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2011

Interim Report

HSBC Bank plc

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Interim Report 2011

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Presentation of Information

This document comprises the Interim Report 2011 for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Interim Management Report and Condensed Financial Statements, together with the Auditor's review report, as required by the Financial Services Authority's ('FSA') Disclosure and Transparency Rules ('DTR'). References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Within the Interim Management Report, the group has presented income statement figures for the three most recent six month periods to illustrate the current performance compared to recent periods. This compares to the condensed financial statements and related notes, prepared in accordance with IAS 34, which include income statement year on year comparatives.

With effect from 1 March 2011, the Asset Management business was moved from Global Banking and Markets to Personal Financial Services which has been renamed 'Retail Banking and Wealth Management' within the UK Retail and Continental Europe Retail business segments. All periods have been adjusted accordingly.

Cautionary Statement Regarding Forward-Looking Statements

This Interim Report contains certain forward-looking statements with respect to the financial condition, results of operations and business of the group.

Certain statements that are not historical facts, including statements about the group's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or subsequent events.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement.

Interim Management Report: Financial Highlights

Reported profit before tax of £1,908 million was 32 per cent lower than the first half of 2010 but 57 per cent higher than that earned in the second half

Net operating income before impairments of £7,139 million was 15 per cent lower than the same period in 2010 primarily due to lower Balance Sheet Management revenues and lower levels of trading revenues in a challenging environment dominated by uncertainty around eurozone sovereign debt. Compared with the second half of 2010, net operating income before impairments was 6 per cent higher

Loan impairments and other credit risk provisions of £731 million were 22 per cent and 28 per cent lower than the first and second halves of 2010 respectively. The fall reflected improved delinquency trends, as a result of enhanced credit risk management practices, and the effects of the low interest rate environment

Total operating expenses of £4,495 million, impacted by a number of one-off items¹, decreased by 3 per cent compared with the first half of 2010. Adjusting for one-off items, operating expenses were 3 per cent higher than the first half of 2010 and broadly in line with the second half. A Europe wide review, initiated to improve cost efficiency and rationalise the business portfolio, resulted in restructuring costs of £56 million. These relate to operational efficiencies in the UK, the closure of the Russian retail business and impairment of software projects which have been deferred or cancelled. An acceleration in the expense recognition of deferred bonus awards also contributed to the increase

The group continued to focus on selected markets where it has scale and opportunities for growth, and to invest in strategic initiatives including the development of Prime Services and equity market capabilities and the expansion of the Rates and Foreign Exchange e-commerce platforms

The rise in the cost efficiency ratio of 63.0 per cent compared with 55.4 per cent in the first half of 2010 reflected a fall in revenue during the period. However, the cost efficiency ratio improved when compared with the second half of 2010, as the group took action to control discretionary spend and make sustainable cost saves

Growth in loans and advances to customers of 9 per cent during 2011 broadly matched the growth in customer accounts. The ratio of customer advances to customer accounts at 30 June 2011 was 83.8 per cent

¹ One-off items in the first half of 2011 comprise £332 million of provisions relating to customer redress programmes, offset by a credit of £360 million relating to a legislative change in the indexation of UK pensions from the Retail Prices Index to the Consumer Prices Index for deferred members. The first half of 2010 included one-off payroll and bonus taxes of £245 million in the UK and France

Financial Highlights of the group

	Half-year to		
	30 June 2011	30 June 2010	31 December 2010
For the period (£m)			
Profit before tax	1,908	2,795	1,216
Total operating income	8,685	9,635	8,464
Net operating income before loan impairment charges and other credit risk provisions	7,139	8,360	6,716
Profit attributable to shareholders of the parent company	1,407	2,002	957
At period end (£m)			
Shareholders' funds of the parent company	31,984	30,278	31,825
Risk-weighted assets	201,865	205,161	201,720
Loans and advances to customers (net of impairment allowances)	311,290	277,024	285,218
Customer accounts	371,527	345,425	344,123
Ratio of customer advances to customer accounts	83.8	80.2	82.9
Capital ratios			
Core Tier 1 ratio	10.5	10.0	10.5
Tier 1 ratio	11.4	10.9	11.4
Total capital ratio	16.0	15.3	16.1
Performance and efficiency ratios (annualised %)			
Return on average shareholders' funds (equity) of the parent company	9.0	13.8	6.4
Cost efficiency ratio	63.0	55.4	66.9

Interim Management Report: Operating and Financial Review

Reconciliation of reported and underlying profit before tax

The group measures its performance internally on a like-for-like basis by eliminating acquisitions and disposals of subsidiaries and businesses, and fair value movement on own debt designated at fair value attributable to credit spreads where the net result of such movements will be zero upon maturity of the debt, all of which distort period-on-period comparisons. The group refers to the adjusted performance measure as its underlying performance.

Reported results include the effects of the above items. They are excluded when monitoring progress against operating plans and previous period results because management believes that the underlying basis more accurately reflects operating performance.

Underlying performance

The tables below compare the group's underlying performance for the half year to 30 June 2011 with the half years to 30 June 2010 and 31 December 2010.

The following items comprise the underlying adjustments:

- the change in own credit spread on long-term debt which resulted in a £11 million loss in the first half of 2011 compared with a gain of £108 million for the first half of 2010 and a loss of £230 million for the second half of 2010 in *Net income/(expense) from financial instruments designated at fair value*
- adjustments across various lines in both halves of 2010 for the disposal of Eversholt Rail Group, reflecting a loss of £56 million in the first half of 2010 and a profit of £7 million in the second half, together with the gain on disposal of £163 million in December 2010 in *Other operating income*, and
- adjustments across various lines in the first half of 2010 for the disposal of the Insurance Brokers business reflecting a loss of £16 million in the first half of 2010 together with the gain on disposal of £83 million in April 2010 in *Other operating income*

Reconciliation of reported and underlying profit before tax

Half year to 30 June 2011 ('1H11') compared with half year to 30 June 2010 ('1H10')								
	1H10 reported £m	1H10 adjust- ments	1H10 underlying £m	1H11 reported £m	1H11 adjust- ments	1H11 underlying £m	Reported change per cent	Underlying change per cent
Net interest income	3,984	11	3,995	3,622	-	3,622	(9%)	(9%)
Net fee income	2,050	(31)	2,019	1,966	-	1,966	(4%)	(3%)
Net trading income	1,498	-	1,498	1,379	-	1,379	(8%)	(8%)
Net income/(expense) from financial instruments designated at fair value	(5)	(108)	(113)	(70)	11	(59)	(1300%)	48%
Gains less losses from financial investments	221	-	221	128	-	128	(42%)	(42%)
Net earned insurance premiums	1,403	-	1,403	1,479	-	1,479	5%	5%
Other operating income	484	(99)	385	181	-	181	(63%)	(53%)
Net insurance claims incurred and movement in liabilities to policyholders	(1,275)	-	(1,275)	(1,546)	-	(1,546)	(21%)	(21%)
Net operating income before loan impairment charges and other credit risk provisions	8,360	(227)	8,133	7,139	11	7,150	(15%)	(12%)
Loan impairment charges and other credit risk provisions	(940)	-	(940)	(731)	-	(731)	22%	22%
Net operating income	7,420	(227)	7,193	6,408	11	6,419	(14%)	(11%)
Total operating expenses	(4,629)	108	(4,521)	(4,495)	-	(4,495)	3%	1%
Operating profit	2,791	(119)	2,672	1,913	11	1,924	(31%)	(28%)
Share of (loss)/profit in associates and joint ventures	4	-	4	(5)	-	(5)	-	-
Profit before tax	2,795	(119)	2,676	1,908	11	1,919	(32%)	(28%)

Interim Management Report: Operating and Financial Review (continued)

	Half year to 30 June 2011 ('1H11') compared with half year to 31 December 2010 ('2H10')							
	2H10 reported £m	2H10 adjust- ments	2H10 underlying £m	1H11 reported £m	1H11 adjust- ments	1H11 underlying £m	Reported change per cent	Underlying change per cent
Net interest income	3,710	20	3,730	3,622	-	3,622	(2%)	(3%)
Net fee income	1,990	-	1,990	1,966	-	1,966	(1%)	(1%)
Net trading income	619	-	619	1,379	-	1,379	123%	123%
Net income/(expense) from financial instruments designated at fair value	281	230	511	(70)	11	(59)	-	-
Gains less losses from financial investments	316	-	316	128	-	128	(59%)	(59%)
Net earned insurance premiums	1,232	-	1,232	1,479	-	1,479	20%	20%
Other operating income	316	(234)	82	181	-	181	(43%)	121%
Net insurance claims incurred and movement in liabilities to policyholders	(1,748)	-	(1,748)	(1,546)	-	(1,546)	12%	12%
Net operating income before loan impairment charges and other credit risk provisions	6,716	16	6,732	7,139	11	7,150	6%	6%
Loan impairment charges and other credit risk provisions	(1,011)	-	(1,011)	(731)	-	(731)	28%	28%
Net operating income	5,705	16	5,721	6,408	11	6,419	12%	12%
Total operating expenses	(4,490)	49	(4,441)	(4,495)	-	(4,495)	-	(1%)
Operating profit	1,215	65	1,280	1,913	11	1,924	57%	50%
Share of (loss)/profit in associates and joint ventures	1	-	1	(5)	-	(5)	-	-
Profit before tax	1,216	65	1,281	1,908	11	1,919	57%	50%

Interim Management Report: Operating and Financial Review (continued)**Financial summary****Summary consolidated income statement**

	Half year to		
	30 June 2011 £m	30 June 2010 £m	31 December 2010 £m
Net interest income	3,622	3,984	3,710
Net fee income	1,966	2,050	1,990
Net trading income	1,379	1,498	619
Net (expense)/ income from financial instruments designated at fair value	(70)	(5)	281
Gains less losses from financial investments	128	221	316
Net earned insurance premiums	1,479	1,403	1,232
Other operating income	181	484	316
Total operating income	8,685	9,635	8,464
Net insurance claims incurred and movement in liabilities to policyholders	(1,546)	(1,275)	(1,748)
Net operating income before loan impairment charges and other credit risk provisions	7,139	8,360	6,716
Loan impairment charges and other credit risk provisions	(731)	(940)	(1,011)
Net operating income	6,408	7,420	5,705
Total operating expenses	(4,495)	(4,629)	(4,490)
Operating profit	1,913	2,791	1,215
Share of (loss)/ profit in associates and joint ventures	(5)	4	1
Profit before tax	1,908	2,795	1,216
Tax expense	(473)	(759)	(237)
Profit for the period	1,435	2,036	979
Profit attributable to shareholders of the parent company	1,407	2,002	957
Profit attributable to non-controlling interests	28	34	22

Economic briefing

The UK's economic recovery remained lacklustre in the first half of 2011. In the first quarter, the level of real Gross Domestic Product ('GDP') rose by 0.5 per cent, having fallen by 0.5 per cent in the previous quarter. The unemployment rate edged down to 7.7 per cent in the three months to April, as modest job shedding in the public sector, in reaction to ongoing fiscal austerity, was offset by job gains in the private sector. The level of turnover in the housing market remained subdued. The Bank of England left interest rates unchanged at 0.5 per cent and the Asset Purchase Facility remained steady at £200 billion. Consumer Prices Index ('CPI') inflation was well above the Bank of England's 2 per cent target throughout the period, reaching 4.5 per cent in May, partly from the rise in VAT at the start of the year and increases in commodity prices.

The eurozone recovery continued to be uneven with the majority of countries in the north of the region demonstrating strong growth while economies in the south, particularly those focused on fiscal consolidation, saw more modest levels of activity. In part because of rising commodity prices, eurozone inflation rose above the European Central Bank's ('ECB') target, reaching 2.7 per cent in June, and the ECB started to tighten monetary policy, raising the refi rate in April and July taking it to 1.5 per cent. For certain countries, particularly Greece, concerns in sovereign bond markets intensified. As it became clear that Greece would be unable to return to the private capital markets in the first half of 2012, the eurozone heads of state arranged for further medium-term financial assistance to be provided to the country.

Review of business performance

Reported pre-tax profits in the first half of 2011 were £1,908 million, a decrease of 32 per cent compared with the first half of 2010 and an increase of 57 per cent compared with the second half of 2010. On an underlying basis, pre-tax profits

Interim Management Report: Operating and Financial Review (continued)

in the first half of 2011 were 28 per cent lower than the first half of 2010 but 50 per cent higher than the second half of 2010

The commentary that follows relates to underlying performance

Profit before tax of £1,919 million was £757 million or 28 per cent lower than the first half of 2010, but £638 million or 50 per cent higher than the second half of 2010. UK Retail Banking and Continental Europe Retail Banking both recorded an increase in underlying profit before tax when compared against both halves of 2010. Global Banking and Markets and Private Banking profit before tax was lower than the first half of 2010, but increased when compared with the second half of 2010. The following commentary compares the first half of 2011 with the first half of 2010, except where stated

Net interest income fell by 9 per cent, due to lower Balance Sheet Management revenues as higher yielding positions matured and the opportunity for reinvestment was limited by the prevailing low interest rate environment. The fall in net interest income in Global Banking and Markets was partially offset by increases in the other business segments. UK Retail benefited from growth in mortgage lending to personal customers and a net increase in advances in corporate lending together with a widening of asset margins. Continental Europe Retail benefited from the combination of an increase in lending volumes and a widening of liability spreads in a number of countries.

Net fee income decreased by 3 per cent, due to lower fee income for management services provided by the bank for its securities investments conduits in Global Banking and Markets. This was partially offset by an increase in fees relating to higher levels of assets under management in Continental Europe Retail. Additionally, UK Retail income grew as a result of higher fee income from domestic and international payments flows.

Trading income fell by 8 per cent impacted by lower fair value gains on structured liabilities as credit spreads widened to a lesser extent than in the first half of 2010. Foreign Exchange revenues fell as increasing competition resulted in lower margins. Credit trading revenues were impacted by the re-emergence of European sovereign debt concerns in the second quarter of 2011 which resulted in a reduction in client activity and a general widening of credit spreads.

These were partly offset by higher revenues in Equities as improved competitive positioning helped capture increasing client flows, particularly during the global rally in the first quarter of 2011. In Global Banking, lower mark-to-market losses were reported in Portfolio Management. Trading income also included the offset to foreign exchange movements on foreign currency debt designated at fair value, reported in '*Net income from financial instruments designated at fair value*'. This resulted in a favourable variance in net trading income as a result of movements on assets held as economic hedges of foreign currency debt. *Gains less losses from financial investments* were 42 per cent lower than in the first half of 2010 driven by lower gains on disposals of debt securities in Balance Sheet Management. In addition, lower levels of gains arose on the disposal of private equity investments.

Gains less losses from financial investments were 42 per cent lower than in the first half of 2010 driven by lower gains on disposals of debt securities in Balance Sheet Management. In addition, lower levels of gains arose on the disposal of private equity investments.

Net earned insurance premiums increased by 5 per cent driven by savings sales campaigns in the personal sector in France, and higher Onshore Investment Bond sales and pensions in the UK. This growth was partially offset by a reduction in premiums resulting from the non-renewal and transfer to third parties of certain contracts in the group's Irish business, and the run off of the legacy motor book in the UK.

Other operating income decreased by 53 per cent as fair value losses on own debt were recognised in the first half of 2011, compared to gains in the prior period and also by the non-recurrence of a gain on the sale and leaseback of the Paris headquarters in the first half of 2010. These were partly offset by a change in methodology used in the recognition of insurance revenues.

Net insurance claims incurred and movement in liabilities to policyholders increased by 21 per cent driven by higher investment gains compared to losses in the first half of 2010. In addition, policyholders' liabilities increased reflecting new business written, consistent with net earned insurance premiums.

Loan impairment charges and other credit risk provisions decreased by 22 per cent reflecting an improved credit environment in the region and successful risk mitigation by management. In the UK and Continental Europe personal businesses, lower loan impairment charges were driven by improved delinquency rates across both the secured and unsecured lending portfolios as a result of better collection capabilities, enhanced credit risk management practices and the continued low interest rate environment. In Commercial Banking, loan impairments declined in the UK but were higher in Continental Europe due to impairments against a small number of customer exposures. Additionally, in the first half of 2011 an impairment of £65 million was recorded in respect of available-for-sale Greek sovereign debt.

Interim Management Report: Operating and Financial Review (continued)

Total operating expenses in the first half of 2011 included £332 million of provisions relating to customer redress programmes, including a provision in respect of the adverse judgement in the judicial review relating to sales of Payment Protection Insurance ('PPI') in the UK, offset by a credit of £360 million relating to a legislative change in the indexation of UK pensions from RPI to CPI for deferred members. The first half of 2010 included one-off payroll and bonus taxes of £245 million in the UK and France.

Excluding these items, operating expenses increased by 3 per cent, reflecting an acceleration in the expense recognition of deferred bonus awards and continued investment in business platforms to deliver revenue growth and improve process automation in light of increasing competition and challenging regulatory requirements. This included continued investment in strategic initiatives in Global Banking and Markets, including the development of Prime Services and equities market capabilities and the expansion of Rates and Foreign Exchange e-commerce platforms.

In order to improve cost efficiency and effectiveness, a review was initiated during the period which resulted in restructuring costs of £56 million, which included impairments on certain software projects which have now been deferred or cancelled. The group announced the closure of its Russian and Polish retail businesses and initiatives to improve operational efficiency in France and the UK. The group continued to monitor its portfolio against strict targets and keep its cost base under review.

Interim Management Report: Operating and Financial Review (continued)

Balance sheet commentary

	At 30 June 2011 £m	At 31 December 2010 £m
Total assets	857,288	798,494
Cash and balances at central banks	16,334	24,495
Trading assets	199,666	159,552
Financial assets designated at fair value	15,565	15,467
Derivative assets	123,823	129,158
Loans and advances to banks	60,687	57,027
Loans and advances to customers	311,290	285,218
Financial investments	103,181	102,086
Other	26,742	25,491
Total liabilities	824,760	766,137
Deposits by banks	42,148	48,287
Customer accounts	371,527	344,123
Trading liabilities	164,731	132,360
Financial liabilities designated at fair value	32,364	27,935
Derivative liabilities	123,952	129,204
Debt securities in issue	49,459	48,119
Liabilities under insurance contracts issued	18,204	17,116
Other	22,375	18,993
Total equity	32,528	32,357
Total shareholders' equity	31,984	31,825
Non-controlling interests	544	532

Total assets amounted to £857 billion, 7 per cent higher than at 31 December 2010, reflecting higher levels of secured lending in the UK, growth in commercial loans and a rise in trading assets to hedge client positions. The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts at 83.8 per cent (31 December 2010: 82.9 per cent). The group's Core tier 1 ratio remained stable at 10.5 per cent.

In terms of lending in the UK, the bank remains on track to achieve its lending goals under the Merlin Agreement, having made available total new facilities of £22.7 billion in the first half of 2011, compared with a full year target of £38.8 billion, with capacity to increase this to £44.1 billion if there is sufficient demand on commercial terms. For UK SMEs, the bank has provided gross new facilities of £5.6 billion compared with a goal of £11.7 billion for the full year, with committed capacity for additional facilities of at least £1.2 billion if required.

Assets

Cash and balances at central banks fell 33 per cent as less residual cash from daily operations was placed with the central banks.

Trading assets increased by 25 per cent. The growth was driven by a significant increase in settlement account balances, which vary considerably in proportion with the level of trading activity, together with higher reverse repo balances used to cover short positions. Holdings of debt securities also increased reflecting higher issuances, in our role as primary market maker, and customer demand for government and government agency debt securities.

Derivative assets reduced by 4 per cent. This resulted from a reduction in the fair value of interest rate contracts as the euro yield curve rose together with higher netting of contracts due to an increase in trading through clearing houses.

Loans and advances to banks grew by 6 per cent due to increased levels of reverse repo transactions with bank counterparties and an increase in settlement account balances.

Loans and advances to customers grew by 9 per cent through targeted commercial loans growth and continued growth in mortgage lending, particularly in the UK. Higher levels of reverse repo transactions with non bank counterparties also contributed to this increase.

Financial assets designated at fair value and *Financial investments* were in line with 31 December 2010.

Interim Management Report: Operating and Financial Review (continued)

Liabilities

Deposits by banks decreased by 13 per cent primarily due to lower levels of repo activity transacted with bank counterparties

Customer accounts were 8 per cent higher, driven by an overall increase in customer deposits in the UK, France and Private Banking. There was also an increase in repo balances and an increase in account balances which did not meet the accounting netting criteria

Trading liabilities increased by 24 per cent due to an increase in settlement account balances which vary in proportion to the volume of trading activity. Repo balances increased to finance a rise in client-driven trading positions. Short bond positions also rose, in line with the growth in the Rates portfolio

Financial liabilities designated at fair value rose by 16 per cent due to new debt issuances during the period

Derivative liabilities fell by 4 per cent. The derivative businesses are managed within market risk limits and, as a consequence, the decrease in the value of derivative liabilities broadly matched that of derivative assets

Debt securities in issue grew by 3 per cent due to new issuances during the period, partially offset by maturities

Liabilities under insurance contracts grew by 6 per cent. This resulted from higher levels of premium income in the period together with higher gains on unit-linked products as investment market values improved

Equity

Total shareholders' equity was broadly flat, as profits generated during the year were offset by repayment of capital securities (with equity characteristics) during the period. These repayments were replaced by the issue of perpetual subordinated debt

Challenges and uncertainties

All the group's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks. The group's risk management framework is detailed in full in the *Annual Report and Accounts 2010* in 'Report of the Directors: Risk' on pages 25 to 64

Challenges to business operations

The group is exposed to many types of operational risk, including fraudulent and other criminal activities, breakdowns in processes or procedures and systems failure or unavailability. The group is also subject to the risk of disruption to its business arising from events that are wholly or partly beyond its control. All of these risks also apply when the group relies on external suppliers or vendors to provide services to the group and its customers

Challenges to governance and internal control systems

Information security and the management of an increasingly complex operating infrastructure remain two of the key emerging operational risks that the group faces. The reliability and security of the group's information and technology infrastructure and customer databases, and its ability to combat internet fraud, are crucial to maintaining its banking applications and processes. Critical system failures, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the group's ability to serve its clients, breach regulations under which it operates and cause long-term damage to its business

Macro-economic and geopolitical

The group's earnings are affected by global and local economic and market conditions. The peripheral eurozone economies came under increasing pressure in the first half of 2011, the dominant concern being over the sustainability of their sovereign debt. In the US, the large budget deficit, growing customer indebtedness and failure to increase the Federal debt ceiling are generating concerns that this will have an impact on the US and global economy and the financial services sector

With unemployment remaining high and consumer confidence weak in developed markets, and amid signs of inflationary pressures in emerging markets, economic conditions remain fragile and volatile. The global economy will remain very volatile and subject to shocks and this could have an adverse effect on the group's results

Interim Management Report: Operating and Financial Review (continued)

In particular, the group may face challenges to its operations and operating model if the demand for borrowing from creditworthy customers diminishes if economic activity slows or remains subdued, European banks come under stress if the sovereign debt crisis increases the need to recapitalise parts of the sector, trade and capital flows contract as a result of protectionist measures being introduced in certain markets or on the emergence of geopolitical risks, the ability to borrow from other financial institutions or to engage in funding transactions is adversely affected by market disruption, for example in the event of contagion from stress in the eurozone sovereign and financial sectors, market developments depress consumer and business confidence

Macro-prudential and regulatory

Financial services providers face increasingly stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, the conduct of business, the structure of operations and the integrity of financial services delivery. Increased government intervention and control over financial institutions, together with measures to reduce systemic risk, may significantly alter the competitive landscape

Prudential measures aimed at increasing resilience in the financial system In July 2011 the European Commission published proposals to implement the Basel III capital and liquidity standards within Europe. The proposals for a new Regulation and Directive, collectively known as 'CRD IV', will incorporate the current Capital Requirements Directive including changes already introduced to increase weightings risk for the trading book and for re-securitisations (due to be implemented by the end of 2011) and new risk-based remuneration rules. The measures are subject to agreement by EU member state governments and the European Parliament, a process that could take 12 to 18 months

The Financial Stability Board and the Basel Committee are currently consulting on an approach to define Global Systemically Important Financial Institutions, introduce more rigorous oversight and co-ordinated assessment of their risks through international supervisory colleges, provide for higher levels of capital and liquidity resilience, and require mandatory recovery and resolution plans with institution-specific crisis co-operation agreements between cross-border crisis management groups. Final recommendations will be submitted to the G20 group of countries in November

The European Commission is expected to introduce legislative proposals, before the end of 2011, which will establish a cross-border crisis management framework encompassing recovery and resolution planning, early intervention tools, resolution tools including bridge banks, asset transfers and bail-in, resolution funds and the conditions under which resolution will be applied

Taxation of the financial sector the European Commission is actively considering specific taxes for the financial sector following a consultation in the first three months of 2011

Deposit Guarantee Schemes Directive new EU rules currently in negotiation propose that deposit guarantee schemes will be required to pre-fund a percentage of potentially guaranteed deposits after a transition period of 15 years. The finally agreed level of pre-funding is likely to be in the 0.5-1.5% range

Derivatives and central counterparties regulation measures have been introduced to give effect to the G20 commitments designed to reduce systemic risk and volatility relating to derivatives trading. The G20 agreed that all standardised over-the-counter ('OTC') derivatives were to be exchange traded where appropriate, reported to trade repositories and centrally cleared by the end of 2012. Higher capital requirements (under Basel III) will be imposed for bilateral (uncleared) transactions to incentivise the use of clearing. The European Commission proposals on central clearing and reporting of OTC derivatives launched in September 2010 are currently under negotiation. Exemptions for foreign exchange swaps and forwards are currently being considered

Markets in financial instruments the European Commission has conducted a major review of the Markets in Financial Instruments Directive ('MiFID') and formal legislative proposals are expected during 2011. This potentially extends the scope of MiFID beyond equities to other asset classes including bonds, exchange-traded funds and other equity-like and non-equity instruments. It also proposes giving additional powers to regulators to ban trading in products that are eligible to be cleared but for which no clearing arrangements are currently available

The UK Independent Commission on Banking ('ICB') published its Interim Report on 11 April 2011. The Commission's reform proposals could have wide ranging implications for the structure of the UK banking industry. In particular, the Commission is considering, inter alia, whether separation of the retail and investment banking operations, through the creation of a ring-fenced retail bank, could make banks more stable. The Commission is further considering whether the ring-fenced retail bank should be required to have a ratio of, at least, 10% equity capital to risk-weighted assets calculated under the Basel III agreement, together with a level of loss-absorbent (bail-inable) debt. Were separation required, given

Interim Management Report: Operating and Financial Review (continued)

the current legal frameworks, it is most likely that the ring-fenced retail bank would be spun-out from the existing UK incorporated universal bank

HSBC maintains that its existing model of universal banking, protected by geographic 'ring-fencing' through subsidiarisation, is already achieving the main goals pursued by the ICB. However, while the Commission will not publish its final recommendations until September 2011, there is a strong possibility that it could recommend changes to the UK banking sector which may require HSBC to make major changes to its corporate structure and business activities conducted in the UK through its major banking subsidiary, HSBC Bank plc. These changes would take an extended period to implement with a significant impact on costs to both implement the changes and run the ongoing operations as restructured. The nature, impact and timing of any such changes remains unclear, as is the effect of changes on the ratings afforded to the debt of HSBC Bank plc.

The Chancellor of the Exchequer has indicated that the UK Government endorses in principle the proposals for bail-inable debt and the ring-fencing of retail banking operations, but the Government is not bound to adopt the Commission's recommendations.

Implementation risks of regulatory change

The extensive programme of regulatory change carries significant implementation risks for authorities and industry participants alike.

Disparities in implementation many official measures are proposals in development and negotiation, and have yet to be enacted into regional and national legislation. Linked to this, some regulators are adopting or considering changes in applying existing rules relating to capital requirements. These processes could result in differing, fragmented and overlapping implementation around the world, leading to risks of regulatory arbitrage, a far from level competitive playing-field and increased compliance costs.

Timetable and market expectations while the Basel Committee has announced the timetable for its core proposals in Basel III, it remains uncertain how these and other measures will play out in practice. Meanwhile, market expectations will exert pressure on institutions to assess and effect compliance well in advance of official timetables.

Wider economic impact and unforeseen consequences while the conclusions of official and industry studies have diverged, the measures proposed will clearly impact on financial and economic activity in ways that cannot yet be clearly foreseen. For example, higher capital requirements may seriously restrict the availability of funds for lending to support economic recovery.

Credit Environment

The eurozone as a whole retained substantial economic and financial strength and demonstrated positive signs of economic recovery in the first half of 2011, despite the stresses from the financial crisis. However, the transfer of private sector liabilities to sovereign bodies which started after the 2007 financial crisis continued to put pressure on government balance sheets. The resulting fiscal imbalance in some industrialised economies led to intensified market concerns about sovereign credit risk in these countries.

In the first half of 2011, there were periods of significant market volatility in relation to the sovereign debt of a number of eurozone countries, notably Greece, Ireland, Portugal, Italy and Spain. Spreads on sovereign debt remained high and the lack of market access eventually resulted in Portugal joining Greece and Ireland in seeking bailout funding amounting to EUR78bn from the European Financial Stability Facility ('EFSF') and IMF in early April 2011. Political instability in Greece, Ireland and Portugal also exacerbated the situation and all three countries were downgraded by major credit rating agencies during the period. Italy and Spain made progress in implementing fiscal adjustments and banking reforms but still experienced volatility in credit spreads.

The group has managed its exposure to the affected countries closely during the period. The overall quality of the group's sovereign portfolio remained strong with most in-country and cross-border limits extended to countries with high grade internal credit risk ratings. The group regularly updates its assessment of higher risk countries and adjusts its risk appetite to reflect such changes.

Continuation of the positive loan impairment trend experienced in the first half of 2011 in the commercial and personal sectors remains sensitive to general economic activity, employment levels, interest rates and house prices.

Interim Management Report: Operating and Financial Review (continued)**Exposure to selected countries in the eurozone**

The table below summarises the group's exposures to governments and central banks of selected eurozone countries, and near/quasi-government agencies and banks domiciled in those countries

30 June 2011						
	Greece	Ireland	Italy	Portugal	Spain	Total
	£m	£m	£m	£m	£m	£m
Total						
Held for trading	431	607	2,132	287	1,169	4,626
Not held for trading	495	745	2,066	313	1,160	4,779
	926	1,352	4,198	600	2,329	9,405
Sovereign & Agencies						
Held for trading	431	136	1,886	234	194	2,881
Not held for trading	242	113	510	23	813	1,701
	673	249	2,396	257	1,007	4,582
Banks						
Held for trading	-	471	246	53	975	1,745
Not held for trading	253	632	1,556	290	347	3,078
	253	1,103	1,802	343	1,322	4,823
31 December 2010						
	Greece	Ireland	Italy	Portugal	Spain	Total
	£m	£m	£m	£m	£m	£m
Total						
Held for trading	890	745	1,305	90	1,360	4,390
Not held for trading	234	590	1,648	376	947	3,795
	1,124	1,335	2,953	466	2,307	8,185
Sovereign & Agencies						
Held for trading	525	60	1,157	20	432	2,194
Not held for trading	211	188	583	70	394	1,446
	736	248	1,740	90	826	3,640
Banks						
Held for trading	365	685	148	70	928	2,196
Not held for trading	23	402	1,065	306	553	2,349
	388	1,087	1,213	376	1,481	4,545

The category 'Held for trading' comprises trading assets. The category 'Not held for trading' comprises financial assets designated at fair value, derivatives, loans and advances to banks, loans and advances to customers and financial investments.

The countries presented were selected because during the period they exhibited levels of market volatility which exceeded other eurozone countries and demonstrated fiscal or political uncertainty which may persist through the second half of 2011. In addition, certain of these countries exhibit high levels of sovereign debt to GDP ratios and short to medium term concentration of those liabilities.

At 30 June 2011, the group's on-balance sheet exposure to the sovereign, agency and bank debt of Greece, Ireland, Italy, Portugal and Spain was £9,405 million. During the first half of 2011, an impairment charge of £65 million was recognised in respect of Greek sovereign, agency and bank exposures classified as available-for-sale debt securities, reflecting the further deterioration in Greece's fiscal position and the recently announced support measures.

The group has no significant net open positions in the credit default swap contracts of any eurozone countries above apart from Greece, where the group has net open protection against its Greek exposures on a net notional of £213 million (fair value £98 million).

Interim Management Report: Operating and Financial Review (continued)

Outlook

The bank expects global economic recovery to continue into the second half of the year, although at a modest pace. Fiscal austerity will continue to restrain activity in large parts of Europe and interest rates are expected to remain exceptionally low.

Eurozone GDP is expected to expand by 2.0 per cent in 2011, following growth of 1.7 per cent in 2010. The divergences in growth across the region, with the majority of countries in the north of the region expected to outperform those in the south, are expected to continue alongside ongoing strain in the peripheral sovereign debt markets.

The bank expects UK GDP to rise by 1.2 per cent in 2011, a deceleration from the 1.4 per cent growth seen in 2010. Despite the fall in sterling in recent years, export performance is unlikely to provide a major support to growth and domestic demand will continue to be restrained by limited growth in government expenditure.

In the second half of 2011, the bank expects that the ECB and eurozone countries will continue to focus on resolving intra-eurozone imbalances, rebuilding public finances, improving fiscal discipline, strengthening the banking system and managing cross-border risk. Concerns of contagion of the debt crisis in Greece, Portugal and Ireland to other peripheral countries, notably Italy and Spain, persist, causing the risk premium on most European countries to remain high.

Interim Management Report: Operating and Financial Review (continued)**Business segment discussion****Profit before tax**

	Half year to					
	30 June 2011 £m Reported	30 June 2010 £m Reported ¹	31 December 2010 £m Reported ¹	30 June 2011 £m Underlying	30 June 2010 £m Underlying ¹	31 December 2010 £m Underlying ¹
UK Retail Banking	843	651	670	843	598	675
Continental Europe Retail Banking	275	235	133	275	235	133
Global Banking and Markets	542	1,376	440	542	1,418	270
Private Banking	304	340	276	304	340	276
Other/Intersegment	(56)	193	(303)	(45)	85	(73)
	1,908	2,795	1,216	1,919	2,676	1,281

¹ Restated to reflect the transfer of the Asset Management business

UK Retail Banking

	Half year to		
	30 June 2011 £m	30 June 2010 ¹ £m	31 December 2010 ¹ £m
Net interest income	1,788	1,732	1,803
Net fee income	884	936	929
Net trading income	23	8	2
Other income	123	165	93
Net operating income before impairments and provisions	2,818	2,841	2,827
Loan impairment charges and other credit risk provisions	(404)	(616)	(606)
Net operating income	2,414	2,225	2,221
Total operating expenses	(1,567)	(1,576)	(1,552)
Operating profit	847	649	669
Share of (loss)/profit in associates and joint ventures	(4)	2	1
Profit before tax	843	651	670

¹ Restated to reflect the transfer of the Asset Management business

The above table is on a reported basis

Overview

UK Retail Banking reported a profit before tax of £843 million, 29 per cent higher than the first half of 2010 and 26 per cent higher than the second half of 2010

On an underlying basis (which adjusts for the UK Retail Banking element of the disposal of the Insurance Brokers business in April 2010) profit before tax showed an increase of 41 per cent. This was primarily as a result of significantly lower loan impairment charges in both the personal and commercial sectors as actions have been taken to improve collections performance, together with the change in mix of new business towards secured and away from unsecured lending. The continuing low interest rate environment in the UK has also allowed many customers to reduce debt levels.

For UK Retail Banking, the following items are significant in comparison of 2011's results against 2010

- provisions of £332 million in the first half of 2011, in respect of customer redress programmes including that estimated for the possible mis-selling of PPI policies in previous years, and
- an accounting gain of £292 million relating to the legislative change in indexation of certain pension liabilities in May 2011

In the personal sector, Premier and Advance attracted 39,000 and 24,000 new customers respectively as the business focused on building long term sustainable customer relationships and wealth management revenues with these customer

Interim Management Report: Operating and Financial Review (continued)

groups. The investment business continued to grow with HSBC World Selection assets under management increasing by 20 per cent in the period to total £2.4 billion.

The group's share of new UK residential mortgage lending in the first half of 2011 was 11 per cent, above the group's total market share of 5 per cent and its 9 per cent share of new lending achieved in 2010. The average loan to value ratio of this new lending was 53 per cent. Mortgage balances increased by 5 per cent to £68 billion in the period. The group continued to support the UK housing market during the first half of 2011, advancing funds to allow 42,000 customers to purchase properties, including 19,000 first time buyers.

In the commercial sector, the number of UK based customers using products to support international activity grew by 38 per cent year on year, with related income growing 16 per cent. The value of import and export transactions grew 16 per cent and 32 per cent respectively on prior year. UK Commercial Banking also launched a full service Renminbi proposition to support customers doing business in China.

Supporting UK based SME customers and commitment to the Merlin agreement remains a priority. Gross new lending to small businesses has risen by 20 per cent compared to the same period in 2010. Corporate lending is a key driver of growth and increased 55 per cent, bringing total gross new lending growth in the UK commercial sector to 39 per cent.

Financial performance

The commentary that follows is on an underlying basis, which adjusts for the UK Retail element of the Insurance Brokers business disposal. It does not adjust for the significant items detailed above.

Net interest income increased by £56 million or 3 per cent, mainly driven by growth in mortgage balances, commercial lending and wider asset margins. The group built on its strong deposit base, despite fierce competition for customer deposits.

Net fee income decreased by £28 million or 3 per cent, as income from overdraft fees reduced due to the portfolio mix continuing to move away from unsecured lending. This was partially offset by higher levels of fee income from domestic and international payments flows.

Other income increased by £23 million or 23 per cent primarily within wealth management as a result of a change in methodology used in the recognition of insurance revenues.

Loan impairment charges and other credit risk provisions decreased by £212 million or 34 per cent. In the personal sector, loan impairment charges decreased by £164 million due to lower levels of delinquencies across both the secured and unsecured portfolios as a result of actions taken to improve collections performance and improve the quality of new business booked, coupled with the effect of low interest rates. In Commercial Banking, despite raising specific impairment charges against a number of customer exposures, loan impairments were lower with improvements noted across the majority of industry sectors.

Given the weakened state of some commercial and consumer customers, continuing positive impairment trends remain sensitive to general economic activity, interest rates, employment levels and house prices.

Total operating expenses were broadly flat against prior year after adjusting for the accounting gain arising from the change in indexation of certain pension liabilities, offset by provisions for PPI and other customer redress programmes. Cost savings achieved by delivering sustainable long-term reductions in the cost base by re-engineering business processes, funded strategic investment in people and infrastructure to support customers.

Interim Management Report: Operating and Financial Review (continued)**Continental Europe Retail Banking**

	Half year to		
	30 June 2011 £m	30 June 2010 ¹ £m	31 December 2010 ¹ £m
Net interest income	886	853	876
Net fee income	383	335	350
Net trading income	15	14	7
Other income	11	13	(5)
Net operating income before impairments and provisions	1,295	1,215	1,228
Loan impairment charges and credit risk provisions	(73)	(80)	(114)
Net operating income	1,222	1,135	1,114
Total operating expenses	(947)	(900)	(981)
Operating profit	275	235	133
Share of profit in associates and joint ventures	-	-	-
Profit before tax	275	235	133

Profit before tax - by country

	30 June 2011 £m	30 June 2010 £m	31 December 2010 £m
France	155	111	66
Germany	38	24	20
Turkey	55	73	62
Malta	40	32	28
Russia	(29)	(15)	(14)
Other	16	10	(29)
Profit before tax	275	235	133

¹ Restated to reflect the transfer of the Asset Management business

The above tables are on a reported basis. There is no difference between reported and underlying performance.

Overview

Continental Europe Retail reported a profit before tax of £275 million, 17 per cent higher than the first half of 2010 and 107 per cent higher than the second half of 2010, driven by revenue growth and lower loan impairment charges.

In the personal sector, in line with HSBC strategy, investment is concentrated on growing wealth management and operations in countries with opportunities for scale. At the same time the group has commenced the process of rationalising the portfolio and exiting underperforming businesses. The closure of the personal operations in Russia was announced in April, for which a £20 million restructuring charge is included in the first half of 2011. In France and Malta, the strong franchises are being leveraged to accelerate growth in the wealth management business, whilst in Turkey the focus is increasingly on the mass affluent market and building on the strong credit card business.

Commercial Banking continued to focus on international and intra-HSBC connectivity. Investment in the region underpinned revenue growth of 11 per cent despite uneven eurozone recovery with countries in the north of the region demonstrating strong growth while economies in the south saw more modest levels of recovery. Growth was seen in trade finance, receivables finance and payments and cash management as companies looked to expand their businesses and manage working capital more efficiently.

Financial performance

The commentary that follows relates to underlying performance.

Net interest income increased by £33 million or 4 per cent. In Commercial Banking, net interest income was £51 million or 16 per cent higher than the first half of 2010 driven by a widening of liability spreads in Germany, Greece and Spain, which more than compensated for lower margins in Turkey. Lending volumes across the region grew by 17 per cent primarily in France, Germany and Turkey with the Czech Republic also contributing to the increase. In the personal sector, higher interest income from growth in liability balances and widening of spreads in France were more than offset

Interim Management Report: Operating and Financial Review (continued)

by a narrowing of asset margins in Turkey following the lowering of the government regulated cap on interest rates that can be charged on credit card balances

Net interest income was also adversely impacted by the decision by the Turkish Central Bank to increase the level of reserve requirements

Net fee income increased by £48 million or 14 per cent on the first half of 2010, primarily due to the fall in fees payable to insurance agents following the decision, taken in 2010, to wind down the Irish re-insurance business. In addition, higher management fees in asset management were driven by a 16 percent increase in the average value of funds under management

Other income was £2 million lower than the first half of 2010, mainly due to a £36 million reduction in insurance premiums from the winding down of the Ireland re-insurance business. This was partly offset by higher levels of net insurance income

Loan impairment charges and other credit risk provisions decreased by £7 million or 9 per cent compared with the first half of 2010. A significant fall in personal sector impairments reflected the continuing improvement in Turkey due to improved delinquency rates and enhanced credit risk management practices implemented in 2010. In addition, impairment against the consumer finance portfolios, which are in run-off in several countries, was also lower than the first half of 2010

In the commercial sector, an increase in impairment charges in the first half of 2011 reflected specific impairments taken in relation to a small number of clients in Greece and further impairments against a single exposure in Ireland. Partially offsetting these impairments were recoveries in Germany against two exposures

Credit risk provisions were raised against a small number of available-for-sale debt securities in the first half of 2011

Total operating expenses increased by £47 million or 5 per cent in the first half of 2011 which included a £20 million restructuring provision in Russia. Excluding this, cost growth of 3 per cent was driven mainly by inflationary pressures in Turkey and further investment in implementing the Commercial Banking strategy in Germany and Switzerland

Interim Management Report: Operating and Financial Review (continued)

Global Banking and Markets

	Half year to		
	30 June	30 June	31 December
	2011	2010 ¹	2010 ¹
	£m	£m	£m
Net interest income ²	692	1,087	824
Net fee income	316	457	363
Net trading income	1,166	1,321	390
Other income	3	341	571
Net operating income before impairments and provisions	2,177	3,206	2,148
Loan impairment charges and credit risk provisions	(234)	(237)	(281)
Net operating income	1,943	2,969	1,867
Total operating expenses	(1,400)	(1,595)	(1,427)
Operating profit	543	1,374	440
Share of (loss)/profit in associates and joint ventures	(1)	2	-
Profit before tax	542	1,376	440

Profit before tax - by country

	30 June	30 June	31 December
	2011	2010	2010
	£m	£m	£m
UK	216	923	299
France	172	254	(16)
Germany	56	66	49
Turkey	27	44	35
Other	71	89	73
Profit before tax	542	1,376	440

¹ Restated to reflect the transfer of the Asset Management business

² The bank's Balance Sheet Management business reported within Global Banking and Markets, provides funding to the trading businesses. To report Global Banking and Markets Trading income on a fully funded basis, Net interest income and Net trading income are grossed up to reflect internal funding transactions prior to their elimination in the Inter Segment column on Page 19

The above tables are on a reported basis

Overview

Global Banking and Markets reported a pre-tax profit of £542 million, 61 per cent lower than the first half of 2010 but £102 million or 23 per cent higher than the second half of 2010. On an underlying basis, profit before tax declined by 62 per cent against the first half of 2010.

Performance was impacted by lower revenues on the legacy Credit portfolio, along with lower income in a challenging trading environment dominated by uncertainty around eurozone sovereign debt. In addition, Balance Sheet Management revenues were lower as higher yielding positions matured and the opportunity for reinvestment was limited by the prevailing low interest rate environment.

In the UK, profit before tax was lower than in the first half of 2010 driven by lower fees from securities investment conduits, a reduction in effective yields and lower holdings of legacy assets in legacy Credit. Revenues in Balance Sheet Management declined while Rates was impacted by lower fair value gains on structured liabilities as credit spreads widened to a lesser extent than in the first half of 2010.

In France, revenues in Rates were impacted by the re-emergence of European sovereign debt concerns which resulted in a widening of spreads. This was compounded by lower fair value gains on structured liabilities.

Interim Management Report: Operating and Financial Review (continued)

Financial performance

The commentary that follows relates to underlying performance, adjusting for the Global Banking and Markets' element of the disposal of the Insurance Brokers business and the disposal of the Eversholt Rail Group

Net interest income decreased by £406 million or 37 per cent against the first half of 2010. Balance Sheet Management revenues were lower as higher yielding positions matured and the opportunity for reinvestment was limited by the prevailing low interest rate environment.

Net fee income decreased by £134 million or 30 per cent against the first half of 2010 due to lower fee income received for management services provided by the bank to its securities investment conduits together with lower fees from higher sales credits and brokerage costs paid.

Trading income was £155 million or 12 per cent lower than the first half of 2010. Lower favourable fair value movements were reported on structured liabilities as credit spreads widened to a lesser extent than in the first half of 2010, fair value gains were £80 million lower as a result. In addition, Foreign Exchange income was impacted by continued margin compression against the back-drop of increasing competition. Credit trading revenues were affected by a general widening of spreads due to the re-emergence of uncertainty in the eurozone in the second quarter of 2011.

These were partly offset by higher revenues in Equities, as improved competitive positioning helped capture increasing client flows, particularly during the global rally in the first quarter of 2011. In Global Banking, lower mark-to-market losses were reported in Portfolio Management. Trading income also included the offset to foreign exchange movements on foreign currency debt designated at fair value, reported in *Other income*. This resulted in a favourable variance in net trading income as a result of movements on assets held as economic hedges of foreign currency debt.

Other income decreased by £304 million or 99 per cent due to foreign exchange losses on debt designated at fair value with the offset reported in *Trading income*, together with lower disposal gains on available-for-sale securities in Balance Sheet Management and lower realisation gains in Principal Investments.

Loan impairment charges and other credit risk provisions were broadly in line with prior year.

Total operating expenses decreased by £123 million or 8 per cent due to the non recurrence of £234 million payroll taxes on certain 2009 bonus payments in the first half of 2010 coupled with an accounting gain of £68 million relating to the change in indexation of certain pension liabilities in the UK in the first half of 2011. Excluding these, the increase in operating expenses reflected investment in people and infrastructure to deliver revenue growth and improved process automation in light of increasing competition and changing regulatory demands. These strategic initiatives include the development of Prime Services and equity market capabilities together with the expansion of the Rates and Foreign Exchange e-commerce platforms which remain key to supporting the Global Banking and Markets customer focused strategy over the long term through enhanced competitive positioning.

Private Banking

	Half year to		
	30 June 2011 £m	30 June 2010 £m	31 December 2010 £m
Net interest income	379	351	373
Net fee income	355	330	320
Net trading income	115	136	117
Other income	16	19	3
Net operating income before impairments and provisions	865	836	813
Loan impairment charges and credit risk provisions	(20)	(7)	(10)
Net operating income	845	829	803
Total operating expenses	(541)	(489)	(527)
Operating profit	304	340	276
Share of profit in associates and joint ventures	-	-	-
Profit before tax	304	340	276

The above table is on a reported basis. There is no difference between reported and underlying performance.

Interim Management Report: Operating and Financial Review (continued)

Overview

Private Banking reported pre-tax profit of £304 million compared with £340 million in the first half of 2010, a decrease of 11 per cent, but 10 per cent higher than the £276 million reported in the second half of 2010. Revenue growth, driven by increased assets under management and client activity as client risk appetite increased, despite the uncertain economic environment, was more than offset by a rise in costs and impairment charges.

Private Banking continued to focus on recruitment of client facing staff to cover the faster growing, emerging markets and on delivering emerging markets products to clients in developed markets. Continued investment was made in front-office and client facing systems, whilst maintaining a focus on cost control and risk management.

Client assets, which include funds under management and cash deposits, increased to £199 billion from £186 billion at 31 December 2010 due to net new money inflows, together with favourable market and foreign exchange movements. Net new money continued to benefit from intra-group referrals and strong inflows from Asia and Latin America.

Financial performance

The commentary that follows relates to underlying performance.

Net interest income increased by £28 million or 8 per cent compared with the first half of 2010. Improved spreads on proprietary positions combined with increased customer loan demand, as market sentiment improved, drove this increase.

Net fee income increased by £25 million or 8 per cent compared with the first half of 2010. Increased transaction volumes, as client risk appetite increased, growth in average client assets under management, driven by net new money inflows of £6 billion, and the focus on faster growing markets resulted in higher net fee income.

Net trading income decreased by £21 million or 15 per cent in the first half of 2011 due to a lower volume of foreign exchange transactions.

Loan impairment charges and other credit risk provisions increased by £13 million compared to the first half of 2010, due to a provision on a Greek available-for-sale debt security.

Total operating expenses increased £52 million or 11 per cent compared with the first half of 2010, primarily driven by the strengthening of the Swiss Franc, in which a significant portion of the costs are incurred, relative to Sterling. Higher costs were incurred as a result of the developing regulatory environment, hiring of front office staff to cover faster growing markets and the acceleration in expense recognition for deferred bonus awards. In addition, the introduction of a cost saving program resulted in additional costs in the first half of 2011 the benefits of which will be seen in future reporting periods.

Other

	Half year to		
	30 June 2011 £m	30 June 2010 £m	31 December 2010 £m
Net interest income/(expense)	(49)	(32)	(68)
Net fee income/(expense)	28	(6)	26
Net trading income/(expense)	(23)	13	(21)
Other income/(expense)	35	283	(210)
Net operating income before impairments and provisions/(expense)	(9)	258	(273)
Loan impairment charges and credit risk provisions	-	-	-
Net operating income/(expense)	(9)	258	(273)
Total operating expenses	(47)	(65)	(30)
Operating profit/(loss)	(56)	193	(303)
Share of profit in associates and joint ventures	-	-	-
Profit/(loss) before tax	(56)	193	(303)

The above table is on a reported basis.

Interim Management Report: Operating and Financial Review (continued)

Reported loss before tax in Other was £56 million, compared with a profit of £193 million in the first half of 2010 and a loss of £303 million in the second half of 2010

Other includes

- the change in own credit spread on long-term debt which resulted in a £11 million loss in the first half of 2011 compared with a gain of £108 million for the first half of 2010 and a loss of £230 million in the second half of 2010, and
- the gain of £125 million on the sale and leaseback of the Paris headquarters building in the first half of 2010

Overall segmental analysis

	UK Retail £m	Continental Europe Retail £m	Global Banking and Markets £m	Private Banking £m	Other £m	Inter Segment £m	Total £m
Net Operating Income							
Half year to							
30 June 2011	2,414	1,222	1,943	845	(9)	(7)	6,408
30 June 2010 ¹	2,225	1,135	2,969	829	258	4	7,420
31 December 2010 ¹	2,221	1,114	1,867	803	(273)	(27)	5,705
Profit before tax							
Half year to							
30 June 2011	843	275	542	304	(56)	-	1,908
30 June 2010 ¹	651	235	1,376	340	193	-	2,795
31 December 2010 ¹	670	133	440	276	(303)	-	1,216

¹ With effect from 1 March 2011, the Asset Management business was moved from Global Banking and Markets to Personal Financial Services which has been renamed 'Retail Banking and Wealth Management' within the UK Retail and Continental Europe business segments. All periods have been adjusted accordingly.

Statement of Directors' Responsibilities

The Directors are required to prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group and bank have the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU,
- the interim management report includes a fair review of the information required by:
 - (a) DTR 4.2.7R of the Disclosure Rules and Transparency Rules, being an indication of important events that have occurred during the first six months of the financial year ending 31 December 2011 and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year, and
 - (b) DTR 4.2.8R of the Disclosure Rules and Transparency Rules, being related parties transactions that have taken place in the first six months of the financial year ending 31 December 2011 and that have materially affected the financial position or performance of the group during that period, and any changes in the related parties transactions described in the *Annual Report and Accounts 2010* that could do so.

A A Flockhart (Chairman), B Robertson (Chief Executive), P Y Antika (Non-Executive Director), P W Boyles (Director), J D Garner (Director), Dame Denise Holt (Independent Non-Executive Director), P J C Houzé (Independent Non-Executive Director), J W Leng (Non-Executive Director), Dame Mary Marsh (Independent Non-Executive Director), R E S Martin (Independent Non-Executive Director), A R D Monro-Davies (Independent Non-Executive Director), P M Shawyer (Independent Non-Executive Director), P A Thurston (Director), J F Trueman (Independent Non-Executive Director)



On behalf of the Board, A A Flockhart (Chairman)

1 August 2011

Condensed Financial Statements (unaudited)

Consolidated income statement for the half-year to 30 June 2011

	Half-year to	
	30 June 2011 £m	30 June 2010 £m
<i>Notes</i>		
Interest income	5,524	5,620
Interest expense	(1,902)	(1,636)
Net interest income	3,622	3,984
Fee income	2,657	2,666
Fee expense	(691)	(616)
Net fee income	1,966	2,050
Trading income excluding net interest income	885	1,016
Net interest income on trading activities	494	482
Net trading income	1,379	1,498
Net income/(expense) from financial instruments designated at fair value	(70)	(5)
Gains less losses from financial investments	128	221
Dividend income	10	11
Net earned insurance premiums	1,479	1,403
Other operating income	171	473
Total operating income	8,685	9,635
Net insurance claims incurred and movement in liabilities to policyholders	(1,546)	(1,275)
Net operating income before loan impairment charges and other credit risk provisions	7,139	8,360
Loan impairment charges and other credit risk provisions	4 (731)	(940)
Net operating income	6,408	7,420
Employee compensation and benefits	5 (2,165)	(2,648)
General and administrative expenses	(2,047)	(1,668)
Depreciation and impairment of property, plant and equipment	(182)	(232)
Amortisation and impairment of intangible assets	(101)	(81)
Total operating expenses	(4,495)	(4,629)
Operating profit	1,913	2,791
Share of (loss)/ profit in associates and joint ventures	(5)	4
Profit before tax	1,908	2,795
Tax expense	(473)	(759)
Profit for the period	1,435	2,036
Profit attributable to shareholders of the parent company	1,407	2,002
Profit attributable to non-controlling interests	28	34

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of comprehensive income for the half-year to 30 June 2011**

	Half-year to	
	30 June 2011 £m	30 June 2010 £m
Profit for the period	1,435	2,036
Other comprehensive income		
Available-for-sale investments		
– fair value gains	512	1,848
– fair value (gains)/losses transferred to income statement on disposal	(74)	57
– amounts transferred to the income statement in respect of impairment losses	176	443
– income taxes	72	(183)
Cash flow hedges		
– fair value gains	80	53
– fair value gains transferred to income statement	(163)	(21)
– income taxes	30	(16)
Actuarial gains/(losses) on defined benefit plans		
– before income taxes	71	221
– income taxes	(34)	(65)
Exchange differences and other	768	(1,149)
Other comprehensive income for the period, net of tax	1,438	1,188
Total comprehensive income for the period	2,873	3,224
Total comprehensive income for the period attributable to		
– shareholders of the parent company	2,836	3,218
– non-controlling interests	37	6
	2,873	3,224

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of financial position at 30 June 2011**

		At 30 June 2011 £m	At 31 December 2010 £m
	Notes		
ASSETS			
Cash and balances at central banks		16,334	24,495
Items in the course of collection from other banks		2,136	1,932
Trading assets	6	199,666	159,552
Financial assets designated at fair value	6	15,565	15,467
Derivatives	6	123,823	129,158
Loans and advances to banks	4,6	60,687	57,027
Loans and advances to customers	4,6	311,290	285,218
Financial investments	6	103,181	102,086
Other assets		6,474	6,118
Current tax assets		445	216
Prepayments and accrued income		3,713	3,568
Interests in associates and joint ventures		73	76
Goodwill and intangible assets		11,639	11,143
Property, plant and equipment		2,083	2,108
Deferred tax assets		179	330
Total assets		<u>857,288</u>	<u>798,494</u>
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	6	42,148	48,287
Customer accounts	6	371,527	344,123
Items in the course of transmission to other banks		1,456	1,411
Trading liabilities	6	164,731	132,360
Financial liabilities designated at fair value	6	32,364	27,935
Derivatives	6	123,952	129,204
Debt securities in issue	6	49,459	48,119
Other liabilities		6,053	4,860
Current tax liabilities		226	153
Liabilities under insurance contracts issued		18,204	17,116
Accruals and deferred income		3,839	3,950
Provisions		750	425
Deferred tax liabilities		31	54
Retirement benefit liabilities		289	733
Subordinated liabilities	6	9,731	7,407
Total liabilities		<u>824,760</u>	<u>766,137</u>
Equity			
Called up share capital		797	797
Share premium account		20,025	20,025
Other equity instruments		—	1,750
Other reserves		1,177	(220)
Retained earnings		9,985	9,473
Total shareholders' equity		<u>31,984</u>	<u>31,825</u>
Non-controlling interests		544	532
Total equity		<u>32,528</u>	<u>32,357</u>
Total equity and liabilities		<u>857,288</u>	<u>798,494</u>

A A Flockhart (Chairman)



1 August 2011

Condensed Financial Statements (unaudited) (continued)**Consolidated statement of cash flows for the half-year to 30 June 2011**

	Half-year to	
	30 June 2011 £m	30 June 2010 £m
Cash flows from operating activities		
Profit before tax	1,908	2,795
Adjustments for		
– non-cash items included in profit before tax	1,296	1,189
– change in operating assets	(27,390)	7,882
– change in operating liabilities	29,739	27,881
– elimination of exchange differences ¹	(1,531)	729
– net gain from investing activities	(144)	(435)
– share of losses/(profits) in associates and joint ventures	5	(4)
– contributions paid to defined benefit pension plans	(90)	(1,891)
– tax paid	(402)	(570)
Net cash generated from operating activities	3,391	37,576
Cash flows used in investing activities		
Purchase of financial investments	(41,207)	(37,507)
Proceeds from the sale and maturity of financial investments	39,643	27,504
Purchase of property, plant and equipment	(160)	(229)
Proceeds from the sale of property, plant and equipment	25	146
Purchase of intangible assets	(138)	(80)
Proceeds from the sale of intangible assets	2	–
Net cash outflow from acquisition of and increase in stake of associates	(2)	–
Net cash inflow from disposal of subsidiaries	–	123
Proceeds from disposal of associates	13	1
Purchase of HSBC Holdings plc shares to satisfy share-based payment transactions	(27)	–
Net cash used in investing activities	(1,851)	(10,042)
Cash flows used in financing activities		
Issue of preference share capital	–	25
Subordinated liabilities issued, net of perpetual subordinated debt classified as equity repaid	1,226	–
Subordinated liabilities repaid	(1,407)	(5)
Net cash outflow from change in stake of subsidiaries	–	(176)
Dividends paid to shareholders of the parent company	(974)	(918)
Dividends paid to non-controlling interests	(25)	(17)
Net cash used in financing activities	(1,180)	(1,091)
Net increase in cash and cash equivalents	360	26,443
Cash and cash equivalents at 1 January	86,005	60,806
Exchange differences in respect of cash and cash equivalents	2,175	(2,004)
Cash and cash equivalents at 30 June	88,540	85,245

¹ Adjustment to bring changes between opening and closing statement of financial position amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense

Condensed Financial Statements (unaudited) (continued)

Consolidated statement of changes in equity for the half-year to 30 June 2011

	Half-year to 30 June 2011									
	Other reserves									
	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Available- for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Total share- holders' equity £m	Non- controlling interests £m	Total equity £m
At 1 January 2011	797	20,025	1,750	9,473	(2,949)	190	2,539	31,825	532	32,357
Profit for the period	-	-	-	1,407	-	-	-	1,407	28	1,435
Other comprehensive income (net of tax)	-	-	-	38	689	(53)	755	1,429	9	1,438
Available-for-sale investments	-	-	-	-	689	-	-	689	(3)	686
Cash flow hedges	-	-	-	-	-	(53)	-	(53)	-	(53)
Actuarial gains/(losses) on defined benefit plans	-	-	-	38	-	-	-	38	(1)	37
Exchange differences and other	-	-	-	-	-	-	755	755	13	768
Total comprehensive income for the period	-	-	-	1,445	689	(53)	755	2,836	37	2,873
Dividends to shareholders	-	-	-	(974)	-	-	-	(974)	(25)	(999)
Net impact of equity-settled share-based payments	-	-	-	38	-	-	-	38	-	38
Repayment of capital securities ¹	-	-	(1,750)	(6)	-	-	-	(1,756)	-	(1,756)
Other movements	-	-	-	(7)	3	-	3	(1)	-	(1)
Tax on items taken directly to equity	-	-	-	16	-	-	-	16	-	16
At 30 June 2011	797	20,025	-	9,985	(2,257)	137	3,297	31,984	544	32,528

1 In March 2011 the bank repaid to HSBC Holdings plc £1 750 million of perpetual subordinated debt. At the same time the bank issued US dollar denominated perpetual subordinated debt of \$2,862 million to HSBC Holdings plc which is included in 'Subordinated liabilities'. See Note 9 for further details.

Condensed Financial Statements (unaudited) (continued)

Half-year to 30 June 2010											
	Other reserves										
	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Total shareholders' equity ¹ £m	Non-controlling interests £m	Total equity £m	
At 1 January 2010	797	20,025	1,750	8,134	(5,911)	351	2,641	27,787	641	28,428	
Profit for the period	-	-	-	2,002	-	-	-	2,002	34	2,036	
Other comprehensive income (net of tax)	-	-	-	161	2,165	16	(1,126)	1,216	(28)	1,188	
Available-for-sale investments	-	-	-	-	2,165	-	-	2,165	-	2,165	
Cash flow hedges	-	-	-	-	-	16	-	16	-	16	
Actuarial gains/(losses) on defined benefit plans	-	-	-	161	-	-	-	161	(5)	156	
Exchange differences and other	-	-	-	-	-	-	(1,126)	(1,126)	(23)	(1,149)	
Total comprehensive income for the period	-	-	-	2,163	2,165	16	(1,126)	3,218	6	3,224	
Dividends to shareholders	-	-	-	(918)	-	-	-	(918)	(17)	(935)	
Net impact of equity-settled share-based payments	-	-	-	197	-	-	-	197	-	197	
Other movements	-	-	-	1	-	-	-	1	8	9	
Change in ownership interest in subsidiaries that did not result in loss of control ¹	-	-	-	(27)	-	-	-	(27)	(149)	(176)	
Tax on items taken directly to equity	-	-	-	19	-	-	-	19	-	19	
At 30 June 2010	797	20,025	1,750	9,569	(3,746)	367	1,515	30,277	489	30,766	

¹ Relates to the purchase of non-controlling interests in HSBC Europe B V. See Note 9 for further details

Notes on the Condensed Financial Statements (unaudited)

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The interim consolidated financial statements of the group have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Services Authority and IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU')

The consolidated financial statements of the group at 31 December 2010 were prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards effective for the year ended 31 December 2010 affecting the consolidated financial statements at that date, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2010 were prepared in accordance with IFRSs as issued by the IASB.

At 30 June 2011, there were no unendorsed standards effective for the period ended 30 June 2011 affecting these interim consolidated financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee ('IFRIC') and its predecessor body. During the period ended 30 June 2011, the group adopted a number of interpretations and amendments to standards which had an insignificant effect on these interim consolidated financial statements.

(b) Comparative information

These interim consolidated financial statements include comparative information as required by IAS 34 and the UK Disclosure and Transparency Rules.

(c) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates, actual results in the future may differ from those reported. Management believes that the group's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, the impairment of available-for-sale financial assets and pensions. These critical accounting policies are described on pages 108 to 111 of the *Annual Report and Accounts 2010*.

(d) Consolidation

The interim consolidated financial statements of the group comprise the condensed financial statements of HSBC Bank plc and its subsidiaries. The method adopted by the group to consolidate its subsidiaries is described on page 90 of the *Annual Report and Accounts 2010*.

(e) Future accounting developments

At 30 June 2011, a number of standards and interpretations, and amendments thereto, had been issued by the IASB which are not yet effective for these consolidated financial statements, the most significant of which are described below. The IASB is continuing to work on projects on insurance, revenue recognition and lease accounting which, together with IFRS 9 and the standards described below, represent widespread and significant changes to accounting requirements from 2013.

IFRS 9 'Financial Instruments' was described on page 91 of the *Annual Report and Accounts 2010*, including the second and third phases in the IASB's project to replace IAS 39, which address the impairment of financial assets measured at amortised cost and hedge accounting. The IASB did not finalise the replacement of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders. As a consequence, the IASB is consulting on its proposal to change the effective date of IFRS 9 to 1 January 2015 to facilitate the adoption of the entire replacement of IAS 39. The EU is not expected to endorse IFRS 9 until the

Notes on the Condensed Financial Statements (unaudited) (continued)

completed standard is available. Therefore, the group remains unable to provide a date by which it plans to apply IFRS 9 and it remains impracticable to quantify the impact of IFRS 9 as at the date of publication of these financial statements.

Standards and Interpretations issued by the IASB but not endorsed by the EU

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements' ('IFRS 10'), IFRS 11 'Joint Arrangements' ('IFRS 11') and IFRS 12 'Disclosures of Interests in Other Entities' ('IFRS 12'). The standards are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are to be applied retrospectively.

Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on rights and obligations rather than legal form, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

The group is currently assessing the impact of these new IFRSs, but it is impracticable to quantify their impact as at the date of publication of these financial statements.

In May 2011, the IASB also issued IFRS 13 'Fair Value Measurement' ('IFRS 13'). The standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

The group is currently assessing the impact of this new IFRS but it is impracticable to quantify its effect as at the date of publication of these financial statements.

In June 2011, the IASB issued amendments to IAS 19 Employee Benefits ('IAS 19 revised'). The revised standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IAS 19 revised must be applied retrospectively.

The most significant amendment for the group is the replacement of interest cost and expected return on plan assets by a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement will be presented in other comprehensive income. The effect of this change is to increase the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

Based on an initial estimate of the impact of this particular amendment on the 2010 financial statements, the change would decrease pre-tax profit, with no effect on the pension liability. The effect on total operating expenses and pre-tax profit is not expected to be material. The effect at the date of adoption will depend on market interest rates and rates of return and the actual mix of scheme assets at that time.

(f) Changes in composition of the group

There were no material changes in the composition of the group in the period.

2 Accounting policies

The accounting policies adopted by the group for these interim consolidated financial statements are consistent with those described on pages 92 to 108 of the *Annual Report and Accounts 2010*, except as discussed in Note 1, 'Basis of preparation'. The methods of computation applied by the group for these interim consolidated financial statements are consistent with those applied for the *Annual Report and Accounts 2010*.

Notes on the Condensed Financial Statements (unaudited) (continued)**3 Dividends**

Dividends to shareholders of the parent company were as follows

	Half-year to 30 June 2011		Year to 31 December 2010	
	£ per share	Total £m	£ per share	Total £m
Dividends declared on ordinary shares				
In respect of previous year				
– second interim dividend	1 15	915	–	–
– third interim dividend	–	–	1 07	850
In respect of current year				
– first interim dividend	–	–	1 13	900
	<u>1 15</u>	<u>915</u>	<u>2 20</u>	<u>1 750</u>

Dividends on preference shares classified as equity

In the first half of 2011 no dividend was paid on the HSBC Bank plc non-cumulative third dollar preference shares (first half 2010 no dividend, second half 2010 £1 18 per share, totalling £41 million)

Interest on capital securities classified as equity

In the first half of 2011, £59 million interest on perpetual subordinated debt was paid at the sole and absolute discretion of the Board of Directors (first half 2010 £67 million, second half 2010 £10 million) In March 2011, the perpetual subordinated debt was repaid

4 Loan impairment charges and other credit risk provisions

	Half-year to	
	30 June 2011 £m	30 June 2010 £m
Total loans and advances		
– new allowances net of allowance releases	705	823
– recoveries of amounts previously written off	(173)	(75)
	<u>532</u>	<u>748</u>
Impairment charges on debt securities and other credit risk provisions	<u>199</u>	<u>192</u>
	<u>731</u>	<u>940</u>

Movement in impairment allowances on total loans and advances

	Individually assessed £m	Collectively assessed £m	Total £m
At 1 January 2011	2,298	1,282	3,580
Amounts written off	(355)	(658)	(1,013)
Recoveries of amounts previously written off	15	158	173
Charge to income statement	279	253	532
Exchange and other movements	19	(10)	9
At 30 June 2011	<u>2,256</u>	<u>1,025</u>	<u>3,281</u>
At 1 January 2010	2,369	1,280	3,649
Amounts written off	(164)	(460)	(624)
Recoveries of amounts previously written off	7	68	75
Charge to income statement	333	415	748
Exchange and other movements	(73)	(7)	(80)
At 30 June 2010	<u>2,472</u>	<u>1,296</u>	<u>3,768</u>

Notes on the Condensed Financial Statements (unaudited) (continued)**5 Post-employment benefits**

Included within 'Employee compensation and benefits' are components of net periodic benefit cost related to the group's defined benefit pension plans and other post-employment benefits, as follows

	Half-year to	
	30 June 2011	30 June 2010
	£m	£m
Current service cost	96	99
Interest cost	408	390
Expected return on plan assets	(430)	(340)
Other (gains)/ losses	(358)	–
Total (gain)/ expense	(284)	149

The group revalues its defined benefit post-employment plans each year at 31 December, in consultation with the plans' local actuaries. The assumptions underlying the calculations are used to determine the expected income statement charge for the following year.

At 30 June each year, the group revalues all plan assets to current market prices. The group also reviews the assumptions used to calculate the defined benefit obligations (the liabilities of the plans) and updates the carrying amount of the obligations if there have been significant changes as a consequence of changes in assumptions.

In the first half of 2011, there was an increase in the average yields of high quality (AA rated or equivalent) debt instruments in the region, together with an increase in inflation expectations. The group has, therefore, revalued certain plan obligations where the impact has been significant.

The change in these and other actuarial assumptions, including revised commutation factors, resulted in a £22 million increase in the defined benefit obligation for the HSBC Bank (UK) Pension Scheme ('the Scheme'). This increase was recognised directly in equity as an actuarial loss.

The actual return on plan assets of the Scheme was approximately £111 million above the expected return. This difference was recognised directly in equity as an actuarial gain.

Move to using the Consumer Prices Index

The expected cash flows of the principal plan were historically projected by reference to the Retail Prices Index ('RPI') swap curve in calculating the liability recognised. The Occupational Pensions (Revaluation) Order 2010 confirmed the UK government's intention to move to using the Consumer Prices Index ('CPI') rather than RPI as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. Historical annual CPI increases have generally been lower than annual RPI increases. The rules of the principal plan prescribe that annual increases for pensions in payment are in line with RPI, but for deferred pensions, i.e. pensions for members of the scheme who have left HSBC employment but who have not yet retired, are linked to the statutory index prior to retirement. However, consistent with communications to Scheme members, the bank has historically used RPI in calculating the pension liability for deferred pensions.

In May 2011, the Trustee communicated to Scheme members the impact on Scheme benefits of the UK government's announcement. At 30 June 2011, the bank used CPI in calculating the pension liability recognised which resulted in a reduction of the Scheme's liabilities, in respect of deferred pensioners, of £360 million. A corresponding gain was recognised in the income statement, as a credit within 'Employee compensation and benefits'.

6 Fair values of financial instruments

Fair values are determined in accordance with the methodology set out in the *Annual Report and Accounts 2010* in the accounting policies on pages 92 to 111, and in Note 31 and Note 32 on pages 169 to 178.

Notes on the Condensed Financial Statements (unaudited) (continued)

Bases of valuing financial assets and liabilities measured at fair value

	Quoted market price Level 1 £m	Valuation techniques		Total £m
		Using observable inputs Level 2 £m	With significant unobservable inputs Level 3 £m	
At 30 June 2011				
Assets				
Trading assets	148,924	48,816	1,926	199,666
Financial assets designated at fair value	9,852	5,713	—	15,565
Derivatives	319	122,089	1,415	123,823
Financial investments available-for-sale	61,955	35,368	1,651	98,974
Liabilities				
Trading liabilities	81,072	80,494	3,165	164,731
Financial liabilities designated at fair value	4,014	28,350	—	32,364
Derivatives	252	121,829	1,871	123,952
At 31 December 2010				
Assets				
Trading assets	110,369	47,635	1,548	159,552
Financial assets designated at fair value	9,674	5,793	-	15,467
Derivatives	783	127,115	1,260	129,158
Financial investments available-for-sale	61,199	34,796	1,810	97,805
Liabilities				
Trading liabilities	71,744	57,440	3,176	132,360
Financial liabilities designated at fair value	3,932	24,003	-	27,935
Derivatives	601	126,543	2,060	129,204

Trading assets, valued using a valuation technique with significant unobservable inputs, include various asset-backed securities, leveraged loans underwritten by the group and corporate and mortgage loans held for securitisation

Derivative products, valued using a valuation technique with significant unobservable inputs, include certain types of correlation products, particularly equity and foreign exchange basket options and foreign exchange-interest rate hybrid transactions, long-dated option transactions, particularly equity options, interest rate and foreign exchange options and certain credit derivatives, including tranching credit default swap transactions and credit derivatives executed with certain monoline insurers

Available-for-sale financial investments and financial assets designated at fair value that are valued using unobservable inputs include holdings of private equity and asset-backed securities

Fair values of financial instruments not carried at fair value

	30 June 2011		31 December 2010	
	Carrying amount £m	Fair Value £m	Carrying amount £m	Fair Value £m
Assets				
Loans and advances to banks	60,687	60,856	57,027	57,019
Loans and advances to customers	311,290	306,609	285,218	281,853
Financial investments debt securities	4,207	4,463	4,281	4,548
Liabilities				
Deposits by banks	42,148	42,148	48,287	48,287
Customer accounts	371,527	371,567	344,123	344,176
Debt securities in issue	49,459	49,355	48,119	47,991
Subordinated liabilities	9,731	9,263	7,407	6,948

Notes on the Condensed Financial Statements (unaudited) (continued)

7 Credit quality of financial instruments

The five credit quality classifications set out and defined on pages 36 to 37 of the *Annual Report and Accounts 2010* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

The following tables set out the group's distribution of financial instruments by measures of credit quality

30 June 2011								
	Neither past due nor impaired				Past due not impaired	Impaired	Impairment allowances	Total
	Strong £m	Medium Good £m	Satisfactory £m	Sub-standard £m				
Cash and balances at central banks	16,334	–	–	–	–	–	–	16,334
Items in the course of collection from other banks	2,136	–	–	–	–	–	–	2,136
Trading assets	140,594	17,225	19,382	1,861				179,062
– treasury and other eligible bills	1,606	417	256	–				2,279
– debt securities	84,054	3,195	6,789	790				94,828
– loans and advances to banks	27,176	6,818	2,167	925				37,086
– loans and advances to customers	27,758	6,795	10,170	146				44,869
Financial assets designated at fair value	3,379	114	3,861	5				7,359
– treasury and other eligible bills	21	–	–	–				21
– debt securities	2,791	114	3,852	5				6,762
– loans and advances to banks	44	–	9	–				53
– loans and advances to customers	523	–	–	–				523
Derivatives	102,928	14,761	4,960	1,174				123,823
Loans and advances held at amortised cost	216,040	89,787	52,819	8,773	1,500	6,339	(3,281)	371,977
– loans and advances to banks	53,913	4,849	1,834	70	–	71	(50)	60,687
– loans and advances to customers	162,127	84,938	50,985	8,703	1,500	6,268	(3,231)	311,290
Financial investments	92,141	3,184	2,782	2,152	–	1,536	–	101,795
– treasury and other similar bills	9,108	21	26	16	–	–	–	9,171
– debt securities	83,033	3,163	2,756	2,136	–	1,536	–	92,624
Other assets	4,874	379	3,390	486	18	8	–	9,155
– endorsements and acceptances	341	16	195	–	1	–	–	553
– accrued income and other	4,533	363	3,195	486	17	8	–	8,602

Notes on the Condensed Financial Statements (unaudited) (continued)

31 December 2010								
	Neither past due nor impaired				Past due not impaired £m	Impaired £m	Impairment allowances £m	Total £m
	Strong £m	Medium Good £m	Satisfactory £m	Sub-standard £m				
Cash and balances at central banks	24,495	-	-	-	-	-	-	24,495
Items in the course of collection from other banks	1,932	-	-	-	-	-	-	1,932
Trading assets	107,068	12,142	15,411	426				135,047
– treasury and other eligible bills	2,278	127	124	-				2,529
– debt securities	65,242	2,398	5,715	416				73,771
– loans and advances to banks	19,245	4,270	3,000	10				26,525
– loans and advances to customers	20,303	5,347	6,572	-				32,222
Financial assets designated at fair value	3,530	260	3,927	-				7,717
– treasury and other eligible bills	20	-	-	-				20
– debt securities	2,977	260	3,924	-				7,161
– loans and advances to banks	24	-	3	-				27
– loans and advances to customers	509	-	-	-				509
Derivatives	103,241	18,840	6,675	402				129,158
Loans and advances held at amortised cost	207,339	69,053	50,281	10,855	1,514	6,783	(3,580)	342,245
– loans and advances to banks	51,290	5,170	366	180	-	71	(50)	57,027
– loans and advances to customers	156,049	63,883	49,915	10,675	1,514	6,712	(3,530)	285,218
Financial investments	91,289	2,559	3,040	2,134	-	1,638	-	100,660
– treasury and other similar bills	9,250	-	74	25	-	5	-	9,354
– debt securities	82,039	2,559	2,966	2,109	-	1,633	-	91,306
Other assets	4,459	520	2,338	503	12	5	-	7,837
– endorsements and acceptances	436	14	44	-	-	-	-	494
– accrued income and other	4,023	506	2,294	503	12	5	-	7,343

Notes on the Condensed Financial Statements (unaudited) (continued)**8 Contingent liabilities, contractual commitments and guarantees**

	At 30 June 2011 £m	31 December 2010 £m
Guarantees and other contingent liabilities		
Guarantees and irrevocable letters of credit pledged as collateral security	16,896	17,324
Other contingent liabilities	150	32
	17,046	17,356
Commitments		
Documentary credits and short-term trade-related transactions	2,178	1,809
Forward asset purchases and forward deposits placed	32	19
Undrawn formal standby facilities, credit lines and other commitments to lend	120,552	112,215
	122,762	114,043

The above table discloses the nominal principal amounts of commitments, guarantees and other contingent liabilities. They are mainly credit-related instruments which include both financial and non-financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements. Contingent liabilities arising from legal proceedings and regulatory matters are disclosed in Note 10.

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The financial impact on the bank, the basis for estimating costs, and the uncertainties involved in estimating the ultimate FSCS levy to the industry, remain consistent with those disclosed on page 185 of the *Annual Report and Accounts 2010*.

Guarantees and other commitments

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed on page 186 of the *Annual Report and Accounts 2010*.

9 Related party transactions**Transaction with HSBC Holdings plc**

In March 2011, the bank repaid to HSBC Holdings plc £1,750 million of perpetual subordinated debt. At the same time, the bank issued US dollar denominated perpetual subordinated debt of \$2,862 million to HSBC Holdings plc. Interest on this debt is payable quarterly at prevailing market rates.

Pension scheme swap transactions

The HSBC Bank (UK) Pension Scheme ('the Scheme') enters into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 30 June 2011, the gross notional value of the swaps was £14,686 million (31 December 2010: £14,686 million), the swaps had a positive fair value of £1,535 million to the Scheme (31 December 2010: positive fair value £1,400 million) and the bank had delivered collateral of £2,479 million (31 December 2010: £2,136 million) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

During the first half of 2010, the bank sold debt security assets to the Scheme at arm's length value, the details of which are provided in Note 7 'Employment compensation and benefits' of the *Annual Report and Accounts 2010*.

Notes on the Condensed Financial Statements (unaudited) (continued)

Purchase of non-controlling interests

In June 2010, the group purchased the minority interest in HSBC Europe B V which was owned by HSBC Holdings (Luxembourg) S A , for cash consideration of £176 million

10 Legal proceedings, investigations and regulatory matters

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions including the UK, EU and the US arising out of its normal business operations. Apart from the matters described below, HSBC considers that none of these matters is material, either individually or in the aggregate. HSBC recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory matters as at 30 June 2011.

Bernard L. Madoff Investment Securities LLC

In December 2008, Bernard L. Madoff ('Madoff') was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), an SEC-registered broker-dealer and investment adviser. Since his appointment, the trustee has been recovering assets and processing claims of Madoff Securities customers. Madoff subsequently pleaded guilty to various charges and is serving a 150 year prison sentence. He has acknowledged, in essence, that while purporting to invest his customers' money in securities and, upon request, return their profits and principal, he in fact never invested in securities and used other customers' money to fulfil requests for the return of profits and principal. The relevant US authorities are continuing their investigations into his fraud, and have brought charges against others.

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities.

Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US\$8.4 billion, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, we estimate that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US\$4.3 billion.

Plaintiffs (including funds, fund investors, and the Madoff Securities trustee) have commenced Madoff-related proceedings against numerous defendants in a multitude of jurisdictions. Various HSBC companies have been named as defendants in suits in the US, Ireland, Luxembourg, and other jurisdictions. The suits (which include US class actions) allege that the HSBC defendants knew or should have known of Madoff's fraud and breached various duties to the funds and fund investors.

One of the funds HSBC companies provided custodial and administration services for was Thema International Fund plc, a limited liability company incorporated and authorised in Ireland as a UCITS fund under the European Communities (Undertaking for Collective Investments in Transferable Securities) Regulations 1985. HSBC estimates that the purported net asset value of Thema International Fund plc as at 30 November 2008 was US\$1.1 billion and that Thema International Fund plc's actual transfers to Madoff Securities minus its actual withdrawals were approximately US\$312m. On 7 June 2011, HSBC Securities Services (Ireland) Limited, HSBC Institutional Trust Services (Ireland) Limited, HSBC Holdings plc and, subject to the granting of leave to effect a proposed pleading amendment, HSBC Bank USA, N.A. entered into an agreement, without any admission of wrongdoing or liability, to settle the action pending in the US District Court for the Southern District of New York, relating to Thema International Fund plc. The settlement is subject to various conditions to its effectiveness and the HSBC defendants may terminate the settlement in certain circumstances. The payment to be made by the HSBC defendants is US\$62.5m.

In December 2010, the Madoff Securities trustee commenced suits against various HSBC companies in the US bankruptcy court and in the English High Court. The US action (which also names certain funds, investment managers, and other entities and individuals) seeks US\$9 billion in damages and additional recoveries from HSBC.

Notes on the Condensed Financial Statements (unaudited) (continued)

and the various co-defendants. It seeks damages against HSBC for allegedly aiding and abetting Madoff's fraud and breach of fiduciary duty. In July 2011, after withdrawing the case from the Bankruptcy Court in order to decide certain threshold issues, the US District Court dismissed the trustee's various common law claims on the grounds that the trustee lacks standing to assert them. The trustee may appeal this ruling. The District Court returned the case to the US Bankruptcy Court for further proceedings on the remaining claims. Those claims seek, pursuant to US bankruptcy law, recovery of unspecified amounts received by HSBC from funds invested with Madoff, including amounts that HSBC received when it redeemed units HSBC held in the various funds. HSBC acquired those fund units in connection with financing transactions HSBC had entered into with various clients. The trustee's US bankruptcy law claims also seek recovery of fees earned by HSBC for providing custodial, administration and similar services to the funds. The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the ground that the HSBC defendants actually or constructively knew of Madoff's fraud.

In July 2011, one of the clients with whom HSBC entered into a Madoff-related financing transaction commenced a suit in the US seeking to rescind the transaction and recover approximately US\$16m it paid to HSBC in connection with the transaction.

Between October 2009 and March 2011, Fairfield Sentry Limited and Fairfield Sigma Limited ('Fairfield'), funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the British Virgin Islands ('BVI') and the US against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield actions seek restitution of amounts paid to the defendants in connection with share redemptions, on the ground that such payments were made by mistake, based on inflated values resulting from Madoff's fraud and some actions also seek recovery of the share redemptions under BVI insolvency law.

There are many factors which may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings including but not limited to the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. Many of the cases where HSBC companies are named as a defendant are at an early stage. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities or ranges of liabilities, that might arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

Payment Protection Insurance Sale

On 10 August 2010 the Financial Services Authority ('FSA') published Policy Statement 10/12 ('PS 10/12') on the assessment and redress of Payment Protection Insurance ('PPI') complaints. On 8 October 2010, an application for Judicial Review was issued by the BBA acting on behalf of a group of UK banks, which included HSBC, seeking an order to quash PS 10/12 and also Guidance issued by the Financial Ombudsman Service ('FOS') on handling PPI complaints. The Judicial Review application was heard by the Court in January 2011.

On 20 April 2011, the High Court issued an adverse judgment on the Judicial Review application. Subsequently the BBA, acting on behalf of its members, confirmed that it would not appeal the judgment. HSBC accepts the High Court's decision and is working with the FSA and the FOS in order to ensure all PPI complaints are handled and, where appropriate, redressed in accordance with PS 10/12.

There are many factors affecting the resulting financial impact of the judgment, including the effect of the decision on the nature and volume of customer complaints, and the extent to which HSBC might be required to take action, and the nature of any such action, in relation to non-complainants. The extent of any redress that may be required as a result of the decision to uphold PS 10/12 and the FOS Guidance will also depend on the facts and circumstances of each individual customer's case. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress for this matter. There is a provision of £253 million as at 30 June 2011 in respect of the estimated liability for redress in respect of the possible mis-selling of PPI policies in previous years.

11 Event after the balance sheet date

A first interim dividend for the financial year ending 31 December 2011 of £800 million was declared by the Directors after 30 June 2011.

Notes on the Condensed Financial Statements (unaudited) (continued)

12 Interim Report 2011 and statutory accounts

The information in this *Interim Report 2011* is unaudited and does not constitute statutory accounts within the meaning of section 434(3) of the Companies Act 2006. The *Interim Report 2011* was approved by the Board of Directors on 1 August 2011. The statutory accounts for the year ended 31 December 2010 have been delivered to the Registrar of Companies in England and Wales in accordance with section 242 of the Companies Act 1985. The auditor has reported on those accounts. Its report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

Independent Review Report by KPMG Audit Plc to HSBC Bank plc

Introduction

We have been engaged by HSBC Bank plc ('the bank') to review the condensed set of financial statements in the half-yearly interim report for the six months ended 30 June 2011 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of financial position, consolidated statement of changes in equity, consolidated cash flow statement and the related explanatory notes. We have read the other information contained in the *Interim Report 2011* and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the bank in accordance with the terms of our engagement to assist the bank in meeting the requirements of the Disclosure and Transparency Rules ('the DTR') of the UK's Financial Services Authority ('the UK FSA'). Our review has been undertaken so that we might state to the bank those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the bank for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The *Interim Report 2011* is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the *Interim Report 2011* in accordance with the DTR of the UK FSA.

As disclosed in note 1, the annual financial statements of the bank are prepared in accordance with IFRSs as adopted by the European Union ('EU'). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

Our responsibility

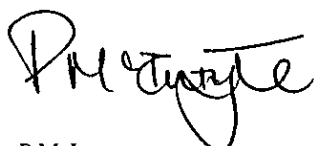
Our responsibility is to express to the bank a conclusion on the condensed set of financial statements in the *Interim Report 2011* based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the *Interim Report 2011* for the six months ended 30 June 2011 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.



P McIntyre
For and on behalf of KPMG Audit Plc
Chartered Accountants
London, England

1 August 2011