Hang Seng Bank Limited (62.14% owned) | Hong Kong | Banking | HK\$9,566m |
| The Hongkong and Shanghai Banking Corporation Limited | Hong Kong | Banking | HK\$16,254m |
| HSBC Insurance Limited | Hong Kong | Insurance | HK\$125m |
| HSBC Investment Bank Asia Limited | Hong Kong | Investment banking | HK\$770m |
| Wayfoong Finance Limited | Hong Kong | Finance | HK\$300m |
| <i>Rest of Asia-Pacific</i> | | | |
| HongkongBank of Australia Limited | Australia | Banking | A\$500m |
| HSBC Bank Malaysia Berhad | Malaysia | Banking | M\$100m |
| <i>North America</i> | | | |
| Hongkong Bank of Canada | Canada | Banking | C\$75m |
| HSBC Americas, Inc. | United States | Holding company | — † |
| HSBC Securities, Inc. | United States | Investment banking | — † |
| Marine Midland Bank | United States | Banking | US\$185m |
| <i>Latin America</i> | | | |
| Banco HSBC Bamerindus S.A. | Brazil | Banking | BRL875m |
| HSBC Banco Roberts S.A. | Argentina | Banking | ARS220m |
| HSBC Bamerindus Seguros S.A. (99.64% owned) | Brazil | Insurance | BRL244m |
| La Buenos Aires Compañía Argentina de Seguros S.A. (98.68% owned) | Argentina | Insurance | ARS21m |

* 15.82% owned by *Trinkaus & Burkhardt KGaA*

† 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 (including Hongkong Bank of Canada, which in previous years has had a 31 October year-end) except for 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 fair value adjustments made in 1997 in respect of the acquisition of selected assets, liabilities and subsidiaries of Banco Bamerindus do Brasil were provisional pending completion of the intervention period. On 25 March 1998, the final date of completion of the intervention period, Banco HSBC Bamerindus S.A. assumed pension plan and life and health insurance provisions previously the responsibility of Banco Bamerindus do Brasil until that date.

Cash of US\$377 million, being the fair value of these liabilities (Note 28b), was transferred to Banco HSBC Bamerindus S.A. from the Central Bank to meet the obligations. No other significant adjustments to the fair values have been made. No adjustment was required to goodwill.

Notes on the Accounts (continued)**23 Other assets**

| | 1998 | 1997 |
|--|----------------------|---------------|
| | US\$m | US\$m |
| Bullion | 309 | 324 |
| Assets, including gains, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market | 18,206 | 21,669 |
| Current taxation recoverable | 140 | 115 |
| Deferred taxation (Note 28) | 195 | 96 |
| Long-term assurance assets attributable to policyholders (Note 27) | 7,582 | 6,741 |
| Other accounts | 5,920 | 4,310 |
| | <u>32,352</u> | <u>33,255</u> |

Included in the above are 2,489,911 (1997: 2,458,506) 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:

| | 1998 | 1997 |
|--|---------------------|--------------|
| | US\$m | US\$m |
| Loans and advances to banks — with Group companies | 261 | 296 |
| Debt securities | 2,757 | 2,660 |
| Equity shares | 2,811 | 2,513 |
| Other assets | 2,354 | 2,352 |
| Prepayments and accrued income | 40 | 40 |
| Other liabilities | (641) | (1,120) |
| | <u>7,582</u> | <u>6,741</u> |

24 Deposits by banks

| | 1998 | 1997 |
|---|----------------------|---------------|
| | US\$m | US\$m |
| Repayable on demand | 12,599 | 11,498 |
| With agreed maturity dates or periods of notice, by remaining maturity: | | |
| — 3 months or less but not repayable on demand | 17,298 | 21,847 |
| — 1 year or less but over 3 months | 3,282 | 4,798 |
| — 5 years or less but over 1 year | 1,061 | 700 |
| — over 5 years | 102 | 104 |
| | <u>34,342</u> | <u>38,947</u> |
| Amounts include: | | |
| Due to associated undertakings | 47 | 79 |
| Due to other participating interests | 4 | — |

25 Customer accounts

| | 1998 | 1997 |
|---|----------------|---------|
| | US\$m | US\$m |
| Repayable on demand | 136,722 | 134,988 |
| With agreed maturity dates or periods of notice, by remaining maturity: | | |
| — 3 months or less but not repayable on demand | 148,597 | 140,278 |
| — 1 year or less but over 3 months | 16,417 | 14,103 |
| — 5 years or less but over 1 year | 5,136 | 3,459 |
| — over 5 years | 2,038 | 1,361 |
| | 308,910 | 294,189 |
| Amounts include: | | |
| Due to associated undertakings | 29 | 40 |

26 Debt securities in issue

| | 1998 | 1997 |
|--|---------------|--------|
| | US\$m | US\$m |
| Bonds and medium-term notes, by remaining maturity: | | |
| — within 1 year | 1,895 | 1,100 |
| — between 1 and 2 years | 1,752 | 468 |
| — between 2 and 5 years | 3,409 | 3,002 |
| — over 5 years | 165 | 231 |
| | 7,221 | 4,801 |
| Other debt securities in issue, by remaining maturity: | | |
| — 3 months or less | 10,025 | 10,933 |
| — 1 year or less but over 3 months | 7,537 | 7,443 |
| — 5 years or less but over 1 year | 4,007 | 4,470 |
| — over 5 years | 400 | 98 |
| | 29,190 | 27,745 |

Notes on the Accounts (continued)

27 Other liabilities

| | 1998 US\$m | 1997 US\$m |
|--|---------------|---------------|
| Short positions in securities: | | |
| Treasury bills and other eligible bills | 1,627 | 1,729 |
| Debt securities | | |
| — government securities | 8,732 | 7,161 |
| — other public sector securities | 94 | 40 |
| — other debt securities | 524 | 949 |
| Equity shares | 674 | 810 |
| | 11,651 | 10,689 |
| Liabilities, including losses, resulting from off-balance-sheet interest rate, exchange rate and equities contracts which are marked-to-market | 19,615 | 21,959 |
| Current taxation | 1,273 | 1,886 |
| Obligations under finance leases | 310 | 293 |
| Dividend payable by the Company | 1,499 | 1,332 |
| Long-term assurance liabilities attributable to policyholders (Note 23) | 7,582 | 6,741 |
| Other liabilities | 6,732 | 6,776 |
| | 48,662 | 49,676 |
| Obligations under finance leases fall due as follows: | | |
| — within 1 year | 33 | 21 |
| — between 1 and 5 years | 7 | 10 |
| — over 5 years | 270 | 262 |
| | 310 | 293 |

28 Provisions for liabilities and charges

a Deferred taxation

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

| | <i>Group</i> | <i>Company</i> |
|--|--------------|----------------|
| | US\$m | US\$m |
| At 1 January 1998 | 843 | 12 |
| Credit to profit and loss account (Note 6) | (71) | (24) |
| Advance corporation tax utilised | 331 | 331 |
| Exchange and other movements | (30) | 2 |
| At 31 December 1998 | 1,073 | 321 |

28 Provisions for liabilities and charges (continued)

| | <i>Group</i> | | <i>Company</i> | |
|---|----------------------|---------------|----------------------|---------------|
| | 1998 US\$m | 1997 US\$m | 1998 US\$m | 1997 US\$m |
| Included in 'Provision for liabilities and charges' | 1,268 | 939 | 321 | 12 |
| Included in 'Other assets' (Note 23) | (195) | (96) | — | — |
| Net deferred taxation provision | 1,073 | 843 | 321 | 12 |
| Comprising: | | | | |
| Short-term timing differences | (21) | 30 | — | — |
| Leasing transactions | 985 | 891 | — | — |
| Relief for tax losses | (11) | (12) | — | — |
| Advance corporation tax on dividends proposed | — | (331) | — | (331) |
| Provision for additional UK tax on profit remittances from overseas | 232 | 233 | 232 | 233 |
| Other items | (112) | 32 | 89 | 110 |
| | 1,073 | 843 | 321 | 12 |

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 US\$304 million provision for a potential UK tax charge established upon the acquisition of Midland, US\$232 million remained at 31 December 1998 (1997: US\$233 million).
- iii No provision is made for deferred taxation on revalued premises. The Directors are of the opinion that, in respect of properties occupied for the purposes of the Group's business, the likelihood of a material taxation liability arising is remote and no useful purpose would be served by attempting to quantify it. In respect of investment and other properties which have been revalued, no material taxation liability is judged likely to arise in the foreseeable future under management's current intentions for these properties.
- iv At 31 December 1998, there were potential future tax benefits of approximately US\$380 million (1997: US\$410 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

| | <i>Provisions for pension and other post-retirement obligations</i> | <i>Provisions for contingent liabilities and commitments</i> | <i>Insurance and other provisions</i> | <i>Total</i> |
|---------------------------------------|---|--|---------------------------------------|--------------|
| | US\$m | US\$m | US\$m | US\$m |
| At 1 January 1998 | 326 | 501 | 1,306 | 2,133 |
| Provisions assumed (Note 22c) | 377 | — | — | 377 |
| Charge to the profit and loss account | 49 | 144 | 1,097 | 1,290 |
| Provisions utilised | (36) | (62) | (876) | (974) |
| Transfers | 50 | (227) | 320 | 143 |
| Exchange and other movements | (16) | (61) | 14 | (63) |
| At 31 December 1998 | 750 | 295 | 1,861 | 2,906 |

Pension provisions assumed relate to amounts transferred to Banco HSBC Bamerindus S.A. which were previously the responsibility of Banco Bamerindus do Brasil until 25 March 1998. This transfer arose on completion of the intervention period.

None of the above provisions relates to the Company (1997: US\$ nil).

Notes on the Accounts (continued)

29 Subordinated liabilities

| | 1998 | 1997 |
|--|---------------|--------|
| | US\$m | US\$m |
| Undated subordinated loan capital: | | |
| — the Company | — | — |
| — other Group | 3,247 | 3,245 |
| | 3,247 | 3,245 |
| Dated subordinated loan capital: | | |
| — the Company | 1,343 | 1,336 |
| — other Group | 6,254 | 5,945 |
| | 7,597 | 7,281 |
| Total subordinated liabilities: | | |
| — the Company | 1,343 | 1,336 |
| — other Group | 9,501 | 9,190 |
| | 10,844 | 10,526 |
| Dated subordinated loan capital is repayable: | | |
| — within 1 year | 624 | 66 |
| — between 1 and 2 years | 266 | 588 |
| — between 2 and 5 years | 2,072 | 1,509 |
| — over 5 years | 4,635 | 5,118 |
| | 7,597 | 7,281 |
| The total subordinated borrowings of the Company are as follows: | | |
| | 1998 | 1997 |
| | US\$m | US\$m |
| £413m 11.69% subordinated bonds 2002 | 685 | 681 |
| £250m 9.875% subordinated bonds 2018 | 408 | 405 |
| US\$250m Subordinated collared floating rate notes 2008 | 250 | 250 |
| | 1,343 | 1,336 |
| Amounts owed to Group undertakings: | | |
| US\$350m 7.525% subordinated loan 2003 — HSBC Finance Nederland B.V. | 349 | 348 |
| | 1,692 | 1,684 |
| The Company's dated subordinated loan capital is repayable: | | |
| — between 2 and 5 years | 1,034 | 681 |
| — over 5 years | 658 | 1,003 |
| | 1,692 | 1,684 |

29 Subordinated liabilities (continued)

At 31 December 1998, the following other Group subordinated borrowings were US\$200 million or over:

| | | 1998 | 1997 |
|------------|---|--------------|-------|
| | | US\$m | US\$m |
| US\$1,200m | Primary capital subordinated undated floating rate notes | 1,200 | 1,200 |
| US\$750m | Undated floating rate primary capital notes | 750 | 750 |
| US\$500m | Undated floating rate primary capital notes | 500 | 500 |
| US\$500m | 7.625% subordinated notes 2006 | 500 | 500 |
| £250m | Subordinated unsecured floating rate notes 2001 | 414 | 412 |
| US\$400m | 8.625% subordinated notes 2004 | 400 | 400 |
| HK\$3,000m | Subordinated collared (7% to 9%) floating rate notes 2003 | 388 | 388 |
| US\$350m | 7.4% subordinated guaranteed notes 2003 | 350 | 350 |
| £200m | 9% subordinated notes 2005 | 332 | 329 |
| £200m | 6.5% subordinated notes 2023* | 327 | — |
| US\$300m | Undated floating rate primary capital notes (Series 3) | 300 | 300 |
| US\$300m | 6.95% subordinated notes 2011 | 300 | 300 |
| US\$300m | 7.65% subordinated notes 2025 | 300 | 300 |
| US\$300m | 7% fixed rate subordinated notes 2006 | 298 | 298 |
| £150m | 9.25% step-up undated subordinated notes | 248 | 247 |
| £150m | 8.625% step-up undated subordinated notes | 248 | 247 |
| £150m | Subordinated step-up coupon floating rate notes 2007 | 248 | 247 |
| ¥24.8b | Fixed rate (5.0% to 5.5%) subordinated loans 2004 | 218 | 189 |
| US\$200m | 7.808% capital securities 2026 | 200 | 200 |
| US\$200m | 8.38% capital securities 2027 | 200 | 200 |
| US\$200m | Guaranteed floating rate notes 1999 | 200 | 200 |
| US\$200m | Floating rate subordinated notes 2000 | 200 | 200 |
| | Other subordinated liabilities less than US\$200m | 1,380 | 1,433 |
| | | 9,501 | 9,190 |

* The proceeds of the issue of 6.5% subordinated notes 2023 were used to support the development of Midland and to strengthen further Midland's capital base.

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 Financial Services Authority, in certain cases at a premium over par. Interest rates on the floating rate loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 14%.

30 Minority interests — non-equity

Preference shares issued by subsidiaries:

| | | 1998 | 1997 |
|----------|----------------------------------|--------------|-------|
| | | US\$m | US\$m |
| US\$875m | Non-cumulative preference shares | 870 | 850 |

Notes on the Accounts (continued)

31 Called up share capital

Authorised:

The authorised ordinary share capital of the Company at 31 December 1998 and 1997 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 1998 and 1997, the authorised preference share capital of the Company is £500 million divided into 500 million non-cumulative preference shares of £1 each.

| Issued: | <i>Number of HK\$10 shares</i> | <i>Number of 75p shares</i> | US\$m |
|------------------------------------|--|-------------------------------------|--------------|
| At 1 January 1998 | 1,801,612,569 | 874,130,350 | 3,406 |
| Shares issued under option schemes | — | 2,427,043 | 3 |
| Shares issued in lieu of dividends | 14,495,821 | 6,392,205 | 27 |
| Exchange movements | — | — | 7 |
| At 31 December 1998 | 1,816,108,390 | 882,949,598 | 3,443 |

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

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

| | <i>Number of shares</i> | <i>Period of exercise</i> | <i>Exercise price</i> |
|-------------------------|-------------------------|---------------------------|---------------------------|
| 31 December 1998 | 46,150,679 | 1999 to 2008 | £1.1843 to £23.395 |
| 31 December 1997 | 43,496,592 | 1998 to 2007 | £1.1843 to £23.395 |

32 Reserves

| | <i>Group</i> | <i>Company</i> | <i>Associated undertakings</i> |
|---|--------------|----------------|------------------------------------|
| | US\$m | US\$m | US\$m |
| Share premium account: | | | |
| At 1 January 1998 | 489 | 489 | — |
| Shares issued under option schemes | 14 | 14 | — |
| Shares issued in lieu of dividends and associated issue costs | (27) | (27) | — |
| Exchange movements | 4 | 4 | — |
| At 31 December 1998 | 480 | 480 | — |

32 Reserves (continued)

| | <i>Group</i> | <i>Company</i> | <i>Associated undertakings</i> |
|--|---------------|----------------|------------------------------------|
| | US\$m | US\$m | US\$m |
| Revaluation reserves: | | | |
| — Investment property revaluation reserve | | | |
| At 1 January 1998 | 516 | — | 104 |
| Unrealised deficit on revaluation of land and buildings | (246) | — | (56) |
| Transfer from revaluation reserve | 59 | — | — |
| Realisation on disposal of properties | (1) | — | — |
| Exchange and other movements | — | — | — |
| At 31 December 1998 | 328 | — | 48 |
| — Revaluation reserve: | | | |
| At 1 January 1998 | 3,746 | 18,432 | 8 |
| Realisation on disposal of properties | (12) | — | — |
| Impairment of land and buildings | (38) | — | — |
| Unrealised (deficit)/surplus on revaluation of Group properties | (1,787) | 1 | — |
| Transfer of depreciation from profit and loss account reserve | (52) | — | — |
| Transfer to investment property revaluation reserve | (59) | — | — |
| Net increase in attributable net assets of subsidiary undertakings | — | 1,142 | — |
| Exchange and other movements | (6) | (9) | — |
| At 31 December 1998 | 1,792 | 19,566 | 8 |
| Total revaluation reserves | 2,120 | 19,566 | 56 |
| Profit and loss account: | | | |
| At 1 January 1998 | 18,923 | 4,753 | 163 |
| Retained profit/(deficit) for the year | 1,823 | (1,423) | 126 |
| Transfer of depreciation to revaluation reserve | 52 | — | — |
| Realisation on disposal of properties | 13 | — | — |
| Arising on shares issued in lieu of dividends | 584 | 584 | — |
| Exchange and other movements | (36) | (1) | (42) |
| At 31 December 1998 | 21,359 | 3,913 | 247 |

In 1998, the Group adopted FRS 10, 'Goodwill and intangible assets'. Prior to 1 January 1998, goodwill amounting to US\$5,136 million has been charged against reserves in respect of acquisitions of subsidiaries in prior years.

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 28a (ii) above, the remittance of reserves may result in further taxation liabilities.

Notes on the Accounts (continued)**33 Analysis of total assets and total liabilities**

| | 1998 | 1997 |
|--|----------------|---------|
| | US\$m | US\$m |
| a <i>Assets and liabilities denominated in foreign currency</i> | | |
| Denominated in US dollars | 154,124 | 169,346 |
| Denominated in currencies other than US dollars | 329,004 | 302,340 |
| Total assets | 483,128 | 471,686 |
| Denominated in US dollars | 142,672 | 172,362 |
| Denominated in currencies other than US dollars | 340,456 | 299,324 |
| Total liabilities | 483,128 | 471,686 |
| b <i>Assets subject to sale and repurchase transactions</i> | 1998 | 1997 |
| | US\$m | US\$m |
| Total assets subject to sale and repurchase transactions | 15,204 | 10,104 |
| c <i>Assets leased to customers</i> | 1998 | 1997 |
| | US\$m | US\$m |
| Loans and advances to customers | 7,723 | 7,665 |
| Tangible fixed assets — equipment on operating leases (Note 21a) | 2,810 | 2,662 |
| | 10,533 | 10,327 |

The cost of assets acquired during 1998 for letting to customers under finance leases and hire purchase contracts by the Group amounted to US\$3,522 million (1997: US\$4,477 million).

d *Assets charged as security for liabilities*

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

| | <i>Amount of liability secured</i> | |
|--------------------------|------------------------------------|-------|
| | 1998 | 1997 |
| | US\$m | US\$m |
| Deposits by banks | 807 | 399 |
| Customer accounts | 1,678 | 1,985 |
| Debt securities in issue | 1,790 | 1,125 |
| Other liabilities | 1,652 | 1,650 |
| | 5,927 | 5,159 |

The amount of assets pledged to secure these amounts is US\$15,196 million (1997: US\$13,685 million). This is mainly made up of items included in 'Debt securities' and 'Treasury bills and other eligible bills' of US\$11,790 million (1997: US\$10,302 million).

34 Memorandum items

| a Group | 1998 | | | 1997 | | |
|--|------------------------|---------------------------------|-----------------------------|------------------------|---------------------------------|-----------------------------|
| | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> | <i>Contract amount</i> | <i>Credit equivalent amount</i> | <i>Risk-weighted amount</i> |
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Contingent liabilities: | | | | | | |
| Acceptances and endorsements | 4,032 | 3,202 | 3,151 | 4,814 | 3,498 | 3,383 |
| Guarantees and assets pledged as collateral security: | | | | | | |
| — guarantees and irrevocable letters of credit | 23,686 | 18,427 | 16,618 | 20,563 | 15,590 | 13,787 |
| Other contingent liabilities | 64 | 64 | 54 | 104 | 104 | 79 |
| | 27,782 | 21,693 | 19,823 | 25,481 | 19,192 | 17,249 |
| Commitments: | | | | | | |
| Documentary credits and short-term trade-related transactions | 5,927 | 1,973 | 1,166 | 8,396 | 2,327 | 1,745 |
| Forward asset purchases and forward deposits placed | 893 | 623 | 212 | 1,187 | 966 | 445 |
| Undrawn note issuing and revolving underwriting facilities | 405 | 203 | 203 | 148 | 74 | 74 |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | | | | | |
| — over 1 year | 27,028 | 13,505 | 12,606 | 26,357 | 13,171 | 12,233 |
| — 1 year and under | 112,399 | — | — | 100,200 | — | — |
| | 146,652 | 16,304 | 14,187 | 136,288 | 16,538 | 14,497 |

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 Financial Services Authority'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.

Notes on the Accounts (continued)

34 Memorandum items (continued)

Exchange rate, interest rate and equities contracts

| | 1998 | | 1997 | |
|-------------------------|------------------------|-------------------------|------------------------|-------------------------|
| | <i>Contract amount</i> | <i>Replacement cost</i> | <i>Contract amount</i> | <i>Replacement cost</i> |
| | US\$m | US\$m | US\$m | US\$m |
| Exchange rate contracts | 765,665 | 8,899 | 746,969 | 14,273 |
| Interest rate contracts | 1,060,563 | 7,297 | 866,546 | 5,177 |
| Equities contracts | 29,799 | 2,218 | 21,964 | 2,017 |

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 US\$760,725 million (1997: US\$741,692 million) contract amount of exchange rate contracts, US\$1,033,299 million (1997: US\$828,405 million) contract amount of interest rate contracts and US\$29,475 million (1997: US\$21,770 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 54.

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 (1997: US\$ nil). 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 41:

Contract amounts

| | <i>Europe</i> | <i>Hong Kong</i> | <i>Rest of Asia-Pacific</i> | <i>North America</i> | <i>Latin America</i> | <i>Total</i> |
|------------------------|---------------|------------------|-----------------------------|----------------------|----------------------|----------------|
| | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Contingent liabilities | | | | | | |
| 1998 | 13,607 | 4,598 | 6,170 | 2,858 | 549 | 27,782 |
| 1997 | 12,410 | 3,651 | 6,351 | 2,782 | 287 | 25,481 |
| Commitments | | | | | | |
| 1998 | 57,880 | 38,200 | 20,883 | 27,363 | 2,326 | 146,652 |
| 1997 | 53,188 | 41,623 | 18,919 | 21,061 | 1,497 | 136,288 |

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

| | 1998 | 1997 |
|--|--------------|----------|
| | US\$m | US\$m |
| Operating profit | 6,185 | 7,434 |
| Change in prepayments and accrued income | (667) | (577) |
| Change in accruals and deferred income | 220 | 1,241 |
| Interest on finance leases and similar hire purchase contracts | 26 | 26 |
| Interest on subordinated loan capital | 814 | 753 |
| Depreciation and amortisation | 914 | 719 |
| Amortisation of discounts and premiums | (53) | (36) |
| Provisions for bad and doubtful debts | 2,637 | 1,014 |
| Loans written off net of recoveries | (1,226) | (579) |
| Provisions for liabilities and charges | 1,290 | 236 |
| Provisions utilised | (974) | (172) |
| Provisions assumed | 377 | — |
| Amounts written off fixed asset investments | 85 | 49 |
| Net cash inflow from trading activities | 9,628 | 10,108 |
| Change in items in the course of collection from other banks | (242) | (569) |
| Change in treasury bills and other eligible bills | (4,797) | (2,366) |
| Change in loans and advances to banks | (5,418) | 7,352 |
| Change in loans and advances to customers | 3,731 | (35,147) |
| Change in other securities | (4,442) | (4,001) |
| Change in other assets | 1,027 | (5,390) |
| Change in deposits by banks | (4,804) | 5,063 |
| Change in customer accounts | 14,721 | 25,115 |
| Change in items in the course of transmission to other banks | 161 | 800 |
| Change in debt securities in issue | 1,445 | 6,298 |
| Change in other liabilities | (295) | 5,843 |
| Elimination of exchange differences* | (1,028) | 1,246 |
| Net cash inflow from operating activities | 9,687 | 14,352 |

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

36 Changes in financing during the year

| | <i>Subordinated loan capital</i> | <i>Preference shares*</i> | <i>Ordinary shares</i> | <i>Share premium</i> |
|------------------------------------|--------------------------------------|-------------------------------|----------------------------|--------------------------|
| | US\$m | US\$m | US\$m | US\$m |
| Balance at 1 January 1998 | 10,526 | 850 | 3,406 | 489 |
| Shares issued in lieu of dividends | — | — | 27 | (27) |
| Issued during the year | 443 | — | 3 | 14 |
| Repaid during the year | (215) | — | — | — |
| Net cash inflow from financing | 228 | — | 3 | 14 |
| Exchange and other movements | 90 | 20 | 7 | 4 |
| Balance at 31 December 1998 | 10,844 | 870 | 3,443 | 480 |

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

Notes on the Accounts (continued)

37 Analysis of cash

a The Group is required to make deposits with central banks as a result of government regulations in the territories in which it operates. As at 31 December 1998, these amounted to US\$2,557 million (1997: US\$3,027 million).

| | 1998 | 1997 |
|---|----------------|--------|
| | US\$m | US\$m |
| Balance at 1 January | 20,756 | 15,105 |
| Net cash (outflow)/inflow before the effect of foreign exchange movements | (6,595) | 6,613 |
| Effect of foreign exchange movements | 42 | (962) |
| Balance at 31 December | 14,203 | 20,756 |

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

| | 1998 | 1997 |
|------------------------------------|---------------|--------|
| | US\$m | US\$m |
| Cash and balances at central banks | 3,048 | 2,961 |
| Loans and advances to banks | 11,155 | 17,795 |
| | 14,203 | 20,756 |

38 Litigation

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

39 Capital commitments

| | 1998 | 1997 |
|--|--------------|-------|
| | US\$m | US\$m |
| Expenditure contracted for | 576 | 163 |
| Expenditure authorised by Directors but not contracted for | 115 | 124 |
| | 691 | 287 |

There were no capital commitments in respect of the Company (1997: US\$ nil).

40 Lease commitments

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

| | 1998 | 1997 |
|--------------------------------|--------------|-------|
| | US\$m | US\$m |
| Leasehold land and buildings | | |
| Operating leases which expire: | | |
| — within 1 year | 33 | 38 |
| — between 1 and 5 years | 149 | 145 |
| — over 5 years | 125 | 122 |
| | 307 | 305 |

40 Lease commitments (continued)

| | 1998 US\$m | 1997 US\$m |
|--------------------------------|---------------|---------------|
| Equipment | | |
| Operating leases which expire: | | |
| — within 1 year | 6 | 8 |
| — between 1 and 5 years | 21 | 17 |
| | <u>27</u> | <u>25</u> |

The Company had no commitments under operating leases at 31 December 1998 (1997: none).

41 Segmental analysis

As the Group is not required to disclose turnover, no segmental analysis of turnover is included. Turnover of non-banking businesses is included in other operating income above. 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.

Due to the expansion of the Group's operations in Latin America, the presentation of the segmental analysis by principal geographic region has been revised. The results for 'Continental Europe' and 'United Kingdom' are reported under 'Europe' and those relating to the geographic regions of 'Latin America' and 'North America' previously disclosed under 'Americas', are separately disclosed. 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 The Hongkong and Shanghai Banking Corporation Limited, 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.

| | At 31 December 1998 | | At 31 December 1997 | |
|---|---------------------|--------------|---------------------|--------------|
| | US\$m | % | US\$m | % |
| Total assets: | | | | |
| Europe | 190,823 | 40.2 | 178,581 | 38.6 |
| Hong Kong | 149,127 | 31.3 | 140,204 | 30.2 |
| Rest of Asia-Pacific | 57,253 | 12.0 | 57,325 | 12.4 |
| North America | 63,903 | 13.4 | 70,598 | 15.2 |
| Latin America | 14,614 | 3.1 | 16,835 | 3.6 |
| | <u>475,720</u> | <u>100.0</u> | <u>463,543</u> | <u>100.0</u> |
| Add: Hong Kong SAR Government certificates of indebtedness | 7,408 | | 8,143 | |
| Total assets | <u>483,128</u> | | <u>471,686</u> | |
| Net assets: | | | | |
| | US\$m | % | US\$m | % |
| Europe | 12,098 | 44.2 | 9,744 | 36.0 |
| Hong Kong | 9,427 | 34.4 | 11,555 | 42.7 |
| Rest of Asia-Pacific | 2,186 | 8.0 | 2,202 | 8.1 |
| North America | 2,494 | 9.1 | 2,892 | 10.7 |
| Latin America | 1,197 | 4.3 | 687 | 2.5 |
| Total net assets | <u>27,402</u> | <u>100.0</u> | <u>27,080</u> | <u>100.0</u> |

Notes on the Accounts (continued)**41 Segmental analysis** (continued)**Profit on ordinary activities before tax:**

| | <i>Europe</i> | <i>Hong Kong</i> | <i>Rest of Asia-Pacific</i> | <i>North America</i> | <i>Latin America</i> | <i>Total</i> |
|--|---------------|------------------|---------------------------------|--------------------------|--------------------------|--------------|
| Year ended | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| 31 December 1998 | | | | | | |
| Interest receivable | 11,762 | 10,934 | 4,196 | 5,121 | 2,839 | 34,852 |
| Interest payable | (7,755) | (7,462) | (2,941) | (3,503) | (1,644) | (23,305) |
| Net interest income | 4,007 | 3,472 | 1,255 | 1,618 | 1,195 | 11,547 |
| Dividend income | 79 | 44 | 2 | 14 | 9 | 148 |
| Fees and commissions receivable | 3,793 | 984 | 677 | 669 | 941 | 7,064 |
| Fees and commissions payable | (698) | (148) | (111) | (73) | (298) | (1,328) |
| Dealing profits | 342 | 310 | 413 | 76 | 8 | 1,149 |
| Other operating income | 853 | 383 | 33 | 185 | 252 | 1,706 |
| Operating income | 8,376 | 5,045 | 2,269 | 2,489 | 2,107 | 20,286 |
| Operating expenses | (5,197) | (1,851) | (1,052) | (1,424) | (1,711) | (11,235) |
| Operating profit before provisions | 3,179 | 3,194 | 1,217 | 1,065 | 396 | 9,051 |
| Provisions for bad and doubtful debts | (369) | (747) | (1,219) | (109) | (193) | (2,637) |
| Provisions for contingent liabilities and commitments | (96) | — | (37) | (10) | (1) | (144) |
| Amounts written off fixed asset investments | (16) | (57) | (11) | — | (1) | (85) |
| Operating profit | 2,698 | 2,390 | (50) | 946 | 201 | 6,185 |
| Share of operating profit in associated undertakings | — | 23 | 91 | 2 | 20 | 136 |
| Gains on disposal of investments and tangible fixed assets | 186 | 14 | (2) | 39 | 13 | 250 |
| Profit on ordinary activities before tax | 2,884 | 2,427 | 39 | 987 | 234 | 6,571 |

41 Segmental analysis (continued)

| | <i>Europe</i> | <i>Hong Kong</i> | <i>Rest of Asia-Pacific</i> | <i>North America</i> | <i>Latin America</i> | <i>Total</i> |
|--|---------------|------------------|---------------------------------|--------------------------|--------------------------|--------------|
| Year ended 31 December 1997 | US\$m | US\$m | US\$m | US\$m | US\$m | US\$m |
| Interest receivable | 9,883 | 9,225 | 3,857 | 4,804 | 1,895 | 29,664 |
| Interest payable | (6,052) | (5,771) | (2,589) | (3,155) | (1,153) | (18,720) |
| Net interest income | 3,831 | 3,454 | 1,268 | 1,649 | 742 | 10,944 |
| Dividend income | 77 | 59 | 3 | 9 | 8 | 156 |
| Fees and commissions receivable | 3,457 | 1,242 | 765 | 671 | 587 | 6,722 |
| Fees and commissions payable | (696) | (143) | (111) | (88) | (215) | (1,253) |
| Dealing profits | 420 | 203 | 319 | 47 | 1 | 990 |
| Other operating income | 594 | 295 | 36 | 83 | 227 | 1,235 |
| Operating income | 7,683 | 5,110 | 2,280 | 2,371 | 1,350 | 18,794 |
| Operating expenses | (4,688) | (1,915) | (1,077) | (1,360) | (1,201) | (10,241) |
| Operating profit before provisions | 2,995 | 3,195 | 1,203 | 1,011 | 149 | 8,553 |
| Provisions for bad and doubtful debts | (69) | (223) | (615) | (79) | (28) | (1,014) |
| Provisions for contingent liabilities and commitments | (22) | (12) | (12) | (6) | (4) | (56) |
| Amounts written off fixed asset investments | 15 | (41) | (5) | — | (18) | (49) |
| Operating profit | 2,919 | 2,919 | 571 | 926 | 99 | 7,434 |
| Share of operating profit in associated undertakings | 14 | 31 | 74 | — | (7) | 112 |
| Gains on disposal of investments and tangible fixed assets | 268 | 296 | 6 | 24 | (10) | 584 |
| Profit on ordinary activities before tax | 3,201 | 3,246 | 651 | 950 | 82 | 8,130 |

Total interest receivable and total interest payable include intra-Group interest of US\$1,232 million (1997: US\$993 million). Fees and commissions receivable and fees and commissions payable include intra-Group items of US\$94 million (1997: US\$100 million). Other operating income and operating expenses include intra-Group items of US\$231 million (1997: US\$185 million).

Notes on the Accounts (continued)

41 Segmental analysis (continued)

b By class of business

| | <i>Commercial banking</i> | | <i>Investment banking</i> | | <i>Total</i> | |
|--|---------------------------|---------------|---------------------------|---------------|----------------------|---------------|
| | 1998 US\$m | 1997 US\$m | 1998 US\$m | 1997 US\$m | 1998 US\$m | 1997 US\$m |
| Profit on ordinary activities before tax | 6,190 | 7,733 | 381 | 397 | 6,571 | 8,130 |
| Total assets | 459,681 | 451,864 | 23,447 | 19,822 | 483,128 | 471,686 |
| Net assets | 25,772 | 25,566 | 1,630 | 1,514 | 27,402 | 27,080 |

The 1997 figures have been restated to reflect the sale of Guyerzeller Bank AG from a commercial banking subsidiary to an investment banking subsidiary.

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:

| | 1998 | | 1997 | |
|---|---------------|--------------|--------|-------|
| | Number | US\$m | Number | US\$m |
| Directors and connected persons and companies controlled by them: | | | | |
| Loans and credit card transactions (including US\$159,000 in credit card transactions (1997: US\$61,000) and US\$57,900,000 in guarantees (1997: US\$52,034,000)) | 82 | 871 | 62 | 639 |
| Officers: | | | | |
| Loans and credit card transactions (including US\$104,000 in credit card transactions (1997: US\$99,000) and US\$ nil in guarantees (1997: US\$ nil)) | 29 | 15 | 19 | 10 |

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

42 Related party transactions (continued)

b Transactions with other related parties of the Group

Associated undertakings

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

- Notes 12 and 13: amounts due from associated undertakings
- Note 18: investments in associated undertakings; principal associated undertakings and interests in loan capital
- Notes 24 and 25: amounts due to associated undertakings.

Pension funds

At 31 December 1998, US\$12.7 billion (1997: US\$11.0 billion) of Group pension fund assets were under management by Group companies of which US\$989 million (1997: US\$842 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 US\$23 million (1997: US\$18 million). The Group's pension funds had deposits of US\$343 million (1997: US\$152 million) with banking subsidiaries within the Group.

43 Foreign currency amounts

The Hong Kong dollar and sterling figures shown in the consolidated profit and loss account and the balance sheets are for information only. They are translated from US dollars at the average rate of exchange for the year ended 31 December 1998 and the closing rate at that date respectively. These were as follows:

| | <i>Average rate</i> | <i>Closing rate</i> |
|-----------------|---------------------|---------------------|
| US\$1.00 = HK\$ | 7.746 | 7.746 |
| US\$1.00 = £ | 0.603 | 0.603 |

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, except as set out below.

The presentation of the cash flow statement is 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'.

In accordance with Financial Reporting Standard 11 'Impairment of Fixed Assets and Goodwill', no charge has been made in the profit and loss account in respect of those decreases in the valuation of Group properties that do not represent impairments. If the Group had prepared its financial statements under Hong Kong Statement of Standard Accounting Practice 17 'Property, plant and equipment', US\$150 million would have been charged to the profit and loss account in respect of valuations below depreciated historical cost (of which US\$15 million relates to minority interests).

45 Approval of accounts

These accounts were approved by the Board of Directors on 22 February 1999.

Taxation of Shares and Dividends

1. Cash Dividends

From 1 January 1993, when the Company became UK resident for UK taxation purposes, to 6 April 1999, the date when advance corporation tax (ACT) was abolished, HSBC Holdings plc had to account to the UK Inland Revenue for ACT when the Company paid a dividend. From 6 April 1999, following the demise of ACT, the Company is subject to replacement corporation tax reform rules whereby the Company will be required to pay corporation tax on its UK taxable profits on a current year instalment basis.

Regardless of the ACT change, 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 UK income tax liability will arise on the receipt of a dividend from the Company. Individual shareholders who are liable to UK income tax at the higher rate on UK dividend income (40 per cent to 5 April 1999, 32.5 per cent thereafter) will be taxed on the combined amount of the dividend and the tax credit (20 per cent to 5 April 1999, 10 per cent thereafter). The tax credit will then be available for set-off against the higher rate liability, leaving net higher rate tax of 25 per cent of the cash dividend to pay (both before and after 5 April 1999). From 6 April 1999 individual UK-resident shareholders will not be entitled to any tax credit repayment, unless the dividend income arises in a Personal Equity Plan (PEP) or Individual Savings Account (ISA), and then only for a five-year period to 5 April 2004.

Although non-UK-resident shareholders are generally not entitled to any repayment of the tax credit in respect of any UK dividend received, some such shareholders may be so entitled under the provisions of a double taxation agreement between the country of residence and the United Kingdom. However, the reduction in tax credit from 20 per cent to 10 per cent referred to above will mean that in most cases no amount of the tax credit will in practice be repayable.

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 1997 second interim dividend and the 1998 first interim dividend was set out in the Secretary's letters to shareholders of 20 March and 28 August 1998. 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 £17.871 for the 1997 second interim dividend and US\$21.348/£12.667 for the 1998 first interim dividend.

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, subject to scrip issues made since 6 April 1998 being treated for tax as a separate holding. Any capital gain arising on a disposal will also be adjusted to take account of indexation allowance and tapering relief.

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

Shareholder Information

Financial Calendar 1999

| | |
|--|----------|
| Publication of <i>Annual Report and Accounts</i> | 16 April |
| Second interim dividend payable | 28 April |
| Annual General Meeting | 28 May |
| Announcement of interim results | 2 August |

Annual General Meeting

The 1999 Annual General Meeting will be held at the Barbican Hall, Barbican Centre, London EC2 on Friday, 28 May 1999 at 11.00 a.m.

Dividends

The Directors have declared a second interim dividend of US\$0.555 per ordinary share (in lieu of a final dividend) which, together with the first interim dividend of US\$0.37 already paid, will make a total distribution for the year of US\$0.925 per share, an increase of 11 per cent on 1997. Information on the HSBC scrip dividend scheme and currencies in which the cash dividend may be paid is contained in the form and circular sent to shareholders on 19 March 1999.

Proposed Share Capital Restructuring and New York Stock Exchange Listing

At the AGM, shareholders will be asked to approve a restructuring of the share capital to facilitate a listing on the New York Stock Exchange to supplement the existing primary listings on the London and Hong Kong stock exchanges. They will also be asked to give the Board authority to purchase the Company's own shares although there is no current intention to do so.

To facilitate the New York listing, the Directors propose to consolidate the two existing classes of ordinary shares of HK\$10 each and 75p each into one class of ordinary shares denominated in US dollars. Shareholders will receive three new ordinary shares of US\$0.50 each for each existing ordinary share of HK\$10 or 75p. It is envisaged that the new shares will be issued in July 1999.

Postal Share-Dealing Service

For shareholders on the UK register, a low-cost postal share-dealing service for buying and selling the Company's shares is available from Midland Stockbrokers, a member of the HSBC Group. Details are available from:

Midland Stockbrokers
 Mariner House, Pepys Street
 London EC3N 4DA
 Telephone: 0171 260 0300
 Facsimile: 0171 260 7556

Shareholder Enquiries

Any matters relating to your shareholding — e.g. transfer of shares, change of name or address, lost share certificates and dividend cheques — should be sent in writing to the registrars:

UK Computershare Services PLC
 PO Box 435, Owen House
 8 Bankhead Crossway North
 Edinburgh EH11 4BR

or

Hong Kong Central Registration Hong Kong Limited
 Rooms 1901-5, Hopewell Centre
 183 Queen's Road East

Shareholder Information (continued)

Investor Relations

Enquiries may be directed to:

Senior Manager Investor Relations
HSBC Holdings plc
10 Lower Thames Street
London EC3R 6AE
UK
Telephone: 44 0171 260 7252
Facsimile: 44 0171 260 9041

Annual Report and Accounts 1998

Further copies may be obtained by writing to either of the following departments.

For those in Europe, the Americas, Middle East and Africa:

Group Corporate Affairs
HSBC Holdings plc
10 Lower Thames Street
London EC3R 6AE
UK

For those in Asia-Pacific:

Group Public Affairs
The Hongkong and Shanghai Banking Corporation Limited
1 Queen's Road Central
Hong Kong

Chinese translation

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

Central Registration Hong Kong Limited
Rooms 1901-5, Hopewell Centre
183 Queen's Road East
Hong Kong

本年報備有中譯本，如欲查閱可向下列公司索取：
香港皇后大道東一八三號合和中心1901-1905室
香港中央證券登記有限公司

Web Site

This *Annual Report and Accounts*, and other information on the HSBC Group, may be viewed on our web site:
www.hsbc.com

HSBC Principal Offices

HSBC Holdings plc

UNITED KINGDOM
Group Head Office
 10 Lower Thames Street
 London EC3R 6AE
 Telephone: 44 0171-260 0500
 Facsimile: 44 0171-260 0501
 Web: www.hsbc.com

COMMERCIAL BANKING

Banco HSBC Bamerindus S.A.

BRAZIL
 Travessa Oliveira Belo, 11-B Centro
 Curitiba-PR
 CEP: 80.020-030
 Telephone: 55 41 321 6070/6517
 Facsimile: 55 41 321 6150

British Arab Commercial Bank Limited*

UNITED KINGDOM
 30 Gresham Street
 London EC2V 7LP
 Telephone: 44 0171-606 7777
 Facsimile: 44 0171-600 3318

The British Bank of the Middle East

CHANNEL ISLANDS
Head Office
 1 Grenville Street, St Helier
 Jersey JE2 4UF
 Telephone: 44 01534-606511
 Facsimile: 44 01534-606149

Egyptian British Bank S.A.E.*

EGYPT
 Abu El Feda Building
 3 Abu El Feda Street, Zamalek,
 Cairo
 Telephone: 20 2 3404849, 3409186
 Facsimile: 20 2 3414010

Hang Seng Bank Limited

HONG KONG
Head Office
 83 Des Voeux Road Central
 Telephone: 852 2825 5111
 Facsimile: 852 2845 9301

The Hongkong and Shanghai Banking Corporation Limited

HONG KONG
Head Office
 1 Queen's Road Central
 Telephone: 852 2822 1111
 Facsimile: 852 2810 1112

HSBC Bank Malaysia Berhad

(formerly Hongkong Bank Malaysia Berhad)
 MALAYSIA
Head Office
 2 Leboh Ampang
 50100 Kuala Lumpur
 Telephone: 60 3 2300744
 Facsimile: 60 3 2301146

HongkongBank of Australia Limited

AUSTRALIA
 Level 10, 1 O'Connell Street
 Sydney, NSW 2000
 Telephone: 61 2 9255-2888
 Facsimile: 61 2 9255-2332

Hongkong Bank of Canada

CANADA
Head Office
 885 West Georgia Street
 Vancouver, BC V6C 3E9
 Telephone: 1 604 685-1000
 Facsimile: 1 604 641-1849

HSBC Banco Roberts S.A.

ARGENTINA
 25 de Mayo 258
 1002 Buenos Aires
 Telephone: 54 1-334 3968
 Facsimile: 54 1-334 6404

HSBC Bank USA

(formerly Marine Midland Bank)
 UNITED STATES OF AMERICA
Corporate Headquarters
 One HSBC Center
 Buffalo, NY 14203
 Telephone: 1 716 841-2424
 Facsimile: 1 716 841-5391

Midland Bank plc

UNITED KINGDOM
Head Office
 27-32 Poultry
 London EC2P 2BX
 Telephone: 44 0171-260 8000
 Facsimile: 44 0171-260 7065

The Saudi British Bank*

SAUDI ARABIA
Head Office
 Al Amir Abdul Aziz Ibn Mossaad
 Ibn Jalawi Street, Riyadh
 Telephone: 966 1 405-0677
 Facsimile: 966 1 405-0660

Wells Fargo HSBC Trade Bank, N.A.*

UNITED STATES OF AMERICA
 525 Market Street, 25th Floor
 San Francisco, California 94105
 Telephone: 1 415-477 6858
 Facsimile: 1 415-541 0299

INVESTMENT BANKING

HSBC Investment Bank plc

UNITED KINGDOM
 Thames Exchange
 10 Queen Street Place
 London EC4R 1BL
 Telephone: 44 0171-621 0011
 Facsimile: 44 0171-621 0496

INVESTMENT BANKING — ADVICE AND FINANCING

HSBC Equator Bank plc

UNITED KINGDOM
 66 Warwick Square
 London SW1V 2AL
 Telephone: 44 0171-821 8797
 Facsimile: 44 0171-821 6221

HSBC Investment Bank Asia Limited

HONG KONG
 Level 15, 1 Queen's Road Central
 Telephone: 852 2841 8888
 Facsimile: 852 2845 9047

HSBC Private Equity Europe Limited

UNITED KINGDOM
 Vintner's Place
 68 Upper Thames Street
 London EC4V 3BJ
 Telephone: 44 0171-336 9955
 Facsimile: 44 0171-336 9961

INVESTMENT BANKING — EQUITY SECURITIES

HSBC Investment Bank plc

HSBC Securities
 UNITED KINGDOM
 Thames Exchange
 10 Queen Street Place
 London EC4R 1BL
 Telephone: 44 0171-621 0011
 Facsimile: 44 0171-621 0496

HSBC Securities Asia Limited

HONG KONG
 Level 17, 1 Queen's Road Central
 Telephone: 852 2843 9111
 Facsimile: 852 2810 7673

HSBC Securities Japan Limited

JAPAN
 HSBC Building
 3-11-1 Nihonbashi
 Chuo-ku
 Tokyo 103
 Telephone: 81 3 5203 3111
 Facsimile: 81 3 5203 3699

Wardley Financial Services Limited

HONG KONG
 3/F, Hutchison House
 10 Harcourt Road
 Telephone: 852 2521 1661
 Facsimile: 852 2810 0145

INVESTMENT BANKING — ASSET MANAGEMENT

HSBC Asset Management Americas Inc.

UNITED STATES OF AMERICA
 6th Floor, 140 Broadway
 New York, NY 10005
 Telephone: 1 212 658-7815
 Facsimile: 1 212 658-7672

HSBC Asset Management Europe Limited

HSBC Unit Trust Management Limited
 UNITED KINGDOM
 6 Bevis Marks
 London EC3A 7QP
 Telephone: 44 0171-955 5050
 Facsimile: 44 0171-955 5052

HSBC Asset Management Hong Kong Limited

HONG KONG
 10/F Citibank Tower
 3 Garden Road
 Telephone: 852 2801 0111
 Facsimile: 852 2845 0226

* Associated company

**INVESTMENT BANKING — PRIVATE BANKING
AND TRUSTEE**

The British Bank of the Middle East
SWITZERLAND
Quai General Guisan 2, 1204 Geneva
Telephone: 41 22 818 05 11
Facsimile: 41 22 818 05 12

**The British Bank of the Middle East
Midland Bank plc**
UNITED KINGDOM
29-31 Hill Street, Mayfair
London W1X 7FD
Telephone: 44 0171-355 6300
Facsimile: 44 0171-355 6415

Guyerzeller Bank AG
SWITZERLAND
Genferstrasse 6-8, CH-8027 Zurich
Telephone: 41 1 206 7111
Facsimile: 41 1 206 7397

**HSBC International Trustee Limited
HSBC Private Bank (Jersey) Limited
HSBC Trustee (Jersey) Limited
Midland Bank Trustee (Jersey) Limited**
CHANNEL ISLANDS
1 Grenville Street, St Helier
Jersey JE2 4UF
Telephone: 44 01534-606500
Facsimile: 44 01534-606504

HSBC Investment Bank Asia Limited
HONG KONG
Level 15
1 Queen's Road Central
Telephone: 852 2841 8888
Facsimile: 852 2845 9047

HSBC Trustee (Hong Kong) Limited
HONG KONG
Level 13, 1 Queen's Road Central
Telephone: 852 2533 6333
Facsimile: 852 2810 5259

Midland Bank Trust Company Limited
UNITED KINGDOM
2/F, Norwich House, Nelson Gate
Commercial Road
Southampton SO15 1GX
Telephone: 44 01703-723 722
Facsimile: 44 01703-723 587

Trinkaus & Burkhhardt KGaA
GERMANY
Königsallee 21/23
D-40212 Düsseldorf 1
Telephone: 49 211 910 0
Facsimile: 49 211 910 616

CAPITAL MARKETS

**Midland Bank plc
HSBC Greenwell**
UNITED KINGDOM
Thames Exchange
10 Queen Street Place
London EC4R 1BQ
Telephone: 44 0171-336 3000
Facsimile: 44 0171-220 7113

HSBC Securities, Inc.
UNITED STATES OF AMERICA
140 Broadway, New York,
NY 10005
Telephone: 1 212 825-6780
Facsimile: 1 212 825-3861

FINANCE

Forward Trust Group Limited
UNITED KINGDOM
Forward Trust House
12 Calthorpe Road
Edgbaston, Birmingham B15 1QZ
Telephone: 44 0121-454 6141
Facsimile: 44 0121-455 3050

HSBC Forfeiting Asia Pte Limited
SINGAPORE
21 Collyer Quay
#19-03 HSBC Building
Singapore 049320
Telephone: 65 2242477
Facsimile: 65 2258021

**HSBC International Trade Finance
Limited**
UNITED KINGDOM
6 Arthur Street
London EC4R 9HT
Telephone: 44 0171-626 9411
Facsimile: 44 0171-260 4829

Mortgage And Finance Berhad
BRUNEI DARUSSALAM
Shops 3 and 4
Goodwood Building
Mile 2 Jalan Gadong
Bandar Seri Begawan 3180
Telephone: 673 2 427969, 427970
Facsimile: 673 2 448474

**Wayfoong Credit Limited
Wayfoong Finance Limited**
HONG KONG
18/F, Leighton Centre
77 Leighton Road
Telephone: 852 2839 6333
Facsimile: 852 2895 4845

**Wayfoong Mortgage And Finance
(Singapore) Limited**
SINGAPORE
6 Claymore Hill
#03-01 Claymore Plaza
Singapore 229571
Telephone: 65 7377977
Facsimile: 65 7378997

**INSURANCE, RETIREMENT BENEFITS,
ACTUARIAL AND PERSONAL FINANCIAL
SERVICES**

**Hang Seng Insurance Company
Limited**
HONG KONG
20/F, World-wide House
19 Des Voeux Road Central
Telephone: 852 2525 2151
Facsimile: 852 2845 9180

Hang Seng Life Limited
HONG KONG
5/F, 83 Des Voeux Road Central
Telephone: 852 2825 3212
Facsimile: 852 2530 3223

**HSBC Gibbs Limited
HSBC Insurance Holdings Limited**
UNITED KINGDOM
Bishops Court
27/33 Artillery Lane
London E1 7LP
Telephone: 44 0171-247 5433
Facsimile: 44 0171-377 2139
(HSBC Gibbs)
Facsimile: 44 0171-247 7373
(HSBC Insurance
Holdings)

**HSBC Gibbs Personal Insurances
Limited**
UNITED KINGDOM
Hexagon House
Cleppa Park
Newport, Gwent NP1 9XT
Telephone: 44 01633-654300
Facsimile: 44 01633-817910

**HSBC Insurance (Asia-Pacific) Holdings
Limited**
HONG KONG
40/F, Sun Hung Kai Centre
30 Harbour Road, Wanchai
Telephone: 852 2827 3322
Facsimile: 852 2827 7636

**La Buenos Aires Compañía Argentina
de Seguros S.A.**
ARGENTINA
Casa Central
Avenida de Mayo 701
1084 Buenos Aires
Telephone: 54 1 331 1961/71/81
Facsimile: 54 1 334 0860

Midland Life Limited
UNITED KINGDOM
Norwich House
Nelson Gate
Commercial Road
Southampton SO15 1GX
Telephone: 44 01703-229929
Facsimile: 44 0117-925 1993

**BULLION DEALING AND COMMODITY/
BROKERAGE SERVICES**

**Wardley Broking Services Private
Limited**
SINGAPORE
21 Collyer Quay
#17-01 HSBC Building
Singapore 049320
Telephone: 65 2254007
Facsimile: 65 2249201

PROPERTY

Wayfoong Property Limited
HONG KONG
31/F, Hopewell Centre
183 Queen's Road East
Telephone: 852 2822 7211
Facsimile: 852 2861 2492

SHIPPING SERVICES

HSBC Shipbrokers Limited
HONG KONG
20/F, 111 Leighton Road
Telephone: 852 2923 7733
Facsimile: 852 2577 4188

© HSBC Holdings plc 1999

Published by Group Corporate Affairs, HSBC Holdings plc,
London

Designed by Group Public Affairs, The Hongkong and Shanghai
Banking Corporation Limited, Hong Kong

Printed by R R Donnelley-Pindar, Feltham, United Kingdom, on
environmentally friendly, totally chlorine-free paper

Photography credits

Cover (from top, left to right):

Background: Group Public Affairs stock, Hong Kong; copyright
© 1996 PhotoDisc, Inc; Rene Mejia, Manila; K Paterson,
Edinburgh; Paul Hu, Hong Kong; Jocelyn Carlin, Auckland;
Claudio Elisabetsky, Rio de Janeiro; Shahin Jalali, Dubai;
R Ian Lloyd, Singapore; Claudio Elisabetsky, Curitiba;
Fi McGhee, London

Page 3: Mark Larkin, London

Page 6: Marty Heitner, New York

Page 8 (clockwise from top left): Jocelyn Carlin, Auckland;
Fi McGhee, London; Fi McGhee, London;
Verachi Jianrungsin, Bangkok; R Ian Lloyd, Singapore; Paul
Hu, Hong Kong; R Moran, Leeds

Page 11 (clockwise from top left): Shahin Jalali, Dubai;
Paul Hu, Hong Kong; Sharvini Patel, Mumbai;
Verachi Jianrungsin, Bangkok; Sharvini Patel, Mumbai;
R Ian Lloyd, Singapore; Fi McGhee, London; R Ian Lloyd,
Singapore

Page 13 (from top, left to right): R Ian Lloyd, Singapore;
Paul Hu, Hong Kong (background); Verachi Jianrungsin,
Bangkok; Shahin Jalali, Dubai; Claudio Elisabetsky,
São Paulo (background); Jocelyn Carlin, Auckland;
Bob Davis, Hong Kong

Page 17 (from top, left to right): Claudio Elisabetsky, Curitiba;
Shahin Jalali, Dubai; Claudio Elisabetsky, Curitiba; Jocelyn
Carlin, Auckland; Fi McGhee, London; Jocelyn Carlin,
Auckland; Rene Mejia, Manila;
R Ian Lloyd, Singapore

Pages 22-25: all photographs by Fi McGhee except
R K F Ch'ien, D G Eldon and W K L Fung by Jackie Wan;
and M Murofushi by Masaki Uchida

Stock number 91216-8

HSBC Holdings plc

10 Lower Thames Street, London EC3R 6AE, United Kingdom