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HSBC HOLDINGS PLC
Form 6-K
March 05, 2007

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer
Pursuant to Rule 13a - 16 or 15d - 16 of
the Securities Exchange Act of 1934

For the month of March, 2007

HSBC Holdings plc

42nd Floor, 8 Canada
Square, London E14 5HQ, England

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F).

Form 20-F Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934).

Yes No

(If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
2006 CONSOLIDATED RESULTS - HIGHLIGHTS

- Net operating income before loan impairment charges and other credit risk provisions up 19.6 per cent to HK\$92,325 million (HK\$77,222 million in 2005).
- Pre-tax profit up 15.0 per cent to HK\$52,016 million (HK\$45,249 million in 2005).
- Attributable profit up 14.7 per cent to HK\$37,709 million (HK\$32,873 million in 2005).
- Return on average shareholders' equity of 31.1 per cent (37.4 per cent in 2005).
- Assets up 17.9 per cent to HK\$3,151 billion (HK\$2,673 billion at the end of 2005); risk-weighted assets up 10.5 per cent to HK\$1,368 billion (HK\$1,238 billion at 31 December 2005).
- Total capital ratio of 13.5 per cent; tier 1 capital ratio of 12.3 per cent (12.4 per cent and 11.7 per cent at 31 December 2005).
- Cost efficiency ratio of 41.4 per cent (41.2 per cent for 2005).

Within this document, the Hong Kong Special Administrative Region of the People's Republic of China has been referred to as 'Hong Kong'.

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Comment by Vincent Cheng, Chairman

In 2006, The Hongkong and Shanghai Banking Corporation achieved a robust pre-tax profit of HK\$52,016 million, up 15.0 per cent over 2005. Buoyant economic conditions, expansion of customer group businesses and widening net interest margins in the region supported this strong result. In Hong Kong, pre-tax profit grew 10.9 per cent to HK\$37,978 million. For the rest of Asia-Pacific, pre-tax profit was up 27.6 per cent to HK\$13,992 million - a significant increase as we continued to reap the benefits of our investments in businesses in countries with strong economic growth.

Around the region, there were several outstanding achievements in 2006. In India, our pre-tax profit grew 86.0 per cent to HK\$2,336 million. Meanwhile, HSBC's mainland China network, excluding associates, recorded a 34.6 per cent rise in profit to HK\$998 million. With more than 50 outlets (including Hang Seng Bank), our mainland China network also remains the largest of any foreign bank. We launched direct banking in Taiwan in September 2006 and in Korea in February of this year. Our consumer finance businesses in Australia and India, launched in 2005, began to pick up momentum and we launched a new consumer finance operation in Indonesia in 2006. In addition, in February 2007 we announced an agreement to increase our stake in Vietnam Technological and Commercial Joint-Stock Bank (Techcombank) from 10 per cent to 20 per cent once regulations permit. In 2006, we launched a new Takaful (Islamic insurance) joint venture company in partnership with Jerneh Asia Berhad and The Employees Provident Fund of Malaysia. While we continue to focus on growing our businesses in the region organically, we remain open to expanding the scope and breadth of our reach through strategic acquisitions if the right opportunities arise.

Our net operating income before loan impairment charges was HK\$92,325 million, up 19.6 per cent. Balance sheet growth, wider deposit spreads, growth in demand for wealth management products in rising equity markets, and successful Global Markets trading activities in the region all contributed to this growth.

The net charge for loan impairment and other credit risk provisions rose by HK\$2,745 million to HK\$4,809 million, reflecting significantly higher provisions linked to personal lending outside Hong Kong, particularly in Taiwan and Indonesia, and higher charges resulting from volume growth in credit cards in Hong Kong.

Personal Financial Services reported a pre-tax profit of HK\$21,889 million, which was up 1.2 per cent compared to 2005 due to the impact of the aforementioned provisions including Taiwan and Indonesia. Net operating income before loan impairment charges rose strongly by 15.9 per cent to HK\$46,073 million as our operations in the region continued to expand.

In Hong Kong there were also several notable successes. In 2006, HSBC was the leading bank in new residential mortgage lending, credit card issuance and receivables, unit trust sales, and the origination and distribution of structured products. In new residential mortgage lending we captured a 17.6 per cent market share, largely due to a simplified pricing campaign launched in the first quarter of 2006. Including Hang Seng Bank, the HSBC Group's market share reached 33.3 per cent. HSBC, again including Hang Seng Bank, now has 4.6 million cards in issue in the territory, up 16.7 per cent from 2005. Average receivables in these portfolios also grew strongly, up 15.0 per cent to HK\$26,655 million. Group fee income from cards rose by HK\$671 million, up 29.1 per cent. Group unit trust sales grew by 60.9 per cent to HK\$59,000 million. Insurance revenues grew by 13.0 per cent to HK\$4,719 million.

In the rest of the region, competitive pricing and increased marketing activity boosted income from mortgages in Singapore and Taiwan. Similarly, increased marketing led to a rise in income from interest earned on credit cards in the Philippines, Indonesia and India. Our cards in issue in the region continued to

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grow strongly. In India we added 800,000 cards to reach two million in issue. Cards in issue increased elsewhere as well: up 34.6 per cent in the Philippines to 816,000; up 20.0 per cent in Singapore to 531,000; up 42.2 per cent in Sri Lanka to 265,000; and up 28.0 per cent in Australia to 189,000. In 2006, HSBC was the second largest credit card issuer in the Philippines in terms of billings and receivables.

Our Commercial Banking business had an outstanding year, reporting pre-tax profit of HK\$14,945 million, up 34.3 per cent. This result was driven by balance sheet growth and widening deposit spreads. Commercial Banking continued to grow deposits, which rose 17.2 per cent to HK\$439 billion, and lending balances, also up 17.2 per cent to HK\$276 billion. We also continued to expand our presence in the SME sector and to increase cross-border referrals to capture opportunities arising from the growing cross-border flows in trade, services and investment. Our Commercial Banking business continues to position itself to provide support for and to benefit from the growing regional trade and payment flows, in particular those associated with China's economic expansion and development. Income from insurance and investment sales rose significantly in Hong Kong, up 59.2 per cent to HK\$1,523 million.

Corporate, Investment Banking and Markets reported a pre-tax profit of HK\$15,243 million, up 15.0 per cent and driven by robust performances in Global Transaction Banking and strong trading profits in Global Markets. These trading results were largely on the back of customer flows, with particular success outside Hong Kong. Declining balance sheet management revenues continued to drag on earnings as the cost of funding fixed rate asset positions, put on in earlier periods, rose significantly. These positions had largely run off by the end of the first half of 2006. Net interest income in Global Transaction Banking increased by 62.7 per cent from business growth and improved deposits spreads most notably in India, Hong Kong, Singapore, Taiwan, mainland China and Korea. Overall, net fee income was boosted by the rising volumes in regional equity markets in the year, increasing by 28.7 per cent to HK\$6,937 million. In particular, fee income from securities services increased 42.0 per cent from rising equity market volumes, notably in India, mainland China and Singapore, and fee income from asset management business rose 48.1 per cent. Net trading income rose 20.3 per cent to HK\$8,682 million as currency volatility provided good trading opportunities and customer volumes increased in India, mainland China and Singapore.

Looking forward, we will continue to invest in growth markets across the Asia-Pacific region, which remains an important growth engine for the HSBC Group. We intend to further strengthen our distribution capability. Our extensive and unique footprint in the region already provides us with a competitive advantage and the use of channels such as direct banking further extends our reach to both existing and new customers. We will continue to enhance and grow our product and service capabilities to ensure we provide comprehensive services for our target customer segments across the region. We will also continue to watch for opportunities presented by possible strategic and selective acquisitions. In Hong Kong, which continues to be a major gateway to mainland China, our operations remain the regional hub and fulcrum point of HSBC in Asia. Our strategy in the territory is straightforward: we intend to maintain our leading position as we further grow both our market share and our share of our customers' business. We will also actively and prudently manage our costs. In mainland China, we will continue our successful two-pronged strategy of growing organically and developing our strategic partnerships.

The general outlook for Asia's burgeoning economies remains positive against a backdrop of supportive global economic growth, demand for goods and services from OECD countries and growth in intra-regional trade, including 'South South' economic flows. HSBC, for its part, has made significant progress in recent years investing in its Asian emerging market operations. As a result, we are well positioned to pursue the expanding opportunities in financial services as

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these economies grow and develop.

Results by Customer Group

| Figures in HK\$m | Personal Financial Services | Commercial Banking | Corporate, Investment Banking and Markets | Private Banking | Other | Intr segme eliminati |
|--|-----------------------------------|-----------------------|---|--------------------|---------|----------------------------|
| Year ended 31Dec06 | | | | | | |
| Net interest income/(expense) | 30,090 | 14,006 | 9,104 | 45 | (4,201) | 2,0 |
| Net fee income/(expense) | 10,512 | 5,018 | 6,937 | 101 | (164) | |
| Net trading income | 889 | 796 | 8,682 | 14 | 825 | (2,2 |
| Net income/(loss) from financial instruments designated at fair value | 3,364 | (384) | 74 | (1) | (616) | 2 |
| Gains less losses from financial investments | 108 | - | 226 | - | 1,132 | |
| Dividend income | 9 | 10 | 55 | - | 675 | |
| Net earned insurance premiums | 20,741 | 972 | 133 | - | - | |
| Other operating income | 2,262 | 348 | 430 | 14 | 7,005 | (4,4 |
| Total operating income | 67,975 | 20,766 | 25,641 | 173 | 4,656 | (4,4 |
| Net insurance claims incurred and movement in policyholders' liabilities | (21,902) | (478) | (100) | - | - | |
| Net operating income before loan impairment charges and other credit risk provisions | 46,073 | 20,288 | 25,541 | 173 | 4,656 | (4,4 |
| Loan impairment charges and other credit risk provisions | (4,528) | (446) | 250 | - | (85) | |
| Net operating income | 41,545 | 19,842 | 25,791 | 173 | 4,571 | (4,4 |
| Operating expenses | (19,913) | (6,531) | (11,219) | (167) | (4,815) | 4,4 |
| Operating profit/(loss) | 21,632 | 13,311 | 14,572 | 6 | (244) | |
| Share of profit in associates and joint venture | 257 | 1,634 | 671 | - | 177 | |
| Profit/(loss) before tax | 21,889 | 14,945 | 15,243 | 6 | (67) | |
| Share of profit/(loss) before tax | 42.1% | 28.7% | 29.3% | - | (0.1%) | |
| Advances to customers | 446,990 | 276,172 | 301,069 | 3,312 | 16,239 | |

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| | | | | | | |
|--|-----------|---------|---------|-------|---------|-------|
| Customer accounts | 1,121,286 | 438,943 | 417,335 | 7,253 | 4,650 | |
| Year ended 31Dec05 | | | | | | |
| Net interest income/(expense) | 26,801 | 11,089 | 8,725 | 63 | (3,800) | 6 |
| Net fee income | 8,050 | 4,524 | 5,388 | 55 | 80 | |
| Net trading income/(loss) | 683 | 638 | 7,215 | 10 | (582) | (7) |
| Net income/(loss) from financial instruments designated at fair value | 666 | (648) | 122 | - | 73 | 1 |
| Gains less losses from financial investments | - | 23 | 19 | - | 714 | |
| Dividend income | 5 | 14 | 167 | - | 182 | |
| Net earned insurance premiums | 18,437 | 756 | 147 | - | - | |
| Other operating income | 1,984 | 295 | 572 | 13 | 6,338 | (4,3) |
| Total operating income | 56,626 | 16,691 | 22,355 | 141 | 3,005 | (4,3) |
| Net insurance claims incurred and movement in policyholders' liabilities | (16,889) | (330) | (72) | - | - | |
| Net operating income before loan impairment charges and other credit risk provisions | 39,737 | 16,361 | 22,283 | 141 | 3,005 | (4,3) |
| Loan impairment charges and other credit risk provisions | (1,344) | (896) | 165 | - | 11 | |
| Net operating income | 38,393 | 15,465 | 22,448 | 141 | 3,016 | (4,3) |
| Operating expenses | (16,932) | (5,424) | (9,642) | (113) | (4,008) | 4,3 |
| Operating profit/(loss) | 21,461 | 10,041 | 12,806 | 28 | (992) | |
| Share of profit in associates and joint venture | 179 | 1,090 | 446 | - | 190 | |
| Profit/(loss) before tax | 21,640 | 11,131 | 13,252 | 28 | (802) | |
| Share of profit/(loss) before tax | 47.8% | 24.6% | 29.3% | - | (1.7%) | |
| Advances to customers | 436,676 | 235,675 | 309,092 | 3,230 | 14,653 | |
| Customer accounts | 984,734 | 374,370 | 366,752 | 7,405 | 1,849 | |

Personal Financial Services reported profit before tax of HK\$21,889 million, an increase of 1.2 per cent over 2005 as strong growth in operating income of 15.9 per cent was offset by higher credit card impairment allowances in Taiwan and Indonesia, and investment expenditure in the rest of Asia-Pacific.

Overall, net interest income increased by HK\$3,289 million, or 12.3 per cent, compared with 2005. In Hong Kong, net interest income rose by HK\$2,029 million, or 10.0 per cent, as effective management of deposit pricing amid the continued

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trend of rising interest rates resulted in a further widening of liability spreads. Average customer account balances rose by 7.1 per cent, reflecting successful promotional campaigns and customer preference for maintaining liquidity in order to take advantage of short-term investment opportunities. The local mortgage market remained highly competitive as sales volumes in the housing market slowed and margins were impacted by a higher cost of funds and competitor price promotions. However, HSBC regained leadership in market share of new business, largely as a result of a simplified pricing campaign launched by the bank in Hong Kong in the first quarter of 2006. Credit card lending grew, but net interest income fell as the benefit of higher receivables was more than offset by a rise in funding costs.

In the rest of Asia-Pacific, net interest income rose by HK\$1,260 million, or 19.6 per cent, reflecting strong balance sheet growth across the region. The deposit base expanded in a number of countries, particularly Singapore, Indonesia and mainland China, reflecting evolution of the focused strategy on HSBC Premier customers, and deposit spreads improved on the back of higher interest rates. Income from mortgages increased as lending grew, notably in Singapore and Taiwan, led by competitive pricing and increased marketing activity. Interest earned on credit cards was higher in the Philippines, Indonesia and India, reflecting growth in receivables, but spreads narrowed in the face of increased funding costs. Credit card interest income fell significantly in Taiwan as lending was reduced following the introduction of a government debt renegotiation scheme with zero or low rates for delinquent borrowers. Income from personal instalment loans rose, notably in India, Korea and Indonesia, following the successful launch of these products in mid-2005.

Net fee income of HK\$10,512 million was 30.6 per cent higher than in 2005, driven by buoyant regional and global stock markets and greater demand for wealth management products. In Hong Kong, fee income was up by HK\$1,828 million, or 31.7 per cent. Fee income from stockbroking and custody services rose by 80.3 per cent, reflecting higher stock market transaction volumes. Sales of unit trusts increased significantly as investors switched to equity-related products, encouraged by improved markets and the launch of new investment funds. In the rest of Asia-Pacific, fee income rose by 27.7 per cent on the back of strong demand for investment products in Korea, Taiwan, India and Singapore, with revenue from wealth management sales in the region increasing by HK\$355 million, or 33.8 per cent.

Fee income from credit cards was HK\$671 million, or 29.1 per cent, higher than in 2005 as the group strengthened its position as the largest card issuer in Hong Kong, with over 4.6 million cards in force. In the rest of Asia-Pacific, particularly India and the Philippines, expansion of the cards business continued. This was supported by extensive marketing campaigns and sales efforts, resulting in a rise of 21.3 per cent in the number of cards to a total of 5.7 million issued, and a 19.3 per cent increase in cardholder spending.

Insurance income rose by 13.0 per cent, with continued focus on the development of the group's retirement planning proposition and was supported by increased levels of marketing activity and distribution channel development. Sales of other life assurance products also grew and revenue from general insurance, particularly medical, travel and home insurance, increased.

Gains from financial investments principally comprise profit realised from the partial disposal of shares held in MasterCard Inc.

Other operating income increased by HK\$278 million, attributable to gains on the sale of the Australian stockbroking, margin lending and broker-originated mortgage businesses, and the share of profit attributable to Personal Financial Services from the transfer of the credit card merchant acquiring business to a joint venture company set up with Global Payments Inc. These gains were partially offset by lower IT cost recoveries in Hong Kong from other regional

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group entities resulting from a change in the charging methodology across customer groups.

The charge for loan impairment increased by HK\$3,184 million to HK\$4,528 million, largely attributable to higher credit card delinquency levels in Taiwan and Indonesia. Delinquency rates and write-offs rose in Taiwan largely as a result of government measures to control consumer credit growth. Indonesia has been affected by higher minimum repayment rules, coupled with a hefty reduction in the government subsidy of fuel prices. Volume growth in credit card receivables in Hong Kong and in personal instalment loans in other parts of the region also contributed to the increased charge, whereas the prior period benefited from non-recurring releases of provisions against mortgage lending and restructured facilities in Hong Kong.

Operating expenses were HK\$2,981 million, or 17.6 per cent, higher than in 2005, principally driven by continued investment to develop and expand the business in the rest of the Asia-Pacific region. In Hong Kong, operating expenses rose by 10.6 per cent, largely in relation to major credit card marketing campaigns and headcount growth in customer-facing roles. Staff recruitment increased to support the introduction in September 2006 of the five-day working week and extended opening hours, and payroll costs further rose due to higher performance-related bonuses and annual salary increments. Technology costs were also higher, reflecting investment in customer portfolio management systems and the enhancement of distribution channel capabilities. In the rest of Asia-Pacific, costs increased by HK\$1,936 million, or 27.4 per cent, notably in India and Korea, as the group continued to pursue organic growth in the region. Headcount rose by 29.1 per cent as sales and support functions were expanded, and premises costs rose as new branches were opened in mainland China and a number of other countries. Higher marketing costs were incurred to drive sales and promote the HSBC brand, with specific campaigns targeted to increase customer numbers and raise market share in credit cards, mortgages and personal loans, and to attract new deposits. In addition, costs were incurred in the start-up of the consumer finance business in the region, particularly in India, Australia and Indonesia, and in relation to the launch of HSBC Direct in Taiwan and Korea in September 2006 and February 2007 respectively.

Income from associates of HK\$257 million includes improved results from Bank of Communications and Industrial Bank.

Commercial Banking reported profit before tax of HK\$14,945 million, an increase of 34.3 per cent over 2005, driven by improved deposit spreads and balance sheet growth.

Net interest income increased by HK\$2,917 million, or 26.3 per cent, compared with 2005. This reflected growth in average deposits and advances as well as improvements in deposit spreads following further rises in interest rates across the region this year. In Hong Kong, net interest income rose by HK\$1,916 million, or 22.5 per cent, due to growth in liability balances, reflecting the active promotion of the 'BusinessVantage' account in Hong Kong and the widening of deposit spreads. Strong demand for credit continued in the property sector and from manufacturers with operations on the Mainland, but lending margins were compressed due to keen market competition and higher funding costs. Emphasis on the small business segment was strengthened with the opening of dedicated small business banking centres, more relationship managers and sales staff, and the launch of a streamlined lending process. Cross-border relationships continued to be an area of emphasis, and the regional alignment proposition was enhanced to capture business flows between Hong Kong, mainland China, Taiwan and Vietnam, which led to a significant increase in inter-office referrals.

In the rest of Asia-Pacific, net interest income grew by 39.0 per cent. Liability spreads improved across the region and the deposit base expanded in various countries, particularly in Taiwan, Singapore and India, following

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successful marketing campaigns and sales incentives. Account balances in India increased also due to the receipt of IPO funds. In addition, the offshore business in Mauritius performed well. Term lending and trade finance increased, notably in mainland China, India, Korea and Australia as a result of promotional activities, enhanced packaged lending propositions, together with expansion of the branch network and internet banking. Asset spreads also improved.

Net fee income rose by HK\$494 million, or 10.9 per cent, largely attributable to higher fees from account services and remittances, particularly in Hong Kong as a result of enhancements to the product range and increased cross-border remittances. Credit card merchant acquiring fees dropped by 11.5 per cent as the majority of the business was transferred in July 2006 into a joint venture company set up with Global Payments Inc. Fees from trade services were higher with increases in mainland China, India, Bangladesh and Indonesia partially offset by lower revenues in Hong Kong due to intense market competition. Buoyant local equity markets and the launch of new investment products contributed to increased wealth management sales in Hong Kong. Income from sales of foreign exchange and interest rate derivative products increased by 24.8 per cent, benefiting from an increase in hedging transactions and cross-border payments.

Insurance revenues, particularly from life insurance products, continued to grow following the establishment of a dedicated commercial banking insurance division last year. Income increased by 71.2 per cent. Fees from the Mandatory Provident Fund business in Hong Kong also grew strongly.

Other operating income increased by HK\$53 million, due to the share of profit attributable to Commercial Banking from the transfer of the credit card merchant acquiring business to a joint venture company set up with Global Payments Inc.

The charge for loan impairment was HK\$450 million lower than in 2005, reflecting a decrease in new specific provisions in Hong Kong, although releases in Hong Kong, mainland China, India and Singapore were lower. Credit quality generally remained stable.

Operating expenses increased by 20.4 per cent over 2005. The number of sales and back-office staff rose in support of SME initiatives, insurance business expansion, product development and increased branch presence, and expenditure rose on marketing campaigns to win new business and raise market penetration. Ongoing investment in the development and promotion of internet banking and other lower-cost delivery channels resulted in higher IT and infrastructure costs. Business Internet Banking in Hong Kong continued to show impressive growth and was enhanced to support sales of unit trusts and structured deposits. User numbers increased by over 20 per cent and the proportion of online transactions grew by 42.2 per cent. Staff costs and marketing expenditure rose in Korea and mainland China in order to further develop the group's commercial banking business in these countries.

Income from associates was HK\$544 million higher than in the prior year and includes improved results from Bank of Communications and Industrial Bank.

Corporate, Investment Banking and Markets reported profit before tax of HK\$15,243 million, 15.0 per cent higher than 2005, attributable to an excellent performance in Global Transaction Banking and strong trading profits in Global Markets.

Net interest income increased by HK\$379 million, or 4.3 per cent, compared with 2005. In Global Markets, balance sheet management revenues declined as the cost of funding fixed rate asset positions, put on in earlier periods, rose significantly, although these asset positions had, however, largely run off by the end of the first half of 2006. In addition, flat yield curves made it difficult to generate income through position-taking. Net interest income in Global Transaction Banking increased by 62.7 per cent, notably in India, Hong

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Kong, Singapore, Taiwan, mainland China and Korea as a result of business growth and interest rate rises in the region. Deposit balances grew by 22.3 per cent as the payments and cash management business successfully completed the implementation of a record number of domestic and cross-border cash management mandates. The securities services business performed well, particularly in India, Taiwan and Korea. Trade finance revenues grew, notably in Japan and Korea. Net interest income from corporate lending fell by 4.7 per cent as the benefit of balance sheet growth in Hong Kong was offset by competitive pressures on spreads. Strong growth in advances to corporates in mainland China was achieved, reflecting investment made in expanding customer relationships and inflow of business into the group's new branches on the Mainland.

Net fee income increased by HK\$1,549 million, or 28.7 per cent. In Global Transaction Banking, fees rose by HK\$1,294 million, or 34.2 per cent. The securities services business continued to broaden capabilities across the region, and was strengthened by the acquisition of the sub-custody business in Australia and New Zealand from Westpac. Volumes benefited from buoyant local stock markets, particularly in Hong Kong, Korea and India. Fee income from the asset management business increased by 48.1 per cent, reflecting higher fund advisory and distribution fees and growth in funds under management. Investment banking revenues were higher as the division arranged a number of structured finance transactions in Hong Kong, but underwriting income declined although several mandates for mid-tier IPOs were won.

Net trading income rose by 20.3 per cent to HK\$8,682 million. Foreign exchange and interest rate derivatives revenues were higher as currency volatility provided good trading opportunities, particularly in regional currencies, and customer volumes increased reflecting HSBC's focus on capturing emerging market flows from heightened client interest in emerging markets, particularly in India and mainland China. Strong results were achieved from equities and equity derivatives trading, reflecting business expansion in these areas and buoyant regional stock markets. Private equity investments also performed strongly. Tighter credit spreads in the corporate bond market created fewer trading opportunities compared to previous years, and there was a reduced contribution from the structured interest rate derivatives business as investors focused on shorter-dated interest rate products and other asset classes.

Gains on the disposal of financial investments were HK\$207 million higher than in 2005 and largely comprised profits made on the sale of Philippine government securities in 2006, together with the non-recurrence of losses on disposals of securities sold in 2005, following strategic decisions to reduce interest rate risk in certain portfolios.

There was a net release of loan impairment provisions of HK\$250 million, compared with a release of HK\$165 million in 2005, as the corporate credit environment throughout the region remained benign.

Operating expenses increased by 16.4 per cent compared with 2005, reflecting headcount increases and IT investment to support business expansion in all areas and higher performance-related remuneration in the investment banking division and in Global Markets. The transfer to the group of HSBC Securities Japan from another HSBC Group company in the second quarter of 2005 also contributed to the increase in expenses as a full period of costs was reflected this year.

Income from associates of HK\$671 million includes improved results from Bank of Communications and Industrial Bank.

Other includes income and expenses relating to certain funding, investment, property and other activities that are not allocated to other customer groups.

Gains from financial investments largely comprise profit on the disposal of part of the group's stake in UTI Bank, and other operating income includes profits

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made on property sales. These gains were partially offset by lower revaluation gains on investment property.

Consolidated Income Statement

| Figures in HK\$m | Year ended 31Dec06 | Year ended 31Dec05 |
|---|-----------------------|-----------------------|
| Interest income | 115,928 | 80,199 |
| Interest expense | (64,829) | (36,708) |
| Net interest income | 51,099 | 43,491 |
| Fee income | 26,554 | 21,671 |
| Fee expense | (4,150) | (3,574) |
| Net fee income | 22,404 | 18,097 |
| Net trading income | 8,918 | 7,180 |
| Net income from financial instruments designated at fair value | 2,670 | 384 |
| Gains less losses from financial investments | 1,466 | 756 |
| Dividend income | 749 | 368 |
| Net earned insurance premiums | 21,846 | 19,340 |
| Other operating income | 5,653 | 4,897 |
| Total operating income | 114,805 | 94,513 |
| Net insurance claims incurred and movement in policyholders' liabilities | (22,480) | (17,291) |
| Net operating income before loan impairment charges and other credit risk provisions | 92,325 | 77,222 |
| Loan impairment charges and other credit risk provisions | (4,809) | (2,064) |
| Net operating income | 87,516 | 75,158 |
| Employee compensation and benefits | (21,042) | (17,736) |
| General and administrative expenses | (14,949) | (12,095) |
| Depreciation of property, plant and equipment | (1,905) | (1,825) |
| Amortisation of intangible assets | (343) | (158) |
| Total operating expenses | (38,239) | (31,814) |
| Operating profit | 49,277 | 43,344 |
| Share of profit in associates and joint venture | 2,739 | 1,905 |
| Profit before tax | 52,016 | 45,249 |
| Tax expense | (9,411) | (8,051) |
| Profit for the year | 42,605 | 37,198 |
| Profit attributable to shareholders | 37,709 | 32,873 |
| Profit attributable to minority interests | 4,896 | 4,325 |

Extract from the Consolidated Balance Sheet

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|---|------------|------------|
| ASSETS | | |
| Cash and short-term funds | 518,022 | 502,730 |
| Items in the course of collection from other banks | 46,519 | 17,782 |
| Placings with banks maturing after one month | 104,037 | 69,554 |
| Certificates of deposit | 73,200 | 53,831 |
| Hong Kong SAR Government certificates of indebtedness | 102,374 | 97,344 |
| Trading assets | 338,792 | 215,681 |
| Financial assets designated at fair value | 50,514 | 37,073 |
| Derivatives | 99,167 | 72,039 |
| Advances to customers | 1,043,782 | 999,326 |
| Financial investments | 484,841 | 394,497 |
| Amounts due from group companies | 161,118 | 101,173 |
| Investments in associates and joint venture | 25,534 | 23,061 |

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|--------------------------------|-----------|-----------|
| Goodwill and intangible assets | 10,428 | 7,252 |
| Property, plant and equipment | 29,159 | 29,805 |
| Deferred tax assets | 1,245 | 1,272 |
| Retirement benefit assets | 2,191 | 1,788 |
| Other assets | 59,917 | 48,324 |
| Total assets | 3,150,840 | 2,672,532 |

LIABILITIES

| | | |
|--|-----------|-----------|
| Hong Kong SAR currency notes in circulation | 102,374 | 97,344 |
| Items in the course of transmission to other banks | 57,226 | 20,927 |
| Deposits by banks | 108,125 | 83,802 |
| Customer accounts | 1,989,467 | 1,735,110 |
| Trading liabilities | 272,545 | 250,198 |
| Financial liabilities designated at fair value | 36,554 | 33,291 |
| Derivatives | 98,659 | 72,009 |
| Debt securities in issue | 69,195 | 61,468 |
| Retirement benefit liabilities | 465 | 394 |
| Amounts due to group companies | 31,356 | 24,777 |
| Other liabilities | 56,478 | 46,628 |
| Liabilities under insurance contracts issued | 61,350 | 41,845 |
| Current tax liabilities | 4,500 | 2,044 |
| Deferred tax liabilities | 4,284 | 3,729 |
| Subordinated liabilities | 16,353 | 12,561 |
| Preference shares | 76,464 | 71,980 |
| Total liabilities | 2,985,395 | 2,558,107 |

EQUITY

| | | |
|----------------------------------|-----------|-----------|
| Share capital | 22,494 | 22,494 |
| Other reserves | 35,514 | 6,037 |
| Retained profits | 80,942 | 64,303 |
| Proposed fourth interim dividend | 6,500 | 4,500 |
| Total shareholders' equity | 145,450 | 97,334 |
| Minority interests | 19,995 | 17,091 |
| | 165,445 | 114,425 |
| Total equity and liabilities | 3,150,840 | 2,672,532 |

Consolidated Statement of Recognised Income and Expense

| Figures in HK\$m | Year ended 31Dec06 | Year ended 31Dec05 |
|---|-----------------------|-----------------------|
| Available-for-sale investments: | | |
| - fair value changes taken to equity | 25,115 | (1,885) |
| - fair value changes transferred to the income statement on disposal or impairment | (1,464) | (787) |
| - fair value changes transferred to the income statement on hedged items due to hedged risk | (105) | 1,077 |
| Cash flow hedges: | | |
| - fair value changes taken to equity | (165) | (2,743) |
| - fair value changes transferred to the income statement | 2,277 | 538 |
| Property revaluation: | | |
| - fair value changes taken to equity | 1,977 | 2,448 |
| Share of changes in equity of associates and joint venture | (186) | 1,098 |
| Exchange differences | 2,779 | (782) |
| Actuarial gains on post-employment benefits | 93 | 144 |
| | 30,321 | (892) |
| Net deferred tax on items taken directly to equity | (738) | 253 |
| Total income and expense taken to equity during the year | 29,583 | (639) |
| Profit for the year | 42,605 | 37,198 |

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| | | |
|---|--------|--------|
| Total recognised income and expense for the year | 72,188 | 36,559 |
| Total recognised income and expense for the year attributable to: | | |
| - shareholders | 66,448 | 32,594 |
| - minority interests | 5,740 | 3,965 |
| | 72,188 | 36,559 |

Consolidated Cash Flow Statement

| Figures in HK\$m | Year ended 31Dec06 | Year ended 31Dec05 |
|--|-----------------------|-----------------------|
| Operating activities | | |
| Cash generated from operations | 88,942 | 31,009 |
| Interest received on financial investments | 17,527 | 14,759 |
| Dividends received on financial investments | 711 | 339 |
| Dividends received from associates | 766 | 108 |
| Taxation paid | (6,159) | (7,313) |
| Net cash inflow from operating activities | 101,787 | 38,902 |
| Investing activities | | |
| Purchase of financial investments | (402,459) | (335,668) |
| Proceeds from sale or redemption of financial investments | 361,794 | 366,294 |
| Purchase of property, plant and equipment | (2,085) | (1,749) |
| Proceeds from sale of property, plant and equipment | 2,697 | 1,153 |
| Purchase of other intangible assets | (1,142) | (670) |
| Proceeds from sale of assets held for sale | 1,479 | - |
| Net cash outflow in respect of the acquisition of and increased shareholding in subsidiary companies | (22) | (1,644) |
| Net cash inflow in respect of the sale of subsidiary companies | 409 | 151 |
| Net cash outflow in respect of the purchase of interests in business portfolios | (775) | - |
| Net cash outflow in respect of the purchase of interests in associates and joint venture | (462) | (3,358) |
| Proceeds from the sale of interests in business portfolios | 16,501 | - |
| Proceeds from the sale of interests in associates | - | 10 |
| Net cash (outflow)/inflow from investing activities | (24,065) | 24,519 |
| Net cash inflow before financing | 77,722 | 63,421 |
| Financing | | |
| Issue of preference share capital | 4,277 | 16,567 |
| Change in minority interest stake | 976 | 362 |
| Repayment of subordinated liabilities | (1,018) | - |
| Issue of subordinated liabilities | 4,661 | 2,500 |
| Ordinary dividends paid | (18,757) | (20,600) |
| Dividends paid to minority interests | (3,841) | (3,983) |
| Interest paid on preference shares | (3,935) | (1,574) |
| Interest paid on subordinated liabilities | (946) | (555) |
| Net cash outflow from financing | (18,583) | (7,283) |
| Increase in cash and cash equivalents | 59,139 | 56,138 |

Additional Information

1. Net interest income

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| Figures in HK\$m | Year ended 31Dec06 | Year ended 31Dec05 |
|---------------------------------|-----------------------|-----------------------|
| Net interest income | 51,099 | 43,491 |
| Average interest-earning assets | 2,212,521 | 2,031,314 |
| Net interest spread | 1.92% | 1.89% |
| Net interest margin | 2.31% | 2.14% |

Net interest income of HK\$51,099 million was HK\$7,608 million, or 17.5 per cent, higher than in 2005. The contribution from balance sheet growth and improved deposit spreads throughout the region was partially offset by significantly lower balance sheet management income.

Net interest income in Personal Financial Services rose by HK\$3,289 million, or 12.3 per cent, partly due to improved liability spreads earned in the higher interest rate environment, coupled with strong growth in the deposit base. Lending growth also contributed to the increase in interest income, particularly personal loans in India and Korea, credit cards in the Philippines, India and Indonesia, and mortgages in Singapore, Taiwan and at Hang Seng Bank. In addition, strong returns were also generated on investments held by the group's insurance companies, benefiting from higher yields and growth in portfolio size. Net interest income in Commercial Banking was HK\$2,917 million, or 26.3 per cent, ahead of the prior period due to balance sheet growth, notably in Hong Kong, India, Singapore and mainland China, and improved deposit spreads. In Corporate, Investment Banking and Markets, net interest income from Global Transaction Banking increased significantly, due to higher deposit balances and spreads, notably in Hong Kong and India. Global Markets saw a decline in balance sheet management revenues, which were impacted by higher funding costs and flat yield curves.

Average interest-earning assets rose by HK\$181.2 billion, or 8.9 per cent, to HK\$2,212.5 billion. Average advances to customers grew by HK\$82.4 billion, or 8.5 per cent, with strong increases in corporate loans in Hong Kong, India, mainland China and Australia, and rises in mortgage lending in Hong Kong, Singapore, Korea, Taiwan and India. Average credit card balances rose in all areas, notably Hong Kong, the Philippines, Indonesia and India, and personal instalment loans grew, most significantly in Korea. Average placements with banks were HK\$56.2 billion higher, and holdings of financial investments rose by HK\$43.4 billion, reflecting the deployment of the commercial surplus.

The group's net interest margin of 2.31 per cent for 2006 was 17 basis points higher than in 2005. The reduction in balance sheet management income negatively affected margin by 11 basis points when compared to 2005. However, net interest spread improved by three basis points overall, attributable to tactical deposit pricing. The contribution from net free funds increased by 14 basis points reflecting higher interest rates and an increase in free funds from retained earnings and trading book structured deposits, although other net trading liabilities decreased.

For the bank in Hong Kong, net interest margin increased by nine basis points to 2.26 per cent for 2006. Spread rose by three basis points, benefiting from higher interest rates. Spreads on Hong Kong dollar and foreign currency current and savings accounts improved as the value of funds rose, whilst increases in interest rates paid to customers were contained. This was partly offset by the negative impact of lower balance sheet management income as fixed rate asset positions faced an increase in funding costs. Spreads on mortgages and credit cards were also affected by a higher cost of funds, and competitive pressures on pricing affected corporate lending margins. The contribution from net free funds increased by six basis points due to the increase in market interest rates.

At Hang Seng Bank, net interest margin improved by 23 basis points as the

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increase in contribution from net free funds outweighed the fall in spread. Net interest spread declined by 11 basis points as returns on treasury balance sheet management portfolios were affected by rising funding costs and flat yield curves, and spreads narrowed on mortgages and corporate loans due to competitive pressures on pricing. These outweighed the favourable impact of the growth in advances and a wider spread between the bank's best lending rate ('BLR') and HIBOR. The contribution from net free funds increased by 34 basis points, benefiting from the rise in market interest rates and from higher balances of structured deposits which are classified as trading liabilities, the related interest expense being included within 'Net trading income'.

In the rest of Asia-Pacific, net interest margin at 2.16 per cent was 16 basis points higher than in 2005. Spread increased by nine basis points to 1.94 per cent. All major sites faced an increase in funding costs due to higher interest rates across the region, but spreads rose in several countries, notably in India due to an increase in higher-yielding personal loans and credit cards and a rise in low cost current account balances from custody and clearing customers. Margins also rose in mainland China from higher spreads on corporate lending as deposit rate rises lagged lending rate increases, in Singapore due to rises in mortgage lending rates, and in Australia from higher yields on corporate bonds. These increases were partially offset by lower spreads on credit card advances in Taiwan and competitive pressures on mortgage lending rates in Korea. The contribution from net free funds rose by seven basis points, benefiting from higher market interest rates.

2. Net fee income

| Figures in HK\$m | 2006 | 2005 |
|-------------------------|---------|---------|
| Account services | 1,501 | 1,314 |
| Credit facilities | 1,245 | 1,159 |
| Import/export | 2,956 | 2,777 |
| Remittances | 1,437 | 1,248 |
| Securities/stockbroking | 5,267 | 3,402 |
| Cards | 4,335 | 4,231 |
| Insurance | 315 | 280 |
| Unit trusts | 2,326 | 1,627 |
| Funds under management | 2,974 | 2,233 |
| Other | 4,198 | 3,400 |
| | | |
| Fee income | 26,554 | 21,671 |
| | | |
| Fee expense | (4,150) | (3,574) |
| | 22,404 | 18,097 |

Net fee income was HK\$4,307 million, or 23.8 per cent, higher than in 2005. Securities broking and custody fees rose by 54.8 per cent, reflecting higher stock market turnover in Hong Kong and the region, with increases from both personal and corporate customers. The buoyant equity markets also stimulated customer demand for unit trusts and structured products. Funds under management and related fees increased, in part due to institutional business transferred from another HSBC Group entity in the second quarter of 2005. Fee income also includes significant fund advisory and performance fees, reflecting the success of certain emerging markets funds. Trade finance income and remittance and other account fees grew, reflecting the group's strong transactional capabilities. Hong Kong Mandatory Provident Fund management fees increased by 34 per cent due to new business and improved investment performance. Gross fee income from

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credit cards was impacted by a loss of revenues in Taiwan as credit card activity fell in the wake of the country's curbs on consumer credit growth, and due to the transfer of the majority of the merchant acquiring business to a joint venture company set up with Global Payments Inc. However, there was strong growth elsewhere in the region due to an increase in the number of cards in circulation and higher cardholder spending. 'Other' fees include an increase in sales credits received from fellow HSBC group companies in respect of treasury business.

Fee expense rose due to increased brokerage fees paid by Global Markets on account of higher trading activity, and higher investment management advisory fees paid to another HSBC Group company.

3. Net trading income

| Figures in HK\$m | 2006 | 2005 |
|---|---------|---------|
| Dealing profits | 10,001 | 8,560 |
| Gain/(loss) from hedging activities | 16 | (1) |
| Net interest expense | (1,307) | (1,484) |
| Dividend income from trading securities | 208 | 105 |
| | 8,918 | 7,180 |

Trading income rose by 24.2 per cent to HK\$8,918 million. Foreign exchange profits benefited from an increase in trading activity against a backdrop of increasing demand for local currency assets as foreign investors sought to participate in local stock markets, coupled with favourable positioning as the US dollar weakened. Revenues grew strongly in the equities and equity derivatives business, reflecting business expansion and buoyant stock markets. Strong gains were also made on the revaluation of private equity investments. However, the contribution from structured derivatives trading declined, and the rising interest rate environment negatively impacted corporate bond trading revenues. Net interest expense decreased due to higher interest income from increased holdings of trading assets, but was largely offset by a rise in interest expense from the increase in structured deposit products issued to retail customers.

4. Gains less losses from financial investments

| Figures in HK\$m | 2006 | 2005 |
|---|-------|------|
| Profit on disposal of available-for-sale securities | 1,466 | 762 |
| Other | - | (6) |
| | 1,466 | 756 |

The profit on the disposal of available-for-sale securities largely comprises the gain on the disposal of part of the group's stake in UTI Bank, reducing the group's interest to 4.99 per cent. Profits were also made on the sale of Philippine government securities and other operational investments.

5. Other operating income

| Figures in HK\$m | 2006 | 2005 |
|------------------|------|------|
|------------------|------|------|

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| | | |
|---|-------|-------|
| Rental income from investment properties | 196 | 215 |
| Movement in present value of in-force insurance business | 1,124 | 1,185 |
| Gains on investment properties | 475 | 1,167 |
| Profit on disposal of property, plant and equipment, and assets held for sale | 981 | 111 |
| Profit on disposal of subsidiaries, associates and business portfolios | 904 | 53 |
| Surplus arising on property revaluation | 70 | 370 |
| Other | 1,903 | 1,796 |
| | 5,653 | 4,897 |

Other operating income for 2006 included gains on the disposal of the stockbroking, margin lending and broker originated mortgage businesses in Australia, a gain on the transfer of the credit card merchant acquiring business to a joint venture company set up with Global Payments Inc., and profits on the sale of property in Hong Kong and Japan.

Gains on investment properties comprise unrealised revaluation gains, together with realised profits on disposals. Gains were lower than in 2005 as valuations were affected by a slowdown in property price rises in Hong Kong.

The surplus arising on property revaluation represents reversals of prior year revaluation deficits that had arisen when the value of certain premises fell below depreciated historical cost. This was lower than in 2005 as the number of properties with revaluation deficits decreased.

'Other' largely comprises recoveries from fellow HSBC group companies of IT and other operating costs incurred on their behalf.

6. Insurance income

Included in the consolidated income statement are the following revenues earned by the group's insurance businesses:

| Figures in HK\$m | 2006 | 2005 |
|--|----------|----------|
| Net interest income | 2,328 | 1,715 |
| Net fee income | 636 | 484 |
| Net income from financial instruments designated at fair value | 2,980 | 16 |
| Gains less losses from financial investments | 29 | 53 |
| Dividend income | 1 | 2 |
| Net earned insurance premiums | 21,846 | 19,340 |
| Movement in present value of in-force business | 1,124 | 1,185 |
| Other operating income | 72 | 90 |
| | 29,016 | 22,885 |
| Net insurance claims incurred and movement in policyholders' liabilities | (22,480) | (17,291) |
| Net operating income | 6,536 | 5,594 |

Premium income rose by HK\$2,506 million, or 13.0 per cent, over 2005, primarily attributable to growth in the life assurance business in Hong Kong. The product range was expanded with the launch of new retirement and other investment-linked products. Investment income was higher, reflecting the growing portfolio size, higher interest yields and improved equity returns. Fee income rose due to the increased portfolio size and improved investment performance of the Hong Kong Mandatory Provident Fund business. The movement in the present value of in-force business fell, despite a rise in premium income, due to a change in product mix which comprised an increase in shorter-term policies. Claims and movement in

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policyholders' liabilities comprise returns owed to investment policyholders as well as general insurance claims. The increase is largely in line with the rise in premium income and investment income.

7. Loan impairment charges and other credit risk provisions

| Figures in HK\$m | 2006 | 2005 |
|---|-------|---------|
| Net charge for impairment of customer advances | | |
| - Individually assessed impairment allowances: | | |
| New allowances | 1,314 | 2,129 |
| Releases | (869) | (1,755) |
| Recoveries | (212) | (267) |
| | 233 | 107 |
| - Net charge for collectively assessed impairment allowances | 4,468 | 1,961 |
| | 4,701 | 2,068 |
| Net charge/(release) of other credit risk provisions | 108 | (4) |
| Net charge for loan impairment and other credit risk provisions | 4,809 | 2,064 |

The net charge for loan impairment and other credit risk provisions was HK\$2,745 million higher than in 2005. The environment for corporate credit remained stable in contrast to more difficult credit conditions for personal lending in some parts of the region.

The charge for new individually assessed allowances was lower, attributable to a decrease in charges against corporate lending, as the prior period included a significant one-time charge. Releases and recoveries were also lower, largely relating to corporates in Hong Kong and the region, and against mortgage lending in Hong Kong.

The net charge for collectively assessed allowances rose significantly, due to higher charges against credit card lending, most notably in Taiwan and Indonesia. Delinquency rates and write-offs rose in Taiwan largely as a result of government measures to curb excessive consumer credit growth. These included increasing the minimum monthly repayment amount, while at the same time introducing a debt renegotiation scheme which offers extended repayment periods at substantially reduced rates. Indonesia was also affected by higher minimum repayment rules, coupled with rises in inflation largely as a result of the reduction of government fuel price subsidies. Elsewhere, volume growth in credit cards and other personal lending, coupled with the non-recurrence of releases in 2005, also contributed to the increase.

Other credit risk provisions include an impairment charge against an available-for-sale equity investment in Taiwan.

8. Employee compensation and benefits

| Figures in HK\$m | 2006 | 2005 |
|---------------------------------|--------|--------|
| Wages, salaries and other costs | 14,302 | 12,311 |
| Performance-related pay | 5,501 | 4,117 |
| Social security costs | 283 | 238 |
| Retirement benefit costs | 956 | 1,070 |
| | 21,042 | 17,736 |

Staff numbers by region^

At 31Dec06 At 31Dec05

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| | | |
|----------------------|--------|--------|
| Hong Kong | 26,496 | 24,842 |
| Rest of Asia-Pacific | 27,518 | 25,956 |
| Americas/Europe | 17 | 18 |
| Total | 54,031 | 50,816 |

^ Full-time equivalent

Staff costs increased by HK\$3,306 million, or 18.6 per cent, compared with 2005. Salaries rose by 16.2 per cent, reflecting increased headcount and annual salary increments. Staff numbers rose in Hong Kong in support of the implementation of the five-day working week and extended weekend opening hours. In the rest of Asia-Pacific region, headcount grew in support of new branch openings, establishment of the consumer finance business, and expansion of the sales force and call centres. Ownership of the group service centre in Guangdong was transferred to another HSBC Group entity with a resultant decrease in headcount of around 3,500 in the rest of Asia-Pacific region. Performance-related pay in Hong Kong and the rest of Asia-Pacific increased in line with improved operating revenues, higher dealing income and the increase in headcount.

9. General and administrative expenses

| Figures in HK\$m | 2006 | 2005 |
|--|--------|--------|
| Premises and equipment | | |
| - Rental expenses | 1,557 | 1,243 |
| - Amortisation of prepaid operating lease payments | 58 | 56 |
| - Other premises and equipment | 2,463 | 2,089 |
| | 4,078 | 3,388 |
| Marketing and advertising expenses | 3,587 | 2,840 |
| Other administrative expenses | 7,268 | 5,554 |
| Litigation and other provisions | 16 | 313 |
| | 14,949 | 12,095 |

The increase in general and administrative expenses of HK\$2,854 million, or 23.6 per cent, reflected additional costs incurred in business expansion throughout the region. Premises costs rose due to new branch openings, expansion of office space and rent increases. Advertising and marketing expenditure was higher, notably in Hong Kong, India, Korea and mainland China, and comprised specific product campaigns, particularly in Personal Financial Services, and other drives to increase brand awareness. Technology costs also increased as the group continued to invest in enhanced channel capabilities and improved portfolio management systems.

10. Share of profit in associates and joint venture

Share of profit in associates and joint venture principally included the group's share of post-tax profits from Bank of Communications and Industrial Bank, and amortisation of intangible assets arising on acquisition.

11. Tax expense

The tax expense in the consolidated income statement comprises:

| Figures in HK\$m | 2006 | 2005 |
|-------------------------|-------|-------|
| Current income tax | | |
| - Hong Kong profits tax | 5,506 | 4,974 |

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| | | |
|---------------------|-------|-------|
| - Overseas taxation | 3,955 | 2,598 |
| Deferred taxation | (50) | 479 |
| | 9,411 | 8,051 |

The effective rate of tax for 2006 was 18.1 per cent compared with 17.8 per cent in 2005. The increase was attributable to a higher proportion of the group's taxable profits being generated in higher tax rate jurisdictions, particularly India, Japan and Australia.

12. Dividends

| | 2006 | | 2005 | |
|--|-------------------|--------|-------------------|--------|
| | HK\$ per share | HK\$m | HK\$ per share | HK\$m |
| Dividends paid on ordinary share capital | | | | |
| - in respect of the previous financial year, approved and paid during the year | 0.50 | 4,500 | 0.53 | 4,800 |
| - in respect of the current financial year | 1.58 | 14,257 | 1.76 | 15,800 |
| | 2.08 | 18,757 | 2.29 | 20,600 |

The Directors have declared a fourth interim dividend in respect of the financial year ending 31 December 2006 of HK\$6,500 million (HK\$0.72 per ordinary share).

13. Advances to customers

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|--|------------|------------|
| Gross advances to customers | 1,050,625 | 1,005,902 |
| Impairment allowances | | |
| - Individually assessed | (2,118) | (2,976) |
| - Collectively assessed | (4,725) | (3,600) |
| | (6,843) | (6,576) |
| | 1,043,782 | 999,326 |
| Allowances as a percentage of gross advances to customers: | | |
| Individually assessed | 0.20% | 0.29% |
| Collectively assessed | 0.45% | 0.36% |
| Total allowances | 0.65% | 0.65% |

14. Impairment allowances against advances to customers

| Figures in HK\$m | Individually assessed allowances | Collectively assessed allowances | Total |
|--|--|--|---------|
| At 1Jan06 | 2,976 | 3,600 | 6,576 |
| Amounts written off | (1,196) | (3,830) | (5,026) |
| Recoveries of advances written off in previous years | 212 | 498 | 710 |
| Net charge to income statement (Note 7) | 233 | 4,468 | 4,701 |
| Unwinding of discount of loan impairment | (85) | (111) | (196) |
| Exchange and other adjustments | (22) | 100 | 78 |
| At 31Dec06 | 2,118 | 4,725 | 6,843 |

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15. Impaired advances to customers and allowances

The geographical information shown below, and in notes 16, 17, 18 and 20, has been classified by location of the principal operations of the subsidiary company or, in the case of the bank, by location of the branch responsible for advancing the funds.

| Figures in HK\$m | Hong Kong | Rest of Asia-Pacific | Americas/ Europe |
|---|-----------|----------------------|---------------------|
| Year ended 31Dec06 | | | |
| Impairment allowance charge | 1,228 | 3,473 | - |
| At 31Dec06 | | | |
| Advances to customers which are considered to be impaired are as follows: | | | |
| Gross impaired advances | 3,530 | 5,071 | - |
| Individually assessed allowances | (1,016) | (1,102) | - |
| | 2,514 | 3,969 | - |
| Individually assessed allowances as a percentage of gross impaired advances | 28.8% | 21.7% | - |
| Gross impaired advances as a percentage of gross advances to customers | 0.6% | 1.2% | - |
| Year ended 31Dec05 | | | |
| Impairment allowance charge/(release) | 1,156 | 924 | (12) |
| At 31Dec05 | | | |
| Advances to customers which are considered to be impaired are as follows: | | | |
| Gross impaired advances | 3,920 | 3,079 | - |
| Individually assessed allowances | (1,345) | (1,631) | - |
| | 2,575 | 1,448 | - |
| Individually assessed allowances as a percentage of gross impaired advances | 34.3% | 53.0% | - |
| Gross impaired advances as a percentage of gross advances to customers | 0.6% | 0.8% | - |

Impaired advances to customers are those advances where objective evidence exists that full repayment of principal or interest is considered unlikely.

The individually assessed allowances are made after taking into account the value of collateral in respect of such advances.

16. Overdue advances to customers

Rest of

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| Figures in HK\$m | Hong Kong | Asia-Pacific | Total |
|--|-----------|-------------------------|-------|
| At 31Dec06 | | | |
| Gross advances to customers which have been overdue with respect to either principal or interest for periods of: | | | |
| - three to six months | 938 | 1,287 | 2,225 |
| - six months to one year | 384 | 595 | 979 |
| - over one year | 1,238 | 859 | 2,097 |
| | 2,560 | 2,741 | 5,301 |
| Overdue advances to customers as a percentage of gross advances to customers: | | | |
| - three to six months | 0.1% | 0.3% | 0.2% |
| - six months to one year | 0.1% | 0.1% | 0.1% |
| - over one year | 0.2% | 0.2% | 0.2% |
| | 0.4% | 0.6% | 0.5% |
| At 31Dec05 | | | |
| Gross advances to customers which have been overdue with respect to either principal or interest for periods of: | | | |
| - three to six months | 1,073 | 891 | 1,964 |
| - six months to one year | 272 | 430 | 702 |
| - over one year | 1,053 | 1,071 | 2,124 |
| | 2,398 | 2,392 | 4,790 |
| Overdue advances to customers as a percentage of gross advances to customers: | | | |
| - three to six months | 0.2% | 0.2% | 0.2% |
| - six months to one year | - | 0.1% | 0.1% |
| - over one year | 0.2% | 0.3% | 0.2% |
| | 0.4% | 0.6% | 0.5% |
| 17. Rescheduled advances to customers | | | |
| Figures in HK\$m | Hong Kong | Rest of Asia-Pacific | Total |
| At 31Dec06 | | | |
| Rescheduled advances to customers | 1,730 | 2,307 | 4,037 |
| Rescheduled advances to customers as a percentage of gross advances to customers | 0.3% | 0.6% | 0.4% |

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At 31Dec05

| | | | |
|--|-------|------|-------|
| Rescheduled advances to customers | 1,941 | 623 | 2,564 |
| Rescheduled advances to customers as a percentage of gross advances to customers | 0.3% | 0.2% | 0.3% |

Rescheduled advances to customers are those advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower or because of the inability of the borrower to meet the original repayment schedule.

Rescheduled advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in 'Overdue advances to customers' (Note 16).

The increase in rescheduled advances since the end of 2005 was largely attributable to the credit card and personal loan balances under the government's debt negotiation scheme in Taiwan.

18. Analysis of advances to customers based on categories used by the HSBC Group

The following analysis of advances to customers is based on categories used by the HSBC Group, including The Hongkong and Shanghai Banking Corporation Limited and its subsidiary companies, to manage associated risks.

| Figures in HK\$m | Hong Kong | Rest of Asia-Pacific | Americas/ Europe |
|---|-----------|----------------------|---------------------|
| At 31Dec06 | | | |
| Residential mortgages | 191,522 | 112,900 | 5 |
| Hong Kong SAR Government's Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme mortgages | 31,708 | - | - |
| Credit card advances | 31,315 | 19,999 | - |
| Other personal | 30,778 | 35,908 | 1 |
| Total personal | 285,323 | 168,807 | 6 |
| Commercial, industrial and international trade | 130,994 | 133,560 | - |
| Commercial real estate | 94,706 | 36,052 | - |
| Other property-related lending | 53,832 | 15,627 | - |
| Government | 4,283 | 6,727 | - |
| Other commercial | 43,186 | 38,781 | - |
| Total corporate and commercial | 327,001 | 230,747 | - |
| Non-bank financial institutions | 18,138 | 16,471 | - |
| Settlement accounts | 3,774 | 358 | - |
| Total financial | 21,912 | 16,829 | - |

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| | | | |
|---|---------|---------|---|
| Gross advances to customers | 634,236 | 416,383 | 6 |
| Impairment allowances | (2,838) | (4,005) | - |
| Net advances to customers | 631,398 | 412,378 | 6 |
| At 31Dec05 | | | |
| Residential mortgages | 182,257 | 117,211 | 4 |
| Hong Kong SAR Government's Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme mortgages | 36,291 | - | - |
| Credit card advances | 29,882 | 16,539 | - |
| Other personal | 27,480 | 31,316 | 1 |
| Total personal | 275,910 | 165,066 | 5 |
| Commercial, industrial and international trade | 129,774 | 110,668 | - |
| Commercial real estate | 97,364 | 32,615 | - |
| Other property-related lending | 47,661 | 17,340 | - |
| Government | 2,347 | 5,891 | - |
| Other commercial | 53,681 | 37,851 | - |
| Total corporate and commercial | 330,827 | 204,365 | - |
| Non-bank financial institutions | 15,246 | 11,987 | - |
| Settlement accounts | 2,173 | 323 | - |
| Total financial | 17,419 | 12,310 | - |
| Gross advances to customers | 624,156 | 381,741 | 5 |
| Impairment allowances | (3,092) | (3,484) | - |
| Net advances to customers | 621,064 | 378,257 | 5 |

Net advances to customers increased by HK\$44.5 billion, or 4.4 per cent, since the end of 2005.

Net advances in Hong Kong rose by HK\$10.3 billion, or 1.7 per cent. Mortgage lending increased by 5.1 per cent due to successful campaigns by the bank in Hong Kong and Hang Seng Bank. This excludes the impact of the fall in lending under the Government Home Ownership Scheme which remained suspended throughout 2006. Credit card and other personal lending rose following extensive marketing activity. Corporate and commercial loan balances decreased, primarily due to the repayment of advances by large corporate customers towards the year end, although advances to smaller businesses in the property and manufacturing sectors grew, boosted by increased demand from manufacturers with operations in mainland China, and trade finance balances increased at Hang Seng Bank.

In the rest of Asia-Pacific, net advances increased by HK\$34.1 billion, or 9.0 per cent. The broker-originated mortgage portfolio in Australia was sold in December 2006 and part of the mortgage book in New Zealand was reclassified as held for sale and included within 'Other assets'. Excluding these portfolios, gross advances grew by HK\$51.1 billion, or 14.0 per cent, reflecting successful business expansion across the region. Mortgage lending increased by 12.0 per

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cent, principally in Australia (non-broker business), India and Taiwan. Credit card receivables grew by 20.9 per cent, largely in India, Australia, the Philippines and Thailand, and the consumer finance business expanded following its successful launch in India, Indonesia and Australia. Lending to commercial and corporate customers rose by 12.9 per cent, notably in mainland China, India, Mauritius and Australia, as the group focused on capturing cross-border business and the provision of trade finance.

19. Analysis of advances to customers by geographic areas according to the location of counterparties, after risk transfer

| Figures in HK\$m | Hong Kong | Rest of Asia-Pacific | Americas/ Europe | Others |
|-------------------------------|-----------|----------------------|---------------------|--------|
| At 31Dec06 | | | | |
| Gross advances to customers | 581,443 | 396,781 | 66,971 | 5,430 |
| Overdue advances to customers | 2,320 | 2,668 | 309 | 4 |
| At 31Dec05 | | | | |
| Gross advances to customers | 570,329 | 354,626 | 73,959 | 6,988 |
| Overdue advances to customers | 2,337 | 2,222 | 223 | 8 |

20. Analysis of advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority ('HKMA')

The following analysis of advances to customers is based on the categories contained in the 'Quarterly Analysis of Loans and Advances and Provisions' return required to be submitted to the HKMA by branches of the bank and by banking subsidiary companies in Hong Kong.

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|--|------------|------------|
| Gross advances to customers for use in Hong Kong | | |
| Industrial, commercial and financial | | |
| Property development | 46,352 | 41,141 |
| Property investment | 99,580 | 104,214 |
| Financial concerns | 10,136 | 12,667 |
| Stockbrokers | 964 | 1,094 |
| Wholesale and retail trade | 36,101 | 34,256 |
| Manufacturing | 17,331 | 17,847 |
| Transport and transport equipment | 27,408 | 31,202 |
| Others | 43,612 | 44,697 |
| | 281,484 | 287,118 |
| Individuals | | |
| Advances for the purchase of flats under the Hong Kong SAR Government's Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | | |
| | 31,708 | 36,291 |
| Advances for the purchase of other residential properties | | |
| | 171,014 | 165,148 |
| Credit card advances | 31,315 | 29,882 |
| Others | 26,966 | 23,826 |
| | 261,003 | 255,147 |
| Gross advances to customers for use in Hong Kong | 542,487 | 542,265 |

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| | | |
|--|-----------|-----------|
| Trade finance | 56,121 | 49,902 |
| Gross advances to customers for use outside Hong Kong made by branches of the bank and subsidiary companies in Hong Kong | 35,628 | 31,989 |
| Gross advances to customers made by branches of the bank and subsidiary companies in Hong Kong | 634,236 | 624,156 |
| Gross advances to customers made by branches of the bank and subsidiary companies outside Hong Kong: | | |
| - Rest of Asia-Pacific | 416,383 | 381,741 |
| - Americas/Europe | 6 | 5 |
| Gross advances to customers | 1,050,625 | 1,005,902 |

21. Cross-border exposure

The country risk exposures in the tables below are prepared in accordance with the HKMA Return of External Positions Part II: Cross-Border Claims (MA(BS)9) guidelines.

Cross-border claims are on-balance sheet exposures to counterparties based on the location of the counterparties after taking into account the transfer of risk.

The tables show claims on individual countries and territories or areas, after risk transfer, amounting to 10 per cent or more of the aggregate cross-border claims.

Cross-border risk is controlled centrally through a well-developed system of country limits and is frequently reviewed to avoid concentration of transfer, economic or political risk.

| Figures in HK\$m | Banks and other financial institutions | Public sector entities | Other | Total |
|----------------------------------|---|------------------------------|---------|---------|
| At 31Dec06 | | | | |
| Americas | | | | |
| United States | 62,558 | 78,354 | 72,669 | 213,581 |
| Other | 38,585 | 6,568 | 47,393 | 92,546 |
| | 101,143 | 84,922 | 120,062 | 306,127 |
| Europe | | | | |
| United Kingdom | 138,625 | 17 | 24,324 | 162,966 |
| Other | 405,950 | 5,010 | 18,981 | 429,941 |
| | 544,575 | 5,027 | 43,305 | 592,907 |
| Asia-Pacific excluding Hong Kong | 213,292 | 93,968 | 116,242 | 423,502 |
| At 31Dec05 | | | | |
| Americas | | | | |
| United States | 38,673 | 72,477 | 34,515 | 145,665 |
| Other | 39,328 | 9,909 | 50,744 | 99,981 |
| | 78,001 | 82,386 | 85,259 | 245,646 |

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| | | | | |
|----------------------------------|---------|--------|---------|--------|
| Europe | | | | |
| United Kingdom | 111,377 | 14 | 22,232 | 133,62 |
| Other | 338,060 | 5,842 | 39,509 | 383,41 |
| | 449,437 | 5,856 | 61,741 | 517,03 |
| Asia-Pacific excluding Hong Kong | 154,135 | 33,897 | 108,476 | 296,50 |

22. Customer accounts

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|------------------------|------------|------------|
| Current accounts | 292,450 | 245,094 |
| Savings accounts | 785,659 | 682,412 |
| Other deposit accounts | 911,358 | 807,604 |
| | 1,989,467 | 1,735,110 |

Customer accounts increased by HK\$254.4 billion, or 14.7 per cent since the end of 2005. This excludes structured deposits, which rose by HK\$26.0 billion, as these are included with 'Trading liabilities'.

In Hong Kong, customer accounts rose by HK\$160.6 billion, or 12.6 per cent, largely in savings account balances, attributable to successful deposit campaigns and effective pricing which made savings products more attractive to customers. Deposits from personal customers increased by HK\$100.7 billion, or 12.2 per cent, as a result. In Commercial Banking and Corporate, Investment Banking and Markets, customer account balances grew by HK\$59.9 billion, or 13.0 per cent, supported by targeted campaigns and a new, dedicated service team to capture the SME customer base, and there was continued growth in the payments and cash management business.

In the rest of Asia-Pacific, customer accounts increased by HK\$94.0 billion, or 20.6 per cent, as the group actively sought to grow the deposit base throughout the region. Deposits from personal customers grew by HK\$37.7 billion, or 23.0 per cent, notably in Singapore, Australia and China. Customer account balances held by corporate customers rose by HK\$56.3 billion, or 19.8 per cent, largely in India, mainland China, Taiwan and Singapore.

The group's advances-to-deposits ratio fell to 52.5 per cent at 31 December 2006 from 57.6 per cent at 31 December 2005.

23. Reserves

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|---|------------|------------|
| Other reserves | | |
| - Property revaluation reserve | 4,798 | 4,082 |
| - Available-for-sale investment reserve | 25,812 | 2,899 |
| - Cash flow hedge reserve | (166) | (1,767) |
| - Foreign exchange reserve | 2,805 | 53 |
| - Other | 2,265 | 770 |
| | 35,514 | 6,037 |
| Retained profits | 80,942 | 64,303 |
| Total reserves | 116,456 | 70,340 |

The property revaluation reserve includes an amount of HK\$62 million in relation to properties classified as assets held for sale at 31 December 2006 (31 December 2005: nil). Assets held for sale are included in 'Other assets' in the consolidated balance sheet.

24. Contingent liabilities, commitments and derivatives

Credit Risk-

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| Figures in HK\$m | Contract amount | equivalent amount | weighted amount |
|--|-----------------|-------------------|-----------------|
| At 31Dec06 | | | |
| Contingent liabilities | | | |
| - Guarantees | 100,964 | 73,862 | 60,534 |
| - Other | 35 | 35 | 35 |
| | 100,999 | 73,897 | 60,569 |
| Commitments | | | |
| - Documentary credits and short-term trade-related transactions | 56,732 | 21,632 | 11,680 |
| - Undrawn note issuing and revolving underwriting facilities | 1,166 | 583 | - |
| - Undrawn formal standby facilities, credit lines and other commitments: | | | |
| - one year and over | 94,241 | 47,120 | 43,635 |
| - under one year | 887,680 | - | - |
| | 1,039,819 | 69,335 | 55,315 |
| Derivatives | | | |
| Exchange rate contracts | | | |
| - Spot and forward foreign exchange | 3,267,333 | 52,122 | 13,334 |
| - Swap and other exchange rate contracts | 1,262,208 | 56,377 | 16,868 |
| | 4,529,541 | 108,499 | 30,202 |
| Interest rate contracts | | | |
| - Interest rate swaps | 6,919,779 | 69,936 | 17,832 |
| - Other interest rate contracts | 918,146 | 5,641 | 1,808 |
| | 7,837,925 | 75,577 | 19,640 |
| Forward asset purchases and forward forward deposits placed | 2,588 | 2,588 | 2,463 |
| Other derivative contracts | 554,801 | 27,935 | 9,041 |
| | 557,389 | 30,523 | 11,504 |
| Impact of counterparty netting agreements on derivatives exposure | - | (67,516) | (14,352) |
| At 31Dec05 | | | |
| Contingent liabilities | | | |
| - Guarantees | 83,114 | 60,166 | 48,893 |
| - Other | 37 | 37 | 37 |
| | 83,151 | 60,203 | 48,930 |
| Commitments | | | |
| - Documentary credits and short-term trade-related transactions | 55,402 | 20,650 | 10,905 |
| - Undrawn note issuing and revolving underwriting facilities | 3,249 | 1,625 | 975 |
| - Undrawn formal standby facilities, credit lines and other commitments: | | | |
| - one year and over | 97,207 | 48,604 | 41,115 |
| - under one year | 752,797 | - | - |
| | 908,655 | 70,879 | 52,995 |
| Derivatives | | | |
| Exchange rate contracts | | | |
| - Spot and forward foreign exchange | 2,536,795 | 36,655 | 9,753 |
| - Swap and other exchange rate contracts | 884,046 | 41,124 | 12,481 |
| | 3,420,841 | 77,779 | 22,234 |
| Interest rate contracts | | | |
| - Interest rate swaps | 4,775,236 | 55,580 | 14,442 |
| - Other interest rate contracts | 815,110 | 4,159 | 1,340 |
| | 5,590,346 | 59,739 | 15,782 |

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| | | | |
|---|---------|----------|----------|
| Forward asset purchases and forward forward deposits placed | 1,849 | 1,849 | 775 |
| Other derivative contracts | 289,019 | 15,885 | 5,649 |
| | 290,868 | 17,734 | 6,424 |
| Impact of counterparty netting agreements on derivatives exposure | - | (55,354) | (11,915) |

The tables above give the nominal contract amounts, credit equivalent amounts and risk-weighted amounts of contingent liabilities, commitments and derivatives. The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Third Schedule of the Hong Kong Banking Ordinance on capital adequacy and depend on the status of the counterparty and maturity characteristics. The risk-weights used range from 0 per cent to 100 per cent.

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

Derivatives arise from futures, forward, swap and option transactions undertaken by the group in the foreign exchange, interest rate, equity, credit and commodity markets. The contract amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value of derivative assets

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|----------------------------|------------|------------|
| Exchange rate contracts | 42,862 | 31,074 |
| Interest rate contracts | 46,809 | 38,319 |
| Other derivative contracts | 9,496 | 2,646 |
| | 99,167 | 72,039 |
| Less: netting adjustments | (40,339) | (32,038) |
| | 58,828 | 40,001 |

The fair value of derivative assets represents the mark-to-market amounts of all derivative contracts with a positive value. These assets arise from contracts with third parties and fellow subsidiaries and are included in the balance sheet as 'Derivatives'.

Fair value is a close approximation of the credit risk for these contracts at the balance sheet date. The actual credit risk is measured internally as the sum of positive mark-to-market values and an estimate for the future fluctuation risk, using a future risk factor.

The netting adjustments represent amounts where the group has in place legally enforceable rights of offset with individual counterparties to offset the gross amount of positive mark-to-market assets with any negative mark-to-market liabilities with the same customer. These offsets are recognised by the HKMA in the calculation of risk assets for the capital adequacy ratio.

25. Foreign exchange exposure

Foreign exchange exposures may be divided broadly into two categories: structural and non-structural. Structural exposures are normally long-term in nature and include those arising from investments in overseas subsidiaries, branches, associates and strategic investments as well as capital instruments denominated in currencies other than Hong Kong dollars. Non-structural exposures

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arise primarily from trading positions and balance sheet management activities. Non-structural exposures can arise and change rapidly. Foreign currency exposures are managed in accordance with the group's risk management policies and procedures.

The group had the following structural foreign currency exposures which exceeded 10 per cent of the total net structural exposure in all foreign currencies:

| Figures in HK\$m | Net structural position |
|-----------------------|-------------------------|
| At 31Dec06 | |
| Chinese renminbi | 54,960 |
| United States dollars | 15,886 |
| At 31Dec05 | |
| Chinese renminbi | 32,510 |
| Indian rupees | 7,979 |
| United States dollars | 11,780 |

The increase in the Chinese renminbi structural position during 2006 was largely attributable to the rise in the market value of the group's shareholding in Ping An Insurance. The Indian rupee exposure fell to below 10 per cent of the group's total foreign currency structural exposure following the disposal of shares in UTI Bank.

The group had the following non-structural foreign currency positions which exceeded 10 per cent of the group's net non-structural positions in all foreign currencies:

| Figures in HK\$m | United States dollars | Singapore dollars | Brunei dollars |
|----------------------|--------------------------|----------------------|-------------------|
| At 31Dec06 | | | |
| Spot assets | 1,205,314 | 118,964 | 27,665 |
| Spot liabilities | (1,222,334) | (140,566) | (107) |
| Forward purchases | 2,222,005 | 168,534 | 24,949 |
| Forward sales | (2,210,290) | (141,505) | (57,857) |
| Net options position | (132) | - | - |
| | (5,437) | 5,427 | (5,350) |
| At 31Dec05 | | | |
| Spot assets | 1,229,340 | 107,578 | 5,523 |
| Spot liabilities | (1,188,737) | (90,549) | (18,062) |
| Forward purchases | 1,507,086 | 157,007 | 43 |
| Forward sales | (1,558,902) | (161,647) | - |
| Net options position | 3,361 | - | - |
| | (7,852) | 12,389 | (12,496) |

26. Segmental analysis

The allocation of earnings reflects the benefits 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. Interest is charged based on market rates. Common costs are included in segments on the basis of the actual recharges made. Geographical information has been classified by the location of the principal operations of the subsidiary company or, in the case of the bank, by the location of the branch responsible for reporting the results or advancing

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the funds. Due to the nature of the group structure, the analysis of profits shown below includes intra-group items between geographical regions with the elimination shown in a separate column.

Consolidated income statement

| Figures in HK\$m | Hong Kong | Rest of Asia-Pacific | Americas/ Europe | I se elimin |
|--|-----------|-------------------------|---------------------|-------------------|
| Year ended 31Dec06 | | | | |
| Interest income | 82,301 | 40,151 | 884 | (|
| Interest expense | (46,490) | (24,960) | (804) | |
| Net interest income | 35,811 | 15,191 | 80 | |
| Fee income | 17,347 | 9,925 | - | |
| Fee expense | (3,030) | (1,826) | (12) | |
| Net trading income/(loss) | 3,077 | 5,871 | (13) | |
| Net income from financial instruments designated at fair value | 2,048 | 622 | - | |
| Gains less losses from financial investments | 1,245 | 221 | - | |
| Dividend income | 525 | 224 | - | |
| Net earned insurance premiums | 20,495 | 1,351 | - | |
| Other operating income | 6,171 | 2,073 | 22 | (|
| Total operating income | 83,689 | 33,652 | 77 | (|
| Net insurance claims incurred and movement in policyholders' liabilities | (20,991) | (1,489) | - | |
| Net operating income before loan impairment charges and other credit risk provisions | 62,698 | 32,163 | 77 | (|
| Loan impairment charges and other credit risk provisions | (1,336) | (3,473) | - | |
| Net operating income | 61,362 | 28,690 | 77 | (|
| Operating expenses | (23,534) | (17,287) | (31) | |
| Operating profit | 37,828 | 11,403 | 46 | |
| Share of profit in associates and joint venture | 150 | 2,589 | - | |
| Profit before tax | 37,978 | 13,992 | 46 | |
| Tax expense | (6,079) | (3,317) | (15) | |
| Profit for the year | 31,899 | 10,675 | 31 | |
| Profit attributable to shareholders | 27,206 | 10,472 | 31 | |
| Profit attributable to minority interests | 4,693 | 203 | - | |
| Year ended 31Dec05 | | | | |
| Interest income | 55,139 | 29,613 | 529 | (|
| Interest expense | (24,149) | (17,336) | (305) | |
| Net interest income | 30,990 | 12,277 | 224 | |
| Fee income | 14,237 | 7,921 | 2 | |
| Fee expense | (2,252) | (1,803) | (8) | |
| Net trading income/(loss) | 3,152 | 4,198 | (170) | |
| Net income/(loss) from financial instruments designated at fair value | (69) | 453 | - | |
| Gains less losses from financial | | | | |

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| | | | |
|--|----------|----------|------|
| investments | 714 | 42 | - |
| Dividend income | 350 | 18 | - |
| Net earned insurance premiums | 18,140 | 1,200 | - |
| Other operating income | 6,480 | 1,131 | 22 |
| Total operating income | 71,742 | 25,437 | 70 |
| Net insurance claims incurred and movement in policyholders' liabilities | (16,002) | (1,289) | - |
| Net operating income before loan impairment charges and other credit risk provisions | 55,740 | 24,148 | 70 |
| Loan impairment charges and other credit risk provisions | (1,161) | (915) | 12 |
| Net operating income | 54,579 | 23,233 | 82 |
| Operating expenses | (20,514) | (13,998) | (38) |
| Operating profit | 34,065 | 9,235 | 44 |
| Share of profit in associates and joint venture | 178 | 1,727 | - |
| Profit before tax | 34,243 | 10,962 | 44 |
| Tax expense | (5,411) | (2,634) | (6) |
| Profit for the year | 28,832 | 8,328 | 38 |
| Profit attributable to shareholders | 24,644 | 8,191 | 38 |
| Profit attributable to minority interests | 4,188 | 137 | - |

27. Capital adequacy

The table below sets out an analysis of regulatory capital and capital adequacy ratios for the group:

| Figures in HK\$m | At 31Dec06 | At 31Dec05 |
|--|------------|------------|
| Composition of capital | | |
| Tier 1: | | |
| Total shareholders' equity | 145,450 | 97,334 |
| Less: proposed dividend | (6,500) | (4,500) |
| property revaluation reserves^ | (7,892) | (7,892) |
| available-for-sale investment reserve^^ | (26,028) | (3,051) |
| classified as regulatory reserve^^^ | (1,689) | (1,319) |
| goodwill | (4,182) | (3,784) |
| others | (138) | 1,769 |
| Irredeemable non-cumulative preference shares | 51,735 | 51,587 |
| Minority interests^^^^ | 17,483 | 14,808 |
| Total qualifying tier 1 capital | 168,239 | 144,952 |
| Tier 2: | | |
| Property revaluation reserves (@70%) | 5,524 | 5,524 |
| Available-for-sale investment reserve (@70%) | 18,220 | 2,136 |
| Collective impairment provision and regulatory reserve | 6,610 | 5,112 |
| Perpetual subordinated debt | 9,370 | 9,359 |
| Term subordinated debt | 9,849 | 6,117 |
| Term preference shares | 8,165 | 3,877 |
| Irredeemable cumulative preference shares | 16,563 | 16,516 |
| Total qualifying tier 2 capital | 74,301 | 48,641 |
| Deductions | (58,559) | (39,528) |
| Total capital | 183,981 | 154,065 |
| Risk-weighted assets | 1,367,607 | 1,238,164 |

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- ^ Includes the revaluation surplus on investment properties, which is now reported as part of retained profits.
- ^^ Includes adjustments made in accordance with guidelines issued by HKMA.
- ^^^ The regulatory reserve is maintained for the purpose of satisfying the Banking Ordinance for prudential supervision. Movements in this reserve are made in consultation with the HKMA.
- ^^^^ After deduction of minority interests in unconsolidated subsidiary companies.

The group's capital adequacy ratios adjusted for market risks calculated in accordance with the HKMA Guideline on 'Maintenance of Adequate Capital Against Market Risks' are as follows:

| | At 31Dec06 | At 31Dec05 |
|----------------|------------|------------|
| Total capital | 13.5% | 12.4% |
| Tier 1 capital | 12.3% | 11.7% |

The group's capital adequacy ratios calculated in accordance with the provisions of the Third Schedule of the Banking Ordinance, which does not take into account market risks, are as follows:

| | | |
|----------------|-------|-------|
| Total capital | 13.0% | 12.0% |
| Tier 1 capital | 11.8% | 11.2% |

With effect from 1 January 2007, the group has adopted the 'standardised approach' of capital calculation under the HKMA 'Banking (Capital) Rules'.

The increase in the group's total capital ratio at 31 December 2006 reflects additional capital raised in anticipation of different capital requirements under the new rules.

28. Liquidity ratio

The Hong Kong Banking Ordinance requires banks operating in Hong Kong to maintain a minimum liquidity ratio of 25 per cent, calculated in accordance with the provisions of the Fourth Schedule of the Banking Ordinance. This requirement applies separately to the Hong Kong branches of the bank and to those subsidiary companies which are Authorised Institutions under the Banking Ordinance in Hong Kong.

| | 2006 | 2005 |
|--|-------|-------|
| The average liquidity ratio for the year was as follows: | | |
| Hong Kong branches of the bank | 49.3% | 48.2% |

29. Property revaluation

The group's premises and investment properties were revalued as at 30 September 2006 and updated for any material changes as at 31 December 2006. The basis of valuation was open market value or depreciated replacement cost.

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Premises and investment properties in the Hong Kong SAR, the Macau SAR and mainland China, which represent 95 per cent by value of the group's properties subject to valuation, were valued by DTZ Debenham Tie Leung Limited. The valuations were carried out by qualified valuers who are members of the Hong Kong Institute of Surveyors. Properties in 11 other countries, which represent five per cent by value of the group's properties, were valued by different independent professionally qualified valuers.

The September property revaluation, together with the revaluation of Hong Kong properties undertaken in June 2006, has resulted in an increase in the group's revaluation reserves of HK\$1,356 million, net of deferred taxation of HK\$383 million, and a credit to the income statement of HK\$389 million. Of the HK\$389 million credit to the income statement, HK\$319 million represents the surplus on the revaluation of investment properties and HK\$70 million relates to the reversal of previous revaluation deficits that had arisen when the value of certain premises fell below depreciated historical cost.

30. Accounting policies

The accounting policies applied in preparing this news release are the same as those applied in preparing the financial statements for the year ended 31 December 2005, as disclosed in the Annual Report and Accounts for 2005.

31. Statutory accounts

The information in this news release is not audited and does not constitute statutory accounts.

Certain financial information in this news release is extracted from the financial statements for the year ended 31 December 2006, which were approved by the Board of Directors on 5 March 2007 and will be delivered to the Registrar of Companies and the HKMA. The Auditors expressed an unqualified opinion on those financial statements in their report dated 5 March 2007. The Annual Report and Accounts for the year ended 31 December 2006, which include the financial statements, can be obtained on request from Group Public Affairs, The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong, and may be viewed on our website: www.hsbc.com.hk on or after 3 April 2007.

32. Ultimate holding company

The Hongkong and Shanghai Banking Corporation Limited is an indirectly held, wholly-owned subsidiary of HSBC Holdings plc.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HSBC Holdings plc

By:
Name: P A Stafford
Title: Assistant Group Secretary
Date: 05 March 2007