HSBC
The world's local bank

Headquartered in London, HSBC is one of the world's largest banking and financial services organisations and one of the industry's most valuable brands. We provide a comprehensive range of financial services to around 95 million customers through two customer groups, Personal Financial Services (including consumer finance), and Commercial Banking, and two global businesses, Global Banking and Markets, and Global Private Banking.

Our international network covers 87 countries and territories in six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, the Middle East, North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 221,000 shareholders in 127 countries and territories.

Highlights

- Pre-tax profit more than doubled to US$19bn on a reported basis.
- Underlying pre-tax profit up by almost US$5bn or 36% to US$18.4bn.
- Profitable in every customer group and region, including North America, for the first time since 2006.
- Dividends declared in respect of 2010 totalled US$6.3bn, or US$0.36 per ordinary share, with a fourth interim dividend for 2010 of US$0.12 per ordinary share.
- Continued capital generation – core tier 1 ratio increased to 10.5% from 9.4%.
- Customer lending up 8% to US$958bn; deposits up 7% to US$1.2 trillion on an underlying basis.

Cover theme

An evening view of the Central Elevated Walkway in Hong Kong's business district. Used by tens of thousands of commuters every day, this walkway forms a vital artery through the heart of Asia's pre-eminent financial centre, which hosts over 190 banks and deposit-taking companies from all over the world.

Report of the Directors: Overview

Financial highlights

Financial highlights

For the year

Profit before taxation

US$19,037m – *up 169%*

2009: US$7,079m
2008: US$9,307m

Underlying profit before taxation

US$18,366m – *up 36%*

2009: US$13,482m

Total operating income

US$80,014m – *up 2%*

2009: US$78,631m
2008: US$88,571m

Net operating income before loan impairment charges and other credit risk provisions

US$68,247m – *up 3%*

2009: US$66,181m
2008: US$81,682m

Profit attributable to shareholders of the parent company

US$13,159m – *up 126%*

2009: US$5,834m
2008: US$5,728m

Earnings per share and dividends per share

Earnings per share

US$0.73 – *up 115%*

2009: US$0.34
2008: US$0.41

Dividends per share[1]

US$0.34

2009: US$0.34
2008: US$0.93

At the year-end

Loans and advances to customers

US$958bn – *up 7%*

2009: US$896bn
2008: US$933bn

Customer accounts

US$1,228bn – *up 6%*

2009: US$1,159bn
2008: US$1,115bn

Ratio of customer advances to customer accounts

78.1%

2009: 77.3%
2008: 83.6%

Total equity

US$155bn – *up 14%*

2009: US$136bn
2008: US$100bn

Average total shareholders' equity to average total assets

5.5%

2009: 4.7%
2008: 4.9%

Risk-weighted assets

US$1,103bn – *down 3%*

2009: US$1,133bn
2008: US$1,148bn

Capital ratios

Core tier 1 ratio

10.5%

2009: 9.4%
2008: 7.0%

Tier 1 ratio

12.1%

2009: 10.8%
2008: 8.3%

Total capital ratio

15.2%

2009: 13.7%
2008: 11.4%

Performance ratios

Credit coverage ratios

Loan impairment charges to total operating income	Loan impairment charges to average gross customer advances	Total impairment allowances to impaired loans at year-end
16.9%	1.5%	71.6%
2009: 31.7%	2009: 2.8%	2009: 83.2%
2008: 27.2%	2008: 2.5%	2008: 94.3%

Return ratios

Return on average invested capital[2]	Return on average total shareholders' equity[3]	Post-tax return on average total assets	Post-tax return on average risk-weighted assets
8.7%	9.5%	0.6%	1.3%
2009: 4.1%	2009: 5.1%	2009: 0.3%	2009: 0.6%
2008: 4.0%	2008: 4.7%	2008: 0.3%	2008: 0.6%

Efficiency and revenue mix ratios

Cost efficiency ratio[4]	Net interest income to total operating income	Net fee income to total operating income	Net trading income to total operating income
55.2%	49.3%	21.7%	9.0%
2009: 52.0%	2009: 51.8%	2009: 22.5%	2009: 12.5%
2008: 60.1%	2008: 48.1%	2008: 22.6%	2008: 7.4%

Share information at the year-end

		Closing market price		
US$0.50 ordinary shares in issue	Market capitalisation	London	Hong Kong	American Depositary Share[5]
17,686m	US$180bn	£6.51	HK$79.70	US$51.04
2009: 17,408m	2009: US$199bn	2009: £7.09	2009: HK$89.40	2009: US$57.09
2008: 12,105m	2008: US$114bn	2008: £5.77	2008: HK$67.81	2008: US$44.15

	Total shareholder return[6]		
	Over 1 year	Over 3 years	Over 5 years
To 31 December 2010	95.3	103.4	103.4
Benchmarks:			
– FTSE 100[7]	112.6	102.8	126.3
– MSCI World[7]	115.9	111.0	127.0
– MSCI Banks[7]	103.7	81.9	79.0

For footnotes, see page 83.

Group Chairman's Statement

When I took on the role of Chairman less than 90 days ago, I was acutely aware of the challenges facing our industry. I was conscious too of the need to demonstrate to all of our stakeholders that HSBC understands the responsibilities that accompany the systemic significance which continued success has built for HSBC in many of the markets in which we operate, not least those in Asia, given their historical significance to the Group. 145 years after we were founded, Hong Kong and the rest of Asia remain at the heart of HSBC's strength and identity and our commitment to the region is unwavering.

I fully acknowledge that our scale, the trust that our depositors place in us and our relevance to our personal and corporate clients – for their financing, banking, investment and risk management needs – all depend upon our maintaining our reputation and our integrity.

I also understand how important it is for you, our shareholders, that HSBC builds sustainable long-term value that is reflected through the share price and rebuilds, as quickly as competing regulatory demands allow, the dividend that was reduced during the financial crisis.

I firmly believe that HSBC has the people, the financial strength and the organisational structure best able to deliver all of the above and it is a privilege to have the opportunity to serve as Group Chairman as we enter a fresh chapter in our history.

Before I go any further, I want to pay tribute to both Stephen Green and Michael Geoghegan, who stepped down at the end of last year from their roles as Group Chairman and Group Chief Executive after, respectively, 28 and 37 years' service to HSBC. It fell to them to be at the helm as HSBC navigated its way through the worst financial crisis since the 1930s. Mike led from the front in addressing the problems in our consumer finance subsidiary in the United States and in reshaping HSBC's organisational structure and operational practices in order to better and more efficiently serve an increasingly interconnected world. Stephen's personal reputation for integrity and probity stood out and distinguished HSBC during a period of intense disaffection with the banking industry. For their contribution over many years we owe them a deep debt of gratitude and wish them both well.

Our performance in 2010

The Group Chief Executive's Business Review sets out clearly how HSBC delivered a much improved balance of profits in 2010. It is reassuring to see our Personal Financial Services businesses returning to profitability in aggregate and Commercial Banking growing significantly, largely in emerging markets. These achievements augmented another year of strong performance in Global Banking and Markets.

Earnings per share improved strongly, rising by 115% to reach US$0.73 per share.

The Group's capital position also strengthened with the core tier 1 ratio, the ratio most favoured by regulators as it comprises equity capital after regulatory adjustments and deductions, increasing from 9.4% to 10.5%, largely due to profit retention throughout the year.

As a consequence of this strong capital generation, together with greater clarity on the direction of regulatory reform of capital requirements and an improving economic backdrop in the developed world – particularly in the United States – the Board has approved increases in both the final dividend payment in respect of 2010 and the planned quarterly dividends for 2011. The final dividend for 2010, payable on 5 May 2011 to shareholders on the register on 17 March 2011, will be 12 cents per ordinary share, up from 10 cents at the same point last year. For the remainder of 2011 we plan to pay quarterly dividends of nine cents for each of the first three quarters compared with eight cents in respect of the equivalent quarters of 2010.

A new leadership team

We enter 2011 with a new leadership team, but only in the sense of changed roles. Everyone has worked together over many years and there is immense experience to draw on both from within HSBC and from earlier careers at peer organisations. Stuart Gulliver is leading the management team as Group Chief Executive. His clear objective is to deliver sustainable long-term value for shareholders consistently in a manner that maintains the confidence of all other key stakeholders in our businesses including depositors, counterparties, long-term creditors, customers, employees, regulators and governments. His review on pages 7 to 9 gives an insight into his immediate priorities.

Everything we do is governed by the imperative of upholding HSBC's corporate reputation and character at the highest level and adding further strength to our brand; we deeply regret that a number of weaknesses in regulatory compliance were highlighted in 2010 and we are resolved to remedy these and reinforce the high standards we demand of ourselves.

For my part, I shall be focusing on engaging at the highest level in the regulatory reform debates that will, in large part, shape our future. I shall also lead the Board in the stewardship and review of performance of our financial and human resources.

In the interest of full transparency, we have today published on our website the respective roles and responsibilities of the Group Chairman, the Deputy Chairman and Senior Independent Director and the Group Chief Executive.

Board changes

I have already paid tribute to the contributions of Stephen Green and Michael Geoghegan. Vincent Cheng has indicated that he will step down at the next AGM and on behalf of the Board I want to thank him for his immense contribution in many roles over 33 years. Vincent will retain an association with the Group by taking on an advisory role to the Group Chief Executive on regional matters. Laura Cha will join the Board on 1 March; Laura has been Deputy Chair of The Hongkong and Shanghai Banking Corporation Limited for four years and brings a wealth of experience of China; fuller details of her background and experience are set out in the Directors' Report.

Regulatory update

There was much progress made during 2010 on the regulatory reform agenda. Although there is still a great deal to do, the shape of capital requirements was broadly clarified and an implementation timetable stretching out to 2019 was agreed to allow time for the industry to adjust progressively. A minimum common equity tier 1 ratio of 7%, including a capital conservation buffer, has been agreed. HSBC already meets this threshold requirement. The Group Chief Executive's Business Review addresses how these revised requirements will impact our targeted return on equity.

During 2011, the debate will be dominated by consideration of the calibration of minimum liquidity standards. Although it is clear that liquidity and funding weaknesses were key elements contributing to the crisis, HSBC agrees with the industry consensus that the revised requirements in these areas are overly conservative and could lead to unnecessary deleveraging at a time of fragile economic recovery in much of the developed world. It will be a near impossibility for the industry to expand business lending at the same time as increasing the amount of deposits deployed in government bonds while, for many banks but not HSBC, reducing dependency on central bank liquidity support arrangements. It is to be hoped that the observation period, which starts this year and precedes the formal introduction of the new requirements, will inform a recalibration of these minimum liquidity standards.

A second debate of importance to HSBC's shareholders in 2011 will concern the designation of 'Systemically Important Financial Institutions' ('SIFI's). Consideration is being given in the regulatory community to mandating higher capital requirements, together with more intense supervision, for institutions classified as SIFIs. We agree with heightened supervision but it is not clear that the reduced shareholder returns that would follow the imposition of incremental capital would be compensated for by improved stability. Classification as a SIFI with a requirement to hold incremental capital would, however, probably lead others to favour SIFIs as counterparties, and may therefore have the unintended consequence of further concentrating the industry.

HSBC's position is that systemic importance should not be determined by size alone. It is clear, however, that, on almost any basis, HSBC would be classified as systemically important. For this reason we are engaging fully in the debate around the consequences of designation as a SIFI. In particular, we draw attention to the benefits of our corporate organisation through separate subsidiaries in mitigation against the imposition of incremental capital for SIFIs based on size alone.

In October 2010, the UK government confirmed its intention to raise the sum of £2.5bn (US$3.9bn) through a levy on bank balance sheets, and recently announced it will accelerate the full impact of this levy to 2011. We take no issue with the right of the UK government to raise a levy on the banking industry, particularly when having had to risk taxpayers' money to rescue a number of important UK institutions. However, as the proposed levy is to

Report of the Directors: Overview (continued)

be applied to the consolidated balance sheet, it applies beyond the legal boundary of the domestic institution to include overseas operations conducted through separately capitalised subsidiaries. This therefore constitutes an additional cost of basing a growing multinational banking group in the UK.

We intend to clarify in each set of results going forward the impact of the levy, split between UK and overseas operations, and Stuart Gulliver covers this in more detail in his review. We regard the levy, which is not tax deductible, as akin to a distribution of profits. For this reason, we intend to add to future shareholder dividends that would otherwise be paid, any amount saved in the event that the levy is restructured or relieved in due course.

The role of banks in society

The recent crisis has caused a proper introspection as to the role that banks play in society and at HSBC we welcome this. Banking is not simply about money. It is about helping individuals and organisations within society to meet personal and corporate objectives by facilitating access to financial capital and protecting value for those who make capital available. Payment mechanisms, the provision of long-term credit, trade finance, hedging and other risk management products, deposit, investment and retirement services are but a few of the activities through which banking groups contribute to today's financial system. Society cannot function without an effective financial system that delivers value to those it serves at an intermediation cost that is proportionate to the value created. Somehow, many participants and not just banks, lost sight of this basic principle in the run-up to the recent financial crisis and the consequences for all have, inevitably, been far reaching. There is no doubt that the scale of regulatory reform will bring many challenges, but it will also open new opportunities.

At HSBC, we shall not forget what happened to precipitate the scale of reform now underway. Although the financial turmoil arising from the events of 2007-2008 has largely moderated, in large part as a result of co-ordinated government action and support to the financial system, we enter 2011 with humility, ready to apply right across HSBC all of the lessons learned, notwithstanding that HSBC itself neither sought nor received support from any government.

Society has a right to ask if banks 'get it'. At HSBC, we do – and we are focused on embedding the necessary changes in our business model for long-term sustainable value creation. But we also do not forget that value creation depends upon HSBC recruiting, training and retaining the right talent in order to manage the risks we accept through intermediating customer flows; design solutions to address complex financial problems; build enduring relationships with core customers; build confidence in the Group's financial strength; and create the strategic options that offer the next generation fresh opportunities to continue building sustainable value.

In this globalised world, there is intense competition for the best people and, given our long history within and connections into the faster-growing developing markets, our best people are highly marketable. It would be irresponsible to allow our comparative advantages to wither by ignoring the market forces that exist around compensation, even though we understand how sensitive this subject is. Reform in this area can only be achieved if there is concerted international agreement on limiting the quantum of pay as well as harmonising pay structures but there appears to be no appetite to take the initiative on this. Our duty to shareholders is to build sustainable value in the economic and competitive environment in which we operate and our principal resource for achieving this is human talent. Under the governance of the Board, we will continue to operate and apply remuneration policies and practices that take full recognition of best practice and are aligned with the long-term interests of shareholders.

HSBC's people

Finally, I want to pay tribute to my 307,000 colleagues. So many of HSBC's people have exemplified commitment and endeavour again in 2010, helping our customers and clients to meet their financial objectives while taking on the additional burden of preparing for regulatory change. This has been done against a backdrop of continuing broad-based fiscal support to many economies, with public opinion consistently and highly critical of our industry. As I look forward, it is the combination of the capabilities of HSBC's people, their determination to do the right thing for our customers and their deep sense of responsibility to the communities they serve that makes me confident that HSBC will play a leading role in rebuilding the trust that our industry has lost and, by doing so, will build sustainable value for you, our shareholders.

Douglas Flint

D J Flint, *Group Chairman*
28 February 2011

Group Chief Executive's Business Review

Underlying financial performance continued to improve in 2010 and shareholders continued to benefit from HSBC's universal banking model. All regions and customer groups were profitable, as Personal Financial Services and North America returned to profit. Commercial Banking made an increased contribution to underlying earnings and Global Banking and Markets also remained strongly profitable, albeit behind 2009's record performance, reflecting a well-balanced and diversified business.

Credit experience continued to improve, as a result of a stronger global economy and our actions to reduce balance sheet risk. As a globally-connected bank with a growing presence across the world's faster-growing regions, HSBC also benefited from higher trade volumes and strong momentum in emerging economies, especially in Asia. Asia contributed the largest proportion to underlying pre-tax profits, while the contributions made by Latin America and the Middle East also increased. Together with our conservative management of the balance sheet, this improved performance allowed us to concentrate on serving our customers and to further strengthen our capital position.

Group performance headlines[1]

- Profit before tax improved year on year. On a reported basis, profits increased by nearly US$12bn from US$7.1bn to US$19bn. On an underlying basis, profits increased by 36%, or almost US$5bn, from US$13.5bn to US$18.4bn.
- In a period of sustained low interest rates, revenues remained constrained, reflecting four principal factors: reducing loan balances in our US business; lower trading income in Global Banking and Markets resulting from lower client activity; adverse fair value movements on non-qualifying hedges; and a reduced contribution from Balance Sheet Management in line with earlier guidance.
- Strong asset growth in Commercial Banking, particularly in Asia, higher trade-related revenues generally, and expansion of our wealth management business, again most notably in Asia, partially offset these revenue pressures.
- Loan impairment charges reduced by almost half to US$14.0bn. All regions and customer groups improved. The US experienced the greatest improvement, largely in the cards and consumer finance portfolios. Loan impairment charges also declined significantly in Latin America and the Middle East.
- In Global Banking and Markets, loan impairment charges fell significantly, notably in Europe as economic conditions improved. Credit risk provisions reduced by US$1bn to US$0.4bn in the available-for-sale asset-backed-securities portfolios due to a slowing in the rate of anticipated losses on underlying assets, in line with previous guidance. The associated available for sale reserve declined to US$6.4bn from US$12.2bn.
- The cost efficiency ratio rose to 55.2%, which is above our target range and unacceptable to me. The causes were constrained revenues and, in part, investment in strategic growth initiatives across the business together with higher staff costs. It additionally reflected one-off payroll taxes of US$0.3bn paid in 2010 in respect of the previous year and a pension accounting credit of US$0.5bn in 2009 and US$0.1bn in 2010. However, it is also clear that we need to re-engineer the business to remove inefficiencies.
- Return on average total shareholders' equity rose from 5.1% to 9.5%, reflecting increased profit generation during the year.
- HSBC continued to grow its capital base and strengthen its capital ratios further. The core tier 1 ratio increased from 9.4% to 10.5%, as a result of capital generation and lower risk weighted assets.

1 *All figures are discussed on a reported basis and all references to profits are profits before tax unless otherwise stated.*

Report of the Directors: Overview (continued)

Group Chief Executive's Business Review

- Total loans and advances to customers increased by 7% to US$958bn while deposits rose by 6% to US$1.2 trillion.

Impact of the evolving regulatory environment on the business

Much of the detail around the potential impact of change for banks remains uncertain. However, analysis of what we know confirms that our ability to generate capital and manage our risk-weighted assets positions HSBC strongly – and competitively – within the industry as the pace of change intensifies.

HSBC fully supports the rationale of the Basel III proposals which require banks to hold more capital. This is absolutely core to ensuring that governments and taxpayers are better protected in future than they have been in the past.

Certain aspects of the Basel III rules remain uncertain as to interpretation and application by national regulators. Notably, this includes any capital requirements which may be imposed on the Group over the implementation period in respect of the countercyclical capital buffer and any additional regulatory requirements for SIFIs. However, we believe that ultimately the level for the common equity tier 1 ratio of the Group may lie in the range 9.5 to 10.5%. This exceeds the minimum requirement for common equity tier 1 capital plus the capital conservation buffer.

We have estimated the pro forma common equity tier 1 ratio of the Group based on our interpretation of the new Basel III rules as they will apply from 1 January 2019, based on the position of the Group at year-end 2010. The rules will be phased in from 2013 with a gradual impact and we have estimated that their full application, on a proforma basis, would result in a common equity tier 1 ratio which is lower than the Basel II core tier 1 ratio by some 250–300 basis points. The changes relate to increased capital deductions, new regulatory adjustments and increases in risk-weighted assets. However, as the changes will progressively take effect over six years leading up to 2019 and as HSBC has a strong track record of capital generation and actively manages its risk-weighted assets, we are confident in our ability to mitigate the effect of the new rules before they come into force.

Last year, HSBC committed to reviewing its target shareholder return on equity once the effects of new regulation became clearer. Now that we have better visibility on the impact of increased capital requirements, we believe that higher costs of the evolving regulatory framework will, all other things being equal, depress returns for shareholders of banks. We will therefore target a return on average shareholders' equity of 12-15% in the future.

As Group Chief Executive, it is right that, in managing the business and developing Group strategy, my principal office should be in Hong Kong – a global financial hub of growing importance at the centre of HSBC's strategically most important region. However, the company is headquartered in London and we hope to remain there. London's pre-eminence as an international financial services centre is widely recognised and well-deserved and reflects successful government policy over decades to build that position. It is therefore important to us that the UK's competitive position is protected and sustained. Appropriate supervision is an important part of the larger equation. Policymakers should continue to legislate and regulate, but they must not destroy London's competitive position in the process.

As the Group Chairman has outlined, new legislation is expected to be enacted in the UK, effective from the start of 2011, one curious consequence of which is an explicit incremental cost of being headquartered in the UK for any global bank. Had this been applied for 2010, this annual charge would have amounted to approximately US$0.6bn in HSBC's case. Moreover, the overseas balance sheet would account for the majority of the annual charge, with the UK balance sheet accounting for approximately one third of the total.

Outlook

We have been closely watching events unfold in parts of the Middle East and North Africa. Our primary concern is for the security of our 12,000 staff across the region and we continue to work to ensure their safety. We have also activated robust continuity plans so that we can also stay open for business and support the needs of our customers. As a strongly capitalised global bank, HSBC's financial performance has not been materially affected by events to date. HSBC has been present in the Middle East for more than 50 years and we remain absolutely committed to its future. We also believe that the region's economies have a number of structural strengths which leave us positive on the longer-term outlook.

In the short term, risks to global growth remain, not least from an elevated oil price. We therefore expect cyclical volatility to continue – including in emerging markets – and progress is unlikely to be linear. In the longer term, we believe that growth rates in many Western markets will continue to significantly underperform those of the emerging world. Emerging markets are no longer simply leading the recovery from a Western crisis; the growth gap has become a sustained secular trend.

The global economy's structural position also requires fundamental readjustment. Many Western economies must still deal with a large overhang of household and government debt and weak growth and high unemployment will make this a slow and painful process. As faster-growing nations seek to limit the effect of Western monetary policy on their own economies, we cannot discount the risk of increased tension over exchange rate and trade issues.

HSBC's balance sheet remains strongly positioned to benefit from future interest rate rises. We are realistic that, in many developed countries at least, historically low rates may continue to constrain income growth in the near-term. Nevertheless, maintaining a conservative liquidity position is core to our proposition and to our funding strength. In our risk appetite statement approved by the Board we have set a maximum advances-to-deposits ratio for the Group of 90%. This underlines our continuing commitment to a high level of liquidity and reflects our philosophy that HSBC should not be reliant on wholesale markets for funding. Even with a ratio currently slightly below 80%, we have capacity for further lending growth.

In the short term, we expect the benefits of asset growth achieved in 2010 to continue to flow into revenues. In the medium term, we will continue to target growth in the most strategically attractive markets for HSBC and build our capabilities in connectivity, one of our distinctive strengths as a globally-connected bank.

At the same time, with demand in many developed markets constrained and interest spreads remaining compressed, we fully recognise the importance of ever more robust cost management discipline and the need to continue re-engineering the business to improve efficiency.

Furthermore, capital is becoming a scarcer resource and, as a new regulatory environment evolves, I am committed to making capital allocation a more disciplined and rigorous process at HSBC in order to drive the correct investment decisions for the future.

We will talk more to investors about each of these initiatives later in the spring. However, as a result of this focus, we are committed to delivering a cost efficiency ratio and a return on average shareholders' equity within our published target range.

We also recognise the importance of reliable dividend income for our shareholders and I believe it should be possible to benchmark a payout ratio of between 40-60% of attributable profits under normal market conditions.

In closing, I would like to acknowledge the huge contribution that my predecessor, Mike Geoghegan, made to HSBC in his five years as Group Chief Executive – not least during 2010 – and I wish him well for the future.

Finally, I am pleased to report that we have had a good start to the year, with continued momentum in lending, mainly in emerging markets and in respect of global trade.

Stuart Gulliver

S T Gulliver, *Group Chief Executive*
28 February 2011

Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$180bn at 31 December 2010. We are headquartered in London.

As 'The world's local bank', we combine the largest global emerging markets banking business and a uniquely cosmopolitan customer base with an extensive international network and substantial financial strength.

HSBC operates through long-established businesses and has an international network of some 7,500 offices in 87 countries and territories in six geographical regions; Europe, Hong Kong, Rest of Asia-Pacific, the Middle East, North America and Latin America.

Our products and services are delivered through two customer groups, Personal Financial Services ('PFS') and Commercial Banking ('CMB'), and two global businesses, Global Banking and Markets ('GB&M'), and Global Private Banking ('GPB'). PFS incorporates the Group's consumer finance businesses, the largest of which is HSBC Finance Corporation ('HSBC Finance').

Taken together, our five largest customers do not account for more than 1% of our income.

We have contractual and other arrangements with numerous third parties in support of our business activities. None of the arrangements is individually considered to be essential to the business of the Group.

There were no significant acquisitions during the year (for details of acquisitions see page 340).

Strategic direction

Our objective is to deliver sustainable long-term value to shareholders through consistent earnings and superior risk-adjusted returns.

Our strategy is to be the world's leading international bank, by:

- leveraging the HSBC brand and our network of businesses which covers the world's most relevant geographies. This network provides access to the world's fastest growing economies, for example Greater China. We serve companies as they grow and become more international and individuals as they become wealthier and require more sophisticated financial services, such as wealth management; and
- competing as a universal bank across the full financial services spectrum only where we have scale and can achieve appropriate returns. This implies building scale in attractive geographical regions and businesses where we can be competitive and reviewing businesses which do not meet our financial hurdles.

The strategy reflects the key trends which are shaping the global economy. In particular, we recognise that over the long term, developing markets are growing faster than mature economies and connectivity continues to increase as world trade is expanding at a greater rate than gross domestic product, generating increased demand for financial services. We are, therefore, continuing to direct incremental investment primarily to the faster growing markets and client segments which have international connectivity. In order to deliver this strategy we pursue a series of initiatives, reflected in the Group's key performance indicators:

- enhance efficiency by taking full advantage of local, regional and global economies of scale, in particular by adopting a common systems architecture wherever possible;
- maintain capital strength and a strong liquidity position. Capital and liquidity are critical for our strategy and are the foundation of decisions about the pace and direction of investment; and
- align objectives and incentives to motivate and reward staff for being fully engaged in delivering the strategy.

Top and emerging risks

All of our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks. We classify risks as 'top' and 'emerging'. A 'top risk' is a current, visible risk with the potential to have a material effect on our financial results or our reputation. An 'emerging risk' is one which has large unknown components which could have a material impact on our long-term strategy. Top and emerging risks are viewed as falling under the following four broad categories:

- challenges to our business operations;
- challenges to our governance and internal control systems;
- macro-economic and geopolitical risk; and
- macro-prudential and regulatory risks to our business model.

The top and emerging risks are summarised below:

Challenges to our business operations

- Challenges to our operating model in an economic downturn (in developed countries) and rapid growth (in emerging markets)
- Internet crime and fraud

Challenges to our governance and internal control systems

- Level of change creating operational complexity
- Information security risk

Macro-economic and geopolitical risk

- Potential emerging markets asset bubble
- Increased geopolitical risk in Asia-Pacific and Middle East regions

Macro-prudential and regulatory risks to our business model

- Regulatory change impacting our business model and Group profitability
- Regulatory requirements affecting conduct of business

Key performance indicators

The Board of Directors and the Group Management Board ('GMB') monitor HSBC's progress against its strategic objectives. Progress is assessed by comparison with our strategy, our operating plan targets and our historical performance using both financial and non-financial measures.

Following a review of our high-level key performance indicators ('KPI's), the GMB decided to make the following changes to the Group's published indicators in order to restrict their number to those which most accurately reflect its management priorities. The Group now has seven financial and three non-financial KPIs.

- the ratio of advances to core funding has been added to highlight the relationship between loans and advances to customers and core customer deposits in our principal banking entities;
- tier 1 capital has been added as a primary indicator of the strength of our capital base, and its ability to support the growth of the business and meet regulatory capital requirements;
- revenue growth, revenue mix factors and credit performance as measured by risk-adjusted margin have been replaced with risk-adjusted revenue growth;
- the GMB will prioritise return on average total shareholders' equity in place of return on average invested capital, which has therefore been excluded; and
- customer transactions processed and percentage of information technology ('IT') services meeting targets form part of management information within our IT function. However, the GMB decided that these measures, which we have previously disclosed, were not appropriate proxies for assessing efficiencies and progress with implementing standard systems architecture.

Report of the Directors: Overview (continued)

Strategic objectives and KPIs

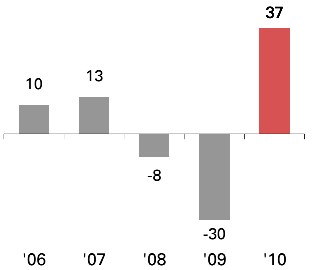
Strategic objectives

Deliver consistent earnings and superior risk-adjusted returns

Key Performance Indicators

Risk-adjusted revenue growth

(2010: underlying growth 15%)

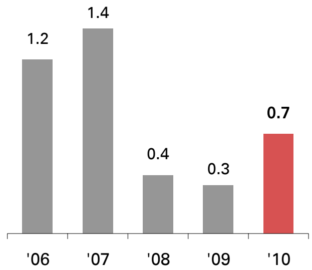


Measure: (percentage) increase in reported net operating income after loan impairment and other credit risk charges since last year.

Target: to deliver consistent growth in risk adjusted revenues.

Outcome: reported risk-adjusted revenue increased, primarily due to a reversal of adverse movements in previous years on the fair value of own debt designated at fair value and lower loan impairment charges. The latter also drove the increase in underlying risk-adjusted revenue.

Basic earnings per ordinary share

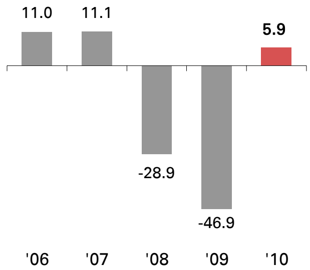


Measure: (US$) level of basic earnings generated per ordinary share.

Target: to deliver consistent growth in basic earnings per share.

Outcome: Earnings per share (**'**EPS') increased in 2010, reflecting significantly lower adverse movements on the fair value of own debt due to credit spreads and lower loan impairment charges, which resulted in an increase in reported profit.

Dividends per share growth



Measure: (percentage) increase in dividends per share since last year, based on dividends paid in respect of the year to which the dividend relates.

Target: to deliver sustained dividend per share growth.

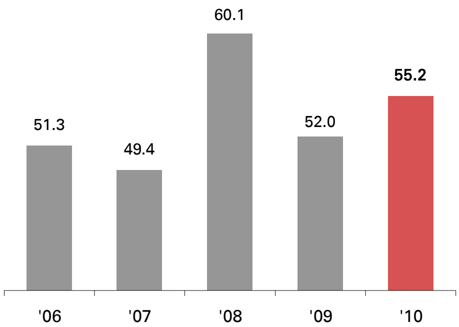
Outcome: dividends per share increased by 5.9%.

Strategic objectives

Enhance efficiency using economies of scale

Key Performance Indicators

Cost efficiency



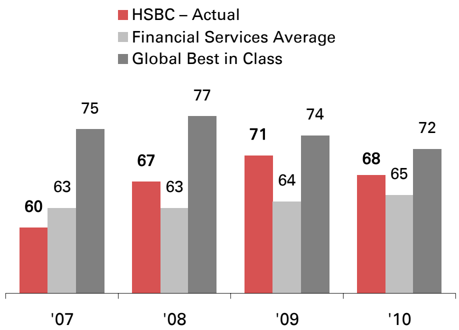
Measure: (percentage) total operating expenses divided by net operating income before loan impairment and other credit risk provisions.

Target: to be between 48% and 52%, a range within which business is expected to remain to accommodate both returns to shareholders and the need for continued investment in support of future business growth.

Outcome: the ratio was outside the target range in part due to one-off costs, but also increased investment in operational infrastructure and strategic initiatives.

Motivate staff to deliver strategy

Employee engagement



Measure: (percentage) measure of employee's emotional and rational attachment to HSBC, a combination of advocacy, satisfaction, commitment and pride.

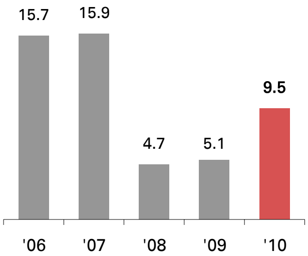
Target: to achieve a 72% global rating in 2010, with progressive improvement to best in class by 2011.

Outcome: 68%, mirroring the fall in global best in class but remaining well above the financial services average.

Strategic objectives

Maintain capital strength and strong liquidity

Return on average total shareholders' equity[3]

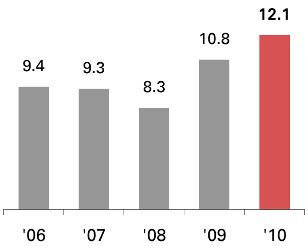


Measure: (percentage) profit attributable to shareholders divided by average total shareholders' equity.

Target: to maintain a return in the medium term of between 15% and 19%. In 2011, we intend to replace the target with one in the 12% to 15% range over the normal cycle.

Outcome: return on equity was below the target range, but 4.4 percentage points higher than in 2009.

Tier 1 capital

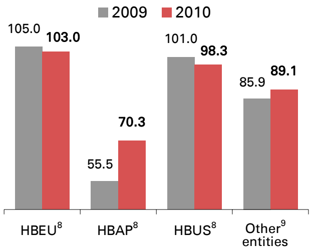


Measure: component of regulatory capital comprising core tier 1 and other tier 1 capital.

Target: to maintain a strong capital base to support the development of the business and meet regulatory capital requirements at all times.

Outcome: the increase in tier 1 capital to 12.1% reflected the contribution of profit to capital, the issue of hybrid capital securities during the year and careful management of RWAs.

Advances to core funding ratio



Measure: current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year.

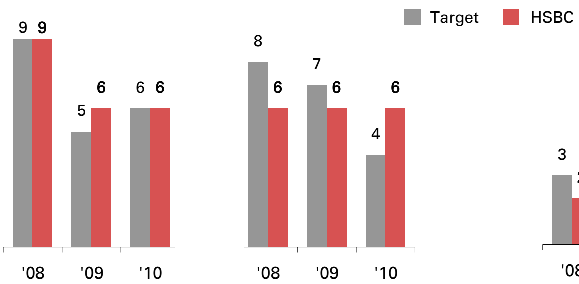
Target: to maintain an advances to core funding ratio below limits set for each entity.

Outcome: ratio within the limits set by the Risk Management Meeting for each site.

Strategic objectives

Reach new customers and expand services to existing customers using the HSBC brand and global network

Brand perception

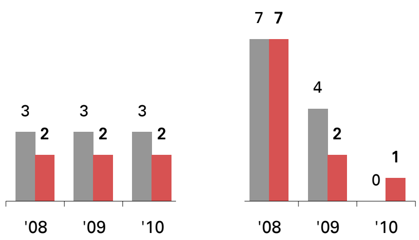


Measure: an independent survey of brands around the world which judges their relative strength. The results are used to form a brand perception index, where the industry average is zero.

Target: to meet or exceed targets based on performance against key competitors and the industry average.

Outcome: PFS and Business Banking customers judged HSBC's brand to be six points stronger than the competitor average. Our ratings met or exceeded our targets in 2010.

Customer recommendation



Measure: an independent survey of customers in up to 15 countries which judges how likely they are to recommend a particular brand. The results are used to create a customer recommendation index, where the industry average is zero.

Target: to meet or exceed targets based on performance against key competitors and the industry average.

Outcome: Business Banking exceeded its target. Personal Financial Services fell short of its challenging target, but remained well above the competitor average.

For footnotes, see page 83.