Financial Statements

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Financial Statements and Notes on the Financial Statements

Financial Statements (continued)

Consolidated income statement / Consolidated statement of comprehensive income

Consolidated income statement for the year ended 31 December 2012

	Notes	2012 US$m	2011 US$m	2010 US$m
Interest income		**56,702**	63,005	58,345
Interest expense		**(19,030)**	(22,343)	(18,904)
Net interest income		**37,672**	40,662	39,441
Fee income		**20,149**	21,497	21,117
Fee expense		**(3,719)**	(4,337)	(3,762)
Net fee income		**16,430**	17,160	17,355
Trading income excluding net interest income		**4,408**	3,283	4,680
Net interest income on trading activities		**2,683**	3,223	2,530
Net trading income		**7,091**	6,506	7,210
Changes in fair value of long-term debt issued and related derivatives		**(4,327)**	4,161	(258)
Net income/(expense) from other financial instruments designated at fair value		**2,101**	(722)	1,478
Net income/(expense) from financial instruments designated at fair value	*3*	**(2,226)**	3,439	1,220
Gains less losses from financial investments		**1,189**	907	968
Dividend income		**221**	149	112
Net earned insurance premiums	*4*	**13,044**	12,872	11,146
Gains on disposal of US branch network, US cards business and Ping An Insurance (Group) Company of China, Limited	*26*	**7,024**	–	–
Other operating income		**2,100**	1,766	2,562
Total operating income		**82,545**	83,461	80,014
Net insurance claims incurred and movement in liabilities to policyholders	*5*	**(14,215)**	(11,181)	(11,767)
Net operating income before loan impairment charges and other credit risk provisions		**68,330**	72,280	68,247
Loan impairment charges and other credit risk provisions	*6*	**(8,311)**	(12,127)	(14,039)
Net operating income		**60,019**	60,153	54,208
Employee compensation and benefits	*7*	**(20,491)**	(21,166)	(19,836)
General and administrative expenses		**(19,983)**	(17,459)	(15,156)
Depreciation and impairment of property, plant and equipment	*24*	**(1,484)**	(1,570)	(1,713)
Amortisation and impairment of intangible assets	*23*	**(969)**	(1,350)	(983)
Total operating expenses		**(42,927)**	(41,545)	(37,688)
Operating profit	*6*	**17,092**	18,608	16,520
Share of profit in associates and joint ventures	*22*	**3,557**	3,264	2,517
Profit before tax		**20,649**	21,872	19,037
Tax expense	*9*	**(5,315)**	(3,928)	(4,846)
Profit for the year		**15,334**	17,944	14,191
Profit attributable to shareholders of the parent company		**14,027**	16,797	13,159
Profit attributable to non-controlling interests		**1,307**	1,147	1,032
		US$	US$	US$
Basic earnings per ordinary share	*11*	**0.74**	0.92	0.73
Diluted earnings per ordinary share	*11*	**0.74**	0.91	0.72

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.

Consolidated statement of comprehensive income for the year ended 31 December 2012

	2012 US$m	2011 US$m	2010 US$m
Profit for the year	**15,334**	17,944	14,191
Other comprehensive income/(expense)			
Available-for-sale investments	**5,070**	674	5,835
– fair value gains[2]	**6,396**	1,279	6,368
– fair value gains transferred to the income statement on disposal	**(1,872)**	(820)	(1,174)
– amounts transferred to the income statement in respect of impairment losses	**1,002**	583	1,118
– income taxes	**(456)**	(368)	(477)
Cash flow hedges	**109**	187	(271)
– fair value gains/(losses)	**552**	(581)	(178)
– fair value (gains)/losses transferred to the income statement	**(423)**	788	(164)
– income taxes	**(20)**	(20)	71
Actuarial gains/(losses) on defined benefit plans	**(195)**	1,009	(61)
– before income taxes	**(391)**	1,267	(60)
– income taxes	**196**	(258)	(1)
Share of other comprehensive income/(expense) of associates and joint ventures	**533**	(710)	107
– share for the year	**311**	(710)	107
– reclassified to income statement on disposal	**222**	–	–
Exchange differences	**1,017**	(2,865)	(567)
– foreign exchange gains reclassified to income statement on disposal of a foreign operation	**(1,128)**	–	–
– other exchange difference	**2,145**	(2,865)	(567)
Income tax attributable to exchange differences	**–**	165	–
Other comprehensive income for the year, net of tax	**6,534**	(1,540)	5,043
Total comprehensive income for the year	**21,868**	16,404	19,234
Total comprehensive income for the year attributable to:			
– shareholders of the parent company	**20,455**	15,366	18,087
– non-controlling interests	**1,413**	1,038	1,147
	21,868	16,404	19,234

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.

Financial Statements (continued)

Consolidated balance sheet at 31 December 2012

	Notes	2012 US$m	2011 US$m
Assets			
Cash and balances at central banks		**141,532**	129,902
Items in the course of collection from other banks		**7,303**	8,208
Hong Kong Government certificates of indebtedness		**22,743**	20,922
Trading assets	*14*	**408,811**	330,451
Financial assets designated at fair value	*18*	**33,582**	30,856
Derivatives	*19*	**357,450**	346,379
Loans and advances to banks		**152,546**	180,987
Loans and advances to customers		**997,623**	940,429
Financial investments	*20*	**421,101**	400,044
Assets held for sale	*26*	**19,269**	39,558
Other assets	*26*	**54,716**	48,699
Current tax assets		**515**	1,061
Prepayments and accrued income		**9,502**	10,059
Interests in associates and joint ventures	*22*	**17,834**	20,399
Goodwill and intangible assets	*23*	**29,853**	29,034
Property, plant and equipment	*24*	**10,588**	10,865
Deferred tax assets	*9*	**7,570**	7,726
Total assets		**2,692,538**	2,555,579
Liabilities and equity			
Liabilities			
Hong Kong currency notes in circulation		**22,742**	20,922
Deposits by banks		**107,429**	112,822
Customer accounts		**1,340,014**	1,253,925
Items in the course of transmission to other banks		**7,138**	8,745
Trading liabilities	*27*	**304,563**	265,192
Financial liabilities designated at fair value	*28*	**87,720**	85,724
Derivatives	*19*	**358,886**	345,380
Debt securities in issue	*29*	**119,461**	131,013
Liabilities of disposal groups held for sale	*30*	**5,018**	22,200
Other liabilities	*30*	**33,862**	27,967
Current tax liabilities		**1,452**	2,117
Liabilities under insurance contracts	*31*	**68,195**	61,259
Accruals and deferred income		**13,184**	13,106
Provisions	*32*	**5,252**	3,324
Deferred tax liabilities	*9*	**1,109**	1,518
Retirement benefit liabilities	*7*	**3,905**	3,666
Subordinated liabilities	*33*	**29,479**	30,606
Total liabilities		**2,509,409**	2,389,486
Equity			
Called up share capital	*38*	**9,238**	8,934
Share premium account		**10,084**	8,457
Other equity instruments		**5,851**	5,851
Other reserves		**29,722**	23,615
Retained earnings		**120,347**	111,868
Total shareholders' equity		**175,242**	158,725
Non-controlling interests	*37*	**7,887**	7,368
Total equity		**183,129**	166,093
Total equity and liabilities		**2,692,538**	2,555,579

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.

D J Flint, *Group Chairman*

Consolidated statement of cash flows for the year ended 31 December 2012

	Notes	2012 US$m	2011 US$m	2010 US$m
Cash flows from operating activities				
Profit before tax		**20,649**	21,872	19,037
Adjustments for:				
– net gain from investing activities		**(2,094)**	(1,196)	(1,698)
– share of profits in associates and joint ventures		**(3,557)**	(3,264)	(2,517)
– gain on disposal of US branch network, US cards business and Ping An Insurance (Group) Company of China, Limited		**(7,024)**	–	–
– other non-cash items included in profit before tax	*39*	**19,778**	19,878	18,887
– change in operating assets	*39*	**(116,521)**	(7,412)	(13,267)
– change in operating liabilities	*39*	**89,070**	44,012	42,272
– elimination of exchange differences[3]		**(3,626)**	10,840	(1,799)
– dividends received from associates		**489**	304	441
– contributions paid to defined benefit plans		**(733)**	(1,177)	(3,321)
– tax paid		**(5,587)**	(4,095)	(2,293)
Net cash (used in)/generated from operating activities		**(9,156)**	79,762	55,742
Cash flows from investing activities				
Purchase of financial investments		**(342,974)**	(319,008)	(341,202)
Proceeds from the sale and maturity of financial investments		**329,926**	311,702	321,846
Purchase of property, plant and equipment		**(1,318)**	(1,505)	(2,533)
Proceeds from the sale of property, plant and equipment		**241**	300	4,373
Proceeds from the sale of loan portfolios		**–**	–	4,243
Net purchase of intangible assets		**(1,008)**	(1,571)	(1,179)
Net cash outflow from acquisition of subsidiaries		**–**	–	(86)
Net cash inflow from disposal of US branch network and US cards business		**20,905**	–	–
Net cash inflow/(outflow) from disposal of other subsidiaries and businesses		**(863)**	216	466
Net cash outflow from acquisition of or increase in stake of associates		**(1,804)**	(90)	(1,589)
Net cash outflow from the deconsolidation of funds		**–**	–	(19,566)
Proceeds from disposal of Ping An Insurance (Group) Company of China, Limited		**1,954**	–	–
Proceeds from disposal of other associates and joint ventures		**594**	25	254
Net cash generated/(used) in investing activities		**5,653**	(9,931)	(34,973)
Cash flows from financing activities				
Issue of ordinary share capital		**594**	96	180
Issue of other equity instruments		**–**	–	3,718
Net sales/(purchases) of own shares for market-making and investment purposes		**(25)**	(225)	163
Net sales/(purchases) of own shares to meet share awards and share option awards		**–**	(136)	11
On exercise of share options		**–**	–	2
Subordinated loan capital issued		**37**	7	4,481
Subordinated loan capital repaid		**(1,754)**	(3,777)	(2,475)
Net cash inflow/(outflow) from change in stake in subsidiaries		**(14)**	104	(229)
Dividends paid to shareholders of the parent company		**(5,925)**	(5,014)	(3,441)
Dividends paid to non-controlling interests		**(572)**	(568)	(595)
Dividends paid to holders of other equity instruments		**(573)**	(573)	(413)
Net cash generated from/(used in) financing activities		**(8,232)**	(10,086)	1,402
Net increase/(decrease) in cash and cash equivalents		**(11,735)**	59,745	22,171
Cash and cash equivalents at 1 January		**325,449**	274,076	250,766
Exchange differences in respect of cash and cash equivalents		**1,594**	(8,372)	1,139
Cash and cash equivalents at 31 December	*39*	**315,308**	325,449	274,076

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.

Financial Statements (continued)

Consolidated statement of changes in equity

Consolidated statement of changes in equity for the year ended 31 December 2012

	2012										
					Other reserves						
	Called up share capital US$m	Share premium[4] US$m	Other equity instru-ments US$m	Retained earnings[5,6,7] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[8] US$m	Foreign exchange reserve US$m	Merger reserve[5,9] US$m	Total share-holders' equity US$m	Non-controlling interests US$m	Total equity US$m
At 1 January	8,934	8,457	5,851	111,868	(3,361)	(95)	(237)	27,308	158,725	7,368	166,093
Profit for the year	–	–	–	14,027	–	–	–	–	14,027	1,307	15,334
Other comprehensive income (net of tax)	–	–	–	321	5,010	108	989	–	6,428	106	6,534
Available-for-sale investments	–	–	–	–	5,010	–	–	–	5,010	60	5,070
Cash flow hedges	–	–	–	–	–	108	–	–	108	1	109
Actuarial gains/(losses) on defined benefit plans	–	–	–	(212)	–	–	–	–	(212)	17	(195)
Share of other comprehensive income of associates and joint ventures	–	–	–	533	–	–	–	–	533	–	533
Exchange differences	–	–	–	–	–	–	989	–	989	28	1,017
Total comprehensive income for the year	–	–	–	14,348	5,010	108	989	–	20,455	1,413	21,868
Shares issued under employee remuneration and share plans	119	1,812	–	(1,337)	–	–	–	–	594	–	594
Shares issued in lieu of dividends and amounts arising thereon[4]	185	(185)	–	2,429	–	–	–	–	2,429	–	2,429
Dividends to shareholders[10]	–	–	–	(8,042)	–	–	–	–	(8,042)	(707)	(8,749)
Tax credit on distributions	–	–	–	32	–	–	–	–	32	–	32
Own shares adjustment	–	–	–	2	–	–	–	–	2	–	2
Cost of share-based payment arrangements	–	–	–	988	–	–	–	–	988	–	988
Income taxes on share-based payments	–	–	–	42	–	–	–	–	42	–	42
Other movements	–	–	–	(26)	–	–	–	–	(26)	(20)	(46)
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	–	–	–	(108)	(108)
Changes in ownership interests in subsidiaries that did not result in loss of control	–	–	–	43	–	–	–	–	43	(59)	(16)
At 31 December	9,238	10,084	5,851	120,347	1,649	13	752	27,308	175,242	7,887	183,129

	2011										
					Other reserves						
	Called up share capital US$m	Share premium[4] US$m	Other equity instru-ments US$m	Retained earnings[5,6,7] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[8] US$m	Foreign exchange reserve US$m	Merger reserve[5,9] US$m	Total share-holders' equity US$m	Non-controlling interests US$m	Total equity US$m
At 1 January	8,843	8,454	5,851	99,105	(4,077)	(285)	2,468	27,308	147,667	7,248	154,915
Profit for the year	–	–	–	16,797	–	–	–	–	16,797	1,147	17,944
Other comprehensive income (net of tax)	–	–	–	368	716	190	(2,705)	–	(1,431)	(109)	(1,540)
Available-for-sale investments	–	–	–	–	716	–	–	–	716	(42)	674
Cash flow hedges	–	–	–	–	–	190	–	–	190	(3)	187
Actuarial gains/(losses) on defined benefit plans	–	–	–	1,078	–	–	–	–	1,078	(69)	1,009
Share of other comprehensive income of associates and joint ventures	–	–	–	(710)	–	–	–	–	(710)	–	(710)
Exchange differences	–	–	–	–	–	–	(2,705)	–	(2,705)	5	(2,700)
Total comprehensive income for the year	–	–	–	17,165	716	190	(2,705)	–	15,366	1,038	16,404
Shares issued under employee share plans	6	90	–	–	–	–	–	–	96	–	96
Shares issued in lieu of dividends and amounts arising thereon[4]	85	(87)	–	2,232	–	–	–	–	2,230	–	2,230
Dividends to shareholders[10]	–	–	–	(7,501)	–	–	–	–	(7,501)	(815)	(8,316)
Tax credit on distributions	–	–	–	128	–	–	–	–	128		128
Own shares adjustment	–	–	–	(361)	–	–	–	–	(361)	–	(361)
Cost of share-based payment arrangements	–	–	–	1,154	–	–	–	–	1,154	–	1,154
Income taxes on share-based payments	–	–	–	21	–	–	–	–	21	–	21
Other movements	–	–	–	(75)	–	–	–	–	(75)	28	(47)
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	–	–	–	(252)	(252)
Changes in ownership interests in subsidiaries that did not result in loss of control	–	–	–	–	–	–	–	–	–	121	121
At 31 December	8,934	8,457	5,851	111,868	(3,361)	(95)	(237)	27,308	158,725	7,368	166,093

Consolidated statement of changes in equity for the year ended 31 December 2012 (continued)

	2010										
					Other reserves						
	Called up share capital US$m	Share premium[4] US$m	Other equity instru-ments US$m	Retained earnings[5,6,7] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[8] US$m	Foreign exchange reserve US$m	Merger reserve[5,9] US$m	Total share-holders' equity US$m	Non-controlling interests US$m	Total equity US$m
At 1 January	8,705	8,413	2,133	88,737	(9,965)	(26)	2,994	27,308	128,299	7,362	135,661
Profit for the year	–	–	–	13,159	–	–	–	–	13,159	1,032	14,191
Other comprehensive income (net of tax)	–	–	–	49	5,671	(266)	(526)	–	4,928	115	5,043
Available-for-sale investments	–	–	–	–	5,671	–	–	–	5,671	164	5,835
Cash flow hedges	–	–	–	–	–	(266)	–	–	(266)	(5)	(271)
Actuarial losses on defined benefit plans	–	–	–	(58)	–	–	–	–	(58)	(3)	(61)
Share of other comprehensive income of associates and joint ventures	–	–	–	107	–	–	–	–	107	–	107
Exchange differences	–	–	–	–	–	–	(526)	–	(526)	(41)	(567)
Total comprehensive income for the year	–	–	–	13,208	5,671	(266)	(526)	–	18,087	1,147	19,234
Shares issued under employee share plans	12	168	–	–	–	–	–	–	180	–	180
Shares issued in lieu of dividends and amounts arising thereon[4]	126	(127)	–	2,524	–	–	–	–	2,523	–	2,523
Capital securities issued[11]	–	–	3,718	–	–	–	–	–	3,718	–	3,718
Dividends to shareholders[10]	–	–	–	(6,350)	–	–	–	–	(6,350)	(725)	(7,075)
Tax credit on distributions	–	–	–	122	–	–	–	–	122	–	122
Own shares adjustment	–	–	–	174	–	–	–	–	174	–	174
Cost of share-based payment arrangements	–	–	–	812	–	–	–	–	812	–	812
Income taxes on share-based payments	–	–	–	(14)	–	–	–	–	(14)	–	(14)
Other movements	–	–	–	(58)	217	7	–	–	166	3	169
Acquisition and disposal of subsidiaries	–	–	–	–	–	–	–	–	–	(436)	(436)
Changes in ownership interests in subsidiaries that did not result in loss of control	–	–	–	(50)	–	–	–	–	(50)	(103)	(153)
At 31 December	8,843	8,454	5,851	99,105	(4,077)	(285)	2,468	27,308	147,667	7,248	154,915

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

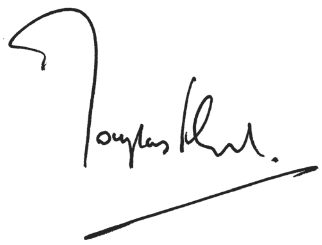
For footnotes, see page 382.

HSBC Holdings balance sheet at 31 December 2012

	Notes	2012 US$m	2011 US$m
Assets			
Cash at bank and in hand:			
– balances with HSBC undertakings		**353**	316
Derivatives	*19*	**3,768**	3,568
Loans and advances to HSBC undertakings		**41,675**	28,048
Financial investments		**1,208**	1,078
Current tax assets		**147**	104
Prepayments and accrued income		**82**	32
Investments in subsidiaries	*25*	**92,234**	90,621
Property, plant and equipment		**3**	4
Deferred tax assets	*9*	**14**	91
Total assets		**139,484**	123,862
Liabilities and equity			
Liabilities			
Amounts owed to HSBC undertakings		**12,856**	2,479
Financial liabilities designated at fair value	*28*	**23,195**	21,151
Derivatives	*19*	**760**	1,067
Debt securities in issue	*29*	**2,691**	2,613
Other liabilities	*30*	**30**	911
Accruals and deferred income		**1,018**	1,008
Subordinated liabilities	*33*	**11,907**	12,450
Total liabilities		**52,457**	41,679
Equity			
Called up share capital	*38*	**9,238**	8,934
Share premium account		**10,084**	8,457
Other equity instruments		**5,828**	5,828
Other reserves		**37,170**	36,849
Retained earnings		**24,707**	22,115
Total equity		**87,027**	82,183
Total equity and liabilities		**139,484**	123,862

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.



D J Flint, *Group Chairman*

Financial Statements (continued)

HSBC Holdings statement of cash flows for the year ended 31 December 2012

	Notes	2012 US$m	2011 US$m
Cash flows from operating activities			
Profit before tax		**8,679**	5,758
Adjustments for:			
– non-cash items included in profit before tax	39	**535**	77
– change in operating assets	39	**(4,011)**	(5,489)
– change in operating liabilities	39	**2,951**	(414)
– net loss from investing activities		**–**	570
– tax paid		**(549)**	(57)
Net cash generated from operating activities		**7,605**	445
Cash flows from investing activities			
Proceeds from sale of financial investments		**–**	941
Net cash outflow from acquisition of or increase in stake of subsidiaries		**(1,973)**	(626)
Net cash from/(used in) investing activities		**(1,973)**	315
Cash flows from financing activities			
Issue of ordinary share capital		**1,905**	96
Sales of own shares to meet share awards and share option awards		**178**	–
Subordinated loan capital repaid		**(760)**	(750)
Debt securities issued		**2,000**	5,338
Debt securities repaid		**(2,420)**	–
Dividends paid		**(5,925)**	(5,014)
Dividends paid to holders of other equity instruments		**(573)**	(573)
Net cash used in financing activities		**(5,595)**	(903)
Net increase/(decrease) in cash and cash equivalents		**37**	(143)
Cash and cash equivalents at 1 January		**316**	459
Cash and cash equivalents at 31 December	39	**353**	316

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnote, see page 382.

HSBC Holdings statement of changes in equity for the year ended 31 December 2012

	Called up share capital US$m	Share premium[4] US$m	Other equity instru-ments US$m	Retained earnings[12] US$m	Other reserves: Available-for-sale fair value reserve US$m	Other reserves: Other paid-in capital[13] US$m	Other reserves: Merger and other reserves[9] US$m	Total share-holders' equity US$m
At 1 January 2012	8,934	8,457	5,828	22,115	12	1,710	35,127	82,183
Profit for the year	–	–	–	8,082	–	–	–	8,082
Other comprehensive income (net of tax)	–	–	–	–	102	–	–	102
Available-for-sale investments	–	–	–	–	129	–	–	129
Income tax	–	–	–	–	(27)	–	–	(27)
Total comprehensive income for the year	–	–	–	8,082	102	–	–	8,184
Shares issued under employee share plans	119	1,812	–	(26)	–	–	–	1,905
Shares issued in lieu of dividends and amounts arising thereon[4]	185	(185)	–	2,429	–	–	–	2,429
Dividends to shareholders[10]	–	–	–	(8,042)	–	–	–	(8,042)
Tax credit on distributions	–	–	–	32	–	–	–	32
Own shares adjustment	–	–	–	379	–	–	–	379
Exercise and lapse of share options	–	–	–	(219)	–	219	–	–
Cost of share-based payment arrangements	–	–	–	55	–	–	–	55
Income taxes on share-based payments	–	–	–	10	–	–	–	10
Equity investments granted to employees of subsidiaries under employee share plans	–	–	–	(108)	–	–	–	(108)
At 31 December 2012	9,238	10,084	5,828	24,707	114	1,929	35,127	87,027
At 1 January 2011	8,843	8,454	5,828	21,440	56	1,583	35,127	81,331
Profit for the year	–	–	–	5,471	–	–	–	5,471
Other comprehensive income (net of tax)	–	–	–	–	(44)	–	–	(44)
Available-for-sale investments	–	–	–	–	(61)	–	–	(61)
Income tax	–	–	–	–	17	–	–	17
Total comprehensive income for the year	–	–	–	5,471	(44)	–	–	5,427
Shares issued under employee share plans	6	90	–	–	–	–	–	96
Shares issued in lieu of dividends and amounts arising thereon[4]	85	(87)	–	2,232	–	–	–	2,230
Dividends to shareholders[10]	–	–	–	(7,501)	–	–	–	(7,501)
Tax credit on distributions	–	–	–	128	–	–	–	128
Own shares adjustment	–	–	–	(265)	–	–	–	(265)
Exercise and lapse of share options	–	–	–	(127)	–	127	–	–
Cost of share-based payment arrangements	–	–	–	57	–	–	–	57
Equity investments granted to employees of subsidiaries under employee share plans	–	–	–	674	–	–	–	674
Other movements	–	–	–	6	–	–	–	6
At 31 December 2011	8,934	8,457	5,828	22,115	12	1,710	35,127	82,183

Dividends per ordinary share at 31 December 2012 were US$0.41 (2011: US$0.39; 2010: US$0.34).

The accompanying notes on pages 383 to 515 form an integral part of these financial statements[1].

For footnotes, see page 382.

Footnotes to Financial Statements

1 *The 'Critical accounting policies' on pages 54 to 57, the audited sections of 'Risk' on pages 123 to 280 and the audited sections of 'Capital' on pages 281 to 300 are also an integral part of these financial statements.*

2 *Fair value gains in available-for-sale investments for 2012 include US$737m relating to the investment in Ping An classified as assets held for sale.*

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

4 *Share premium includes a nil deduction in respect of issuance costs incurred during the year (2011: US$2m; 2010: US$1m).*

5 *Cumulative goodwill amounting to US$5,138m has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US$3,469m charged against the merger reserve arising on the acquisition of HSBC Bank plc. The balance of US$1,669m has been charged against retained earnings.*

6 *Retained earnings include 86,394,826 (US$874m) of own shares held within HSBC's Insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets (2011: 98,498,019 (US$1,320m); 2010: 123,331,979 (US$1,799m)).*

7 *The movement in reserves relating to equity-settled share-based payment arrangement is recognised in 'Retained earnings' in the 'Consolidated Statement of change in equity' with effect from 1 January 2011. Previously it was disclosed separately in a 'Share-based payment reserve' within 'Other reserves'. Comparative data have been restated accordingly. The adjustment reduced 'Other reserves' and increased 'Retained earnings' by US$1,982m at 31 December 2012 (2011: US$2,274m; 2010: US$1,755m). There was no effect on basic or diluted earnings per share following this change.*

8 *Amounts transferred to the income statement in respect of cash flow hedges include US$43m gain (2011: US$104m gain; 2010: US$605m gain) taken to 'Net interest income' and US$380m gain (2011: US$893m loss; 2010: US$441m loss) taken to 'Net trading income'.*

9 *Statutory share premium relief under Section 131 of the Companies Act 1985 (the 'Act') was taken in respect of the acquisition of HSBC Bank plc in 1992, HSBC France in 2000 and HSBC Finance Corporation in 2003 and the shares issued were recorded at their nominal value only. In HSBC's consolidated financial statements the fair value differences of US$8,290m in respect of HSBC France and US$12,768m in respect of HSBC Finance Corporation were recognised in the merger reserve. The merger reserve created on the acquisition of HSBC Finance Corporation subsequently became attached to HSBC Overseas Holdings (UK) Limited ('HOHU'), following a number of intra-group reorganisations. During 2009, pursuant to Section 131 of the Companies Act 1985, statutory share premium relief was taken in respect of the rights issue and US$15,796m was recognised in the merger reserve. The merger reserve includes the deduction of US$614m in respect of costs relating to the rights issue, of which US$149m was subsequently transferred to the income statement. Of this US$149m, US$121m was a loss arising from accounting for the agreement with the underwriters as a contingent forward contract. The merger reserve excludes the loss of US$344m on a forward foreign exchange contract associated with hedging the proceeds of the rights issue.*

10 *Including distributions paid on preference shares and capital securities classified as equity.*

11 *During June 2010, HSBC Holdings issued US$3,800m of Perpetual Subordinated Capital Securities, Series 2 ('capital securities') on which there were US$82m of external issuance costs and US$23m of intra-group issuance costs which are classified as equity under IFRSs. The capital securities are exchangeable at HSBC Holdings' option into non-cumulative US dollar preference shares on any coupon payment date. Interest on the captial securities is paid quarterly and may be deferred at the discretion of HSBC Holdings. The capital securities may only be redeemed at the option of HSBC Holdings.*

12 *Retained earnings include 3,903,901 (US$57m) of own shares held to fund employee share plans (2011: 33,557,764 (US$563m)).*

13 *Other paid-in capital arises from the exercise and lapse of share options granted to employees of HSBC Holdings subsidiaries.*

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('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 2012, there were no unendorsed standards effective for the year ended 31 December 2012 affecting these consolidated and separate 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 HSBC. Accordingly, HSBC's financial statements for the year ended 31 December 2012 are prepared in accordance with IFRSs as issued by the IASB.

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.

As a result of changing market practices in response to regulatory and accounting changes, as well as general market developments, HSBC revised its methodology for estimating the credit valuation adjustment ('CVA') for derivatives at 31 December 2012. Previously, the probability of default ('PD') used in the CVA calculation was based on HSBC's internal credit rating for the counterparty taking into account how credit ratings may deteriorate over the duration of the exposure based on historical rating transition matrices. The revised methodology maximises the use of the PDs based on market-observable data, such as credit default swap ('CDS') spreads. Where CDS spreads are not available, PDs are estimated having regard to market practice, considering relevant data including both CDS indices and historical rating transition matrices. In addition, HSBC aligned its methodology for estimating the debit valuation adjustment ('DVA') to be consistent with that applied for CVA as at 31 December 2012. Historically, HSBC considered that a zero spread was appropriate in respect of own credit risk and consequently did not adjust derivative liabilities for its own credit risk.

At 31 December 2012, the effect of the changes in fair value estimates as a result of the revisions to methodology was to reduce derivative liabilities by US$518m and to reduce derivative assets by US$899m resulting in a reduction in net trading income of US$381m. It is impracticable to estimate the effect of the changes in fair value estimates on future periods. See Note 15 for further information on CVA and DVA methodologies.

During 2012, HSBC adopted a number of interpretations and amendments to standards which had an insignificant effect on the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings.

(b) Differences between IFRSs and Hong Kong Financial Reporting Standards

There are no significant differences between IFRSs and Hong Kong Financial Reporting Standards in terms of their application to HSBC and consequently there would be no significant differences had the financial statements been prepared in accordance with Hong Kong Financial Reporting Standards. The Notes on the Financial Statements, taken together with the Report of the Directors, include the aggregate of all disclosures necessary to satisfy IFRSs and Hong Kong reporting requirements.

(c) Presentation of information

Disclosures under IFRS 4 'Insurance Contracts' and IFRS 7 'Financial Instruments: Disclosures' concerning the nature and extent of risks relating to insurance contracts and financial instruments have been included in the audited sections of the 'Report of the Directors: Risk' on pages 123 to 280.

Capital disclosures under IAS 1 'Presentation of Financial Statements' have been included in the audited sections of 'Report of the Directors: Capital' on pages 281 to 300.

Disclosures relating to HSBC's securitisation activities and structured products have been included in the audited section of 'Report of the Directors: Risk' on pages 123 to 280.

In accordance with HSBC's policy to provide disclosures that help investors and other stakeholders understand the Group's performance, financial position and changes thereto, the information provided in the Notes on the Financial Statements and the Report of the Directors goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules. In particular, HSBC has provided additional disclosures following the issue of the Enhanced Disclosures Task Force ('EDTF') report 'Enhancing the Risk Disclosures of Banks' in 2012 and will further enhance its risk disclosures in 2013. The report aims to help financial institutions identify areas that investors had highlighted needed better and more transparent information about banks' risks, and how these risks relate to performance measurement and reporting. The recommendations for disclosure improvement focused on the principal risks faced by the banking industry, and included disclosures about risk governance, capital adequacy, liquidity, funding, credit risk, market risk and other risks. In addition, HSBC follows the British Bankers' Association Code for Financial Reporting Disclosure ('the BBA Code'). The BBA Code aims to increase the quality and comparability of UK banks' disclosures and sets out five disclosure principles together with supporting guidance. In line with the principles of the BBA Code, HSBC assesses good practice recommendations issued from time to time by relevant regulators and standard setters and will assess the applicability and relevance of such guidance, enhancing disclosures where appropriate.

In publishing the parent company financial statements here together with the Group financial statements, HSBC Holdings has taken advantage of the exemption in section 408(3) of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these financial statements.

HSBC's consolidated financial statements are presented in US dollars which is also HSBC Holdings' functional currency. HSBC Holdings' functional currency is the US dollar because the US dollar and currencies linked to it are the most significant currencies relevant to the underlying transactions, events and conditions of its subsidiaries, as well as representing a significant proportion of its funds generated from financing activities. HSBC uses the US dollar as its presentation currency in its consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts and funds its business.

(d) 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 estimates upon which financial information is prepared. Management believes that HSBC'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, deferred tax assets and provisions for liabilities. See 'Critical accounting policies' on pages 54 to 57, which form an integral part of these financial statements.

Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in the Notes on the Financial Statements.

(e) Consolidation

The consolidated financial statements of HSBC comprise the financial statements of HSBC Holdings and its subsidiaries made up to 31 December, with the exception of the banking and insurance subsidiaries of HSBC Bank Argentina, whose financial statements are made up to 30 June annually to comply with local regulations. Accordingly, HSBC uses their audited interim financial statements, drawn up to 31 December annually.

Subsidiaries are consolidated from the date that HSBC gains control. The acquisition method of accounting is used when subsidiaries are acquired by HSBC. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of HSBC's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. In a business combination achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with the resulting gain or loss recognised in the income statement. In the event that the amount of net assets acquired is in excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of HSBC's previously held equity interest, the difference is recognised immediately in the income statement.

Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Entities that are controlled by HSBC are consolidated until the date that control ceases.

In the context of Special Purpose Entities ('SPE's), the following circumstances may indicate a relationship in which, in substance, HSBC controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefits from the SPE's operation;
- HSBC has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, HSBC has delegated these decision-making powers;
- HSBC has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or
- HSBC retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

HSBC performs a re-assessment of consolidation whenever there is a change in the substance of the relationship between HSBC and an SPE.

All intra-HSBC transactions are eliminated on consolidation.

The consolidated financial statements of HSBC also include the attributable share of the results and reserves of joint ventures and associates. These are based on financial statements made up to 31 December, with the exception of BoCom, Ping An and Industrial Bank which are included on the basis of financial statements made up for the twelve months to 30 September. These are equity accounted three months in arrears in order to meet the requirements of the Group's reporting timetable. HSBC takes into account the effect of significant transactions or events that occur between the period from 1 October to 31 December that would have a material effect on its results. As discussed further in Note 26, HSBC announced disposal of its entire shareholding in Ping An. As a result of the disposal of the first tranche of shares on 7 December 2012, HSBC no longer had significant influence over Ping An at 31 December 2012 and ceased to account for it as an associate.

(f) Future accounting developments

At 31 December 2012, a number of standards and amendments to standards had been issued by the IASB which are not effective for these consolidated financial statements. In addition to the projects to complete financial instrument accounting, the IASB is continuing to work on projects on insurance, revenue recognition and lease accounting which, together with the standards described below, could represent significant changes to accounting requirements in the future.

Amendments issued by the IASB

Standards applicable in 2013

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements,' IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of Interests in Other Entities.' In June 2012, the IASB issued amendments to IFRS 10, IFRS 11 and IFRS 12 'Transition Guidance'. The standards and amendments are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are required to be applied retrospectively.

Under IFRS 10, there is one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This replaced the approach which applies to these financial statements which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on the investors' rights and obligations than on the structure of the arrangement, and introduces the concept of a joint operation. IFRS 12 is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including for unconsolidated structured entities.

We do not expect the overall effect of IFRS 10 and IFRS 11 on the financial statements to be material.

Notes on the Financial Statements (continued)

In May 2011, the IASB also issued IFRS 13 'Fair Value Measurement.' This 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 effect of IFRS 13 is not expected to be material to HSBC.

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 is required to be applied retrospectively.

The most significant amendment for HSBC 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 our estimate of the effect of this particular amendment on the 2012 consolidated financial statements, the change would have an immaterial effect on pre-tax profit and total operating expenses, with no effect on the pension liability. Therefore, the effect at the date of adoption on 1 January 2013 was not material to HSBC.

In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

Standards applicable in 2014

In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarify the requirements for offsetting financial instruments and address inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively.

Based on our initial assessment, we do not expect the amendments to IAS 32 to have a material effect on HSBC's financial statements.

In October 2012, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 27 'Investment Entities', which introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating all subsidiaries in its consolidated and separate financial statements. The amendments are effective from 1 January 2014 with early adoption permitted. Based on our initial assessment, we do not expect the amendments to have a material effect on HSBC's consolidated financial statements.

Standards applicable in 2015

In November 2009, the IASB issued IFRS 9 'Financial Instruments' which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued an amendment to IFRS 9 incorporating requirements for financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement.'

Following the IASB's decision in December 2011 to defer the effective date, the standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively but prior periods need not be restated.

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets and hedge accounting.

The IASB is in the process of amending the requirements for classification and measurement in IFRS 9 to address practice and other issues.

The final IFRS 9 requirements for classification and measurement and impairment remain uncertain and so HSBC remains unable to provide a date by which it will apply IFRS 9 as a whole and it remains impracticable to quantify the effect of IFRS 9 as at the date of the publication of these financial statements.

EU endorsement

All the standards applicable in 2013 and 2014 have been endorsed for use in the EU, except for the amendments to IFRS 10, IFRS 11 and IFRS 12 'Transition Guidance' and the amendments to IFRS 10, IFRS 12 and IAS 27 'Investment Entities'. Until these amendments are endorsed, the relief they provide for comparatives disclosures in accordance with IFRS 12 will not be available for use in the EU.

2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (except for debt securities issued by HSBC and derivatives managed in conjunction with those debt securities) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, HSBC estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by HSBC that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(b) Non-interest income

Fee income is earned from a diverse range of services provided by HSBC to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income'.

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with the related interest income, expense and dividends.

Net income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on these financial instruments are also included, except for interest arising from debt securities issued by HSBC, and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense' (Note 2a).

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(c) Operating segments

Due to the nature of the Group, HSBC's chief operating decision-maker regularly reviews operating activity on a number of bases, including by geographical region and by global business. HSBC considers that geographical operating segments represent the most appropriate information for the users of the financial statements to best evaluate the nature and financial effects of the business activities in which HSBC engages, and the economic environments in which it operates. This reflects the importance of geographic factors on business strategy and performance, the allocation of capital resources, and the role of geographical regional management in executing strategy. As a result, HSBC's operating segments are considered to be geographical regions.

Measurement of segmental assets, liabilities, income and expenses is in accordance with the Group's accounting policies. Segmental income and expenses include transfers between segments and these transfers are conducted on arm's length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made. The expense of the UK bank levy is included in the Europe geographical region as HSBC regards the levy as a cost of being headquartered in the UK.

(d) Valuation of financial instruments

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, HSBC recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value from the transaction price as indicated by the valuation model is not recognised immediately in the income statement. Instead, it is recognised over the life of the transaction on an appropriate basis, when the inputs become observable, the transaction matures or is closed out, or when HSBC enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value are measured in accordance with HSBC's valuation methodologies, which are described in Notes 15 and 16.

(e) Reclassification of financial assets

Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category in the following circumstances:

– financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and

– financial assets (except financial assets that would have met the definition of loans and receivables at initial recognition) may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

When a financial asset is reclassified as described in the above circumstances, the financial asset is reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in the income statement is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

(f) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by HSBC which are not classified as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction from impairment or uncollectibility. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment relating only to the hedged risk.

Loans and advances are reclassified to 'Assets held for sale' when their carrying amounts are to be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable (Note 2ac); however, such loans and advances continue to be measured in accordance with the policy described above.

HSBC may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of HSBC. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative and measured at fair value through profit or loss. On drawdown, the loan is classified as held for trading and measured at fair value through profit or loss. Where it is not HSBC's intention to trade but hold the loan, a provision on the loan commitment is only recorded where it is probable that HSBC will incur a loss. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the loan to be held is recorded at its fair value and subsequently measured at amortised cost using the effective interest method. For certain transactions, such as leveraged finance and syndicated lending activities, the cash advanced is not necessarily the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write-down is charged to the income statement. The write-down will be recovered over the life of the loan, through the recognition of interest income using the effective interest method, unless the loan becomes impaired. The write-down is recorded as a reduction to other operating income.

Financial assets which have been reclassified into the loans and receivables category are initially recorded at the fair value at the date of reclassification and are subsequently measured at amortised cost, using the effective interest rate determined at the date of reclassification.

(g) Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses which may arise from future events are not recognised.

Individually assessed loans and advances

The factors considered in determining whether a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio; and
- the importance of the individual loan relationship, and how this is managed.

Loans that meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

Loans considered as individually significant are typically to corporate and commercial customers and are for larger amounts, which are managed on an individual relationship basis. Retail lending portfolios are generally assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogeneous loans.

For all loans that are considered individually significant, HSBC assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. The criteria used by HSBC to determine that there is such objective evidence include:

– known cash flow difficulties experienced by the borrower;

– contractual payments of either principal or interest being past due for more than 90 days;

– the probability that the borrower will enter bankruptcy or other financial realisation;

– a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and

– there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

– HSBC's aggregate exposure to the customer;

– the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors' commitments ranking ahead of, or pari passu with, HSBC and the likelihood of other creditors continuing to support the company;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of security (or other credit mitigants) and likelihood of successful repossession;

– the likely deduction of any costs involved in recovery of amounts outstanding;

– the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and

– when available, the secondary market price of the debt.

The realisable value of security is determined based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices; however, adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

– to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and

– for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective impairment. These credit risk characteristics may include country of origination, type of business involved, type of products offered, security obtained or other relevant factors. This reflects impairment losses that HSBC has incurred as a result of events occurring before the balance sheet date, which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

– management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. As it is assessed empirically on a periodic basis the estimated period between a loss occurring and its identification may vary over time as these factors change.

Homogeneous groups of loans and advances

Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan assessment is impracticable. Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group. Two alternative methods are used to calculate allowances on a collective basis:

– When appropriate empirical information is available, HSBC utilises roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. In addition to the delinquency groupings, loans are segmented according to their credit characteristics as described above. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.

– When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, HSBC adopts a basic formulaic approach based on historical loss rate experience. The period between a loss occurring and its identification is explicitly estimated by local management, and is typically between six and twelve months.

The inherent loss within each portfolio is assessed on the basis of statistical models using historical data observations, which are updated periodically to reflect recent portfolio and economic trends. When the most recent trends arising from changes in economic, regulatory or behavioural conditions are not fully reflected in the statistical models, they are taken into account by adjusting the impairment allowances derived from the statistical models to reflect these changes as at the balance sheet date.

These additional portfolio risk factors may include recent loan portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features (such as the ability of borrowers to repay adjustable-rate loans where reset interest rates give rise to increases in interest charges), economic conditions such as national and local trends in housing markets and interest rates, portfolio seasoning, account management policies and practices, current levels of write-offs, adjustments to the period of time between loss identification and write-off, changes in laws and regulations and other factors which can affect customer payment patterns on outstanding loans, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

Reclassified loans and advances

Where financial assets have been reclassified out of the fair value through profit or loss category to the loans and receivables category, the effective interest rate determined at the date of reclassification is used to calculate any impairment losses.

Following reclassification, where there is a subsequent increase in the estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of change in the estimate rather than as an adjustment to the carrying amount of the asset at the date of change in the estimate.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as assets held for sale and reported in 'Other assets' if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and their sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement, in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write-down, is also recognised in 'Other operating income', together with any realised gains or losses on disposal.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments required have been received. Loans subject to collective impairment assessment whose terms have been renegotiated are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument.

(h) Trading assets and trading liabilities

Treasury bills, debt securities, equity securities, loans, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date, when HSBC enters into contractual arrangements with counterparties to purchase or sell the financial instruments, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in the income statement in 'Net trading income'.

(i) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. HSBC may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by HSBC are:

  Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on 'receive fixed/pay variable' interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the income statement.

  Financial assets and financial liabilities under unit-linked insurance and unit-linked investment contracts. Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in the income statement. If no designation was made for the assets relating to the customer liabilities they would be classified as available for sale and the changes in fair value would be recorded in other comprehensive income. These financial instruments are managed on a fair value basis and management information is also prepared on this basis. Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair values to be recorded in the income statement and presented in the same line;

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion, certain financial assets held to meet liabilities under non-linked insurance contracts are the main class of financial instrument so designated. HSBC has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations; and

- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, including certain debt issues and debt securities held.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when HSBC enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities).

Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in the income statement in 'Net income from financial instruments designated at fair value'.

(j) Financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis, other than those designated at fair value, are classified as available for sale or held to maturity. Financial investments are recognised on trade date when HSBC enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

(i) Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale investments – fair value gains/(losses)' until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement as 'Gains less losses from financial investments'.

Interest income is recognised on available-for-sale debt securities using the effective interest rate, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been established.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the income statement and impairment losses for available-for-sale equity securities are recognised within 'Gains less losses from financial investments' in the income statement. The impairment methodologies for available-for-sale financial assets are set out in more detail below.

– **Available-for-sale debt securities**. When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, HSBC considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer.

  These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

  In addition, when assessing available-for-sale asset-backed securities ('ABS's) for objective evidence of impairment, HSBC considers the performance of underlying collateral and the extent and depth of market price declines. Changes in credit ratings are considered but a downgrade of a security's credit rating is not, of itself, evidence of impairment. The primary indicators of potential impairment are considered to be adverse fair value movements and the disappearance of an active market for a security. ABS impairment methodologies are described in more detail in 'Impairment methodologies' on page 260.

- **Available-for-sale equity securities**. Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

  A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. If there is no longer objective evidence that the debt security is impaired, the impairment loss is also reversed through the income statement;
- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

(ii) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that HSBC positively intends, and is able, to hold to maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

(k) Sale and repurchase agreements (including stock lending and borrowing)

When securities are sold subject to a commitment to repurchase them at a predetermined price (‘repos’), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell (‘reverse repos’) are not recognised on the balance sheet and the consideration paid is recorded in ‘Loans and advances to banks’, ‘Loans and advances to customers’ or ‘Trading assets’ as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement for loans and advances to banks and customers, and as net trading income for trading assets.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in ‘Net trading income’.

(l) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, HSBC classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, HSBC documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. HSBC also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case, it is released to the income statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income within 'Cash flow hedges – fair value gains/(losses)'. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement.

The accumulated gains and losses recognised in other comprehensive income are reclassified to the income statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognised in other comprehensive income are removed from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised in other comprehensive income at that time remains in equity until the forecast transaction is eventually recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in other comprehensive income is immediately reclassified to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in other comprehensive income; a gain or loss on the ineffective portion is recognised immediately in the income statement. Gains and losses previously recognised in other comprehensive income are reclassified to the income statement on the disposal, or part disposal, of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, HSBC requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80% to 125%.

Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in 'Net trading income', except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives managed in conjunction with debt securities issued by HSBC), in which case gains and losses are reported in 'Net income from financial instruments designated at fair value'. The interest on derivatives managed in conjunction with debt securities issued by HSBC which are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

Derivatives that do not qualify for hedge accounting include non-qualifying hedges entered into as part of documented interest rate management strategies for which hedge accounting was not, or could not, be applied. The size and direction of changes in fair value of non-qualifying hedges can be volatile from year to year, but do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the assets and liabilities to which the documented interest rate strategies relate. Non-qualifying hedges therefore operate as economic hedges of the related assets and liabilities.

(m) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when HSBC has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- HSBC has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled, or expires.

(n) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Notes on the Financial Statements (continued)

2 – Summary of significant accounting policies

(o) Subsidiaries, associates and joint ventures

HSBC classifies investments in entities which it controls as subsidiaries. Where HSBC is a party to a contractual arrangement whereby, together with one or more parties, it undertakes an economic activity that is subject to joint control, HSBC classifies its interest in the venture as a joint venture. HSBC classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor joint ventures, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

HSBC Holdings' investments in subsidiaries are stated at cost less any impairment losses. An impairment loss recognised in prior periods shall be reversed through the income statement if, and only if, there has been a change in the estimates used to determine the recoverable amount of the investment in subsidiary since the last impairment loss was recognised.

Investments in associates and interests in joint ventures are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in HSBC's share of net assets.

(p) Goodwill and intangible assets

(i) Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquiree exceed the amount of the identifiable assets and liabilities acquired. If the amount of the identifiable assets and liabilities acquired is greater, the difference is recognised immediately in the income statement. Goodwill arises on the acquisition of interests in joint ventures and associates when the cost of investment exceeds HSBC's share of the net fair value of the associate's or joint venture's identifiable assets and liabilities.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units ('CGU') for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. HSBC's cash-generating units are based on geographical regions subdivided by global business. Impairment testing is performed at least annually, and whenever there is an indication that the CGU may be impaired, by comparing the recoverable amount of a CGU with its carrying amount. The carrying amount of a CGU is based on the assets and liabilities of each CGU, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a cash-generating unit. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is stated at cost less accumulated impairment losses.

Goodwill on acquisitions of interests in joint ventures and associates is included in 'Interests in associates and joint ventures' and is not tested separately for impairment.

At the date of disposal of a business, attributable goodwill is included in HSBC's share of net assets in the calculation of the gain or loss on disposal.

Goodwill is included in a disposal group if the disposal group is a CGU to which goodwill has been allocated or it is an operation within such a CGU. The amount of goodwill included in a disposal group is measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained.

(ii) Intangible assets include the present value of in-force long-term insurance business, computer software, trade names, mortgage servicing rights, customer lists, core deposit relationships, credit card customer relationships and merchant or other loan relationships. Computer software includes both purchased and internally generated software. The cost of internally generated software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Where:

- intangible assets have an indefinite useful life, or are not yet ready for use, they are tested for impairment annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognised during the current period is tested before the end of the current year; and
- intangible assets have a finite useful life, except for the present value of in-force long-term insurance business, they are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life. The amortisation of mortgage servicing rights is included within 'Net fee income'.

For the accounting policy governing the present value of in-force long-term insurance business (see Note 2y).

(iii) Intangible assets with finite useful lives are amortised, generally on a straight-line basis, over their useful lives as follows:

Trade names	10 years
Mortgage servicing rights	generally between 5 and 12 years
Internally generated software	between 3 and 5 years
Purchased software	between 3 and 5 years
Customer/merchant relationships	between 3 and 10 years
Other	generally 10 years

(q) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less any impairment losses and depreciation calculated to write-off the assets over their estimated useful lives as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated at the greater of 2% per annum on a straight-line basis or over their remaining useful lives; and
- leasehold land and buildings are depreciated over the shorter of their unexpired terms of the leases or their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where HSBC is the lessor) are stated at cost less any impairment losses and depreciation, is calculated on a straight-line basis to write-off the assets over their useful lives, which run to a maximum of 35 years but are generally between 5 years and 20 years.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the balance sheet at fair value with changes in fair value recognised in the income statement. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

(r) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When HSBC is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers', as appropriate. The finance income receivable is recognised in 'Net interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When HSBC is a lessee under finance leases, the leased assets are capitalised and included in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in 'Net interest income' over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, HSBC includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the assets is thereby impaired. When HSBC is the lessee, leased assets are not recognised on the balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income', respectively.

(s) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. HSBC provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. Current tax assets and liabilities are offset when HSBC intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, by the balance sheet date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when HSBC has a legal right to offset.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised in other comprehensive income. Deferred tax relating to share-based payment transactions is recognised directly in equity to the extent that the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense. Deferred tax relating to fair value re-measurements of available-for-sale investments and cash flow hedging instruments which are charged or credited directly to other comprehensive income, is also charged or credited to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

(t) Pension and other post-employment benefits

HSBC operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment healthcare.

Payments to defined contribution plans and state-managed retirement benefit plans, where HSBC's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as the employees render service.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the schemes' actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognised on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in other comprehensive income in the period in which they arise.

The defined benefit liability recognised in the balance sheet represents the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

The cost of obligations arising from other post-employment defined benefit plans, such as defined benefit health-care plans, are accounted for on the same basis as defined benefit pension plans.

(u) Share-based payments

HSBC enters into both equity-settled and cash-settled share-based payment arrangements with its employees as compensation for services provided by employees. Equity-settled share-based payment arrangements entitle employees to receive equity instruments of HSBC. Cash-settled share-based payment arrangements entitle employees to receive cash or other assets based on the price or value of the equity instruments of HSBC.

The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to 'Retained earnings'. The vesting period is the period during which all the specified vesting conditions of the arrangement are to be satisfied. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

For cash-settled share-based payment arrangements, the services acquired and liability incurred are measured at the fair value of the liability, as the employees render service. Until settlement, the fair value of the liability is remeasured, with changes in fair value recognised in the income statement.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions of the award. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of grant, so that an award is treated as vesting irrespective of whether these conditions are satisfied, provided all other vesting conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Where HSBC Holdings enters into share-based payment arrangements involving employees of subsidiaries, the cost is recognised in 'Investment in subsidiaries' and credited to the 'Retained earnings' over the vesting period. When a subsidiary funds the share-based payment arrangement, 'Investment in subsidiaries' is reduced by the fair value of the equity instruments.

(v) Foreign currencies

Items included in the financial statements of each of HSBC's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). HSBC's consolidated financial statements are presented in US dollars which is also HSBC Holdings' functional currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised in other comprehensive income if the gain or loss on the non-monetary item is recognised in other comprehensive income. Any exchange component of a gain or loss on a non-monetary item is recognised in the income statement if the gain or loss on the non-monetary item is recognised in the income statement.

In the consolidated financial statements, the assets, including related goodwill where applicable, and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars, are translated into the Group's presentation currency at the rate of exchange ruling at the balance sheet date. The results of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars are translated into US dollars at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net assets, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are recognised in other comprehensive income. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements. In consolidated financial statements these exchange differences are recognised in other comprehensive income. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in other comprehensive income are reclassified to the income statement as a reclassification adjustment when the gain or loss on disposal is recognised.

(w) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive 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.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of HSBC; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(x) Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

HSBC Holdings has issued financial guarantees and similar contracts to other Group entities. Where it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, HSBC may elect to account for guarantees as an insurance contract in HSBC Holdings' financial statements. This election is made on a contract by contract basis, but the election for each contract is irrevocable. Where these guarantees have been classified as insurance contracts, they are measured and recognised as insurance liabilities.

(y) Insurance contracts

Through its insurance subsidiaries, HSBC issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which HSBC accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4.

Insurance premiums

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Gross insurance premiums for non-life insurance business are reported as income over the term of the insurance contracts based on the proportion of risks borne during the accounting period. The unearned premium (the proportion of the business underwritten in the accounting year relating to the period of risk after the balance sheet date) is calculated on a daily or monthly pro rata basis.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

Insurance claims and reinsurance recoveries

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Gross insurance claims for non-life insurance contracts include paid claims and movements in outstanding claims liabilities.

Reinsurance recoveries are accounted for in the same period as the related claim.

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Outstanding claims liabilities for non-life insurance contracts are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claim-handling costs and a reduction for the expected value of salvage and other recoveries. Liabilities for claims incurred but not reported are made on an estimated basis, using appropriate statistical techniques.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

Future profit participation on insurance contracts with discretionary participation features

Where contracts provide discretionary profit participation benefits to policyholders, liabilities for these contracts include provisions for the future discretionary benefits to policyholders. These provisions reflect actual performance of the investment portfolio to date and management expectation on the future performance in connection with the assets backing the contracts, as well as other experience factors such as mortality, lapses and operational efficiency, where appropriate. This benefit may arise from the contractual terms, regulation, or past distribution policy.

Investment contracts

Unit-linked and non-linked

Customer liabilities under linked and certain non-linked investment contracts and the corresponding financial assets are designated at fair value. Movements in fair value are recognised in ‘Net income from financial investments designated at fair value'. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Liabilities under linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Investment management fees receivable are recognised in the income statement over the period of the provision of the investment management services, in 'Net fee income'.

The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

Investment contracts with discretionary participation features

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4. The Group therefore recognises the premiums for those contracts as revenue and recognises as an expense the resulting increase in the carrying amount of the liability.

In the case of net unrealised investment gains on these contracts, whose discretionary benefits principally reflect the actual performance of the investment portfolio, the corresponding increase in the liabilities is recognised in either the income statement or other comprehensive income, following the treatment of the unrealised gains on the relevant assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable. Movements in the liabilities arising from realised gains and losses on relevant assets are recognised in the income statement.

Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business or long-term investment contracts with discretionary participating features ('DPF') and are in force at the balance sheet date is recognised as an asset. The asset represents the present value of the equity holders' interest in the issuing insurance companies' profits expected to emerge from these contracts written at the balance sheet date.

The present value of in-force long-term insurance business and long-term investment contracts with DPF, referred to as 'PVIF', is determined by discounting the equity holders' interest in future profits expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses, and a risk discount rate that reflects the risk premium attributable to the respective contracts. The PVIF incorporates allowances for both non-market risk and the value of financial options and guarantees. The PVIF asset is presented gross of attributable tax in the balance sheet and movements in the PVIF asset are included in 'Other operating income' on a gross of tax basis.

(z) Debt securities issued and deposits by customers and banks

Financial liabilities are recognised when HSBC enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

(aa) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

HSBC Holdings plc shares held by HSBC are recognised in equity as a deduction from retained earnings until they are cancelled. When such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity, net of any directly attributable incremental transaction costs and related income tax effects.

(ab) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition. Cash and cash equivalents include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks, and certificates of deposit.

(ac) Assets held for sale

Non-current assets and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' such as deferred taxes, financial instruments, investment properties, insurance contracts and assets and liabilities arising from employee benefits. These are measured in accordance with the accounting policies described above. Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable IFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of the assets and liabilities noted above that are not within the scope of the measurement requirements of IFRS 5 are remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

Income earned and expenses incurred on assets held for sale and liabilities of disposal groups held for sale continue to be recognised in the appropriate line items in the income statement until the transaction is complete. Loan impairment charges incurred on assets held for sale continue to be recognised in 'Loan impairment charges and other credit risk provisions' and interest income and expense continue to be recognised in 'Net interest income'. Once classified as held for sale, movements arising from the initial measurement or subsequent remeasurement of the non-current assets (or disposal groups) are recognised in 'Other operating income'.

3 Net income/(expense) from financial instruments designated at fair value

Net income/(expense) from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income, interest expense and dividend income in respect of:
  - financial assets and liabilities designated at fair value; and
  - derivatives managed in conjunction with the above,

  except for interest arising from HSBC's issued debt securities and derivatives managed in conjunction with those debt securities, which is recognised in 'Interest expense'.

Net income/(expense) from financial instruments designated at fair value

	2012 US$m	2011 US$m	2010 US$m
Net income/(expense) arising on:			
– financial assets held to meet liabilities under insurance and investment contracts	**2,980**	(933)	2,349
– other financial assets designated at fair value	**83**	1,050	230
– derivatives managed in conjunction with other financial assets designated at fair value	**35**	(182)	(149)
	3,098	(65)	2,430
– liabilities to customers under investment contracts	**(996)**	231	(946)
– HSBC's long-term debt issued and related derivatives	**(4,327)**	4,161	(258)
– changes in own credit spread on long-term debt	**(5,215)**	3,933	(63)
– derivatives managed in conjunction with HSBC's issued debt securities	**431**	3,165	(275)
– other changes in fair value	**457**	(2,937)	80
– other financial liabilities designated at fair value	**(23)**	(911)	(18)
– derivatives managed in conjunction with other financial liabilities designated at fair value	**22**	23	12
	(5,324)	3,504	(1,210)
	(2,226)	3,439	1,220

HSBC Holdings

Net income/(expense) arising on HSBC Holdings long-term debt issued and related derivatives

	2012 US$m	2011 US$m	2010 US$m
Net income/(expense) arising on:			
– changes in own credit spread on long-term debt	**(2,260)**	1,657	248
– derivatives managed in conjunction with HSBC Holdings issued debt securities	**456**	1,368	(482)
– other changes in fair value	**(474)**	(1,113)	373
	(2,278)	1,912	139

4 Net earned insurance premiums

	Non-life insurance US$m	Life insurance (non-linked) US$m	Life insurance (linked) US$m	Investment contracts with DPF[1] US$m	Total US$m
2012					
Gross earned premiums	**716**	**6,862**	**3,325**	**2,699**	**13,602**
– gross written premiums	**760**	**6,815**	**3,325**	**2,699**	**13,599**
– movement in unearned premiums	**(44)**	**47**	**–**	**–**	**3**
Reinsurers' share of gross earned premiums	**(107)**	**(443)**	**(8)**	**–**	**(558)**
– gross written premiums ceded to reinsurers	**(104)**	**(408)**	**(8)**	**–**	**(520)**
– reinsurers' share of movement in unearned premiums	**(3)**	**(35)**	**–**	**–**	**(38)**
	609	**6,419**	**3,317**	**2,699**	**13,044**
2011					
Gross earned premiums	1,144	6,238	2,801	3,155	13,338
– gross written premiums	1,175	6,207	2,804	3,155	13,341
– movement in unearned premiums	(31)	31	(3)	–	(3)
Reinsurers' share of gross earned premiums	(180)	(278)	(8)	–	(466)
– gross written premiums ceded to reinsurers	(182)	(255)	(8)	–	(445)
– reinsurers' share of movement in unearned premiums	2	(23)	–	–	(21)
	964	5,960	2,793	3,155	12,872
2010					
Gross earned premiums	1,275	5,427	1,956	2,951	11,609
– gross written premiums	1,192	5,357	1,956	2,951	11,456
– movement in unearned premiums	83	70	–	–	153
Reinsurers' share of gross earned premiums	(160)	(289)	(14)	–	(463)
– gross written premiums ceded to reinsurers	(172)	(266)	(8)	–	(446)
– reinsurers' share of movement in unearned premiums	12	(23)	(6)	–	(17)
	1,115	5,138	1,942	2,951	11,146

1 *Discretionary participation features.*

5 Net insurance claims incurred and movement in liabilities to policyholders

	Non-life insurance US$m	Life insurance (non-linked) US$m	Life insurance (linked) US$m	Investment contracts with DPF[1] US$m	Total US$m
2012					
Gross claims incurred and movement in liabilities	**342**	**6,558**	**3,984**	**3,645**	**14,529**
– claims, benefits and surrenders paid	**339**	**1,566**	**1,810**	**2,525**	**6,240**
– movement in liabilities	**3**	**4,992**	**2,174**	**1,120**	**8,289**
Reinsurers' share of claims incurred and movement in liabilities	**(58)**	**(479)**	**223**	**–**	**(314)**
– claims, benefits and surrenders paid	**(57)**	**(160)**	**(681)**	**–**	**(898)**
– movement in liabilities	**(1)**	**(319)**	**904**	**–**	**584**
	284	**6,079**	**4,207**	**3,645**	**14,215**

Net insurance claims incurred and movement in liabilities to shareholders (continued)

	Non-life insurance US$m	Life insurance (non-linked) US$m	Life insurance (linked) US$m	Investment contracts with DPF[1] US$m	Total US$m
2011					
Gross claims incurred and movement in liabilities	435	5,729	2,462	3,005	11,631
– claims, benefits and surrenders paid	631	1,793	1,129	2,628	6,181
– movement in liabilities	(196)	3,936	1,333	377	5,450
Reinsurers' share of claims incurred and movement in liabilities	(85)	(254)	(111)	–	(450)
– claims, benefits and surrenders paid	(81)	(164)	(56)	–	(301)
– movement in liabilities	(4)	(90)	(55)	–	(149)
	350	5,475	2,351	3,005	11,181
2010					
Gross claims incurred and movement in liabilities	625	5,108	2,520	3,716	11,969
– claims, benefits and surrenders paid	815	1,355	507	2,023	4,700
– movement in liabilities	(190)	3,753	2,013	1,693	7,269
Reinsurers' share of claims incurred and movement in liabilities	(100)	(201)	99	–	(202)
– claims, benefits and surrenders paid	(114)	(143)	(45)	–	(302)
– movement in liabilities	14	(58)	144	–	100
	525	4,907	2,619	3,716	11,767

1 *Discretionary participation features.*

6 Operating profit

Operating profit is stated after the following items of income, expense, gains and losses:

	2012 US$m	2011 US$m	2010 US$m
Income			
Interest recognised on impaired financial assets[1]	**1,261**	1,604	516
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**10,042**	11,318	11,445
Fees earned on trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	**2,897**	3,072	3,074
Income from listed investments	**5,850**	8,283	7,418
Income from unlisted investments	**7,677**	8,031	7,187
Gain arising from dilution of interests in associates and joint ventures	**–**	208	188
Expense			
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**(17,625)**	(20,965)	(17,549)
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**(1,501)**	(1,697)	(1,529)
Fees payable relating to trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	**(170)**	(182)	(151)
UK bank levy	**(472)**	(570)	–
Auditors' remuneration (see Note 8)	**(49)**	(51)	(51)
Gains/(losses)			
Gain on disposal or settlement of loans and advances	**24**	116	121
Impairment of available-for-sale equity securities	**(420)**	(177)	(105)
Gains on disposal of property, plant and equipment, intangible assets and non-financial investments	**187**	57	701
Loan impairment charges and other credit risk provisions	**(8,311)**	(12,127)	(14,039)
Net impairment charge on loans and advances	**(8,160)**	(11,505)	(13,548)
Impairment of available-for-sale debt securities	**(99)**	(631)	(472)
Release/(impairment) in respect of other credit risk provisions	**(52)**	9	(19)

1 *During 2011 the Group adopted a more stringent treatment for impaired loans for geographical regions with significant levels of forbearance. As a result loans and advances have been classified as impaired that under the previous disclosure convention would otherwise have been classified as neither past due nor impaired or past due but not impaired. The effect of this change on 2011 reported numbers was to increase interest earned on impaired loans from US$0.3bn to US$1.5bn. Restatement of comparative data prior to 31 December 2010 is impracticable (see page 162, 'Impaired loans disclosure', for further details).*

7 Employee compensation and benefits

	2012 US$m	2011 US$m	2010 US$m
Wages and salaries	**17,780**	18,923	17,193
Social security costs	**1,633**	1,754	1,567
Post-employment benefits	**1,078**	489	1,076
	20,491	21,166	19,836

Average number of persons employed by HSBC during the year

	2012	2011	2010
Europe	**77,204**	81,263	79,902
Hong Kong	**28,764**	30,323	29,105
Rest of Asia-Pacific	**88,015**	92,685	89,737
Middle East and North Africa	**8,645**	8,816	8,983
North America	**27,396**	34,871	36,822
Latin America	**54,162**	58,026	57,778
Total	**284,186**	305,984	302,327

Included in 'Wages and salaries' above are share-based payment arrangements, as follows:

Share-based payments income statement charge

	2012 US$m	2011 US$m	2010 US$m
Restricted and performance share awards[1]	**912**	1,041	685
Savings-related and other share option plans	**96**	121	127
	1,008	1,162	812
Equity-settled share-based payments	**988**	1,154	812
Cash-settled share-based payments	**20**	8	–

1 *Restricted share awards include awards granted under the Group Performance Share Plan ('GPSP').*

The share-based payment income statement charge above includes US$837m (2011: US$974m; 2010: US$610m) relating to deferred share awards. These awards are generally granted to employees early in the year following the year to which the award relates. The charge for these awards is recognised from the start of the period to which the service relates to the end of the vesting period. The vesting period is the period over which the employee satisfies certain service conditions in order to become entitled to the award. Due to the staggered vesting profile of certain deferred share awards, the employee becomes entitled to a portion of the award at the end of each year during the vesting period. The income statement charge reflects this vesting profile.

In addition, wages and salaries also includes US$111m (2011: US$88m; 2010: US$15m) in respect of deferred cash awards for current and prior performance years. The reconciliation of total incentive awards (both deferred and non-deferred) to income statement charge is as follows:

Notes on the Financial Statements (continued)

7 – Employee compensation and benefits

Reconciliation of total incentive awards granted to incentive awards in employee compensation and benefits

	2012 US$m	2011 US$m	2010 US$m
Total incentive awards approved and granted for the current year[1]	**3,689**	3,966	4,297
Less: deferred bonuses awarded for the current year but not amortised	**(355)**	(369)	(778)
Total incentives awarded and recognised in the current year	**3,334**	3,597	3,519
Current year charges for deferred bonuses from previous years	**671**	897	625
Other[2]	**(28)**	(261)	(109)
Total incentive awards for the current year included in employee compensation and benefits	**3,977**	4,233	4,035

1 *This represents the amount of the Group variable pay pool that has been approved and granted. The total amount of Group variable pay pool approved by the Group Remuneration Committee is disclosed in the Directors' Remuneration Report on page 347.*
2 *This mainly comprises incentive awards paid to employees acting as selling agents, which form an integral part of the effective interest of a financial instrument, recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.*

The following table identifies the charge recognised in the current year, or expected to be recognised in future years, in relation to deferred bonus awards from the current year and prior year bonus pools.

Income statement charge for current and prior year bonus pools

	Current year bonus pool[1] US$m	Prior year bonus pools US$m	Total US$m
2012			
Charge recognised in 2012	**277**	**671**	**948**
Deferred share awards	**224**	**613**	**837**
Deferred cash awards	**53**	**58**	**111**
Charge expected to be recognised in 2013 or later	**355**	**376**	**731**
Deferred share awards	**315**	**335**	**650**
Deferred cash awards	**40**	**41**	**81**
2011			
Charge recognised in 2011	165	897	1,062
Deferred share awards	131	843	974
Deferred cash awards	34	54	88
Charge expected to be recognised in 2012 or later	369	731	1,100
Deferred share awards	289	652	941
Deferred cash awards	80	79	159
2010			
Charge recognised in 2010	–	625	625
Deferred share awards	–	610	610
Deferred cash awards	–	15	15
Charge expected to be recognised in 2011 or later	778	802	1,580
Deferred share awards	759	801	1,560
Deferred cash awards	19	1	20

1 *Current year bonus pool relates to the bonus pool declared for the reporting period (2012 for the current year, 2011 for the 2011 comparatives and 2010 for the 2010 comparatives).*

Share-based payments

HSBC share awards

Award	Policy	Purpose
Restricted share awards (including GPSP awards)	• Vesting of awards generally subject to continued employment with HSBC. • Vesting is generally staggered over three years. GPSP awards vest after five years. • Certain shares subject to a retention requirement post-vesting. In the case of GPSP awards retention applies until cessation of employment. • Awards generally not subject to performance conditions. • Awards granted from 2010 onwards are subject to clawback provision prior to vesting.	• Rewards employee performance and potential and supports retention of key employees. • To defer variable pay.

Movement on HSBC share awards

	Restricted share awards[1]		Performance share awards[2]	
	2012 Number (000s)	2011 Number (000s)	**2012 Number (000s)**	2011 Number (000s)
Outstanding at 1 January	**262,241**	229,092	**–**	4,425
Additions during the year	**107,928**	100,819	**–**	154
Released in the year	**(193,692)**	(56,301)	**–**	(883)
Forfeited in the year	**(10,888)**	(11,369)	**–**	(3,696)
Outstanding at 31 December	**165,589**	262,241	**–**	–
Weighted average fair value of awards granted (US$)	**8.93**	10.11	**–**	–

1 *Restricted share awards include awards granted under the Group Performance Share Plan ('GPSP').*
2 *Additions during 2011 comprised reinvested dividend equivalents. The last award of performance shares was made in 2008, and shares under the plan were released in March 2011.*

HSBC share option plans

Main plans	Policy	Purpose
Savings-related share option plans	• Exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively. • The exercise price is set at a 20% (2011: 20%) discount to the market value immediately preceding the date of invitation (except for the one-year options granted under the US sub-plan where a 15% discount is applied).	• Eligible employees save up to £250 per month (or its equivalent in US dollars, Hong Kong dollars or euros), with the option to use the savings to acquire shares. • To align the interests of all employees with the creation of shareholder value.
HSBC Holdings Group share option plan	• Plan ceased in May 2005. • Exercisable between third and tenth anniversaries of the date of grant.	• Long-term incentive plan between 2000 and 2005 during which certain HSBC employees were awarded share options.

The table on page 412 shows the movement on HSBC share option plans during the year.

Calculation of fair values

The fair values of share options at the date of grant of the option are calculated using a Black-Scholes model.

The fair value of a share award is based on the share price at the date of the grant. The fair value of a share option is inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

Notes on the Financial Statements (continued)

7 – Employee compensation and benefits

Significant weighted average assumptions used to estimate the fair value of options granted

	Savings-related share option plans		
	1-year plan	3-year plans	5-year plans
2012			
Risk-free interest rate[1] (%)	**0.4**	**0.6**	**1.2**
Expected life (years)	**1**	**3**	**5**
Expected volatility[2] (%)	**25**	**25**	**25**
Share price at grant date (£)	**5.46**	**5.46**	**5.46**
2011			
Risk-free interest rate[1] (%)	0.8	1.7	2.5
Expected life (years)	1	3	5
Expected volatility[2] (%)	25	25	25
Share price at grant date (£)	6.37	6.37	6.37
2010			
Risk-free interest rate[1] (%)	0.7	1.9	2.9
Expected life (years)	1	3	5
Expected volatility[2] (%)	30	30	30
Share price at grant date (£)	6.82	6.82	6.82

1 *The risk-free rate was determined from the UK gilts yield curve. A similar yield curve was used for the HSBC Holdings Savings-Related Share Option Plan: International.*
2 *Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC Holdings ordinary shares of similar maturity to those of the employee options.*

The expected US dollar denominated dividend yield was determined to be 5.0% per annum in line with consensus analyst forecasts (2011: 4.5%; 2010: 4.5%).

HSBC subsidiary company share option plans

There are a number of employee share option plans relating to HSBC France, HSBC Finance and HSBC Bank Bermuda as a result of the acquisition of these entities.

Options granted prior to public announcement of the acquisitions vested on acquisition and are not included in the table below. HSBC France and HSBC Finance granted share options after announcement of the acquisition which vested in subsequent years. Of these, at 31 December 2012, none remained outstanding (2011: 2.4m). Full details of all options outstanding under these plans can be found in Note 38.

Movement on HSBC share option plans

	Savings-related share option plans		HSBC Holdings Group share option plan		HSBC Finance share option plan	
	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] US$
2012						
Outstanding at 1 January	**153,465**	**3.80**	**120,792**	**7.02**	**2,429**	**9.29**
Granted during the year[2]	**44,868**	**4.44**	**–**	**–**	**–**	**–**
Exercised during the year[3]	**(63,954)**	**3.47**	**(1,606)**	**6.02**	**(2,054)**	**9.29**
Expired during the year	**(21,627)**	**4.82**	**(32,013)**	**7.29**	**(375)**	**9.29**
Outstanding at 31 December	**112,752**	**4.04**	**87,173**	**6.94**	**–**	**–**
At 31 December 2012						
Exercise price range (£):						
3.00 – 4.50	**95,333**		**–**		**–**	
4.51 – 6.00	**16,129**		**–**		**–**	
6.01 – 7.50	**1,290**		**82,278**		**–**	
7.51 – 7.96	**–**		**4,895**		**–**	
Of which exercisable	**4,538**		**87,173**		**–**	
Weighted average remaining contractual life (years)	**2.26**		**1.11**		**–**	
2011						
Outstanding at 1 January	157,855	3.87	152,758	7.12	2,429	9.29
Granted during the year[2]	23,199	5.11	–	–	–	–
Exercised during the year[3]	(7,439)	5.27	(646)	6.06	–	–
Expired during the year	(20,150)	4.71	(31,320)	7.56	–	–
Outstanding at 31 December	153,465	3.80	120,792	7.02	2,429	9.29

	Savings-related share option plans		HSBC Holdings Group share option plan		HSBC Finance share option plan	
	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] £	Number (000s)	WAEP[1] US$
At 31 December 2011						
Exercise price range (£):						
3.00 – 4.50	117,387		–		–	
4.51 – 6.00	32,778		–		–	
6.01 – 7.50	2,341		115,901		–	
7.51 – 9.29	959		4,891		2,429	
Of which exercisable	3,209		120,792		2,429	
Weighted average remaining contractual life (years)	2.04		1.66		0.89	

1 *Weighted average exercise price.*
2 *The weighted average fair value of options granted during the year was US$1.63 (2011: US$2.11).*
3 *The weighted average share price at the date the options were exercised was US$8.78 (2011: US$8.65) and US$9.00 (2011: US$9.51) for the savings-related share option plans and HSBC Holdings Group share option plan, respectively.*

Post-employment benefit plans

Income statement charge

	2012 US$m	2011 US$m	2010 US$m
Defined benefit pension plans	**427**	(172)	468
– HSBC Bank (UK) Pension Scheme	**169**	(428)	308
– other plans	**258**	256	160
Defined contribution pension plans	**599**	626	545
	1,026	454	1,013
Defined benefit healthcare plans	**49**	32	58
Defined contribution healthcare plans	**3**	3	5
	1,078	489	1,076

Net assets/(liabilities) recognised on balance sheet in respect of defined benefit plans

	2012 US$m	2011 US$m
Defined benefit pension plans		
HSBC Bank (UK) Pension Scheme	**2,617**	2,237
– fair value of plan assets	**29,092**	26,604
– present value of defined benefit obligations	**(26,475)**	(24,367)
Other plans	**(2,585)**	(2,445)
– fair value of plan assets	**9,015**	8,232
– present value of defined benefit obligations	**(11,600)**	(10,680)
– effect of limit on plan surpluses	**(19)**	(18)
– unrecognised past service cost	**19**	21
Total	**32**	(208)
Defined benefit healthcare plans		
– fair value of plan assets	**189**	151
– present value of defined benefit obligations	**(1,261)**	(1,091)
– unrecognised past service cost	**(19)**	(21)
Total	**(1,091)**	(961)
Fair value of plan assets	**38,296**	34,987
Present value of defined benefit obligations	**(39,336)**	(36,138)
Effect of limit on plan surpluses	**(19)**	(18)
	(1,059)	(1,169)
Retirement benefit liabilities	**(3,905)**	(3,666)
Retirement benefit assets	**2,846**	2,497

Notes on the Financial Statements (continued)

7 – Employee compensation and benefits

Cumulative actuarial gains/(losses) recognised in other comprehensive income

	2012 US$m	2011 US$m	2010 US$m
At 1 January	**(3,453)**	(4,720)	(4,660)
HSBC Bank (UK) Pension Scheme	**208**	1,945	321
Other plans	**(440)**	(642)	(275)
Healthcare plans	**(154)**	(61)	(112)
Change in the effect of limit on plan surpluses[1]	**(5)**	25	6
Total actuarial gains/(losses) recognised in other comprehensive income	**(391)**	1,267	(60)
At 31 December[2]	**(3,844)**	(3,453)	(4,720)

1 *Excludes exchange loss of US$4m (2011: US$4m loss; 2010: US$6m gain)*
2 *Includes cumulative movements related to the limit on plan surpluses. This limit was US$19m at 31 December 2012 (2011: US$18m; 2010: US$47m)*

HSBC pension plans

	2012	2011	2010
Number of plans worldwide	**225**	230	218
	%	%	%
Percentage of HSBC employees:			
– enrolled in defined contribution plans	**62**	64	63
– enrolled in defined benefit plans	**23**	25	27
– covered by HSBC pension plans	**85**	89	90

HSBC has been progressively offering all new employees membership of defined contribution plans.

The majority of the Group's defined benefit plans are funded plans. The assets of most of the larger plans are held in trusts or similar funds separate from HSBC. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligations and related current service costs vary according to the economic conditions of the countries in which the plans are situated.

At 31 December 2012, the present values of the defined benefit obligations of The HSBC Bank (UK) Pension Scheme was US$26,475m (2011: US$24,367m), The HSBC Group Hong Kong Local Staff Retirement Benefit Scheme was US$1,476m (2011:US$1,523m) and the HSBC North America (US) Retirement Income Plan was US$4,374m (2011: US$3,895m). These defined benefit pension plans covered 12% of HSBC's employees and represented 82% of the Group's present value of defined benefit obligations. The Pension Risk section on page 246 and the Appendix to Risk on page 252 contain details about the characteristics and risks and amount, timing and uncertainty of future cash flows and policies and practices associated with these three schemes.

The determinations described in the Pension Risk section on page 246 for actuarial funding valuation purposes are based on different methods and assumptions from those used for financial reporting purposes, and as a result should neither be compared nor related to other determinations included in these financial statements. There is no actuarial deficit in the Principal plan.

HSBC healthcare benefits plans

HSBC also provides post-employment healthcare benefits under plans in the UK, the US, Bermuda, Canada, Mexico and Brazil, the majority of which are unfunded. The majority of post-employment healthcare benefits plans are defined benefit plans and are accounted for in the same manner as defined benefit pension plans. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligation and related current service cost vary according to the economic conditions of the countries in which they are situated.

At 31 December 2012, the present value of the defined benefit obligation of HSBC's healthcare benefit plans was US$1,261m (2011: US$1,091m). In aggregate, healthcare benefit plans comprised 3% of HSBC's present value of defined benefit obligations.

Defined benefit pension plans

Net asset/(liability) under defined benefit pension plans

	HSBC Bank (UK) Pension Scheme		Other plans	
	2012	2011	**2012**	2011
	US$m	US$m	**US$m**	US$m
Fair value of plan assets				
At 1 January	**26,604**	22,236	**8,232**	7,559
Expected return on plan assets	**1,245**	1,325	**486**	481
Contributions by HSBC	**238**	600	**475**	565
– normal	**238**	314	**191**	176
– special	**–**	286	**284**	389
Contributions by employees	**37**	34	**20**	22
Experience gains	**680**	3,426	**410**	200
Benefits paid	**(907)**	(803)	**(630)**	(495)
Assets distributed on settlements	**–**	–	**(16)**	(25)
Exchange differences	**1,195**	(214)	**38**	(75)
At 31 December	**29,092**	26,604	**9,015**	8,232
Present value of defined benefit obligations				
At 1 January	**(24,367)**	(22,858)	**(10,680)**	(9,785)
Current service cost	**(236)**	(251)	**(310)**	(299)
Interest cost	**(1,178)**	(1,233)	**(404)**	(456)
Contributions by employees	**(36)**	(34)	**(21)**	(22)
Actuarial losses	**(472)**	(1,481)	**(850)**	(842)
Benefits paid	**906**	804	**743**	569
Past service cost – vested immediately	**–**	587	**(47)**	(40)
Past service cost – unvested benefits	**–**	–	**2**	2
Reduction in liabilities resulting from curtailments	**–**	–	**11**	59
Liabilities extinguished on settlements	**–**	–	**26**	29
Exchange differences	**(1,092)**	99	**(70)**	105
At 31 December	**(26,475)**	(24,367)	**(11,600)**	(10,680)
Funded	**(26,475)**	(24,367)	**(10,956)**	(10,074)
Unfunded	**–**	–	**(644)**	(606)
Effect of limit on plan surpluses	**–**	–	**(19)**	(18)
Unrecognised past service cost	**–**	–	**19**	21
Net asset/(liability)	**2,617**	2,237	**(2,585)**	(2,445)
Retirement benefit liabilities recognised in the balance sheet	**–**	–	**(2,814)**	(2,705)
Retirement benefit assets recognised in the balance sheet (within 'Other assets')	**2,617**	2,237	**229**	260

Plan assets of the Group's pension schemes included US$20m (2011: US$45m) of equities and no bonds (2011: nil) issued by HSBC and US$292m (2011: US$1,228m) of other assets placed or transacted with HSBC. The fair value of plan assets included derivatives entered into with HSBC Bank plc by the HSBC Bank (UK) Pension Scheme with a positive fair value of US$5,226m at 31 December 2012 (2011: US$5,560m positive fair value) and US$328m positive fair value (2011: US$297m positive fair value) in respect of the HSBC International Staff Retirement Benefits Scheme. Further details of these swap arrangements are included in Note 44.

In December 2011, HSBC Bank plc made a £184m (US$286m) special contribution to the HSBC Bank (UK) Pension Scheme. Following the contribution the Scheme purchased asset-backed securities from HSBC at an arm's length value, determined by the Scheme's independent third-party advisers.

The special contributions of US$284m to other plans include an additional contribution of US$181m to the HSBC North America (US) Retirement Income Plan which was made to maintain a minimum funding level.

The actual return on plan assets for the year ended 31 December 2012 was a positive return of US$2,784m (2011: positive US$5,432m).

HSBC expects to make US$604m of contributions to defined benefit pension plans during 2013. Benefits expected to be paid from the plans to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

Notes on the Financial Statements (continued)

7 – Employee compensation and benefits

Benefits expected to be paid from plans

	2013 US$m	2014 US$m	2015 US$m	2016 US$m	2017 US$m	2018-2022 US$m
HSBC Bank (UK) Pension Scheme ..	745	776	810	849	899	5,411
Other plans	556	541	557	577	624	3,595

Total (income)/expense recognised in the income statement in 'Employee compensation and benefits'

	HSBC Bank (UK) Pension Scheme			Other plans		
	2012 US$m	2011 US$m	2010 US$m	**2012 US$m**	2011 US$m	2010 US$m
Current service cost	**236**	251	252	**310**	299	300
Interest cost	**1,178**	1,233	1,148	**404**	456	438
Expected return on plan assets	**(1,245)**	(1,325)	(1,092)	**(486)**	(481)	(437)
Past service cost	**–**	(587)	–	**51**	45	12
Gains on curtailments	**–**	–	–	**(11)**	(59)	(151)
Gains on settlements	**–**	–	–	**(10)**	(4)	(2)
Total (income)/expense	**169**	(428)	308	**258**	256	160

Summary

	HSBC Bank (UK) Pension Scheme				
	2012 US$m	2011 US$m	2010 US$m	2009 US$m	2008 US$m
Present value of defined benefit obligation	**(26,475)**	(24,367)	(22,858)	(21,523)	(15,257)
Fair value of plan assets	**29,092**	26,604	22,236	17,701	14,865
Net surplus/(deficit)	**2,617**	2,237	(622)	(3,822)	(392)
Experience gains/(losses) on plan liabilities	**880**	(383)	(327)	(234)	(49)
Experience gains/(losses) on plan assets	**680**	3,426	1,772	871	(2,861)
Gains/(losses) from changes in actuarial assumptions	**(1,352)**	(1,098)	(1,124)	(4,329)	3,081
Total net actuarial gains/(losses)	**208**	1,945	321	(3,692)	171

	Other plans				
	2012 US$m	2011 US$m	2010 US$m	2009 US$m	2008 US$m
Present value of defined benefit obligation	**(11,600)**	(10,680)	(9,785)	(9,109)	(8,787)
Fair value of plan assets	**9,015**	8,232	7,559	6,822	6,024
Net deficit	**(2,585)**	(2,448)	(2,226)	(2,287)	(2,763)
Experience gains/(losses) on plan liabilities	**56**	(78)	(73)	20	(52)
Experience gains/(losses) on plan assets	**410**	200	394	65	(1,452)
Gains/(losses) from changes in actuarial assumptions	**(906)**	(764)	(596)	94	(306)
Total net actuarial gains/(losses)	**(440)**	(642)	(275)	179	(1,810)

Post-employment defined benefit plans' principal actuarial financial assumptions

The principal actuarial financial assumptions used to calculate the Group's obligations for the largest defined benefit pension plans at 31 December for each period, and used as the basis for measuring periodic costs under the plans in the following periods, were as follows:

Principal actuarial assumptions

	Discount rate %	Inflation rate %	Rate of increase for pensions %	Rate of pay increase %
At 31 December 2012				
UK[1]	**4.50**	**3.10**	**2.90**	**3.60**
Hong Kong	**0.60**	**n/a**	**n/a**	**4.00**
US	**3.95**	**2.50**	**n/a**	**2.75**
At 31 December 2011				
UK[1]	4.80	3.20	3.10	3.70
Hong Kong	1.47	n/a	n/a	5.00
US	4.60	2.50	n/a	2.75
At 31 December 2010				
UK[1]	5.40	3.70	3.50	4.20
Hong Kong	2.85	n/a	n/a	5.00
US	5.41	2.50	n/a	2.75

1 *Rate of increase for pensions in the UK is for pensions in payment only, capped at 5%. Deferred pensions are projected to increase in line with the CPI, capped at 5%. For 2010, deferred pensions were projected to increase in line with the RPI, capped at 5%.*

HSBC determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. In countries where there is not a deep market in corporate bonds, government bond yields have been used. The yield curve has been extrapolated where the term of the liabilities is longer than the duration of available bonds and the discount rate used then takes into account the term of the liabilities and the shape of the yield curve. When determining the discount rate with reference to a bond index, an appropriate index for the specific region has been used.

Mortality tables and average life expectancy at age 65

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
At 31 December 2012					
UK	**SAPS S1[1]**	**23.9**	**25.6**	**25.4**	**27.7**
Hong Kong[2]	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
US	**RP 2000 fully generational[3]**	**21.1**	**23.1**	**23.2**	**25.0**
At 31 December 2011					
UK	SAPS MC[4]	22.5	24.4	23.5	25.4
Hong Kong[2]	n/a	n/a	n/a	n/a	n/a
US	RP 2000 fully generational[3]	19.4	20.9	21.3	22.2

1 *SAPS S1 with Continuous Mortality Investigation 2011 improvements and a 1.25% long-term allowance improvement. Light table with 1.01 rating for male pensioners and 1.02 rating for female pensioners.*
2 *The significant plans in Hong Kong are lump sum plans which do not use a post-retirement mortality table.*
3 *The projections scale applied to the mortality rates has changed from AA at 31 December 2011 to BB at 31 December 2012, to better reflect observed mortality improvements.*
4 *SAPS MC projections with 1% minimum improvement beyond 2002. Light table with 1.08 rating for male pensioners and standard table with 1.06 rating for female pensioners.*

Notes on the Financial Statements (continued)

Expected rates of return

	2012		2011	
	Expected rates of return[1] %	**Value US$m**	Expected rates of return[1] %	Value US$m
HSBC Bank (UK) Pension Scheme				
Fair value of plan assets		**29,092**		26,604
Equities	**7.1**	**3,899**	7.2	3,190
Bonds	**4.0**	**22,258**	4.1	20,737
Property	**6.7**	**1,583**	6.7	1,524
Other	**3.1**	**1,352**	2.8	1,153
Other plans				
Fair value of plan assets		**9,015**		8,232
Equities	**7.9**	**2,688**	7.7	2,184
Bonds	**4.1**	**4,963**	4.7	4,659
Property	**5.0**	**107**	4.6	106
Other	**3.6**	**1,257**	4.0	1,283

1 *The expected rates of return are used to measure the net defined benefit pension costs in each subsequent year, and weighted on the basis of the fair value of the plan assets. In 2013 the basis will change as described on page 386.*

The expected return on plan assets represents the best estimate of long-term future asset returns, which takes into account historical market returns plus additional factors such as the current rate of inflation and interest rates.

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions on the principal defined benefit pension plan:

The effect of changes in key assumptions on the principal plan

	HSBC Bank (UK) Pension Scheme	
	2012 US$m	2011 US$m
Discount rate		
Change in pension obligation at year end from a 25bps increase	**(1,191)**	(980)
Change in pension obligation at year end from a 25bps decrease	**1,275**	1,045
Change in 2013 pension cost from a 25bps increase[1]	**(78)**	2
Change in 2013 pension cost from a 25bps decrease[1]	**76**	(2)
Rate of inflation		
Change in pension obligation at year end from a 25bps increase	**881**	1,026
Change in pension obligation at year end from a 25bps decrease	**(842)**	(978)
Change in 2013 pension cost from a 25bps increase[1]	**48**	57
Change in 2013 pension cost from a 25bps decrease[1]	**(47)**	(54)
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at year end from a 25bps increase	**719**	876
Change in pension obligation at year end from a 25bps decrease	**(692)**	(841)
Change in 2013 pension cost from a 25bps increase[1]	**36**	43
Change in 2013 pension cost from a 25bps decrease[1]	**(34)**	(42)
Rate of pay increase		
Change in pension obligation at year end from a 25bps increase	**175**	248
Change in pension obligation at year end from a 25bps decrease	**(173)**	(240)
Change in 2013 pension cost from a 25bps increase[1]	**15**	19
Change in 2013 pension cost from a 25bps decrease[1]	**(13)**	(15)
Investment return		
Change in 2013 pension cost from a 25bps increase[1]	**–**	(65)
Change in 2013 pension cost from a 25bps decrease[1]	**–**	67
Mortality		
Change in pension obligation from each additional year of longevity assumed	**663**	619

1 *The change in 2013 pension cost from a 25bps increase/decrease was calculated based on the requirements of IAS 19 revised, which will be adopted from 1 January 2013. The comparative numbers, which show the change in 2012 pension cost from a 25bps increase/decrease, were calculated in accordance with the accounting policy set out in Note 2(t).*

The effect of changes in the discount rate and in mortality rates on plans other than the principal plan

	Other plans	
	2012	2011
	US$m	US$m
Change in defined benefit obligation at year end from a 25bps increase in discount rate	**(379)**	(325)
Change in 2013 pension cost from a 25bps increase in discount rate[1]	**(17)**	–
Increase in defined benefit obligation from each additional year of longevity assumed	**174**	144

1 *The change in 2013 pension cost from a 25bps increase/decrease was calculated based on the requirements of IAS 19 revised, which will be adopted from 1 January 2013. The comparative numbers, which show the change in 2012 pension cost from a 25bps increase/decrease, were calculated in accordance with the accounting policy set out in Note 2(t).*

HSBC Holdings

Employee compensation and benefit expense in respect of HSBC Holdings' employees in 2012 amounted to US$439m (2011: US$413m). The average number of persons employed by HSBC Holdings during 2012 was 1,323 (2011: 1,212).

Employees of HSBC Holdings who are members of defined benefit pension plans are principally members of either the HSBC Bank (UK) Pension Scheme or the HSBC International Staff Retirement Benefits Scheme. HSBC Holdings pays contributions to such plans for its own employees in accordance with the schedules of contributions determined by the Trustees of the plan.

Directors' emoluments

The aggregate emoluments of the Directors of HSBC Holdings, computed in accordance with the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 were:

	2012	2011	2010
	US$000	US$000	US$000
Fees	**5,435**	5,108	3,597
Salaries and other emoluments	**10,316**	12,906	12,841
Annual incentives	**13,983**	12,516	14,294
Total	**29,734**	30,530	30,732
Vesting of long-term incentive awards	**5,733**	2,596	8,523

In addition, there were payments under retirement benefit agreements with former Directors of US$1,171,796 (2011: US$1,166,580). The provision at 31 December 2012 in respect of unfunded pension obligations to former Directors amounted to US$19,285,971 (2011: US$18,006,894).

During the year, aggregate contributions to pension schemes in respect of Directors were US$29,078 (2011: US$373,310). Discretionary annual incentives for Directors are based on a combination of individual and corporate performance and are determined by the Group Remuneration Committee. Details of Directors' remuneration, share options and awards under the HSBC Share Plan and HSBC Share Plan 2011 are included in the 'Directors' Remuneration Report' on pages 347 to 367.

8 Auditors' remuneration

	2012	2011	2010
	US$m	US$m	US$m
Audit fees payable to KPMG[1]	**47.2**	48.8	49.1
Audit fees payable to non-KPMG entities	**1.4**	1.9	2.3
Total auditors' remuneration	**48.6**	50.7	51.4

1 *Fees payable to KPMG for HSBC Holdings' statutory audit and audit of HSBC's subsidiaries, pursuant to legislation.*

The following fees were payable by HSBC to the Group's principal auditor, KPMG Audit Plc and its associates (together 'KPMG'):

Notes on the Financial Statements (continued)

Fees payable by HSBC to KPMG

	2012 US$m	2011 US$m	2010 US$m
Fees for HSBC Holdings' statutory audit[1]	**13.2**	12.7	11.8
– relating to current year	**12.8**	12.4	11.8
– relating to prior year	**0.4**	0.3	–
Fees for other services provided to HSBC	**67.3**	74.4	66.5
Audit of HSBC's subsidiaries[2]	**34.0**	36.1	37.3
Audit-related assurance services[3]	**23.6**	25.7	20.8
Taxation-related services:			
– taxation compliance services	**2.1**	2.8	1.5
– taxation advisory services	**1.3**	1.5	0.9
Other assurance services	**1.1**	1.3	1.4
Other non-audit services[4]	**5.2**	7.0	4.6
Total fees payable	**80.5**	87.1	78.3

1 *Fees payable to KPMG for the statutory audit of the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings. They include amounts payable for services relating to HSBC Holdings' subsidiaries consolidation returns which are clearly identifiable as being in support of the Group audit opinion, with effect from 1 January 2012. Previously these fees were included in 'Fees for other services provided to HSBC'. Comparative information has been updated accordingly. The adjustment reduced 'Fees for other services provided to HSBC' and increased 'Fees for HSBC Holdings' statutory audit' by US$11.0m in 2012 (2011: US$10.5m; 2010: US$9.4m). There was no effect on basic or diluted earnings per share following the change.*
2 *Fees payable for the statutory audit of HSBC's subsidiaries financial statements.*
3 *Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews.*
4 *Including valuation and actuarial services, translation services, ad-hoc accounting advice, review of financial models, advice on IT security and business continuity, corporate finance transactions and performing agreed-upon IT testing procedures.*

No fees were payable by HSBC to KPMG for the following types of services: internal audit services, services related to litigation and recruitment and remuneration.

Fees payable by HSBC's associated pension schemes to KPMG

	2012 US$000	2011 US$000	2010 US$000
Audit of HSBC's associated pension schemes	**256**	248	384
Taxation-related services	**–**	11	–
– taxation compliance services	**–**	–	–
– taxation advisory services	**–**	11	–
Total fees payable	**256**	259	384

No fees were payable by HSBC's associated pension schemes to KPMG for the following types of services: audit related assurance services, internal audit services, other assurance services, services related to corporate finance transactions, valuation and actuarial services, litigation, recruitment and remuneration, and information technology.

In addition to the above, KPMG estimate they have been paid fees of US$3.3m (2011: US$8.6m; 2010: US$14.9m) by parties other than HSBC but where HSBC is connected with the contracting party and therefore may be involved in appointing KPMG. These fees arise from services such as auditing mutual funds managed by HSBC and reviewing the financial position of corporate concerns which borrow from HSBC.

Fees payable to KPMG for non-audit services for HSBC Holdings are not disclosed separately because such fees are disclosed on a consolidated basis for HSBC Group.

9 Tax

Tax charged to the income statement

	2012 US$m	2011 US$m	2010 US$m
Current tax			
UK corporation tax	**250**	820	383
– for this year	**60**	462	404
– adjustments in respect of prior years	**190**	358	(21)
Overseas tax[1]	**5,560**	4,255	3,328
– for this year	**5,421**	4,155	3,235
– adjustments in respect of prior years	**139**	100	93
	5,810	5,075	3,711
Deferred tax	**(495)**	(1,147)	1,135
Origination and reversal of temporary differences	**(269)**	(1,178)	1,176
Effect of changes in tax rates	**66**	(3)	31
Adjustments in respect of prior years	**(292)**	34	(72)
Total tax charged to the income statement	**5,315**	3,928	4,846

1 *Overseas tax included Hong Kong profits tax of US$1,049m (2011: US$997m; 2010: US$962m). The Hong Kong tax rate applying to the profits of subsidiaries assessable in Hong Kong was 16.5% (2011: 16.5%; 2010: 16.5%). Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.*

Tax reconciliation

The tax charged to the income statement differs to the tax charge that would apply if all profits had been taxed at the UK corporation tax rate as follows:

	2012		2011		2010	
	US$m	**%**	US$m	%	US$m	%
Profit before tax	**20,649**		21,872		19,037	
Tax at 24.5% (2011: 26.5%; 2010: 28.0%)	**5,057**	**24.5**	5,796	26.5	5,330	28.0
Impact of differently taxed overseas profits	**(57)**	**(0.3)**	(492)	(2.2)	(744)	(3.9)
Adjustments in respect of prior period liabilities	**37**	**0.2**	495	2.3	–	–
Deferred tax temporary differences not recognised/ (previously not recognised)	**374**	**1.8**	(923)	(4.2)	(6)	–
Effect of profits in associates and joint ventures	**(872)**	**(4.3)**	(865)	(4.0)	(758)	(4.0)
Tax impact of intra-group transfer of subsidiary	**–**	**–**	–	–	1,216	6.4
Tax impact of disposal of Ping An	**(204)**	**(1.0)**	–	–	–	–
Non taxable income and gains	**(542)**	**(2.6)**	(613)	(2.8)	(700)	(3.7)
Permanent disallowables	**1,092**	**5.3**	467	2.1	355	1.9
Change in tax rates	**78**	**0.4**	(3)	–	31	0.2
Local taxes and overseas withholding taxes	**581**	**2.8**	267	1.2	224	1.2
Other items	**(229)**	**(1.1)**	(201)	(0.9)	(102)	(0.6)
Total tax charged to the income statement	**5,315**	**25.7**	3,928	18.0	4,846	25.5

The effective tax rate for the year was 25.7% compared with 18.0% for 2011. The higher effective tax rate in 2012 reflects the non tax deductible effect of fines and penalties as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanction laws, together with the non-recognition of the tax benefit in respect of the accounting charge associated with negative fair value movements on own debt. The lower effective tax rate in 2011 included the benefit of deferred tax of US$0.9bn in respect of foreign tax credits in the US.

The UK corporation tax rate applying to HSBC Holdings and its subsidiaries was 24.5% (2011: 26.5%; 2010: 28%).

The UK Government announced that the main rate of corporation tax for the year beginning 1 April 2012 will reduce from 26% to 24% to be followed by a 1% reduction to 23% for the year beginning 1 April 2013 and a further 2% reduction to 21% for the year beginning 1 April 2014. The reduction in the corporate tax rate to 24% was substantively enacted in the first half of 2012 and this results in a weighted average rate of 24.5% for 2012

(2011: 26.5%). The reduction to 23% was enacted through the 2012 Finance Act in July and the reduction to 21% announced in the 2012 Autumn Statement is expected to be enacted through the 2013 Finance Act. It is not expected that the proposed future rate reductions will have a significant effect on the Group.

The Group's legal entities are subject to routine review and audit by tax authorities in the territories in which the Group operates. The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters. A substantial proportion of the material open issues related to the UK of which the principal matter concerned the application of the UK Controlled Foreign Company ('CFC') rules. Following further discussion with Her Majesty's Revenue and Customs, the CFC and certain other open UK issues have now been resolved.

Deferred taxation

The table overleaf shows the gross deferred tax assets and liabilities recognised in the balance sheet and the related amounts recognised in the income statement, other comprehensive income and directly in equity.

The amounts presented in the balance sheet are different from the amounts disclosed in the table overleaf as they are presented after offsetting asset and liability balances where HSBC has the legal right to set-off and intends to settle on a net basis.

US

Of the total net deferred tax assets of US$6.5bn at 31 December 2012 (2011: US$6.2bn), the net deferred tax asset relating to HSBC's operations in the US was US$4.6bn (2011: US$5.2bn). The deferred tax assets included in this total reflected the carry forward of no tax losses and tax credits (2011: US$1.2bn), deductible temporary differences in respect of loan impairment allowances of US$2.0bn (2011: US$2.7bn) and other temporary differences of US$2.6bn (2011: US$1.3bn).

Deductions for loan impairments for US tax purposes generally occur when the impaired loan is charged off, often in the period subsequent to that in which the impairment is recognised for accounting purposes. As a result, the amount of the associated deferred tax asset should generally move in line with the impairment allowance balance. The taxable gains on the disposal of the US branch network and Card and Retail Services business has resulted in a reduction in the amount of deferred tax assets related to carried forward tax losses and tax credits. This was offset in part by the reversal of deferred tax liabilities as a result of these disposals.

On the evidence available, including historical levels of profitability, management projections of future income and HSBC Holdings' commitment to continue to invest sufficient capital in North America to recover the deferred tax asset, it is expected that there will be sufficient taxable income generated by the business to realise these assets. Management projections of profits from the US operations are prepared for a 10-year period and include assumptions about future house prices and US economic conditions, including unemployment levels.

The current level of the deferred tax asset in respect of loan impairment allowances is projected to reduce over the 10-year period in line with the reduction in the Consumer and Mortgage Lending portfolio.

As there has been a recent history of losses in HSBC's US operations, management's analysis of the recognition of these deferred tax assets significantly discounts any future expected profits from the US operations and relies to a greater extent on capital support from HSBC Holdings, including tax planning strategies in relation to such support. The principal strategy involves generating future taxable profits through the retention of capital in the US in excess of normal regulatory requirements in order to reduce deductible funding expenses or otherwise deploy such capital to increase levels of taxable income.

Movement of deferred tax assets and liabilities before offsetting balances within countries

	Retirement benefits US$m	Loan impairment provisions US$m	Unused tax losses and tax credits US$m	Accelerated capital allowances US$m	Available-for-sale investments US$m	Cash flow hedges US$m	Share-based payments US$m	Assets leased to customers US$m	Revaluation of property US$m	Fee income US$m	Other US$m	Total US$m
2012												
Assets	**742**	**4,448**	**1,328**	**117**	**–**	**487**	**286**	**14**	**–**	**–**	**1,709**	**9,131**
Liabilities	**(107)**	**–**	**–**	**–**	**(557)**	**(137)**	**–**	**(595)**	**(227)**	**(737)**	**(563)**	**(2,923)**
At 1 January	**635**	**4,448**	**1,328**	**117**	**(557)**	**350**	**286**	**(581)**	**(227)**	**(737)**	**1,146**	**6,208**
Acquisitions and disposals	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**3**	**3**
Income statement	**(313)**	**(590)**	**(692)**	**168**	**(270)**	**(9)**	**(52)**	**569**	**111**	**616**	**957**	**495**
Other comprehensive income	**174**	**–**	**(33)**	**–**	**(395)**	**(90)**	**–**	**–**	**–**	**–**	**–**	**(344)**
Equity	**–**	**–**	**–**	**–**	**–**	**–**	**45**	**–**	**–**	**–**	**–**	**45**
Foreign exchange and other adjustments	**(27)**	**54**	**14**	**(50)**	**19**	**(10)**	**26**	**24**	**19**	**16**	**(31)**	**54**
At 31 December	**469**	**3,912**	**617**	**235**	**(1,203)**	**241**	**305**	**12**	**(97)**	**(105)**	**2,075**	**6,461**
Assets	**469**	**3,912**	**617**	**289**	**–**	**285**	**305**	**184**	**–**	**–**	**2,965**	**9,026**
Liabilities	**–**	**–**	**–**	**(54)**	**(1,203)**	**(44)**	**–**	**(172)**	**(97)**	**(105)**	**(890)**	**(2,565)**
2011												
Assets	1,538	4,799	351	109	11	352	241	–	–	–	957	8,358
Liabilities	–	–	(3)	(126)	(135)	(88)	–	(707)	(225)	(756)	(400)	(2,440)
At 1 January	1,538	4,799	348	(17)	(124)	264	241	(707)	(225)	(756)	557	5,918
Acquisitions and disposals	3	–	11	–	(3)	(5)	1	–	22	–	(6)	23
Income statement	(437)	(224)	945	137	10	14	1	93	(36)	17	627	1,147
Other comprehensive income	(322)	–	–	–	(533)	53	–	–	–	–	–	(802)
Equity	–	–	–	–	–	–	27	–	–	–	–	27
Foreign exchange and other adjustments	(147)	(127)	24	(3)	93	24	16	33	12	2	(32)	(105)
At 31 December	635	4,448	1,328	117	(557)	350	286	(581)	(227)	(737)	1,146	6,208
Assets	742	4,448	1,328	117	–	487	286	14	–	–	1,709	9,131
Liabilities	(107)	–	–	–	(557)	(137)	–	(595)	(227)	(737)	(563)	(2,923)

Brazil

The net deferred tax asset relating to HSBC's operations in Brazil was US$0.9bn (2011: US$0.7bn). The deferred tax assets included in this total arose primarily in relation to deductible temporary differences in respect of loan impairment allowances. Deductions for loan impairments for Brazilian tax purposes generally occur in periods subsequent to those in which they are recognised for accounting purposes and, as a result, the amount of the associated deferred tax assets move in line with the impairment allowance balance.

Loan impairment deductions are recognised for tax purposes typically within 24 months of accounting recognition. On the evidence available, including historic levels of profitability, management projections of income and the state of the Brazilian economy, it is anticipated that there will be sufficient taxable income generated by the business to realise these assets when deductible for tax purposes.

There were no material carried forward tax losses or tax credits recognised within the Group's deferred tax assets in Brazil.

Mexico

The net deferred tax asset relating to HSBC's operations in Mexico was US$0.6bn (2011: US$0.5bn). The deferred tax assets included in this total related primarily to deductible temporary differences in respect of accounting provisions for impaired loans, including losses realised on sales of impaired loans. The annual deduction for loan impairments is capped under Mexican legislation at 2.5% of the average qualifying loan portfolio. The balance is carried forward to future years without expiry but with the annual deduction subject to the 2.5% cap.

On the evidence available, including historic and projected levels of loan portfolio growth, loan impairment rates and profitability, it is anticipated that the business will realise these assets within the next 15 years. The projections assume that loan impairment rates will remain at levels consistently below the annual 2.5% cap over the medium term.

There were no material carried forward tax losses or tax credits recognised within the Group's deferred tax assets in Mexico.

UK

The net deferred tax asset relating to HSBC's operations in the UK was US$0.3bn (2011: liability US$0.2bn). The deferred tax assets included in this total relate primarily to the carry forward of tax losses.

On the evidence available, including historical levels of profitability and management projections of future income it is anticipated that there will be sufficient taxable income generated by the business to recover the deferred tax asset over the next 12 months.

Unrecognised deferred tax

The amount of temporary differences, unused tax losses and tax credits for which no deferred tax asset is recognised in the balance sheet was US$16.6bn (2011: US$14.7bn). These amounts included unused state losses arising in our US operations of US$12.6bn (2011: US$12.5bn).

Of the total amounts unrecognised, US$3.9bn (2011: US$2.4bn) had no expiry date, US$0.3bn (2011: US$0.1bn) was scheduled to expire within 10 years (2011: 10 years) and the remaining will expire after 10 years.

Deferred tax is not recognised in respect of the Group's investments in subsidiaries and branches where remittance or other realisation is not probable, and for those associates and interests in joint ventures where it has been determined that no additional tax will arise. No amount is disclosed for the unrecognised deferred tax or the 2012 and 2011 temporary differences associated with such investments as it is impracticable to determine the amount of income taxes that would be payable when any temporary differences reverse. Deferred tax of US$0.3bn (2011: US$0.2bn) has, however, been provided in respect of distributable reserves of associates that, on distribution, would attract withholding tax.

HSBC Holdings

Movement of deferred tax assets

	Accelerated capital allowances US$m	Short-term timing differences US$m	Available-for-sale investments US$m	Fair valued assets and liabilities US$m	Share-based payments US$m	Unused tax losses US$m	Total US$m
2012							
At 1 January	**–**	**–**	**(4)**	**46**	**9**	**40**	**91**
Income statement	**2**	**–**	**–**	**(15)**	**(7)**	**(40)**	**(60)**
Other comprehensive income	**–**	**–**	**(27)**	**–**	**–**	**–**	**(27)**
Equity	**–**	**–**	**–**	**–**	**10**	**–**	**10**
At 31 December	**2**	**–**	**(31)**	**31**	**12**	**–**	**14**
2011							
At 1 January	–	1	(21)	61	16	–	57
Income statement	–	(1)	–	(15)	(7)	40	17
Other comprehensive income	–	–	17	–	–	–	17
At 31 December	–	–	(4)	46	9	40	91

The amount of unused tax losses for which no deferred tax asset is recognised in the balance sheet was US$1,775m (2011: US$8m) of which US$9m (2011: US$8m) relate to capital losses. The losses have no expiry date.

10 Dividends

Dividends to shareholders of the parent company

	2012			2011			2010		
	Per share US$	**Total US$m**	**Settled in scrip US$m**	Per share US$	Total US$m	Settled in scrip US$m	Per share US$	Total US$m	Settled in scrip US$m
Dividends declared on ordinary shares									
In respect of previous year:									
– fourth interim dividend	**0.14**	**2,535**	**259**	0.12	2,119	1,130	0.10	1,733	838
In respect of current year:									
– first interim dividend	**0.09**	**1,633**	**748**	0.09	1,601	204	0.08	1,394	746
– second interim dividend	**0.09**	**1,646**	**783**	0.09	1,603	178	0.08	1,402	735
– third interim dividend	**0.09**	**1,655**	**639**	0.09	1,605	720	0.08	1,408	205
	0.41	**7,469**	**2,429**	0.39	6,928	2,232	0.34	5,937	2,524
Quarterly dividends on preference shares classified as equity									
March dividend	**15.50**	**22**		15.50	22		15.50	22	
June dividend	**15.50**	**23**		15.50	23		15.50	23	
September dividend	**15.50**	**22**		15.50	22		15.50	22	
December dividend	**15.50**	**23**		15.50	23		15.50	23	
	62.00	**90**		62.00	90		62.00	90	

Quarterly coupons on capital securities classified as equity[1]

	2012		2011		2010	
	Per share US$	**Total US$m**	Per share US$	Total US$m	Per share US$	Total US$m
January coupon	**0.508**	**44**	0.508	44	0.508	44
March coupon	**0.500**	**76**	0.500	76	–	–
April coupon	**0.508**	**45**	0.508	45	0.508	45
June coupon	**0.500**	**76**	0.500	76	–	–
July coupon	**0.508**	**45**	0.508	45	0.508	45
September coupon	**0.500**	**76**	0.500	76	0.450	68
October coupon	**0.508**	**45**	0.508	45	0.508	45
December coupon	**0.500**	**76**	0.500	76	0.500	76
	4.032	**483**	4.032	483	2.982	323

1 *HSBC Holdings issued Perpetual Subordinated Capital Securities of US$3,800m in June 2010 and US$2,200m in April 2008, which are classified as equity under IFRSs.*

The Directors declared after the end of the year a fourth interim dividend in respect of the financial year ended 31 December 2012 of US$0.18 per ordinary share, a distribution of approximately US$3,327m. The fourth interim dividend will be payable on 8 May 2013 to holders of record on 21 March 2013 on the Hong Kong Overseas Branch Register and 22 March 2013 on the Principal Register in the UK or the Bermuda Overseas Branch Register. No liability is recorded in the financial statements in respect of the fourth interim dividend for 2012.

On 15 January 2013, HSBC paid a further coupon on the capital securities of US$0.508 per security, a distribution of US$44m. No liability is recorded in the balance sheet at 31 December 2012 in respect of this coupon payment.

11 Earnings per share

Basic earnings per ordinary share was calculated by dividing the profit attributable to ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding, excluding own shares held. Diluted earnings per ordinary share was calculated by dividing the basic earnings, which require no adjustment for the effects of dilutive potential ordinary shares, by the weighted average number of ordinary shares outstanding, excluding own shares held, plus the weighted average number of ordinary shares that would be issued on conversion of dilutive potential ordinary shares.

Profit attributable to the ordinary shareholders of the parent company

	2012 US$m	2011 US$m	2010 US$m
Profit attributable to shareholders of the parent company	14,027	16,797	13,159
Dividend payable on preference shares classified as equity	(90)	(90)	(90)
Coupon payable on capital securities classified as equity	(483)	(483)	(323)
Profit attributable to the ordinary shareholders of the parent company	13,454	16,224	12,746

Basic and diluted earnings per share

	2012			2011			2010		
	Profit US$m	Number of shares (millions)	Per share US$	Profit US$m	Number of shares (millions)	Per share US$	Profit US$m	Number of shares (millions)	Per share US$
Basic[1]	13,454	18,125	0.74	16,224	17,700	0.92	12,746	17,404	0.73
Effect of dilutive potential ordinary shares		146			222			229	
– Savings-related Share Option Plan		23			45			55	
– Other plans		123			177			174	
Diluted[1]	13,454	18,271	0.74	16,224	17,922	0.91	12,746	17,633	0.72

1 *Weighted average number of ordinary shares outstanding (basic) or assuming dilution (diluted).*

The weighted average number of dilutive potential ordinary shares excluded 103m employee share options that were anti-dilutive (2011: 151m; 2010: 150m).

12 Segmental analysis

HSBC's operating segments are organised into six geographical regions, Europe, Hong Kong, Rest of Asia-Pacific, Middle East and North Africa ('MENA'), North America and Latin America.

Geographical information is classified by the location of the principal operations of the subsidiary or, for The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the branch responsible for reporting the results or advancing the funds.

HSBC's chief operating decision-maker is the Group Management Board ('GMB') which operates as a general management committee under the direct authority of the Board. Information provided to GMB to make decisions about allocating resources to, and assessing the performance of, operating segments is measured in accordance with IFRSs. The financial information shown below includes the effects of intra-HSBC transactions between operating segments which are conducted on an arm's length basis and are eliminated in arriving at the total. Shared costs are included in operating segments on the basis of the actual recharges made.

Products and services

HSBC provides a comprehensive range of banking and related financial services to its customers in its six geographical regions. The products and services offered to customers are organised by global business.

- Retail Banking and Wealth Management ('RBWM') offers a broad range of products and services to meet the personal banking and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products, global asset management services and financial planning services).
- Commercial Banking ('CMB') offers a broad range of products and services to serve the needs of our commercial customers, including small and medium sized enterprises, mid-market enterprises and corporates. These include credit and lending, international trade and receivables finance, treasury management and liquidity solutions (payments and cash management and commercial cards), commercial insurance and investments. We also offer our customers access to products and services offered by other global businesses, for example Global Banking and Markets ('GB&M') which include foreign exchange products, raising capital on debt and equity markets and advisory services.
- GB&M provides tailored financial solutions to major government, corporate and institutional clients and private investors worldwide. The client-focused business lines deliver a full range of banking capabilities including financing, advisory and transaction services, a markets business that provides services in credit, rates, foreign exchange, money markets and securities services, and principal investment activities.
- Global Private Banking ('GPB') provides a range of services to high net worth individuals and families with complex and international needs.

Financial information

In the following segmental analysis, the benefit of shareholders' funds impacts the analysis only to the extent that these funds are actually allocated to businesses in the segment by way of intra-HSBC capital and funding structures.

Notes on the Financial Statements (continued)

12 – Segmental analysis

Profit/(loss) for the year

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
2012								
Net interest income	10,394	5,316	5,391	1,470	8,117	6,984	–	37,672
Net fee income	6,169	3,335	2,083	595	2,513	1,735	–	16,430
Net trading income/(expense)	2,707	1,463	1,053	390	507	971	–	7,091
Gains on disposal of US branch network, US cards business and Ping An	–	–	3,012	–	4,012	–	–	7,024
Other income	(1,662)	2,308	2,045	(25)	(456)	1,261	(3,358)	113
Net operating income[1]	17,608	12,422	13,584	2,430	14,693	10,951	(3,358)	68,330
Loan impairment charges and other credit risk provisions	(1,921)	(74)	(436)	(286)	(3,457)	(2,137)	–	(8,311)
Net operating income	15,687	12,348	13,148	2,144	11,236	8,814	(3,358)	60,019
Employee compensation and benefits	(8,070)	(2,572)	(3,140)	(652)	(3,243)	(2,814)	–	(20,491)
General and administrative expenses	(10,059)	(1,860)	(2,433)	(459)	(5,413)	(3,117)	3,358	(19,983)
Depreciation and impairment of property, plant and equipment	(597)	(236)	(191)	(44)	(195)	(221)	–	(1,484)
Amortisation and impairment of intangible assets	(369)	(180)	(42)	(11)	(89)	(278)	–	(969)
Total operating expenses	(19,095)	(4,848)	(5,806)	(1,166)	(8,940)	(6,430)	3,358	(42,927)
Operating profit	(3,408)	7,500	7,342	978	2,296	2,384	–	17,092
Share of profit in associates and joint ventures	(6)	82	3,106	372	3	–	–	3,557
Profit before tax	(3,414)	7,582	10,448	1,350	2,299	2,384	–	20,649
Tax income/(expense)	(173)	(1,095)	(1,616)	(254)	(1,313)	(864)	–	(5,315)
Profit for the year	(3,587)	6,487	8,832	1,096	986	1,520	–	15,334
2011								
Net interest income	11,001	4,691	5,102	1,432	11,480	6,956	–	40,662
Net fee income	6,236	3,097	2,111	627	3,308	1,781	–	17,160
Net trading income/(expense)	2,161	1,189	1,658	482	(362)	1,378	–	6,506
Other income	4,848	1,705	1,842	66	1,574	1,338	(3,421)	7,952
Net operating income[1]	24,246	10,682	10,713	2,607	16,000	11,453	(3,421)	72,280
Loan impairment charges and other credit risk provisions	(2,512)	(156)	(267)	(293)	(7,016)	(1,883)	–	(12,127)
Net operating income	21,734	10,526	10,446	2,314	8,984	9,570	(3,421)	60,153
Employee compensation and benefits	(7,621)	(2,610)	(3,179)	(659)	(3,928)	(3,169)	–	(21,166)
General and administrative expenses	(8,473)	(1,724)	(2,378)	(458)	(4,404)	(3,443)	3,421	(17,459)
Depreciation and impairment of property, plant and equipment	(581)	(245)	(198)	(36)	(261)	(249)	–	(1,570)
Amortisation and impairment of intangible assets	(394)	(179)	(51)	(6)	(326)	(394)	–	(1,350)
Total operating expenses	(17,069)	(4,758)	(5,806)	(1,159)	(8,919)	(7,255)	3,421	(41,545)
Operating profit	4,665	5,768	4,640	1,155	65	2,315	–	18,608
Share of profit in associates and joint ventures	6	55	2,831	337	35	–	–	3,264
Profit before tax	4,671	5,823	7,471	1,492	100	2,315	–	21,872
Tax income/(expense)	(1,589)	(1,043)	(1,315)	(266)	958	(673)	–	(3,928)
Profit for the year	3,082	4,780	6,156	1,226	1,058	1,642	–	17,944

2010	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
Net interest income	11,250	4,246	3,828	1,367	12,439	6,311	–	39,441
Net fee income	6,371	2,962	1,932	677	3,664	1,749	–	17,355
Net trading income	2,863	1,312	1,618	370	314	733	–	7,210
Other income/(expense)	2,266	1,682	1,854	(4)	630	938	(3,125)	4,241
Net operating income[1]	22,750	10,202	9,232	2,410	17,047	9,731	(3,125)	68,247
Loan impairment charges and other credit risk provisions	(3,020)	(114)	(439)	(627)	(8,295)	(1,544)	–	(14,039)
Net operating income	19,730	10,088	8,793	1,783	8,752	8,187	(3,125)	54,208
Employee compensation and benefits	(7,875)	(2,341)	(2,719)	(579)	(3,672)	(2,650)	–	(19,836)
General and administrative expenses	(6,499)	(1,686)	(2,181)	(450)	(4,179)	(3,286)	3,125	(15,156)
Depreciation and impairment of property, plant and equipment	(719)	(237)	(189)	(42)	(288)	(238)	–	(1,713)
Amortisation and impairment of intangible assets	(352)	(167)	(54)	(7)	(183)	(220)	–	(983)
Total operating expenses	(15,445)	(4,431)	(5,143)	(1,078)	(8,322)	(6,394)	3,125	(37,688)
Operating profit	4,285	5,657	3,650	705	430	1,793	–	16,520
Share of profit in associates and joint ventures	17	35	2,252	187	24	2	–	2,517
Profit before tax	4,302	5,692	5,902	892	454	1,795	–	19,037
Tax income/(expense)	(1,006)	(987)	(962)	(138)	(1,180)	(573)	–	(4,846)
Profit/(loss) for the year	3,296	4,705	4,940	754	(726)	1,222	–	14,191

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

Notes on the Financial Statements (continued)

12 – Segmental analysis

Other information about the profit/(loss) for the year

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
2012								
Net operating income	**15,687**	**12,348**	**13,148**	**2,144**	**11,236**	**8,814**	**(3,358)**	**60,019**
External	**14,484**	**11,233**	**12,150**	**2,169**	**11,109**	**8,874**	**–**	**60,019**
Inter-segment	**1,203**	**1,115**	**998**	**(25)**	**127**	**(60)**	**(3,358)**	**–**
Profit for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	**966**	**416**	**233**	**55**	**363**	**499**	**–**	**2,532**
Loan impairment losses gross of recoveries and other credit risk provisions	**2,329**	**105**	**586**	**361**	**3,587**	**2,489**	**–**	**9,457**
Impairment of financial investments	**420**	**(21)**	**83**	**1**	**32**	**4**	**–**	**519**
Changes in fair value of long-term debt and related derivatives	**(3,091)**	**–**	**(4)**	**(13)**	**(1,219)**	**–**	**–**	**(4,327)**
Restructuring costs	**292**	**21**	**107**	**27**	**219**	**94**	**–**	**760**
2011								
Net operating income	21,734	10,526	10,446	2,314	8,984	9,570	(3,421)	60,153
External	20,676	9,442	9,396	2,316	8,744	9,579	–	60,153
Inter-segment	1,058	1,084	1,050	(2)	240	(9)	(3,421)	–
Profit for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	975	424	249	42	802	643	–	3,135
Loan impairment losses gross of recoveries and other credit risk provisions	3,085	202	453	395	7,147	2,271	–	13,553
Impairment of financial investments	705	55	25	13	9	1	–	808
Changes in fair value of long-term debt and related derivatives	3,180	–	4	10	967	–	–	4,161
Restructuring costs	357	47	34	27	73	259	–	797
2010								
Net operating income	19,730	10,088	8,793	1,783	8,752	8,187	(3,125)	54,208
External	18,881	9,170	7,728	1,774	8,504	8,151	–	54,208
Inter-segment	849	918	1,065	9	248	36	(3,125)	–
Profit for the year includes the following significant non-cash items:								
Depreciation, amortisation and impairment	1,071	404	243	49	576	458	–	2,801
Loan impairment losses gross of recoveries and other credit risk provisions	3,303	169	615	684	8,476	1,812	–	15,059
Impairment of financial investments	33	41	4	5	21	1	–	105
Changes in fair value of long-term debt and related derivatives	(365)	(2)	(2)	–	111	–	–	(258)
Restructuring costs	86	15	36	5	13	3	–	158

Balance sheet information

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
At 31 December 2012								
Loans and advances to customers (net)	**463,440**	**173,613**	**138,119**	**28,086**	**140,756**	**53,609**	**–**	**997,623**
Interests in associates and joint ventures	**178**	**224**	**15,085**	**2,262**	**85**	**–**	**–**	**17,834**
Total assets	**1,389,240**	**518,334**	**342,269**	**62,605**	**490,247**	**131,277**	**(241,434)**	**2,692,538**
Customer accounts	**555,009**	**346,208**	**183,621**	**39,583**	**149,037**	**66,556**	**–**	**1,340,014**
Total liabilities	**1,327,487**	**496,640**	**308,815**	**53,498**	**450,480**	**113,923**	**(241,434)**	**2,509,409**
Capital expenditure incurred[1]	**925**	**336**	**208**	**102**	**248**	**458**	**–**	**2,277**
At 31 December 2011								
Loans and advances to customers (net)	434,336	157,665	123,868	25,875	142,747	55,938	–	940,429
Interests in associates and joint ventures	150	196	17,916	2,036	101	–	–	20,399
Total assets	1,281,945	473,024	317,816	57,464	504,302	144,889	(223,861)	2,555,579
Customer accounts	493,404	315,345	174,012	36,422	155,982	78,760	–	1,253,925
Total liabilities	1,224,386	458,179	288,485	49,005	464,990	128,302	(223,861)	2,389,486
Capital expenditure incurred[1]	1,177	432	207	29	342	951	–	3,138
At 31 December 2010								
Loans and advances to customers (net)	435,799	140,691	108,731	24,626	190,532	57,987	–	958,366
Interests in associates and joint ventures	186	207	15,035	1,661	104	5	–	17,198
Total assets	1,249,527	429,565	278,062	52,757	492,487	139,938	(187,647)	2,454,689
Customer accounts	491,563	297,484	158,155	33,511	158,486	88,526	–	1,227,725
Total liabilities	1,189,996	422,101	246,989	45,379	459,301	123,655	(187,647)	2,299,774
Capital expenditure incurred[1]	865	836	168	46	774	788	–	3,477

1 *Expenditure incurred on property, plant and equipment and other intangible assets. Excludes assets acquired as part of business combinations and goodwill.*

Other financial information

Net operating income by global business

	RBWM[1] US$m	CMB US$m	GB&M[1] US$m	GPB US$m	Other[2] US$m	Intra-HSBC items US$m	Total US$m
2012							
Net operating income[3]	**33,861**	**16,551**	**18,273**	**3,172**	**2,332**	**(5,859)**	**68,330**
External	**31,980**	**17,295**	**20,410**	**2,413**	**(3,768)**	**–**	**68,330**
Internal	**1,881**	**(744)**	**(2,137)**	**759**	**6,100**	**(5,859)**	**–**
2011							
Net operating income[3]	33,533	15,611	17,057	3,292	9,145	(6,358)	72,280
External	32,024	15,362	19,881	2,207	2,806	–	72,280
Internal	1,509	249	(2,824)	1,085	6,339	(6,358)	–
2010							
Net operating income[3]	33,611	13,834	18,912	3,093	4,660	(5,863)	68,247
External	32,056	13,224	21,812	2,182	(1,027)	–	68,247
Internal	1,555	610	(2,900)	911	5,687	(5,863)	–

1 *With effect from 1 March 2011, our Global Asset Management business was moved from Global Banking and Markets to Retail Banking and Wealth Management.*
2 *The main items reported in the 'Other' category are certain property activities, unallocated investment activities, centrally held investment companies, movements in fair value of own debt and HSBC's holding company and financing operations. The 'Other' category also includes gains and losses on the disposal of certain significant subsidiaries or business units.*
3 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue. The table previously reported net operating income after loan impairment charges and other credit risk provisions.*

Information by country

	2012		2011		2010	
	External net operating income[1,2] US$m	**Non-current assets[3] US$m**	External net operating income[1,2] US$m	Non-current assets[3] US$m	External net operating income[1,2] US$m	Non-current assets[3] US$m
UK	**9,149**	**18,391**	16,058	21,414	14,171	19,661
Hong Kong	**11,307**	**11,657**	9,600	6,257	9,282	4,630
USA	**11,779**	**6,718**	12,972	3,830	14,032	6,669
France	**2,881**	**11,074**	2,747	10,790	3,345	10,914
Brazil	**6,395**	**2,017**	6,637	2,149	5,408	2,025
Other countries	**26,819**	**30,078**	24,266	31,590	22,009	29,747
	68,330	**79,935**	72,280	76,030	68,247	73,646

1 *External net operating income is attributed to countries on the basis of the location of the branch responsible for reporting the results or advancing the funds.*
2 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue. The table previously reported net operating income after loan impairment charges and other credit risk provisions.*
3 *Non-current assets consist of property, plant and equipment, goodwill, other intangible assets, interests in associates and joint ventures and certain other assets expected to be recovered more than twelve months after the reporting period.*

13 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 2 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading.

	At 31 December 2012							
	Held for trading US$m	Designated at fair value US$m	Held-to-maturity securities US$m	Available-for-sale securities US$m	Financial assets and liabilities at amortised cost US$m	Derivatives designated as fair value hedging instruments US$m	Derivatives designated as cash flow hedging instruments US$m	Total US$m
Financial assets								
Cash and balances at central banks	–	–	–	–	141,532	–	–	141,532
Items in the course of collection from other banks	–	–	–	–	7,303	–	–	7,303
Hong Kong Government certificates of indebtedness	–	–	–	–	22,743	–	–	22,743
Trading assets	408,811	–	–	–	–	–	–	408,811
Financial assets designated at fair value	–	33,582	–	–	–	–	–	33,582
Derivatives	353,803	–	–	–	–	199	3,448	357,450
Loans and advances to banks	–	–	–	–	152,546	–	–	152,546
Loans and advances to customers	–	–	–	–	997,623	–	–	997,623
Financial investments	–	–	23,413	397,688	–	–	–	421,101
Assets held for sale	9	72	–	10,700	7,341	–	–	18,122
Other assets	–	–	–	–	23,584	–	–	23,584
Accrued income	–	–	–	–	8,540	–	–	8,540
Total financial assets	762,623	33,654	23,413	408,388	1,361,212	199	3,448	2,592,937
Financial liabilities								
Hong Kong currency notes in circulation	–	–	–	–	22,742	–	–	22,742
Deposits by banks	–	–	–	–	107,429	–	–	107,429
Customer accounts	–	–	–	–	1,340,014	–	–	1,340,014
Items in the course of transmission to other banks	–	–	–	–	7,138	–	–	7,138
Trading liabilities	304,563	–	–	–	–	–	–	304,563
Financial liabilities designated at fair value	–	87,720	–	–	–	–	–	87,720
Derivatives	352,195	–	–	–	–	4,450	2,241	358,886
Debt securities in issue	–	–	–	–	119,461	–	–	119,461
Liabilities of disposal groups held for sale	8	23	–	–	3,772	–	–	3,803
Other liabilities	–	–	–	–	32,417	–	–	32,417
Accruals	–	–	–	–	11,663	–	–	11,663
Subordinated liabilities	–	–	–	–	29,479	–	–	29,479
Total financial liabilities	656,766	87,743	–	–	1,674,115	4,450	2,241	2,425,315

Notes on the Financial Statements (continued)

13 – Analysis of financial assets and liabilities

Analysis of financial assets and liabilities be measurement basis (continued)

HSBC

At 31 December 2011	Held for trading US$m	Designated at fair value US$m	Held-to-maturity securities US$m	Available-for-sale securities US$m	Financial assets and liabilities at amortised cost US$m	Derivatives designated as fair value hedging instruments US$m	Derivatives designated as cash flow hedging instruments US$m	Total US$m
Financial assets								
Cash and balances at central banks	–	–	–	–	129,902	–	–	129,902
Items in the course of collection from other banks	–	–	–	–	8,208	–	–	8,208
Hong Kong Government certificates of indebtedness	–	–	–	–	20,922	–	–	20,922
Trading assets	330,451	–	–	–	–	–	–	330,451
Financial assets designated at fair value	–	30,856	–	–	–	–	–	30,856
Derivatives	342,914	–	–	–	–	446	3,019	346,379
Loans and advances to banks	–	–	–	–	180,987	–	–	180,987
Loans and advances to customers	–	–	–	–	940,429	–	–	940,429
Financial investments	–	–	21,199	378,845	–	–	–	400,044
Assets held for sale	308	–	–	482	37,018	–	–	37,808
Other assets	–	–	–	–	24,040	–	–	24,040
Accrued income	–	–	–	–	8,951	–	–	8,951
Total financial assets	673,673	30,856	21,199	379,327	1,350,457	446	3,019	2,458,977
Financial liabilities								
Hong Kong currency notes in circulation	–	–	–	–	20,922	–	–	20,922
Deposits by banks	–	–	–	–	112,822	–	–	112,822
Customer accounts	–	–	–	–	1,253,925	–	–	1,253,925
Items in the course of transmission to other banks	–	–	–	–	8,745	–	–	8,745
Trading liabilities	265,192	–	–	–	–	–	–	265,192
Financial liabilities designated at fair value	–	85,724	–	–	–	–	–	85,724
Derivatives	338,788	–	–	–	–	4,332	2,260	345,380
Debt securities in issue	–	–	–	–	131,013	–	–	131,013
Liabilities of disposal groups held for sale	803	16	–	–	21,181	–	–	22,000
Other liabilities	–	–	–	–	25,911	–	–	25,911
Accruals	–	–	–	–	11,799	–	–	11,799
Subordinated liabilities	–	–	–	–	30,606	–	–	30,606
Total financial liabilities	604,783	85,740	–	–	1,616,924	4,332	2,260	2,314,039

	Held for trading US$m	Designated at fair value US$m	Loans and receivables US$m	Available-for-sale securities US$m	Other financial assets and liabilities at amortised cost US$m	Total US$m
At 31 December 2012						
Financial assets						
Cash at bank and in hand	**–**	**–**	**–**	**–**	**353**	**353**
Derivatives	**3,768**	**–**	**–**	**–**	**–**	**3,768**
Loans and advances to HSBC undertakings	**–**	**–**	**41,675**	**–**	**–**	**41,675**
Financial investments	**–**	**–**	**–**	**1,208**	**–**	**1,208**
Other assets	**–**	**–**	**–**	**–**	**4**	**4**
Total financial assets	**3,768**	**–**	**41,675**	**1,208**	**357**	**47,008**
Financial liabilities						
Amounts owed to HSBC undertakings	**–**	**–**	**–**	**–**	**12,856**	**12,856**
Financial liabilities designated at fair value	**–**	**23,195**	**–**	**–**	**–**	**23,195**
Derivatives	**760**	**–**	**–**	**–**	**–**	**760**
Debt securities in issue	**–**	**–**	**–**	**–**	**2,691**	**2,691**
Accruals	**–**	**–**	**–**	**–**	**605**	**605**
Subordinated liabilities	**–**	**–**	**–**	**–**	**11,907**	**11,907**
Total financial liabilities	**760**	**23,195**	**–**	**–**	**28,059**	**52,014**
At 31 December 2011						
Financial assets						
Cash at bank and in hand	–	–	–	–	316	316
Derivatives	3,568	–	–	–	–	3,568
Loans and advances to HSBC undertakings	–	–	28,048	–	–	28,048
Financial investments	–	–	–	1,078	–	1,078
Other assets	–	–	–	–	1	1
Total financial assets	3,568	–	28,048	1,078	317	33,011
Financial liabilities						
Amounts owed to HSBC undertakings	–	–	–	–	2,479	2,479
Financial liabilities designated at fair value	–	21,151	–	–	–	21,151
Derivatives	1,067	–	–	–	–	1,067
Debt securities in issue	–	–	–	–	2,613	2,613
Other liabilities	–	–	–	–	885	885
Accruals	–	–	–	–	575	575
Subordinated liabilities	–	–	–	–	12,450	12,450
Total financial liabilities	1,067	21,151	–	–	19,002	41,220

14 Trading assets

	2012 US$m	2011 US$m
Trading assets:		
– not subject to repledge or resale by counterparties	305,312	235,916
– which may be repledged or resold by counterparties	103,499	94,535
	408,811	330,451
Treasury and other eligible bills	26,282	34,309
Debt securities	144,677	130,487
Equity securities	41,634	21,002
Trading assets at fair value	212,593	185,798
Loans and advances to banks	78,271	75,525
Loans and advances to customers	117,947	69,128
	408,811	330,451

Trading assets valued at fair value[1]

	Fair value 2012 US$m	Fair value 2011 US$m
US Treasury and US Government agencies[2]	28,405	15,686
UK Government	11,688	12,917
Hong Kong Government	6,228	8,844
Other government	91,498	90,816
Asset-backed securities[3]	2,896	2,913
Corporate debt and other securities	30,244	33,620
Equity securities	41,634	21,002
	212,593	185,798

1 *Included within these figures are debt securities issued by banks and other financial institutions of US$20,274m (2011: US$24,956m), of which US$3,469m (2011: US$5,269m) are guaranteed by various governments.*
2 *Includes securities that are supported by an explicit guarantee issued by the US Government.*
3 *Excludes asset-backed securities included under US Treasury and US Government agencies.*

Trading assets listed on a recognised exchange and unlisted

	Treasury and other eligible bills US$m	Debt securities US$m	Equity securities US$m	Total US$m
Fair value at 31 December 2012				
Listed on a recognised exchange[1]	606	82,732	39,945	123,283
Unlisted[2]	25,676	61,945	1,689	89,310
	26,282	144,677	41,634	212,593
Fair value at 31 December 2011				
Listed on a recognised exchange[1]	789	78,760	19,994	99,543
Unlisted[2]	33,520	51,727	1,008	86,255
	34,309	130,487	21,002	185,798

1 *Included within listed investments are US$2,828m (2011: US$2,836m) of investments listed in Hong Kong.*
2 *Unlisted treasury and other eligible bills primarily comprise treasury bills not listed on a recognised exchange but for which there is a liquid market.*

Loans and advances to banks held for trading

	2012 US$m	2011 US$m
Reverse repos	45,015	45,490
Settlement accounts	6,324	7,555
Stock borrowing	5,361	5,531
Other	21,571	16,949
	78,271	75,525

Loans and advances to customers held for trading

	2012 US$m	2011 US$m
Reverse repos	**73,666**	34,358
Settlement accounts	**8,186**	5,804
Stock borrowing	**10,710**	3,928
Other	**25,385**	25,038
	117,947	69,128

15 Fair values of financial instruments carried at fair value

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2. The use of assumptions and estimation in valuing financial instruments is described on page 56.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments carried at fair value and bases of valuation[1]

		Valuation techniques		
	Quoted market price Level 1 US$m	Using observable inputs Level 2 US$m	With significant unobservable inputs Level 3 US$m	Total US$m
At 31 December 2012				
Assets				
Trading assets	**198,843**	**205,590**	**4,378**	**408,811**
Financial assets designated at fair value	**25,575**	**7,594**	**413**	**33,582**
Derivatives	**1,431**	**352,960**	**3,059**	**357,450**
Financial investments: available for sale	**253,246**	**135,931**	**8,511**	**397,688**
Liabilities				
Trading liabilities	**116,550**	**180,543**	**7,470**	**304,563**
Financial liabilities designated at fair value	**10,703**	**77,017**	**–**	**87,720**
Derivatives	**1,506**	**354,375**	**3,005**	**358,886**
At 31 December 2011				
Assets				
Trading assets	180,043	145,628	4,780	330,451
Financial assets designated at fair value	22,496	7,644	716	30,856
Derivatives	1,262	340,668	4,449	346,379
Financial investments: available for sale	217,788	151,936	9,121	378,845
Liabilities				
Trading liabilities	98,208	159,157	7,827	265,192
Financial liabilities designated at fair value	27,461	57,696	567	85,724
Derivatives	1,991	340,260	3,129	345,380

1 *The above table does not include financial instruments within the Assets held for sale and Liabilities of disposal groups held for sale categorisations.*

The increase in Level 1 trading assets and liabilities reflects an increase in equity securities and settlement account balances, the latter varying considerably in proportion with the level of trading activity. The increase in Level 2 assets reflects higher reverse repo balances used to cover short positions and an increase in repo balances contributed to the growth in Level 2 liabilities.

As described on page 446, HSBC Holdings transferred financial liabilities designated at fair value from Level 1 to Level 2. There were no other material transfers between Level 1 and Level 2 in the year. An analysis of the movements of Level 3 financial instruments is provided on page 447.

Notes on the Financial Statements (continued)

15 – Fair values of financial instruments carried at fair value

Control framework

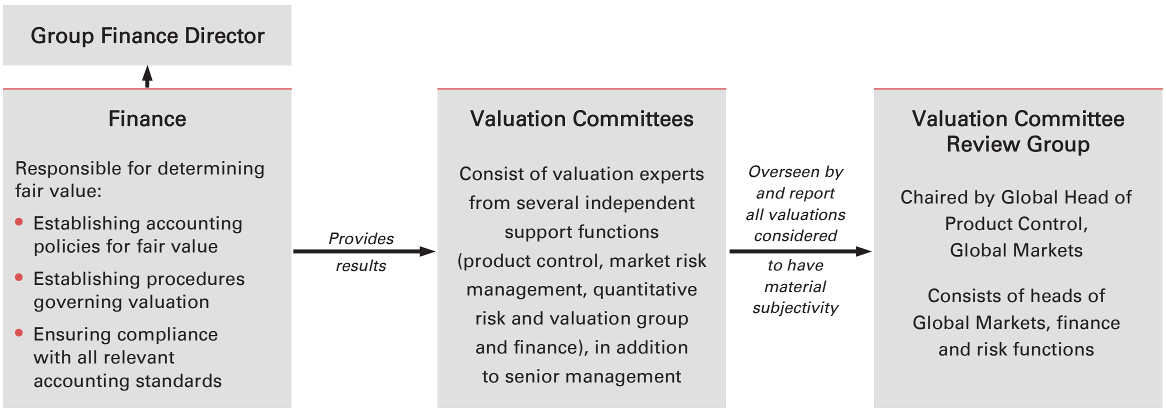
Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, HSBC will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, *inter alia*:

- the extent to which prices may be expected to represent genuine traded or tradeable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

The fair value governance structure is as follows:



Determination of fair value

Fair values are determined according to the following hierarchy:

- *Level 1 – quoted market price:* financial instruments with quoted prices for identical instruments in active markets.
- *Level 2 – valuation technique using observable inputs:* financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- *Level 3 – valuation technique with significant unobservable inputs:* financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price. In the event that the market for a financial instrument is not active, a valuation technique is used.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations, including interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. For swaps with collateralised counterparties and in significant major currencies, HSBC uses a discounting curve that reflects the overnight interest rate ('OIS discounting').

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit ('day 1 gain or loss') or greater than 5% of the instrument's carrying value is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

In certain circumstances, HSBC records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, where available. An example of this is where own debt in issue is hedged with interest rate derivatives. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to HSBC's liabilities. The change in fair value of issued debt securities attributable to the Group's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a Libor-based discount curve. The difference in the valuations is attributable to the Group's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which HSBC issues structured notes.

Gains and losses arising from changes in the credit spread of liabilities issued by HSBC reverse over the contractual life of the debt, provided that the debt is not repaid at a premium or a discount.

Fair value adjustments

Fair value adjustments are adopted when HSBC considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. The magnitude of fair value adjustments depends upon many entity-specific factors, and therefore fair value adjustments may not be comparable across the banking industry.

HSBC classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to GB&M.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

Notes on the Financial Statements (continued)

15 – Fair values of financial instruments carried at fair value

Global Banking and Markets fair value adjustments

	At 31 December	
	2012	2011
	US$m	US$m
Type of adjustment		
Risk-related	**2,013**	1,899
Bid-offer	**638**	695
Uncertainty	**142**	154
Credit valuation adjustment	**1,747**	1,050
Debit valuation adjustment	**(518)**	–
Other	**4**	–
Model-related	**162**	567
Model limitation	**161**	567
Other	**1**	–
Inception profit (Day 1 P&L reserves) (Note 19)	**181**	200
	2,356	2,666

The increase in credit valuation adjustment and debit valuation adjustment reflects a refinement in methodology, described on page 441. The decrease in model limitation adjustments reflects the inclusion of OIS discounting within the modelled value of many interest rate derivatives such that an adjustment is no longer required outside the model, in addition to market movements and the unwind or maturity of certain legacy credit structures.

Risk-related adjustments

Bid-offer

IAS 39 requires that financial instruments are marked at bid or offer, as appropriate. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the cost that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the actual position.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

Credit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that HSBC may not receive the full market value of the transactions.

Debit valuation adjustment

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that HSBC may default, and that HSBC may not pay full market value of the transactions.

Model-related adjustments

Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs. The accounting for inception profit adjustments is discussed on page 388. An analysis of the movement in the deferred Day 1 P&L reserve is provided on page 454.

Credit valuation adjustment/debit valuation adjustment methodology

HSBC calculates a separate credit valuation adjustment ('CVA') and debit valuation adjustment ('DVA') for each HSBC legal entity, and within each entity for each counterparty to which the entity has exposure. The calculation of the monoline CVA is described on page 189.

HSBC calculates the CVA by applying the probability of default ('PD') of the counterparty conditional on the non-default of HSBC, to the expected positive exposure of HSBC to the counterparty, and multiplying the result by the loss expected in the event of default. Conversely, HSBC calculates the DVA by applying the PD of HSBC, conditional on the non-default of the counterparty, to the expected positive exposure of the counterparty to HSBC, and multiplying by the loss expected in the event of default. Both calculations are performed over the life of the potential exposure.

As set out on page 383, from 31 December 2012 HSBC revised its methodology for estimating the CVA and the DVA for derivatives. The CVA calculation maximises the use of PD based on relevant, observable market data, such as credit default swap ('CDS') spreads. Where CDS spreads are not available, PDs are estimated having regard to market practice, considering relevant data including both CDS indices and historical rating transition matrices. HSBC aligned its methodology for estimating the DVA to be consistent with that applied for the CVA as at 31 December 2012. Historically, HSBC considered that a zero spread was appropriate in respect of own credit risk and consequently did not adjust derivative liabilities for its own credit risk.

For most products, to calculate the expected positive exposure to a counterparty, HSBC uses a simulation methodology to incorporate the range of potential exposures across the portfolio of transactions with the counterparty over the life of an instrument. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty. A standard loss given default assumption of 60% is generally adopted for developed market exposures, and 75% for emerging market exposures. Alternative loss given default assumptions may be adopted where both the nature of the exposure and the available data support this.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, HSBC adopts alternative methodologies. These may involve mapping to the results for similar products from the simulation tool or where such a mapping approach is not appropriate, a simplified methodology is used, generally following the same principles as the simulation methodology. The calculation is applied at a trade level, with more limited recognition of credit mitigants such as netting or collateral agreements than used in the simulation methodology described previously.

The methodologies do not, in general, account for 'wrong-way risk'. Wrong-way risk arises where the underlying value of the derivative prior to any CVA is positively correlated to the probability of default of the counterparty. Where there is significant wrong-way risk, a trade-specific approach is applied to reflect the wrong-way risk within the valuation.

With the exception of certain central clearing parties, HSBC includes all third-party counterparties in the CVA and DVA calculations and does not net these calculations across HSBC Group entities.

Notes on the Financial Statements (continued)

Fair value valuation bases

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3

	Assets				Liabilities		
	Available for sale US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m
At 31 December 2012							
Private equity including strategic investments	**3,582**	**92**	**377**	**–**	**–**	**–**	**–**
Asset-backed securities	**2,288**	**652**	**–**	**–**	**–**	**–**	**–**
Loans held for securitisation	**–**	**547**	**–**	**–**	**–**	**–**	**–**
Structured notes	**–**	**23**	**–**	**–**	**6,987**	**–**	**–**
Derivatives with monolines	**–**	**–**	**–**	**630**	**–**	**–**	**–**
Other derivatives	**–**	**–**	**–**	**2,429**	**–**	**–**	**3,005**
Other portfolios	**2,641**	**3,064**	**36**	**–**	**483**	**–**	**–**
	8,511	**4,378**	**413**	**3,059**	**7,470**	**–**	**3,005**
At 31 December 2011							
Private equity including strategic investments	4,565	88	432	–	–	–	–
Asset-backed securities	2,584	710	–	–	–	–	–
Loans held for securitisation	–	682	–	–	–	–	7
Structured notes	–	92	–	–	7,340	–	–
Derivatives with monolines	–	–	–	940	–	–	–
Other derivatives	–	–	–	3,509	–	–	3,122
Other portfolios	1,972	3,208	284	–	487	567	–
	9,121	4,780	716	4,449	7,827	567	3,129

Private equity and strategic investments

HSBC's private equity and strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Asset-backed securities

While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required. For ABSs including residential MBSs, the valuation uses an industry standard model and the assumptions relating to prepayment speeds, default rates and loss severity based on collateral type, and performance, as appropriate. The valuations output is benchmarked for consistency against observable data for securities of a similar nature.

Loans, including leveraged finance and loans held for securitisation

Loans held at fair value are valued from broker quotes and/or market data consensus providers when available. In the absence of an observable market, the fair value is determined using valuation techniques. These techniques include discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan, derived from other market instruments issued by the same or comparable entities.

Structured notes

The fair value of structured notes valued using a valuation technique is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes, which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures or estimated from historical data or other sources. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices. The valuation of derivatives with monolines is discussed on page 189.

Derivative products valued using valuation techniques with significant unobservable inputs included certain types of correlation products, such as foreign exchange basket options, equity basket options, foreign exchange interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options and certain credit derivatives. Credit derivatives include certain tranched CDS transactions.

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available for sale US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m
2012							
At 1 January	9,121	4,780	716	4,449	7,827	567	3,129
Total gains/(losses) recognised in profit or loss	(414)	356	10	(974)	319	–	10
Total gains/(losses) recognised in other comprehensive income[1]	472	78	(32)	92	143	–	84
Purchases	1,738	942	113	–	(368)	–	–
New issuances	–	–	–	–	2,852	–	–
Sales	(840)	(1,408)	(69)	–	–	–	–
Settlements	(367)	(617)	(25)	(14)	(1,604)	–	18
Transfers out	(2,944)	(298)	(350)	(571)	(1,901)	(567)	(291)
Transfers in	1,745	545	50	77	202	–	55
At 31 December	8,511	4,378	413	3,059	7,470	–	3,005
Total gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December:	166	339	9	(1,294)	384	–	(395)
– net interest income	44	–	–	–	–	–	–
– trading income excluding net interest income	–	326	–	(1,294)	396	–	(395)
– net interest income on trading activities	–	13	–	–	(12)	–	–
– net income from other financial instruments designated at fair value	–	–	9	–	–	–	–
– dividend income	122	–	–	–	–	–	–

Notes on the Financial Statements (continued)

15 – Fair values of financial instruments carried at fair value

Movement in Level 3 financial instruments (continued)

	Assets				Liabilities		
	Available for sale US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m	Held for trading US$m	Designated at fair value through profit or loss US$m	Derivatives US$m
2011							
At 1 January	8,237	5,689	587	3,961	11,393	570	3,806
Total gains/(losses) recognised in profit or loss	222	(330)	11	767	36	8	628
Total gains/(losses) recognised in other comprehensive income[1]	(179)	(12)	(15)	(16)	11	(11)	–
Purchases	1,858	1,483	242	–	(1,843)	–	–
New issuances	–	–	–	–	4,569	–	–
Sales	(756)	(2,578)	(69)	–	–	–	–
Settlements	(1,088)	(199)	(7)	(33)	(1,528)	–	(1,083)
Transfers out	(1,891)	(569)	(173)	(410)	(5,266)	–	(608)
Transfers in	2,718	1,296	140	180	455	–	386
At 31 December	9,121	4,780	716	4,449	7,827	567	3,129
Total gains/(losses) recognised in profit or loss relating to assets and liabilities held on 31 December:	134	(237)	36	617	101	8	80
– net interest income	105	–	–	–	–	–	–
– trading income/(expense) excluding net interest income	–	(265)	–	617	119	–	80
– net interest income/(expense) on trading activities	–	28	–	–	(18)	–	–
– net income from other financial instruments designated at fair value	–	–	36	–	–	8	–
– dividend income	29	–	–	–	–	–	–

1 *Included in 'Available-for-sale investments: Fair value gains/losses' and 'Exchange differences' in the consolidated statement of comprehensive income.*

Available-for-sale securities: Purchases of Level 3 AFS assets relate principally to Emerging Market corporate bonds. Sales of Level 3 AFS assets relate principally to private equity disposals. Transfers in and out of Level 3 relate principally to ABS securities, and the excess of transfers out over transfers in reflects some improvement in ABS liquidity over the year.

Derivatives: The reduction in Level 3 derivative assets predominantly reflected reductions in the fair value of legacy structured credit assets as credit spreads narrowed and the unwind or maturity of certain other structured derivatives.

Trading liabilities: Movements in Level 3 trading liability balances primarily reflect issue and redemption of structured notes, particularly equity-linked notes. Transfers out reflect structured notes, particularly equity linked notes, becoming observable as their residual maturity decreased.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonably possible alternative assumptions

	Reflected in profit or loss		**Reflected in other comprehensive income**	
	Favourable changes US$m	**Unfavourable changes US$m**	**Favourable changes US$m**	**Unfavourable changes US$m**
At 31 December 2012				
Derivatives, trading assets and trading liabilities[1]	**465**	**(384)**	**–**	**–**
Financial assets and liabilities designated at fair value	**41**	**(41)**	**–**	**–**
Financial investments: available for sale	**–**	**–**	**680**	**(710)**
	506	**(425)**	**680**	**(710)**

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes US$m	Unfavourable changes US$m	Favourable changes US$m	Unfavourable changes US$m
At 31 December 2011				
Derivatives, trading assets and trading liabilities[1]	369	(436)	–	–
Financial assets and liabilities designated at fair value	72	(72)	–	–
Financial investments: available for sale	–	–	814	(818)
	441	(508)	814	(818)

1 *Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.*

In derivatives, trading assets and trading liabilities greater pricing certainty has arisen during the year in respect of legacy structured credit assets, as narrowing credit spreads have reduced exposures. This has been offset by greater pricing uncertainty in some other areas, most notably in certain interest rate derivative products and the pricing of the derivative representing the forward sale of Ping An.

The reduction in pricing uncertainty in available-for-sale securities reflects greater liquidity in the ABS market.

Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type

	Reflected in profit or loss		**Reflected in other comprehensive income**	
	Favourable changes US$m	**Unfavourable changes US$m**	**Favourable changes US$m**	**Unfavourable changes US$m**
At 31 December 2012				
Private equity investments	**62**	**(62)**	**353**	**(353)**
Asset-backed securities	**41**	**(27)**	**143**	**(139)**
Loans held for securitisation	**3**	**(3)**	**–**	**–**
Structured notes	**4**	**(5)**	**–**	**–**
Derivatives with monolines	**36**	**(20)**	**–**	**–**
Other derivatives	**320**	**(267)**	**–**	**–**
Other portfolios	**40**	**(41)**	**184**	**(218)**
	506	**(425)**	**680**	**(710)**
At 31 December 2011				
Private equity investments	123	(83)	451	(451)
Asset-backed securities	3	(3)	183	(175)
Loans held for securitisation	4	(4)	–	–
Structured notes	6	(6)	–	–
Derivatives with monolines	76	(178)	–	–
Other derivatives	145	(154)	–	–
Other portfolios	84	(80)	180	(192)
	441	(508)	814	(818)

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amenable to statistical analysis, quantification of uncertainty is judgemental.

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

In respect of private equity investments, in many of the methodologies, the principal assumption is the valuation multiple to be applied to the main financial indicators. This may be determined with reference to multiples for comparable listed companies and includes discounts for marketability.

For ABSs, the principal assumptions in the models are based on benchmark information about prepayment speeds, default rates, loss severities and the historical performance of the underlying assets.

For leveraged finance, loans held for securitisation and derivatives with monolines, the principal assumption concerns the appropriate value to be attributed to the counterparty credit risk. This requires estimation of exposure at default, probability of default and recovery in the event of default. For loan transactions, assessment of exposure at default is straightforward. For derivative transactions, a future exposure profile is generated on the basis of current market data.

Probabilities of default and recovery levels are estimated using available evidence, which may include financial information, historical experience, CDS spreads and consensus recovery levels.

For structured notes and other derivatives, principal assumptions concern the value to be attributed to future volatility of asset values and the future correlation between asset values. These principal assumptions include credit volatilities and correlations used in the valuation of structured credit derivatives (including leveraged credit derivatives). For such unobservable assumptions, estimates are based on available market data, which may include the use of a proxy method to derive a volatility or a correlation from comparable assets for which market data is more readily available, and/or an examination of historical levels.

HSBC Holdings

The following table provides an analysis of the basis for valuing financial assets and financial liabilities measured at fair value in the financial statements:

Bases of valuing HSBC Holdings' financial assets and liabilities measured at fair value

		Valuation techniques		
	Quoted market price Level 1 US$m	Using observable inputs Level 2 US$m	With significant unobservable inputs Level 3 US$m	Total US$m
At 31 December 2012				
Assets				
Derivatives	–	**3,768**	–	**3,768**
Available for sale	–	**1,208**	–	**1,208**
Liabilities				
Designated at fair value	–	**23,195**	–	**23,195**
Derivatives	–	**760**	–	**760**
At 31 December 2011				
Assets				
Derivatives	–	3,568	–	3,568
Available for sale	–	–	1,078	1,078
Liabilities				
Designated at fair value	17,196	3,955	–	21,151
Derivatives	–	1,067	–	1,067

Liabilities designated at fair value: Transfers out of Level 1 were to bring these instruments in line with the classification methodology adopted for other corporate bonds within the Group.

Available for sale securities: Transfers out of Level 3 reflect increased observability in prices and improved market liquidity for these financial investments.

Financial instruments measured at fair value – Level 3

Financial investments measured using a valuation technique with significant unobservable inputs (Level 3) comprise fixed-rate preferred securities and senior notes purchased from HSBC undertakings. The unobservable elements of the valuation technique include the use of implied credit spreads and simplified bond pricing assumptions.

Movement in Level 3 financial instruments available for sale

	2012 US$m	2011 US$m
At 1 January	**1,078**	2,025
Total gains or losses:		
– recognised in profit or loss	**–**	55
– recognised in other comprehensive income	**130**	(61)
Settlements	**–**	(941)
Transfers out	**(1,208)**	–
At 31 December	**–**	1,078
Total gains or losses recognised in profit or loss relating to those assets and liabilities held on 31 December	**–**	18

In certain circumstances, the fair value of financial instruments are measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of non-derivative financial instruments to reasonably possible alternative assumptions:

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

	Reflected in equity	
	Favourable changes US$m	**Unfavourable changes US$m**
Financial investments: available for sale		
At 31 December 2012	**–**	**–**
At 31 December 2011	69	(77)

16 Fair values of financial instruments not carried at fair value

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2.

Fair values of financial instruments which are not carried at fair value on the balance sheet

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Assets and liabilities not held for sale				
Assets				
Loans and advances to banks	**152,546**	**152,823**	180,987	181,302
Loans and advances to customers	**997,623**	**973,741**	940,429	914,485
Financial investments: debt securities	**23,413**	**25,458**	21,018	22,500
Financial investments: treasury and other eligible bills	**–**	**–**	181	181
Liabilities				
Deposits by banks	**107,429**	**107,392**	112,822	112,848
Customer accounts	**1,340,014**	**1,340,521**	1,253,925	1,254,313
Debt securities in issue	**119,461**	**120,779**	131,013	130,914
Subordinated liabilities	**29,479**	**32,159**	30,606	29,351
Loans and advances and customer accounts held for sale				
Loans and advances to banks and customers	**6,632**	**6,387**	35,720	37,832
Customer accounts	**2,990**	**2,990**	20,138	19,130

1 *Including financial instruments within disposal groups held for sale.*

Notes on the Financial Statements (continued)

16 – Fair values of financial instruments not carried at fair value

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets
Cash and balances at central banks
Items in the course of collection from other banks
Hong Kong Government certificates of indebtedness
Endorsements and acceptances
Short-term receivables within 'Other assets'
Accrued income

Liabilities
Hong Kong currency notes in circulation
Items in the course of transmission to other banks
Investment contracts with discretionary participation features within 'Liabilities under insurance contracts'
Endorsements and acceptances
Short-term payables within 'Other liabilities'
Accruals

Analysis of loans and advances to customers by geographical segment

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	Fair value US$m	Carrying amount US$m	Fair value US$m
Loans and advances to customers				
Europe	463,440	453,382	434,336	426,039
Hong Kong	173,613	171,926	157,665	154,054
Rest of Asia-Pacific	138,119	138,015	123,868	123,662
Middle East and North Africa	28,086	27,954	25,875	25,758
North America	140,756	128,637	142,747	128,608
Latin America	53,609	53,827	55,938	56,364
	997,623	973,741	940,429	914,485

Valuation

The calculation of fair value incorporates HSBC's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that HSBC expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

The fair values of loans and advances to customers in the US are substantially lower than their carrying amount, reflecting the market conditions at the balance sheet date. The secondary market demand and estimated value for US loans and advances has been heavily influenced by the challenging economic conditions during the past number of years, including house price depreciation, rising unemployment, changes in consumer behaviour, changes in discount rates and the lack of financing options available to support the purchase of loans and advances. Many investors are non-bank financial institutions or hedge funds with high equity levels and a high cost of debt. For certain consumer loans, investors take a more conservative view of future performance than HSBC. As a result, third parties are likely to assume higher charge-off levels and/or slower voluntary prepayment speeds than HSBC believes will ultimately be the case. The investor discount rates reflect this difference in the overall cost of capital as well as the potential volatility in the underlying cash flow assumptions, the combination of which may yield a significant pricing discount from HSBC's intrinsic value.

There was a modest decrease year on year in the fair value of loans and advances to customers in Europe relative to their carrying amount, largely in the UK mortgage portfolio which is sensitive to changes in market pricing between the balance sheet dates given its size and the competitive UK market. We also enhanced fair value estimation processes for mortgage and corporate lending in the UK to reflect risk factors, product characteristics and prepayment estimates at a more granular level. This overall decrease was mitigated by higher valuations of ABSs classified as loans and receivables following improved market appetite for such securities.

The fair values of loans and advances to customers in Latin America are higher than their carrying amount, primarily driven by a decrease in market interest rates, and in particular for the mortgage portfolios.

Fair values of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third party brokers which reflect over-the-counter trading activity; forward looking discounted cash flow models using assumptions which HSBC believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

Valuation techniques are calibrated on a regular basis and tested for validity using prices from observable current market transactions in the same instrument, without modification or repackaging, or are based on any available observable market data.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value impact of repricing between origination and the balance sheet date. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

Deposits by banks and customer accounts

For the purpose of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to HSBC as a going concern.

HSBC Holdings

The methods used by HSBC Holdings to determine fair values of financial instruments for the purpose of measurement and disclosure are described above.

The following table provides an analysis of the fair value of financial instruments not carried at fair value on the balance sheet:

Fair values of HSBC Holdings' financial instruments not carried at fair value on the balance sheet

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	Fair value US$m	Carrying amount US$m	Fair value US$m
Assets				
Loans and advances to HSBC undertakings	41,675	42,843	28,048	27,562
Liabilities				
Amounts owed to HSBC undertakings	12,856	13,133	2,479	2,485
Debt securities in issue	2,691	3,188	2,613	2,922
Subordinated liabilities	11,907	14,865	12,450	13,052

17 Reclassification of financial assets

In 2008, HSBC reclassified US$15.3bn and US$2.6bn of financial assets from the held-for-trading category to the loans and receivables and available-for-sale classifications, respectively, as permitted by the relevant amendment to IAS 39 and explained in Note 2(e) on the Financial Statements. No further reclassifications were undertaken.

Reclassification of HSBC's financial assets

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	Fair value US$m	Carrying amount US$m	Fair value US$m
Reclassification to loans and receivables	6,378	5,616	7,867	6,651
Reclassification to available for sale	12	12	33	33
	6,390	5,628	7,900	6,684

The following table shows the fair value gains and losses, income and expense recognised in the income statement in respect of reclassified assets and the gains and losses that would have been recognised if no reclassification had taken place:

Effect of reclassifying and not reclassifying financial assets

	2012 US$m	2011 US$m	2010 US$m
Reclassification to loans and receivables			
Recorded in the income statement[1]	179	318	610
Assuming no reclassification[2]	653	317	1,260
Net income statement effect of reclassification	(474)	1	(650)
Reclassification to available for sale			
Recorded in the income statement[1]	–	1	56
Assuming no reclassification[2]	1	(2)	59
Net income statement effect of reclassification	(1)	3	(3)

1 *'Income and expense' recorded in the income statement include the accrual of the effective interest rate and, for 2012, includes US$84m in respect of impairment (2011: US$69m; 2010: US$6m).*
2 *Effect on the income statement during the year had the reclassification not occurred.*

18 Financial assets designated at fair value

	At 31 December 2012 US$m	2011 US$m
Financial assets designated at fair value:		
– not subject to repledge or resale by counterparties	**33,562**	30,738
– which may be repledged or resold by counterparties	**20**	118
	33,582	30,856
Treasury and other eligible bills	**54**	123
Debt securities	**12,551**	11,834
Equity securities	**20,868**	17,930
Securities designated at fair value	**33,473**	29,887
Loans and advances to banks	**55**	119
Loans and advances to customers	**54**	850
	33,582	30,856

Securities designated at fair value[1]

	At 31 December 2012 US$m	2011 US$m
Fair value		
US Treasury and US Government agencies[2]	**37**	35
UK Government	**625**	812
Hong Kong Government	**135**	151
Other government	**4,508**	3,964
Asset-backed securities[3]	**158**	201
Corporate debt and other securities	**7,142**	6,794
Equities	**20,868**	17,930
	33,473	29,887

1 *Included within these figures are debt securities issued by banks and other financial institutions of US$3,509m (2011: US$3,497m), of which US$5m (2011: US$40m) are guaranteed by various governments.*
2 *Includes securities that are supported by an explicit guarantee issued by the US Government.*
3 *Excludes asset-backed securities included under US Treasury and US Government agencies.*

Securities listed on a recognised exchange and unlisted

	Treasury and other eligible bills US$m	Debt securities US$m	Equity securities US$m	Total US$m
Fair value at 31 December 2012				
Listed on a recognised exchange[1]	**–**	**3,007**	**14,063**	**17,070**
Unlisted	**54**	**9,544**	**6,805**	**16,403**
	54	**12,551**	**20,868**	**33,473**
Fair value at 31 December 2011				
Listed on a recognised exchange[1]	4	3,607	11,859	15,470
Unlisted	119	8,227	6,071	14,417
	123	11,834	17,930	29,887

1 *Included within listed investments are US$931m of investments listed in Hong Kong (2011: US$631m).*

19 Derivatives

Fair values of derivatives by product contract type held by HSBC

	Assets			Liabilities		
	Trading US$m	Hedging US$m	Total US$m	Trading US$m	Hedging US$m	Total US$m
At 31 December 2012						
Foreign exchange	**68,277**	**1,227**	**69,504**	**70,944**	**239**	**71,183**
Interest rate	**628,162**	**2,417**	**630,579**	**618,808**	**6,491**	**625,299**
Equity	**15,413**	**–**	**15,413**	**19,889**	**–**	**19,889**
Credit	**12,740**	**–**	**12,740**	**13,508**	**–**	**13,508**
Commodity and other	**1,443**	**–**	**1,443**	**1,236**	**–**	**1,236**
Gross total fair values	**726,035**	**3,644**	**729,679**	**724,385**	**6,730**	**731,115**
Netting			**(372,229)**			**(372,229)**
Total			**357,450**			**358,886**
At 31 December 2011						
Foreign exchange	74,958	1,026	75,984	75,077	371	75,448
Interest rate	510,652	2,439	513,091	502,906	6,221	509,127
Equity	15,262	–	15,262	19,363	–	19,363
Credit	25,694	–	25,694	25,800	–	25,800
Commodity and other	2,198	–	2,198	1,492	–	1,492
Gross total fair values	628,764	3,465	632,229	624,638	6,592	631,230
Netting			(285,850)			(285,850)
Total			346,379			345,380

The 3% increase in the fair value of derivative assets during 2012 was driven by increased interest rate derivative fair values as major currency yield curves continued to decline, in particular, the euro. This drove both the increase in gross fair values and the increase in the netting adjustment.

Fair values of derivatives by product contract type held by HSBC Holdings with subsidiaries

	At 31 December 2012		At 31 December 2011	
	Trading assets US$m	Trading liabilities US$m	Trading assets US$m	Trading liabilities US$m
Foreign exchange	**1,636**	**760**	1,546	1,067
Interest rate	**2,132**	**–**	2,022	–
	3,768	**760**	3,568	1,067

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives enable users to increase, reduce or alter exposure to credit or market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. A description of how the fair value of derivatives is derived is set out on page 443. Derivative assets and liabilities on different transactions are only set off (netted) if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

Use of derivatives

HSBC transacts derivatives for three primary purposes: to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge HSBC's own risks. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. Within the held-for-trading classification are two types of derivatives: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

HSBC's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels. When entering into derivative transactions, HSBC employs the same credit risk management framework to assess and approve potential credit exposures that is used for traditional lending.

Trading derivatives

Most of HSBC's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin and for the risk management of exposure arising from customer activities. Positions may be traded actively or be held over a period of time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held for trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. Trading derivatives also include derivatives managed in conjunction with financial instruments designated at fair value.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income' except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value' together with the gains and losses on the economically hedged items. Where the derivatives are managed with debt securities in issue, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt. Substantially all of HSBC Holdings' derivatives entered into with HSBC undertakings are managed in conjunction with financial liabilities designated at fair value.

The notional contract amounts of derivatives held for trading purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk. The 9% increase in the notional contract amounts of HSBC's derivatives during 2012 was primarily driven by an increase in the trading volumes of interest rate contracts.

Notional contract amounts of derivatives held for trading purposes by product type

	HSBC		HSBC Holdings	
	At 31 December 2012 US$m	At 31 December 2011 US$m	**At 31 December 2012 US$m**	At 31 December 2011 US$m
Foreign exchange	**4,435,729**	3,945,774	**17,576**	18,942
Interest rate	**21,355,749**	19,788,710	**11,554**	10,954
Equity	**495,668**	265,577	**–**	–
Credit	**901,507**	1,049,147	**–**	–
Commodity and other	**80,219**	76,487	**–**	–
	27,268,872	25,125,695	**29,130**	29,896

Credit derivatives

HSBC trades credit derivatives through its principal dealing operations and acts as a principal counterparty to a broad range of users, structuring transactions to produce risk management products for its customers, or making markets in certain products. Risk is typically controlled through entering into offsetting credit derivative contracts with other counterparties.

HSBC manages the credit risk arising on buying and selling credit derivative protection by including the related credit exposures within its overall credit limit structure for the relevant counterparty. Trading of credit derivatives is restricted to a small number of offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

Notes on the Financial Statements (continued)

19 – Derivatives

Credit derivatives are also deployed to a limited extent for the risk management of the Group's loan portfolios. The notional contract amount of credit derivatives of US$901,507m (2011: US$1,049,147m) consisted of protection bought of US$446,410m (2011: US$517,737m) and protection sold of US$455,097m (2011: US$531,410m). The credit derivative business operates within the market risk management framework described on page 265.

Derivatives valued using models with unobservable inputs

The difference between the fair value at initial recognition (the transaction price) and the value that would have been derived had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Unamortised balance of derivatives valued using models with significant unobservable inputs

	2012 US$m	2011 US$m
Unamortised balance at 1 January	**200**	250
Deferral on new transactions	**149**	234
Recognised in the income statement during the period:		
– amortisation	**(112)**	(143)
– subsequent to unobservable inputs becoming observable	**(1)**	(71)
– maturity, termination or offsetting derivative	**(46)**	(60)
– risk hedged	**(11)**	(8)
Exchange differences	**2**	(2)
Unamortised balance at 31 December[1]	**181**	200

1 *This amount is yet to be recognised in the consolidated income statement.*

Hedge accounting derivatives

HSBC uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables HSBC to optimise the overall cost to the Group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, cash flow hedges, or hedges of net investment in foreign operations. These are described under the relevant headings below.

The notional contract amounts of derivatives held for hedge accounting purposes indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Notional contract amounts of derivatives held for hedge accounting purposes by product type

	At 31 December 2012		At 31 December 2011	
	Cash flow hedge US$m	Fair value hedge US$m	Cash flow hedge US$m	Fair value hedge US$m
Foreign exchange	**16,716**	**112**	12,078	1,363
Interest rate	**182,688**	**75,505**	228,052	76,950
	199,404	**75,617**	240,130	78,313

Fair value hedges

HSBC's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the hedging period.

Fair value of derivatives designated as fair value hedges

	At 31 December 2012		At 31 December 2011	
	Assets	**Liabilities**	Assets	Liabilities
	US$m	**US$m**	US$m	US$m
Foreign exchange	**–**	**–**	77	1
Interest rate	**199**	**4,450**	369	4,331
	199	**4,450**	446	4,332

Gains or losses arising from fair value hedges

	2012	2011	2010
	US$m	US$m	US$m
Gains/(losses):			
– on hedging instruments	**(898)**	(4,082)	(830)
– on the hedged items attributable to the hedged risk	**871**	3,858	868
	(27)	(224)	38

The gains and losses on ineffective portions of fair value hedges are recognised immediately in 'Net trading income'.

Cash flow hedges

HSBC's cash flow hedges consist principally of interest rate swaps, futures and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognised in other comprehensive income, and accumulated in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Fair value of derivatives designated as cash flow hedges

	At 31 December 2012		At 31 December 2011	
	Assets	**Liabilities**	Assets	Liabilities
	US$m	**US$m**	US$m	US$m
Foreign exchange	**1,230**	**200**	949	370
Interest rate	**2,218**	**2,041**	2,070	1,890
	3,448	**2,241**	3,019	2,260

Forecast principal balances on which interest cash flows are expected to arise

	3 months or less	More than 3 months but less than 1 year	5 years or less but more than 1 year	More than 5 years
	US$m	**US$m**	**US$m**	**US$m**
At 31 December 2012				
Assets	**112,846**	**93,072**	**72,557**	**5,055**
Liabilities	**(68,534)**	**(43,800)**	**(29,401)**	**(4,777)**
Net cash inflows exposure	**44,312**	**49,272**	**43,156**	**278**
At 31 December 2011				
Assets	139,701	110,960	66,383	4,460
Liabilities	(77,898)	(50,480)	(36,296)	(4,693)
Net cash inflows/(outflows) exposure	61,803	60,480	30,087	(233)

This table reflects the interest rate repricing profile of the underlying hedged items.

The gains and losses on ineffective portions of such derivatives are recognised immediately in 'Net trading income'. During the year to 31 December 2012 a gain of US$35m (2011: gain of US$26m; 2010: loss of US$9m) was recognised due to hedge ineffectiveness.

Hedges of net investments in foreign operations

The Group applies hedge accounting in respect of certain consolidated net investments. Hedging is undertaken using forward foreign exchange contracts or by financing with currency borrowings.

At 31 December 2012, the fair values of outstanding financial instruments designated as hedges of net investments in foreign operations were assets of US$3m (2011: US$121m) and liabilities of US$50m (2011: US$36m) and notional contract values of US$2,654m (2011: US$3,920m).

The ineffectiveness recognised in 'Net trading income' in the year ended 31 December 2012 that arose from hedges in foreign operations was nil (2011 and 2010: nil).

20 Financial investments

	At 31 December	
	2012 US$m	2011 US$m
Financial investments:		
– not subject to repledge or resale by counterparties	**399,613**	364,906
– which may be repledged or resold by counterparties	**21,488**	35,138
	421,101	400,044

Carrying amount and fair value of financial investments

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Treasury and other eligible bills	**87,550**	**87,550**	65,223	65,223
– available for sale	**87,550**	**87,550**	65,042	65,042
– held to maturity	**–**	**–**	181	181
Debt securities	**327,762**	**329,807**	327,611	329,093
– available for sale	**304,349**	**304,349**	306,593	306,593
– held to maturity	**23,413**	**25,458**	21,018	22,500
Equity securities	**5,789**	**5,789**	7,210	7,210
– available for sale	**5,789**	**5,789**	7,210	7,210
Total financial investments	**421,101**	**423,146**	400,044	401,526

Financial investments at amortised cost and fair value

	Amortised cost[1] US$m	**Fair value[2] US$m**
At 31 December 2012		
US Treasury	**60,657**	**61,925**
US Government agencies[3]	**22,579**	**23,500**
US Government sponsored entities[3]	**5,262**	**5,907**
UK Government	**17,018**	**17,940**
Hong Kong Government	**42,687**	**42,711**
Other government	**146,507**	**149,179**
Asset-backed securities[4]	**29,960**	**26,418**
Corporate debt and other securities	**86,099**	**89,777**
Equities	**4,284**	**5,789**
	415,053	**423,146**

	Amortised cost[1] US$m	Fair value[2] US$m
At 31 December 2011		
US Treasury	43,848	45,283
US Government agencies[3]	25,079	26,093
US Government sponsored entities[3]	4,425	5,056
UK Government	32,165	33,603
Hong Kong Government	33,359	33,374
Other government	125,623	127,049
Asset-backed securities[4]	35,096	28,625
Corporate debt and other securities	94,110	95,233
Equities	5,122	7,210
	398,827	401,526
At 31 December 2010		
US Treasury	37,380	37,255
US Government agencies[3]	20,895	21,339
US Government sponsored entities[3]	5,029	5,267
UK Government	31,069	31,815
Hong Kong Government	29,770	29,793
Other government	108,947	109,806
Asset-backed securities[4]	39,845	33,175
Corporate debt and other securities	124,704	125,311
Equities	5,605	7,983
	403,244	401,744

1 *Represents the amortised cost or cost basis of the financial investment.*
2 *Included within these figures are debt securities issued by banks and other financial institutions of US$59,908m (2011: US$68,334m; 2010: US$99,733m), of which US$6,916m (2011: US$17,079m; 2010: US$38,862m) are guaranteed by various governments. The fair value of the debt securities issued by banks and other financial institutions was US$60,616m (2011: US$68,765m; 2010: US$100,070m).*
3 *Includes securities that are supported by an explicit guarantee issued by the US Government.*
4 *Excludes asset-backed securities included under US Government agencies and sponsored entities.*

Financial investments listed on a recognised exchange and unlisted

	Treasury and other eligible bills available for sale US$m	Treasury and other eligible bills held to maturity US$m	Debt securities available for sale US$m	Debt securities held to maturity US$m	Equity securities available for sale US$m	Total US$m
Carrying amount at 31 December 2012						
Listed on a recognised exchange[1]	**3,284**	**–**	**113,399**	**5,599**	**536**	**122,818**
Unlisted[2]	**84,266**	**–**	**190,950**	**17,814**	**5,253**	**298,283**
	87,550	**–**	**304,349**	**23,413**	**5,789**	**421,101**
Carrying amount at 31 December 2011						
Listed on a recognised exchange[1]	4,077	–	121,303	4,370	535	130,285
Unlisted[2]	60,965	181	185,290	16,648	6,675	269,759
	65,042	181	306,593	21,018	7,210	400,044

1 *The fair value of listed held-to-maturity debt securities as at 31 December 2012 was US$6,123m (2011: US$4,641m). Included within listed investments were US$3,512m (2011: US$3,544m) of investments listed in Hong Kong.*
2 *Unlisted treasury and other eligible bills available for sale primarily comprise treasury bills not listed on a recognised exchange but for which there is a liquid market.*

Maturities of investments in debt securities at their carrying amount

	At 31 December 2012 US$m	2011 US$m
Remaining contractual maturity of total debt securities:		
1 year or less	**67,268**	87,080
5 years or less but over 1 year	**157,075**	128,192
10 years or less but over 5 years	**47,123**	52,251
Over 10 years	**56,296**	60,088
	327,762	327,611
Remaining contractual maturity of debt securities available for sale:		
1 year or less	**65,500**	85,821
5 years or less but over 1 year	**149,195**	120,763
10 years or less but over 5 years	**39,498**	44,946
Over 10 years	**50,156**	55,063
	304,349	306,593
Remaining contractual maturity of debt securities held to maturity:		
1 year or less	**1,768**	1,259
5 years or less but over 1 year	**7,880**	7,429
10 years or less but over 5 years	**7,625**	7,305
Over 10 years	**6,140**	5,025
	23,413	21,018

Contractual maturities and weighted average yields of investment debt securities at 31 December 2012

	Within one year Amount US$m	Within one year Yield %	After one year but within five years Amount US$m	After one year but within five years Yield %	After five years but within ten years Amount US$m	After five years but within ten years Yield %	After ten years Amount US$m	After ten years Yield %
Available for sale								
US Treasury	12,306	0.4	30,334	0.5	6,113	2.0	2,237	3.5
US Government agencies	6	2.6	7	5.3	94	1.9	22,128	2.9
US Government-sponsored agencies	5	2.0	360	2.6	2,968	3.1	807	3.7
UK Government	162	0.2	13,793	1.5	1,286	5.9	634	5.1
Hong Kong Government	946	0.5	686	2.0	–	–	–	–
Other governments	38,327	2.5	60,048	2.7	10,198	4.4	2,112	3.8
Asset-backed securities	336	0.1	2,682	0.4	7,643	0.2	19,181	0.2
Corporate debt and other securities	13,312	3.2	39,667	2.5	8,123	3.5	3,325	5.1
Total amortised cost	65,400		147,577		36,425		50,424	
Total carrying value	65,500		149,195		39,498		50,156	
Held to maturity								
US Treasury	22	4.2	21	4.4	50	4.8	143	4.4
US Government agencies	–	–	1	7.6	3	7.7	338	6.5
US Government-sponsored agencies	1	8.1	6	7.8	1	7.8	1,113	6.2
Hong Kong Government	–	–	30	0.4	10	4.1	3	1.2
Other governments	71	2.8	480	3.8	254	5.2	562	5.1
Asset-backed securities	–	–	–	–	–	–	118	6.3
Corporate debt and other securities	1,674	4.4	7,342	3.8	7,307	4.2	3,863	4.2
Total amortised cost	1,768		7,880		7,625		6,140	
Total carrying value	1,768		7,880		7,625		6,140	

The maturity distributions of asset-backed securities are presented in the above table on the basis of contractual maturity dates. The weighted average yield for each range of maturities is calculated by dividing the annualised interest income for the year ended 31 December 2012 by the book amount of available-for-sale debt securities at that date. The yields do not include the effect of related derivatives.

21 Transfers of financial assets

HSBC enters into transactions in the normal course of business by which it transfers financial assets to third parties including SPEs. Depending on the circumstances these transfers may either result in these financial assets being derecognised or continuing to be recognised.

- Full derecognition occurs when HSBC transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, foreign currency, prepayment and other price risks.
- Derecognition does not occur when HSBC transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, but either:
  - i) retains substantially all of the risks and rewards of ownership of the transferred asset; or
  - ii) neither retains nor transfers substantially all of the risks and rewards of ownership but has retained control of the financial asset. In this situation the financial assets are recognised on the balance sheet to the extent of HSBC's continuing involvement.

The majority of transferred financial assets that do not qualify for derecognition are (i) debt securities held by counterparties as collateral under repurchase agreements or (ii) equity securities lent under securities lending agreements.

As the substance of these transactions is secured borrowings the asset collateral continues to be recognised in full and the related liability reflecting the Group's obligation to repurchase the transferred assets for a fixed price at a future date is recognised in deposits from banks or customers as appropriate. As a result of these transactions, the Group is unable to use, sell or pledge the transferred assets for the duration of the transaction. The Group remains exposed to interest rate risk and credit risk on these pledged instruments. The counterparty's recourse is not limited to the transferred assets.

Other transactions where the counterparty's recourse is only to the transferred asset includes a Canadian government sponsored securitisation programme, where HSBC Bank Canada assigns ownership and its right to sell or pledge residential mortgages. HSBC Bank Canada remains exposed to credit and interest rate risk on the assigned residential mortgages, which continue to be recorded as loans and advances. Third party funds received by HSBC Bank Canada under the programme are accounted for as secured borrowings and presented as debt securities in issue on the consolidated balance sheet.

In a small number of securitisation transactions, HSBC has neither transferred nor retained substantially all the risks and rewards of ownership of the transferred assets, and has retained control of the transferred assets. Circumstances in which HSBC has continuing involvement in the transferred assets may include retention of servicing rights over the transferred assets, entering into a derivative transaction with the securitisation vehicle or retaining an interest in the securitisation vehicle. Where HSBC has continuing involvement it continues to recognise the transferred assets to the extent of its continuing involvement and recognises an associated liability. The net carrying amount of the transferred assets and associated liabilities reflects the rights and obligations that HSBC has retained.

The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities, including those that are recognised to the extent of HSBC's continuing involvement and the associated liabilities.

Financial assets not qualifying for full derecognition and associated financial liabilities[1]

	Carrying amount of assets before transfer US$m	Carrying amount of transferred assets US$m	Carrying amount of associated liabilities US$m	Fair value of transferred assets US$m	Fair value of associated liabilities US$m	Net position US$m
At 31 December 2012						
Repurchase agreements		122,130	121,589			
Securities lending agreements		5,891	5,820			
Other sales (recourse to transferred asset only)		9,727	9,733	9,767	9,856	(89)
Securitisations recognised to the extent of continuing involvement	17,427	12	6	12	6	6

1 *The disclosure for 2012 reflects amendments made to IFRS 7 that are effective prospectively for annual reporting periods beginning on or after 1 July 2011.*

At 31 December 2011, the carrying amount of transferred assets and associated liabilities for repurchase agreements were US$124,982m and US$124,413m respectively, and for securities lending agreements were US$7,129m and US$7,039m, respectively.

At 31 December 2011, the carrying amount of transferred assets and associated liabilities for securitisations recognised to the extent of continuing involvement were US$22m and US$11m, respectively. The carrying amount of these assets before transfer was US$17,427m.

Financial assets qualifying for full derecognition and associated financial liabilities[1]

	At 31 December 2012				2012			
	Carrying amount of continuing involvement in the balance sheet		Fair value of continuing involvement		Maximum exposure to loss	Gain or loss recognised at transfer date	Income/ (expenses) recognised in year	Income/ (expenses) recognised cumulatively
	Assets US$m	Liabilities US$m	Assets US$m	Liabilities US$m	US$m	US$m	US$m	US$m
Type of continuing involvement								
Interest in SPEs	393	–	354	–	393	10	8	58

1 *The disclosure for 2012 reflects amendments made to IFRS 7 that are effective prospectively for annual reporting periods beginning on or after 1 July 2011.*

The assets in the table above represent our continuing involvement in securitisations where HSBC has transferred assets to an unconsolidated SPE, but has retained some of the notes issued by the SPE. These notes are reported in loans and advances to customers. The maximum exposure to loss is the carrying amount of the notes.

22 Interests in associates and joint ventures

Associates

Principal associates of HSBC

	At 31 December 2012		At 31 December 2011	
	Carrying amount US$m	Fair value US$m	Carrying amount US$m	Fair value US$m
Listed				
Bank of Communications Co., Limited	11,770	10,633	8,507	8,234
Industrial Bank Co., Limited	2,851	3,665	2,214	2,743
Ping An Insurance (Group) Company of China, Limited	–	–	6,373	8,110
The Saudi British Bank	2,135	3,189	1,886	3,256
	16,756	17,487	18,980	22,343

	At 31 December 2012		
	Country of incorporation	HSBC's interest in equity capital	Issued equity capital
Listed			
Bank of Communications Co., Limited	PRC[1]	19.03%	RMB74,263m
Industrial Bank Co., Limited	PRC[1]	12.80%	RMB10,786m
The Saudi British Bank	Saudi Arabia	40.00%	SR10,000m
Unlisted			
Barrowgate Limited[2]	Hong Kong	24.64%	–
Vietnam Technological and Commercial Joint Stock Bank	Vietnam	19.48%	VND8,848,079m
Yantai Bank Co., Limited[3]	PRC[1]	20.00%	RMB2,000m

1 *People's Republic of China.*
2 *Issued equity capital is less than HK$1m.*
3 *The investment is held through Hang Seng Bank Limited, a 62.14% owned subsidiary of HSBC.*

All the above investments in associates are owned by subsidiaries of HSBC Holdings.

Details of all HSBC associates and joint ventures, as required under Section 409 Companies Act 2006, will be annexed to the next Annual Return of HSBC Holdings filed with the UK Registrar of Companies.

HSBC had US$11,770m (2011: US$14,880m) of investments in associates and joint ventures listed in Hong Kong.

For the year ended 31 December 2012, HSBC's share of associates and joint ventures' tax on profit was US$959m (2011: US$890m), which is included within 'Share of profit in associates and joint ventures' in the income statement.

Summarised aggregate financial information on associates

	At 31 December	
	2012	2011
	US$m	US$m
HSBC's share of:		
– assets	**237,338**	249,461
– liabilities	**220,455**	230,902
– revenues	**14,206**	12,009
– profit after tax	**3,521**	3,221

HSBC's investment in Bank of Communications Co., Limited ('BoCom') was equity accounted with effect from August 2004. HSBC's significant influence in BoCom was established as a result of representation on the Board of Directors, and in accordance with the Technical Support and Assistance Agreements, HSBC is assisting in the maintenance of financial and operating policies and a number of staff have been seconded to assist in this process. During 2012, the market value of the investment in BoCom was below the carrying amount for a period of approximately ten months. As a result, we performed impairment tests on the carrying amount of the investment in BoCom. The result confirmed that there was no impairment. The impairment test was performed by comparing the recoverable amount of BoCom, determined by a value in use ('VIU') calculation, with its carrying amount. The calculation of VIU used discounted cash flow projections based on management's estimates. Cash flows beyond the next five years were then extrapolated in perpetuity using a long-term growth rate. The discount rate used was based on a cost of capital used to evaluate investments in mainland China. Management judgement is required in estimating the future cash flows of BoCom which are sensitive to the cash flows projected in the short- and medium-term, and also to the key assumptions regarding the long-term sustainable cash flows thereafter. The key assumptions are consistent with external sources of information.

HSBC's investment in Industrial Bank Co., Limited ('Industrial Bank') was equity accounted with effect from May 2004. HSBC's significant influence has been established as a result of representation on the Board of Directors. In January 2013 HSBC was no longer in a position to exercise significant influence over Industrial Bank and ceased to account for it as an associate. For further details, see Note 45.

HSBC's investment in Ping An Insurance (Group) Company of China Limited ('Ping An') was equity accounted with effect from August 2005, reflecting HSBC's significant influence over this associate. HSBC's significant influence was established as a result of representation on the Board of Directors. In June 2011, following a further issue of shares by Ping An to a third party, HSBC's holding was diluted to 15.57% and a dilution gain of US$181m was recognised in 'Other operating income'.

In July 2011, Ping An increased its ownership interest in Shenzhen Development Bank ('SDB') from 29.99% to 52.38%. As a result, the status of its investment in SDB changed from an interest in an associate to an investment in subsidiary. As a result of this transaction, Ping An recognised a re-measurement loss; HSBC's share of this re-measurement loss was US$48m.

In December 2012 approximately 20.8% of HSBC's holding in Ping An was disposed of. Following the disposal, HSBC no longer has significant influence over Ping An and has ceased to account for Ping An as an associate. For further details on investment in Ping An, see Note 26.

The statutory accounting reference date of BoCom, Ping An and Industrial Bank is 31 December. For the year ended 31 December 2012, these companies were included on the basis of financial statements made up for the twelve months to 30 September 2012, taking into account changes in the subsequent period from 1 October 2012 to 31 December 2012 that would have materially affected their results.

HSBC acquired 15% of Vietnam Technological & Commercial Joint Stock Bank in October 2007. This investment was equity accounted from that date due to HSBC's representation on the Board of Directors and involvement in the Technical Support and Assistance Agreement. In December 2007, as a result of a rights issue in which HSBC did not

Notes on the Financial Statements (continued)

participate, HSBC's equity interest was diluted to 14.44%. In September 2008, HSBC increased its equity interest to 20%. HSBC's equity interest has been subsequently diluted to below 20% due to the issue of shares by the associate to its own employees.

Joint ventures

Principal interests in joint ventures

	At 31 December 2012			
	Country of incorporation	Principal activity	HSBC's interest in equity capital	Issued equity capital
HSBC Saudi Arabia Limited	**Saudi Arabia**	**Investment banking**	**49.00%**	**SR500m**
Vaultex UK Limited	**England**	**Cash management**	**50.00%**	**£10m**
Hana HSBC Life Insurance Co., Ltd	**South Korea**	**Insurance manufacturing**	**49.99%**	**KRW110,201m**
Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited	**India**	**Insurance manufacturing**	**26.00%**	**INR9,500m**

Summarised aggregate financial information on joint ventures

	At 31 December 2012 US$m	At 31 December 2011 US$m
HSBC's share of:		
– current assets	**1,964**	1,556
– non-current assets	**202**	196
– current liabilities	**924**	747
– non-current liabilities	**961**	715
– income	**347**	383
– expenses	**311**	339

In December 2011, following the issue of shares by HSBC Saudi Arabia Limited to a third party, HSBC's holding was diluted from 60% to 49% and a dilution gain of US$27m was recognised in 'Other operating income'.

Associates and joint ventures

Movements in investments in associates and joint ventures

	2012 US$m	2011 US$m
At 1 January	**20,399**	17,198
Additions	**1,804**	90
Disposals	**(7,580)**	(25)
Share of results	**3,557**	3,264
Dividends	**(489)**	(304)
Exchange differences	**60**	681
Share of other comprehensive income/(expense) of associates and joint ventures	**311**	(710)
Other movements	**(228)**	205
At 31 December	**17,834**	20,399

Goodwill included in carrying amount of associates and joint ventures

	2012 US$m	2011 US$m
Gross amount		
At 1 January	**1,551**	1,518
Disposals	**(874)**	–
Exchange differences	**3**	57
Other changes	**(10)**	(24)
At 31 December[1]	**670**	1,551

1 *Includes the carrying amount of goodwill arising from joint ventures of US$30m (2011: US$31m).*

23 Goodwill and intangible assets

	At 31 December 2012 US$m	At 31 December 2011 US$m
Goodwill	**21,390**	21,338
Present value of in-force long-term insurance business ('PVIF')[1]	**4,847**	4,092
Other intangible assets	**3,616**	3,604
	29,853	29,034

1 *Disclosures on PVIF are provided on page 243.*

Goodwill

Reconciliation of goodwill

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Gross amount							
At 1 January 2012	**14,433**	**124**	**1,063**	**63**	**8,747**	**3,765**	**28,195**
Disposals	**(2)**	**(4)**	**(5)**	**–**	**–**	**(21)**	**(32)**
Exchange differences	**229**	**(6)**	**(38)**	**(3)**	**–**	**23**	**205**
Reclassified to held for sale	**–**	**–**	**–**	**–**	**(408)**	**(121)**	**(529)**
At 31 December 2012	**14,660**	**114**	**1,020**	**60**	**8,339**	**3,646**	**27,839**
Accumulated impairment losses							
At 1 January 2012	**–**	**–**	**–**	**–**	**(6,857)**	**–**	**(6,857)**
Reclassified to held for sale	**–**	**–**	**–**	**–**	**408**	**–**	**408**
At 31 December 2012	**–**	**–**	**–**	**–**	**(6,449)**	**–**	**(6,449)**
Net carrying amount at 31 December 2012	**14,660**	**114**	**1,020**	**60**	**1,890**	**3,646**	**21,390**
Gross amount							
At 1 January 2011	14,885	124	1,115	65	12,465	4,316	32,970
Disposals	(3)	–	–	–	–	(46)	(49)
Exchange differences	(449)	–	(35)	(2)	(1)	(272)	(759)
Reclassified to held for sale	–	–	–	–	(3,717)	(231)	(3,948)
Other changes	–	–	(17)	–	–	(2)	(19)
At 31 December 2011	14,433	124	1,063	63	8,747	3,765	28,195
Accumulated impairment losses							
At 1 January 2011	–	–	–	–	(10,564)	–	(10,564)
Reclassified to held for sale	–	–	–	–	3,707	–	3,707
At 31 December 2011	–	–	–	–	(6,857)	–	(6,857)
Net carrying amount at 31 December 2011	14,433	124	1,063	63	1,890	3,765	21,338

Impairment testing

Timing of impairment testing

HSBC's impairment test in respect of goodwill allocated to each cash-generating unit ('CGU') is performed as at 1 July each year. In line with the accounting policy set out in Note 2(p), goodwill is also retested for impairment whenever there is an indication that it may be impaired. For the purpose of impairment testing, the Group's CGUs are based on geographical regions subdivided by global business. The CGUs represent the lowest level at which goodwill is monitored for internal management purposes. The GB&M-Europe CGU experienced significantly reduced profitability in the second half of 2012 and was retested for impairment as at 31 December 2012. For other CGUs there was no indication of impairment in the period to 31 December 2012 and therefore goodwill has not been retested since 1 July 2012.

Notes on the Financial Statements (continued)

23 – Goodwill and intangible assets

Basis of the recoverable amount – value in use or fair value less costs to sell

The recoverable amount of all CGUs to which goodwill has been allocated was equal to its VIU at each respective testing date for 2011 and 2012.

For each significant CGU, the VIU is calculated by discounting management's cash flow projections for the CGU. The discount rate used is based on the cost of capital HSBC allocates to investments in the countries within which the CGU operates. The long-term growth rate is used to extrapolate the cash flows in perpetuity because of the long-term perspective within the Group of the business units making up the CGUs. In 2012, management's cash flow projections until the end of 2014 were used.

Key assumptions in VIU calculation and management's approach to determining the values assigned to each key assumption

	2012			2011		
	Goodwill at 1 July 2012 US$m	**Discount rate %**	**Nominal growth rate beyond initial cash flow projections %**	Goodwill at 1 July 2011 US$m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
Cash-generating unit						
Retail Banking and Wealth Management – Europe	**4,054**	**10.0**	**3.9**	4,794	10.0	4.7
Commercial Banking – Europe	**2,968**	**10.2**	**3.7**	3,574	10.1	4.5
Global Private Banking – Europe	**4,139**	**9.1**	**3.2**	4,456	10.0	4.3
Global Banking and Markets – Europe	**3,016**	**10.2**	**3.5**	3,139	10.2	4.4
Retail Banking and Wealth Management – Latin America	**1,994**	**15.3**	**8.7**	2,537	16.0	9.3
Total goodwill in the CGUs listed above	**16,171**			18,500		

At 1 July 2012, aggregate goodwill of US$4,741m (1 July 2011: US$5,091m) had been allocated to CGUs that were not considered individually significant. These CGUs do not carry on their balance sheets any significant intangible assets with indefinite useful lives, other than goodwill.

Nominal long-term growth rate: this growth rate reflects GDP and inflation for the countries within which the CGU operates. The rates are based on IMF forecast growth rates as these rates are regarded as the most relevant estimate of likely future trends. The rates used for 2011 and 2012 do not exceed the long-term growth rate for the countries within which the CGU operates.

Discount rate: the discount rate used to discount the cash flows is based on the cost of capital assigned to each CGU, which is derived using a Capital Asset Pricing Model ('CAPM'). The CAPM depends on inputs reflecting a number of financial and economic variables including the risk-free rate and a premium to reflect the inherent risk of the business being evaluated. These variables are based on the market's assessment of the economic variables and management's judgement. In addition, for the purposes of testing goodwill for impairment, management supplements this process by comparing the discount rates derived using the internally generated CAPM with cost of capital rates produced by external sources. HSBC uses externally-sourced cost of capital rates where, in management's judgement, those rates reflect more accurately the current market and economic conditions. For 2012 and 2011, internal costs of capital rates were consistent with externally-sourced rates.

Management's judgement in estimating the cash flows of a CGU: the cash flow projections for each CGU are based on plans approved by the Group Management Board. The key assumptions in addition to the discount rate and nominal long-term growth rate for each significant CGU are discussed below.

Retail Banking and Wealth Management – Europe and Commercial Banking – Europe: the assumptions included in the cash flow projections for RBWM – Europe and CMB – Europe reflect the economic environment and financial outlook of the European countries within these two CGUs. Key assumptions include the level of interest rates and the level and change in unemployment rates. While current economic conditions in Europe continue to be challenging, management's cash flow projections are based primarily on these prevailing conditions. Risks include a further recession in the UK and an uncertain regulatory environment. RBWM – Europe specifically, is sensitive to further customer remediation costs in relation to PPI. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of RBWM – Europe or CMB – Europe.

Global Private Banking – Europe: the revenues in GPB – Europe are predominately generated through HSBC's client relationships. The cash flow forecast reflects current economic conditions and key assumptions include the level of interest rates and client risk appetite. Further economic deterioration could result in a decrease in assets under management and a reduction in fee and trading income through increased client risk aversion. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of GPB – Europe.

Global Banking and Markets – Europe: the key assumption included in the cash flow projection for GB&M – Europe is that European markets will continue to recover during 2013. Accordingly, European revenues are forecast to recover in 2013 and this recovery is assumed to continue over the projection period into 2014. Our ability to achieve the forecast cash flows for GB&M – Europe could be adversely impacted by regulatory change during the forecast period including but not limited to the extent that the recommendations set out in the Final Report by the Independent Commission on Banking are implemented.

Based on management's value in use calculation, GB&M – Europe has an excess of recoverable amount over carrying amount ('headroom') of US$2.3bn as at 1 July 2012. Headroom was US$2.3bn as at 31 December 2012 based on goodwill at that point of US$3.1bn. The change in carrying value between 1 July 2012 and 31 December 2012 arises from retranslating goodwill into the presentation currency of the group. The same assumptions were used in the impairment tests as at 1 July 2012 and 31 December 2012. The following changes to the key assumptions used in the value in use calculation would be necessary in order to reduce headroom to nil:

Key assumption	**Change to key assumption to reduce headroom to nil**
Discount rate	Increase by 64 basis points
Nominal growth rate beyond initial cash flow projection	Decrease by 69 basis points
Revenue compound annual growth rate	Decrease from 10.3% to 8.3%

Retail Banking and Wealth Management – Latin America: the assumptions included in the cash flow projections for RBWM – Latin America reflect the economic environment and financial outlook of the countries within this segment, with Brazil and Mexico being two of the largest countries included within this segment. Key assumptions include the growth in lending and deposit volumes and the credit quality of the loan portfolios. Mexico and Panama in particular are sensitive to economic conditions in the US which could constrain demand. Based on the conditions at the balance sheet date, management determined that a reasonably possible change in any of the key assumptions described above would not cause an impairment to be recognised in respect of RBWM – Latin America.

Other intangible assets

Movement of intangible assets excluding goodwill and the PVIF

	Trade names US$m	Mortgage servicing rights US$m	Internally generated software US$m	Purchased software US$m	Customer/ merchant relation-ships US$m	Other US$m	Total US$m
Cost							
At 1 January 2012	60	591	5,598	856	1,354	454	8,913
Additions[1]	1	30	765	78	120	48	1,042
Disposals	–	(123)	(32)	(61)	(5)	–	(221)
Amount written off	–	–	(680)	(21)	(39)	–	(740)
Exchange differences	–	–	62	–	(48)	12	26
Reclassified to held for sale	–	–	(26)	(15)	(7)	(14)	(62)
Other changes	–	–	16	78	(8)	4	90
At 31 December 2012	61	498	5,703	915	1,367	504	9,048

Notes on the Financial Statements (continued)

Movement of intangible assets excluding goodwill and the PVIF (continued)

	Trade names US$m	Mortgage servicing rights US$m	Internally generated software US$m	Purchased software US$m	Customer/ merchant relation-ships US$m	Other US$m	Total US$m
Accumulated amortisation							
At 1 January 2012	**(51)**	**(369)**	**(3,437)**	**(672)**	**(649)**	**(131)**	**(5,309)**
Charge for the year[2]	**(5)**	**(78)**	**(645)**	**(103)**	**(127)**	**(21)**	**(979)**
Impairment	**–**	**–**	**(63)**	**(3)**	**–**	**(2)**	**(68)**
Disposals	**2**	**123**	**28**	**53**	**5**	**–**	**211**
Amount written off	**–**	**–**	**680**	**21**	**39**	**–**	**740**
Exchange differences	**–**	**(2)**	**(47)**	**1**	**15**	**(1)**	**(34)**
Reclassified to held for sale	**–**	**–**	**24**	**9**	**5**	**10**	**48**
Other changes	**(1)**	**–**	**(9)**	**(41)**	**8**	**2**	**(41)**
At 31 December 2012	**(55)**	**(326)**	**(3,469)**	**(735)**	**(704)**	**(143)**	**(5,432)**
Net carrying amount at 31 December 2012	**6**	**172**	**2,234**	**180**	**663**	**361**	**3,616**
Cost							
At 1 January 2011	68	636	5,202	1,065	1,987	503	9,461
Additions[1]	–	40	1,129	102	379	6	1,656
Disposals	–	(91)	(44)	(102)	(181)	(1)	(419)
Amount written off	–	–	(365)	(133)	–	(2)	(500)
Exchange differences	(6)	–	(109)	(40)	(79)	(14)	(248)
Reclassified to held for sale	(2)	–	(197)	(22)	(746)	(46)	(1,013)
Other changes	–	6	(18)	(14)	(6)	8	(24)
At 31 December 2011	60	591	5,598	856	1,354	454	8,913
Accumulated amortisation							
At 1 January 2011	(52)	(240)	(2,958)	(848)	(1,143)	(144)	(5,385)
Charge for the year[2]	(4)	(215)	(609)	(106)	(212)	(29)	(1,175)
Impairment	–	–	(386)	(3)	–	(1)	(390)
Disposals	–	91	29	100	111	3	334
Amount written off	–	–	365	133	–	2	500
Exchange differences	3	–	44	31	29	–	107
Reclassified to held for sale	2	–	50	18	563	36	669
Other changes	–	(5)	28	3	3	2	31
At 31 December 2011	(51)	(369)	(3,437)	(672)	(649)	(131)	(5,309)
Net carrying amount at 31 December 2011	9	222	2,161	184	705	323	3,604

1 *At 31 December 2012, HSBC had no contractual commitments (2011: nil) to acquire intangible assets.*
2 *The amortisation charge for the year is recognised within the income statement under 'Amortisation and impairment of intangible assets', with the exception of the amortisation of mortgage servicing rights which is recognised in 'Net fee income'.*

24 Property, plant and equipment

	Freehold land and buildings US$m	Long leasehold land and buildings US$m	Short leasehold land and buildings[1] US$m	Equipment, fixtures and fittings[2] US$m	Equipment on operating leases US$m	Total[3] US$m
Cost or fair value						
At 1 January 2012	**3,537**	**1,800**	**3,872**	**11,579**	**71**	**20,859**
Additions at cost[4]	**135**	**89**	**209**	**1,016**	**50**	**1,499**
Fair value adjustments	**(35)**	**31**	**76**	**–**	**–**	**72**
Disposals	**(141)**	**–**	**(68)**	**(915)**	**(14)**	**(1,138)**
Reclassified to held for sale	**(10)**	**(36)**	**(6)**	**(70)**	**–**	**(122)**
Transfers	**59**	**(7)**	**(55)**	**3**	**–**	**–**
Exchange differences	**(59)**	**10**	**40**	**195**	**4**	**190**
Other changes	**9**	**(23)**	**–**	**(148)**	**–**	**(162)**
At 31 December 2012	**3,495**	**1,864**	**4,068**	**11,660**	**111**	**21,198**
Accumulated depreciation and impairment						
At 1 January 2012	**(544)**	**(332)**	**(1,181)**	**(7,909)**	**(28)**	**(9,994)**
Depreciation charge for the year	**(72)**	**(57)**	**(201)**	**(1,055)**	**(12)**	**(1,397)**
Disposals	**44**	**–**	**53**	**844**	**13**	**954**
Reclassified to held for sale	**13**	**1**	**1**	**27**	**–**	**42**
Transfers	**(26)**	**1**	**22**	**3**	**–**	**–**
Impairment losses recognised	**(9)**	**(4)**	**(11)**	**(63)**	**–**	**(87)**
Exchange differences	**(8)**	**(2)**	**(15)**	**(137)**	**(1)**	**(163)**
Other changes	**(67)**	**3**	**12**	**84**	**3**	**35**
At 31 December 2012	**(669)**	**(390)**	**(1,320)**	**(8,206)**	**(25)**	**(10,610)**
Net carrying amount at 31 December 2012	**2,826**	**1,474**	**2,748**	**3,454**	**86**	**10,588**
Cost or fair value						
At 1 January 2011	3,952	1,673	4,004	12,529	53	22,211
Additions at cost[4]	353	114	180	1,183	19	1,849
Fair value adjustments	(15)	44	89	–	–	118
Disposals	(188)	(19)	(279)	(1,400)	–	(1,886)
Reclassified to held for sale	(424)	(19)	(158)	(260)	–	(861)
Transfers	(12)	(35)	25	10	–	(12)
Exchange differences	(203)	1	15	(395)	(1)	(583)
Other changes	74	41	(4)	(88)	–	23
At 31 December 2011	3,537	1,800	3,872	11,579	71	20,859
Accumulated depreciation and impairment						
At 1 January 2011	(586)	(307)	(1,268)	(8,506)	(23)	(10,690)
Depreciation charge for the year	(88)	(51)	(211)	(1,157)	(9)	(1,516)
Disposals	60	2	262	1,319	–	1,643
Reclassified to held for sale	133	13	80	138	–	364
Transfers	5	35	(34)	(6)	–	–
Impairment losses recognised	(13)	–	(16)	(25)	–	(54)
Exchange differences	18	(1)	8	260	1	286
Other changes	(73)	(23)	(2)	68	3	(27)
At 31 December 2011	(544)	(332)	(1,181)	(7,909)	(28)	(9,994)
Net carrying amount at 31 December 2011	2,993	1,468	2,691	3,670	43	10,865

1 *Including assets held on finance leases with a net book value of US$5m (2011: US$7m).*
2 *Including assets held on finance leases with a net book value of US$182m (2011: US$210m).*
3 *Including assets with a net book value of US$39m (2011: US$33m) pledged as security for liabilities.*
4 *At 31 December 2012, HSBC had US$412m (2011: US$517m) of contractual commitments to acquire property, plant and equipment.*

Leasehold land and buildings

Leasehold land and buildings are considered to be held under finance lease contracts where the value of the land cannot reliably be separated from the value of the lease and the respective contracts do not meet the criteria for classification as operating leases. Included within 'Short leasehold land and buildings' are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

Leasehold land and buildings

	2012		2011	
	Cost US$m	Accumulated depreciation US$m	Cost US$m	Accumulated depreciation US$m
At 1 January	**1,669**	**(751)**	1,944	(933)
Additions	**119**	**–**	171	–
Disposals	**(65)**	**47**	(269)	262
Depreciation charge for the year	**–**	**(133)**	–	(139)
Impairment loss recognised	**–**	**(6)**	–	(15)
Exchange differences	**28**	**(13)**	(13)	2
Reclassified as held for sale	**(10)**	**(1)**	(154)	73
Other changes	**(23)**	**(9)**	(10)	(1)
At 31 December	**1,718**	**(866)**	1,669	(751)
Net carrying amount at 31 December	**852**		918	

Investment properties

Movement on the fair value of investment properties

	Freehold land and buildings US$m	Long leasehold land and buildings US$m	Short leasehold land and buildings US$m	Total US$m
Fair value				
At 1 January 2012	**745**	**192**	**402**	**1,339**
Additions at cost	**9**	**–**	**–**	**9**
Fair value adjustments	**(35)**	**31**	**76**	**72**
Reclassified to held for sale	**–**	**(29)**	**–**	**(29)**
Exchange differences	**(64)**	**–**	**1**	**(63)**
Other changes	**(3)**	**1**	**8**	**6**
At 31 December 2012	**652**	**195**	**487**	**1,334**
Fair value				
At 1 January 2011	667	156	310	1,133
Additions at cost	242	–	–	242
Fair value adjustments	(15)	44	89	118
Disposals	(47)	(17)	–	(64)
Exchange differences	(22)	1	1	(20)
Other changes	(80)	8	2	(70)
At 31 December 2011	745	192	402	1,339

Investment properties are valued on a market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of properties. Investment properties in Hong Kong, the Macau Special Administrative Region and mainland China, which represent more than 51% by value of HSBC's investment properties subject to revaluation, were valued by DTZ Debenham Tie Leung Limited whose valuers are members of the Hong Kong Institute of Surveyors. Properties in other countries, which represent 49% by value of HSBC's investment properties, were valued by different independent professionally qualified valuers.

HSBC Holdings had no investment properties at 31 December 2012 or 2011.

HSBC properties leased to customers

HSBC properties leased to customers included US$694m at 31 December 2012 (2011: US$618m) let under operating leases, net of accumulated depreciation of US$16m (2011: US$12m). None was held by HSBC Holdings.

At 31 December 2012, the classification of land and buildings in Hong Kong in accordance with Hong Kong Companies Ordinance requirements was freehold nil (2011: nil), long leasehold US$1,319m (2011: US$1,363m), medium leasehold US$1,600m (2011: US$1,484m) and short leasehold US$3m (2011: US$4m).

25 Investments in subsidiaries

Principal subsidiaries of HSBC Holdings

	At 31 December 2012			
	Country of incorporation or registration	HSBC's interest in equity capital %	Issued equity capital	Share class
Europe				
HSBC Asset Finance (UK) Limited	England	100	£265m	Ordinary £1
HSBC Bank A.S.	Turkey	100	TRL652m	A–Common TRL1
				B–Common TRL1
HSBC Bank Malta p.l.c.	Malta	70.03	€88m	Ordinary €0.30
HSBC Bank plc	England	100	£797m	Ordinary £1
				Preferred Ordinary £1
				Series 2 Third Dollar Preference US$0.01
				Third Dollar Preference US$0.01
HSBC France	France	99.99	€337m	Shares €5.00
HSBC Bank International Limited	Jersey	100	£1m	Ordinary £1
HSBC Life (UK) Limited	England	100	£94m	Ordinary £1
HSBC Private Banking Holdings (Suisse) SA	Switzerland	100	CHF1,363m	Ordinary CHF1,000
HSBC Trinkaus & Burkhardt AG	Germany	80.62	€28m	Shares of no par value
Marks and Spencer Retail Financial Services Holdings Limited	England	100	£67m	Ordinary £1
Hong Kong				
Hang Seng Bank Limited[1]	Hong Kong	62.14	HK$9,559m	Ordinary HK$5.00
HSBC Insurance (Asia) Limited	Hong Kong	100	HK$2,798m	Ordinary HK$1,000
HSBC Life (International) Limited	Bermuda	100	HK$2,778m	Ordinary HK$1.00
The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	100	HK$58,969m	Ordinary HK$2.50
				CIP[2] US$1.00
				CRP[3] US$1.00
				NIP[4] US$1.00
Rest of Asia-Pacific				
HSBC Bank Australia Limited	Australia	100	A$751m	Ordinary no par value
			A$60m	Pref shares of no par value
HSBC Bank (China) Company Limited	PRC[5]	100	RMB12,400m	Ordinary CNY1.00
HSBC Bank Malaysia Berhad	Malaysia	100	RM115m	Ordinary RM0.50
Middle East and North Africa				
HSBC Bank Middle East Limited	Jersey	100	US$931m	Ordinary US$1.00
				CRP[3] US$1.00
HSBC Bank Egypt S.A.E.	Egypt	94.53	EGP2,079m	Ordinary EGP84.00
North America				
HSBC Bank Bermuda Limited	Bermuda	100	BMD30m	Common BMD1.00
HSBC Bank Canada	Canada	100	C$1,571m	Class 1 Pref of NPV[6]
				Class 2 Pref of NPV[6]
				Common of NPV[6]
HSBC Bank USA, N.A.	US	100	US$2m	Common US$100
HSBC Finance Corporation	US	100	–[7]	Common US$0.01
HSBC Securities (USA) Inc.	US	100	–[7]	Common US$0.05
Latin America				
HSBC Bank Argentina S.A.	Argentina	99.99	ARS1,244m	Ordinary–A ARS1.00
				Ordinary–B ARS1.00
HSBC Bank Brasil S.A. – Banco Múltiplo	Brazil	100	BRL5,994m	Shares of no par value
HSBC Mexico, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC	Mexico	99.99	MXN5,261m	Ordinary MXN2.00
HSBC Bank (Panama) S.A.	Panama	100	US$10m	Ordinary PAB1.00

1 *Listed in Hong Kong.*
2 *Cumulative Irredeemable Preference shares.*
3 *Cumulative Redeemable Preference shares.*
4 *Non-cumulative Irredeemable Preference shares.*
5 *People's Republic of China.*
6 *Preference shares of nil par value.*
7 *Issued equity capital is less than US$1m.*

Details of the debt, subordinated debt and preference shares issued by the principal subsidiaries to parties external to the Group are included in the Notes 29 'Debt securities in issue', 33 'Subordinated liabilities' and 37 'Non-controlling interests', respectively.

All the above subsidiaries are included in the HSBC consolidated financial statements.

Notes on the Financial Statements (continued)

Details of all HSBC subsidiaries will be annexed to the next Annual Return of HSBC Holdings filed with the UK Registrar of Companies.

All the above make their financial statements up to 31 December except for HSBC Bank Argentina S.A., whose financial statements are made up to 30 June annually.

The principal countries of operation are the same as the countries of incorporation except for HSBC Bank Middle East Limited which operates mainly in the Middle East and North Africa and HSBC Life (International) Limited which operates mainly in Hong Kong.

In February 2013, we announced an agreement to sell HSBC Bank (Panama) S.A. to Bancolombia S.A. For further details see Note 45.

During 2012 and 2011, none of the Group's subsidiaries experienced significant restrictions on paying dividends or repaying loans and advances.

Acquisitions

In June 2012, HSBC merged its operations in Oman with the Oman International Bank S.A.O.G. for total consideration of US$0.2bn. HSBC owns 51% of the combined entity, HSBC Bank Oman S.A.O.G., which had net assets of US$0.8bn immediately following the merger.

In October 2012, HSBC acquired the onshore retail and commercial banking business of Lloyds Banking Group in the United Arab Emirates for a total consideration of US$0.1bn. As a result of the transaction HSBC acquired net assets of US$0.2bn.

SPEs consolidated by HSBC where HSBC owns less than 50% of the voting rights

	Carrying value of total consolidated assets		Nature of SPE
	2012	2011	
	US$bn	US$bn	
Barion Funding Limited	**3.9**	3.8	Securities investment conduit
Bryant Park Funding LLC	**0.9**	2.8	Conduit
HSBC Home Equity Loan Corporation I	**2.0**	2.1	Securitisation
HSBC Home Equity Loan Corporation II	**2.2**	2.4	Securitisation
HSBC Receivables Funding, Inc. II	**–**	1.9	Securitisation
Malachite Funding Limited	**3.4**	3.6	Securities investment conduit
Mazarin Funding Limited	**8.0**	8.0	Securities investment conduit
Metrix Funding Ltd	**–**	0.7	Securitisation
Metrix Securities plc	**–**	0.4	Securitisation
Regency Assets Limited	**10.1**	7.5	Conduit
Solitaire Funding Ltd	**11.3**	12.5	Securities investment conduit

In addition to the above, HSBC consolidates a number of individually insignificant SPEs with total assets of US$17bn. For further details, see Note 42.

In each of the above cases, HSBC has less than 50% of the voting rights, but consolidates because it has the majority of risks and rewards of ownership of the SPE, or the substance of the relationship with the SPE is such that its activities are conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefit from the SPE's operation. The consolidation of SPEs sponsored by HSBC is discussed on page 384.

26 Assets held for sale and other assets

Assets held for sale

	2012 US$m	2011 US$m
Disposal groups	5,797	38,903
Non-current assets held for sale:	13,472	655
– property, plant and equipment	500	589
– investment in Ping An	8,168	–
– loans and advances to customers	3,893	–
– other	911	66
	19,269	39,558

Disposal groups

At 31 December 2012, the following businesses represented the majority of disposal groups held for sale:

- Latin American businesses, which include banking operations in Peru, Colombia and Paraguay.
- US life insurance businesses.

The following significant businesses that were held for sale at 31 December 2011 were sold in 2012:

- The sale of the US Card and Retail Services business that was completed on 1 May 2012 with a gain on disposal of US$3.1bn.
- The sale of 195 US branches were completed in several stages in 2012. 138 branches were sold on 18 May 2012, recognising a gain of US$661m. The remaining branches were sold in the third quarter of 2012 with a gain of US$203m.
- Central American businesses, which include banking operations in Costa Rica, El Salvador and Honduras were sold in November and December 2012 with a loss on disposal of US$62m.

The major classes of assets and associated liabilities of disposal groups held for sale were as follows:

	At 31 December 2012			
	South America businesses US$m	US life insurance businesses US$m	Other US$m	Total US$m
Assets of disposal groups held for sale				
Trading assets	4	–	–	4
Loans and advances to banks	344	–	164	508
Loans and advances to customers	1,929	–	302	2,231
Financial investments	364	1,396	229	1,989
Prepayments and accrued income	27	15	5	47
Goodwill and intangible assets	33	53	60	146
Other assets of disposal groups	622	109	141	872
Total assets	3,323	1,573	901	5,797
Liabilities of disposal groups held for sale (Note 30)				
Deposits by banks	26	–	10	36
Customer accounts	2,154	–	836	2,990
Debt securities in issue	566	–	(1)	565
Liabilities under insurance contracts	–	998	162	1,160
Other liabilities of disposal groups	132	39	96	267
Total liabilities	2,878	1,037	1,103	5,018
Net unrealised losses recognised in ‘other operating income’ as a result of reclassification to held for sale	(96)	–	–	(96)
Expected date of completion	Q4 2013	Q1 2013		
Operating segment	Latin America	North America		

Notes on the Financial Statements (continued)

Property, plant and equipment

The property, plant and equipment classified as held for sale is the result of repossession of property that had been pledged as collateral by customers. Substantially all of these assets are disposed of within 12 months of acquisition. The majority arose within the North America operating segment.

Investment in Ping An

On 5 December 2012, we entered into an agreement to dispose of our entire 15.57% shareholding in Ping An for US$9.4bn. The disposal was carried out in two tranches, an initial tranche of 256,694,218 shares representing 3.24% of Ping An's issued share capital, then the remaining 976,121,395 shares representing 12.33% of Ping An's issued share capital. The selling price for both the tranches was fixed at HK$59 per share.

The first tranche of shares was disposed on 7 December 2012. Following this disposal, HSBC no longer had significant influence over Ping An and ceased to account for it as an associate. The gain from the disposal of the first tranche of shares and the gain from the consequent discontinuance of associate accounting for the remaining 12.33% shareholding in Ping An totalled US$3bn, and was recognised in the income statement. The remaining 12.33% shareholding was recognised as an available-for-sale investment, measured initially at fair value on the date of discontinuance of associate accounting, and thereafter carried at fair value with unrealised gains or losses recorded in other comprehensive income.

The fixing of the sale price gave rise to a contingent forward sale contract, the fair value of which at year end was based on the difference between the agreed sale price and the market price for the shares, adjusted for an assessment of the probability of the transaction being completed. The adverse fair value of this contract was US$553m at 31 December 2012, recorded in net trading income.

At 31 December 2012, the fair value of our 12.33% shareholding in Ping An was US$8.2bn included within 'Assets held for sale' above, with US$737m accumulated unrealised gains in other comprehensive income which arose after the date of the agreement and represent the difference between Ping An's share price at the year-end and the share price on the date of recognition as an available-for-sale investment.

The sale of the second tranche was completed on 6 February 2013 where the net impact of the change in fair value of the contingent forward sale contract to the point of delivery of the shares and the derecognition of the available-for-sale investment resulted in an income statement gain before tax in 2013 of US$553m.

Loans and advances to customers

Loans and advances to customers held for sale at 31 December 2012 include US personal loan balances of US$3.4bn, net of impairment allowances.

Other assets

	At 31 December	
	2012	2011
	US$m	US$m
Bullion	**26,508**	19,824
Reinsurers' share of liabilities under insurance contracts (Note 31)	**1,407**	1,801
Endorsements and acceptances	**12,032**	11,010
Retirement benefit assets	**2,846**	2,497
Other accounts	**11,923**	13,567
	54,716	48,699

27 Trading liabilities

	At 31 December 2012 US$m	2011 US$m
Deposits by banks	**61,686**	47,506
Customer accounts	**150,705**	123,344
Other debt securities in issue (Note 29)	**31,198**	29,987
Other liabilities – net short positions in securities	**60,974**	64,355
	304,563	265,192

At 31 December 2012, the cumulative amount of change in fair value attributable to changes in HSBC credit risk was a loss of US$29m (2011: gain of US$599m).

Deposits by banks held for trading

	At 31 December 2012 US$m	2011 US$m
Repos	**26,740**	16,687
Settlement accounts	**7,647**	7,221
Stock lending	**4,523**	2,821
Other	**22,776**	20,777
	61,686	47,506

Customer accounts held for trading

	At 31 December 2012 US$m	2011 US$m
Repos	**103,483**	70,151
Settlement accounts	**9,461**	6,909
Stock lending	**2,295**	1,774
Other	**35,466**	44,510
	150,705	123,344

28 Financial liabilities designated at fair value

HSBC

	At 31 December 2012 US$m	2011 US$m
Deposits by banks and customer accounts	**496**	517
Liabilities to customers under investment contracts	**12,456**	11,399
Debt securities in issue (Note 29)	**53,209**	52,197
Subordinated liabilities (Note 33)	**16,863**	17,503
Preferred securities (Note 33)	**4,696**	4,108
	87,720	85,724

The carrying amount at 31 December 2012 of financial liabilities designated at fair value was US$7,032m more than the contractual amount at maturity (2011: US$1,377m more). The cumulative amount of the change in fair value attributable to changes in credit risk was a loss of US$88m (2011: gain of US$5,118m).

Notes on the Financial Statements (continued)

HSBC Holdings

	At 31 December	
	2012	2011
	US$m	US$m
Debt securities in issue (Note 29):		
– owed to third parties	**8,577**	5,753
Subordinated liabilities (Note 33):		
– owed to third parties	**10,358**	11,443
– owed to HSBC undertakings	**4,260**	3,955
	23,195	21,151

The carrying amount at 31 December 2012 of financial liabilities designated at fair value was US$3,199m more than the contractual amount at maturity (2011: US$722m more). The cumulative amount of the change in fair value attributable to changes in credit risk was a loss of US$164m (2011: gain of US$2,096m).

29 Debt securities in issue

	At 31 December	
	2012	2011
	US$m	US$m
Bonds and medium-term notes	**155,661**	151,367
Other debt securities in issue	**48,207**	61,830
	203,868	213,197
Of which debt securities in issue reported as:		
– trading liabilities (Note 27)	**(31,198)**	(29,987)
– financial liabilities designated at fair value (Note 28)	**(53,209)**	(52,197)
	119,461	131,013

Certain debt securities in issue are managed on a fair value basis as part of HSBC's interest rate risk management policies. The debt securities being hedged are presented within the balance sheet caption 'Financial liabilities designated at fair value', with the remaining debt securities included within 'Trading liabilities'. The following table analyses the carrying amount of bonds and medium-term notes in issue at 31 December with original maturities greater than one year:

Bonds and medium-term notes

HSBC

	At 31 December	
	2012	2011
	US$m	US$m
Fixed rate		
Secured financing:		
0.01% to 3.99%: until 2056	**7,514**	8,259
4.00% to 4.99%: until 2013	**231**	1,307
5.00% to 5.99%: until 2019	**189**	332
8.00% to 9.99%: until 2028	**252**	276
Other fixed rate senior debt:		
0.01% to 3.99%: until 2078	**48,620**	38,346
4.00% to 4.99%: until 2046	**18,722**	15,515
5.00% to 5.99%: until 2041	**14,766**	17,525
6.00% to 6.99%: until 2046	**5,207**	7,056
7.00% to 7.99%: until 2026	**713**	3,083
8.00% to 9.99%: until 2036	**199**	379
10.00% or higher: until 2028	**108**	437
	96,521	92,515
Variable interest rate		
Secured financings – 0.01% to 13.99%: until 2068	**7,897**	7,279
FHLB advances – 0.01% to 0.99%: until 2036	**1,000**	1,000
Other variable interest rate senior debt – 0.01% to 12.99%: until 2057	**43,104**	47,393
	52,001	55,672

	At 31 December	
	2012	2011
	US$m	US$m
Brought forward	**148,522**	148,187
Structured notes		
Interest rate, equity, equity index or credit-linked	**7,139**	3,180
	155,661	151,367

HSBC Holdings

	At 31 December	
	2012	2011
	US$m	US$m
Debt securities	**11,268**	8,366
Of which debt securities in issue reported as:		
– financial liabilities designated at fair value (Note 28)	**(8,577)**	(5,753)
	2,691	2,613
Fixed rate senior debt, unsecured		
3.00% to 3.99%: until 2016	**1,258**	1,177
4.00% to 4.99%: until 2022	**4,945**	2,573
5.00% to 5.99%: until 2021	**2,990**	2,730
6.00% to 6.99%: until 2042	**2,075**	1,886
	11,268	8,366

30 Liabilities of disposal groups held for sale and other liabilities

Liabilities of disposal groups held for sale

	HSBC	
	2012	2011
	US$m	US$m
Liabilities of disposal groups held for sale[1]	**5,018**	22,200

1 *An analysis of liabilities of disposal groups held for sale is provided on page 471.*

Other liabilities

	HSBC		HSBC Holdings	
	2012	2011	**2012**	2011
	US$m	US$m	**US$m**	US$m
Amounts due to investors in funds consolidated by HSBC	**564**	720	**–**	–
Obligations under finance leases (Note 41)	**304**	428	**–**	–
Dividend declared and payable by HSBC Holdings (Note 10)	**–**	885	**–**	885
Endorsements and acceptances	**12,031**	11,009	**–**	–
Other liabilities	**20,963**	14,925	**30**	26
	33,862	27,967	**30**	911

31 Liabilities under insurance contracts

	Gross	**Reinsurers' share**	**Net**
	US$m	**US$m**	**US$m**
At 31 December 2012			
Non-life insurance liabilities			
Unearned premium provision	**34**	**(6)**	**28**
Notified claims	**29**	**(6)**	**23**
Claims incurred but not reported	**12**	**–**	**12**
Other	**6**	**(2)**	**4**
	81	**(14)**	**67**

Notes on the Financial Statements (continued)

31 – Liabilities under insurance contracts

Liabilities under insurance contracts (continued)

	Gross US$m	Reinsurers' share US$m	Net US$m
Brought forward	**81**	**(14)**	**67**
Life insurance liabilities to policyholders			
Life (non-linked)	**30,684**	**(938)**	**29,746**
Investment contracts with discretionary participation features[1]	**24,374**	**–**	**24,374**
Life (linked)	**13,056**	**(455)**	**12,601**
	68,114	**(1,393)**	**66,721**
	68,195	**(1,407)**	**66,788**
At 31 December 2011			
Non-life insurance liabilities			
Unearned premium provision	621	(112)	509
Notified claims	510	(91)	419
Claims incurred but not reported	449	(51)	398
Other	55	4	59
	1,635	(250)	1,385
Life insurance liabilities to policyholders			
Life (non-linked)	26,926	(649)	26,277
Investment contracts with discretionary participation features[1]	21,488	–	21,488
Life (linked)	11,210	(903)	10,307
	59,624	(1,552)	58,072
	61,259	(1,802)	59,457

1 *Though investment contracts with discretionary participation features are financial instruments, HSBC treats them as insurance contracts as permitted by IFRS 4.*

Movement on non-life insurance liabilities

	Gross US$m	Reinsurers' share US$m	Net US$m
2012			
Unearned premium reserve ('UPR')			
At 1 January	**621**	**(112)**	**509**
Changes in UPR recognised as (income)/expense	**44**	**3**	**47**
Gross written premiums	**760**	**(104)**	**656**
Gross earned premiums	**(716)**	**107**	**(609)**
Disposals	**(497)**	**91**	**(406)**
Exchange differences and other movements	**(134)**	**12**	**(122)**
At 31 December	**34**	**(6)**	**28**
Notified and incurred but not reported claims			
At 1 January	**959**	**(142)**	**817**
Notified claims	**510**	**(91)**	**419**
Claims incurred but not reported	**449**	**(51)**	**398**
Claims paid in current year	**(339)**	**57**	**(282)**
Claims incurred in respect of current year	**341**	**(53)**	**288**
Claims incurred in respect of prior years	**1**	**(5)**	**(4)**
Disposals	**(486)**	**137**	**(349)**
Exchange differences and other movements	**(435)**	**–**	**(435)**
At 31 December	**41**	**(6)**	**35**
Notified claims	**29**	**(6)**	**23**
Claims incurred but not reported	**12**	**–**	**12**
Other	**6**	**(2)**	**4**
Total non-life insurance liabilities	**81**	**(14)**	**67**

	Gross US$m	Reinsurers' share US$m	Net US$m
2011			
Unearned premium reserve ('UPR')			
At 1 January	727	(129)	598
Changes in UPR recognised as (income)/expense	31	(2)	29
Gross written premiums	1,175	(182)	993
Gross earned premiums	(1,144)	180	(964)
Exchange differences and other movements	(137)	19	(118)
At 31 December	621	(112)	509
Notified and incurred but not reported claims			
At 1 January	1,624	(305)	1,319
Notified claims	879	(230)	649
Claims incurred but not reported	745	(75)	670
Claims paid in current year	(631)	81	(550)
Claims incurred in respect of current year	481	(99)	382
Claims incurred in respect of prior years	(46)	14	(32)
Disposals	(317)	129	(188)
Exchange differences and other movements	(152)	38	(114)
At 31 December	959	(142)	817
Notified claims	510	(91)	419
Claims incurred but not reported	449	(51)	398
Other	55	4	59
Total non-life insurance liabilities	1,635	(250)	1,385

Life insurance liabilities to policyholders

	Gross US$m	**Reinsurers' share US$m**	**Net US$m**
2012			
Life (non-linked)			
At 1 January	**26,926**	**(649)**	**26,277**
Benefits paid	**(1,566)**	**160**	**(1,406)**
Increase in liabilities to policyholders	**6,558**	**(479)**	**6,079**
Exchange differences and other movements	**(1,234)**	**30**	**(1,204)**
At 31 December	**30,684**	**(938)**	**29,746**
Investment contracts with discretionary participation features			
At 1 January	**21,488**	**–**	**21,488**
Benefits paid	**(2,525)**	**–**	**(2,525)**
Increase in liabilities to policyholders	**3,645**	**–**	**3,645**
Exchange differences and other movements[1]	**1,766**	**–**	**1,766**
At 31 December	**24,374**	**–**	**24,374**
Life (linked)			
At 1 January	**11,210**	**(903)**	**10,307**
Benefits paid	**(1,810)**	**681**	**(1,129)**
Increase in liabilities to policyholders	**3,984**	**223**	**4,207**
Exchange differences and other movements[2]	**(328)**	**(456)**	**(784)**
At 31 December	**13,056**	**(455)**	**12,601**
Total liabilities to policyholders	**68,114**	**(1,393)**	**66,721**

Life insurance liabilities to policyholders (continued)

	Gross US$m	Reinsurers' share US$m	Net US$m
2011			
Life (non-linked)			
At 1 January	23,583	(673)	22,910
Benefits paid	(1,793)	164	(1,629)
Increase in liabilities to policyholders	5,729	(254)	5,475
Exchange differences and other movements	(593)	114	(479)
At 31 December	26,926	(649)	26,277
Investment contracts with discretionary participation features			
At 1 January	22,074	–	22,074
Benefits paid	(2,628)	–	(2,628)
Increase in liabilities to policyholders	3,005	–	3,005
Exchange differences and other movements[1]	(963)	–	(963)
At 31 December	21,488	–	21,488
Life (linked)			
At 1 January	10,496	(760)	9,736
Benefits paid	(1,129)	56	(1,073)
Increase in liabilities to policyholders	2,462	(111)	2,351
Exchange differences and other movements[2]	(619)	(88)	(707)
At 31 December	11,210	(903)	10,307
Total liabilities to policyholders	59,624	(1,552)	58,072

1 *Includes movement in liabilities relating to discretionary profit participation benefits due to policyholders arising from net unrealised investment gains recognised in other comprehensive income.*
2 *Includes amounts arising under reinsurance agreements.*

The increase in liabilities to policyholders represents the aggregate of all events giving rise to additional liabilities to policyholders in the year. The key factors contributing to the movement in liabilities to policyholders include death claims, surrenders, lapses, liabilities to policyholders created at the initial inception of the policies, the declaration of bonuses and other amounts attributable to policyholders.

32 Provisions

	Restructuring costs US$m	Contingent liabilities and contractual commitments US$m	Legal proceedings and regulatory matters US$m	Customer remediation US$m	Other provisions US$m	Total US$m
At 1 January 2012	**169**	**206**	**1,473**	**1,067**	**409**	**3,324**
Additional provisions/increase in provisions	**434**	**73**	**2,779**	**2,473**	**376**	**6,135**
Provisions utilised	**(320)**	**(2)**	**(2,510)**	**(1,022)**	**(153)**	**(4,007)**
Amounts reversed	**(89)**	**(58)**	**(104)**	**(137)**	**(63)**	**(451)**
Unwinding of discounts	**–**	**–**	**42**	**1**	**5**	**48**
Exchange differences and other movements	**57**	**82**	**(13)**	**5**	**72**	**203**
At 31 December 2012	**251**	**301**	**1,667**	**2,387**	**646**	**5,252**
At 1 January 2011	21	405	969	442	301	2,138
Additional provisions/increase in provisions	221	14	896	1,078	184	2,393
Provisions utilised	(58)	(5)	(367)	(386)	(71)	(887)
Amounts reversed	(14)	(41)	(28)	(87)	(86)	(256)
Unwinding of discounts	–	1	56	–	5	62
Exchange differences and other movements	(1)	(168)	(53)	20	76	(126)
At 31 December 2011	169	206	1,473	1,067	409	3,324

Further details of legal proceedings and regulatory matters are set out in Note 43. Legal proceedings include civil court, arbitration or tribunal proceedings brought against HSBC companies (whether by way of claim or counterclaim) or civil disputes that may, if not settled, result in court, arbitration or tribunal proceedings. Regulatory matters refer to investigations, reviews and other actions carried out by, or in response to the actions of, regulators or law enforcement agencies in connection with alleged wrongdoing by HSBC. In December 2012, HSBC made payments totalling US$1,921m to US authorities in relation to investigations regarding inadequate compliance with anti-money laundering and sanctions laws. Further details of the agreements reached with the US authorities are set out on page 510.

Customer remediation refers to activities carried out by HSBC to compensate customers for losses or damages associated with a failure to comply with regulations or to treat customers fairly. Customer remediation is initiated by HSBC in response to customer complaints and/or industry developments in sales practices, and not necessarily initiated by regulatory action.

Payment protection insurance

An increase in provisions of US$1,681m was recognised during the year 2012 in respect of the estimated liability for redress regarding the mis-selling of payment protection insurance (‘PPI’) policies in previous years. Cumulative provisions made since the Judicial Review ruling in 2011 amount to US$2,397m, of which US$957m has been paid in 2012 (2011: US$325m). At 31 December 2012, the provision amounted to US$1,321m (2011: US$506m).

The estimated liability for redress is calculated based on the total premiums paid by the customer plus simple interest of 8% per annum (or the rate inherent in the related loan product where higher). The basis for calculating the redress liability is the same for single premium and regular premium policies. Future estimated redress levels are based on historically observed redress per policy.

A total of 5.4 million PPI policies have been sold by HSBC since 2000, which generated estimated revenues of US$4.1bn at 2012 average exchange rates. The gross written premiums on these polices was approximately US$5.1bn at 2012 average exchange rates. At 31 December 2012, the estimated total complaints expected to be received was 1.4 million, representing 25% of total policies sold. It is estimated that contact will be made with regard to 1.8 million policies, representing 33% of total policies sold. This estimate includes inbound complaints as well as HSBC’s proactive contact exercise on certain policies (‘outbound contact’).

During 2012, we increased the estimate of the total number of policies to be ultimately redressed, as the level of complaints received was higher in volume and over a more sustained period than previously assumed. This change in assumptions contributed approximately US$1.2bn to the increased provision for the year with the balance consisting of US$0.2bn attributable to regulatory changes and US$0.3bn other assumption and model changes.

The following table details the cumulative number of complaints received at 31 December 2012 and the number of claims expected in the future:

	Cumulative to 31 December 2012	Future expected
Inbound complaints[1] (000s of policies)	801	348
Outbound contact (000s of policies)	43	547
Response rate to outbound contact	37%	38%
Average uphold rate per claim[2]	78%	79%
Average redress per claim (US$)	2,325	2,290

1 *Excludes invalid claims where the complainant has not held a PPI policy.*
2 *Claims include inbound and responses to outbound contact.*

The main assumptions involved in calculating the redress liability are the volume of inbound complaints, the projected period of inbound complaints, the decay rate of complaint volumes, the population identified as systemically mis-sold and the number of policies per customer complaint. The main assumptions are likely to evolve over time as root cause analysis continues, more experience is available regarding customer initiated complaint volumes received, and we handle responses to our ongoing outbound contact.

A 100,000 increase/decrease in the total inbound complaints would increase/decrease the redress provision by approximately US$180m. Each 1% increase/decrease in the response rate to our outbound contact exercise would increase/decrease the redress provision by approximately US$10m.

In addition to these factors and assumptions, the extent of the required redress 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.

Interest rate derivatives

A provision of US$598m was recognised relating to the estimated liability for redress in respect of the possible mis-selling of interest rate derivatives in the UK. Of this provision, US$272m related to the estimated redress payable to customers in respect of historical payments under derivative contracts, US$254m covered the expected write-off by the bank of open derivative contracts balances, and US$72m covers estimated project costs.

Following an FSA review of the sale of interest rate derivatives, HSBC agreed to pay redress to customers where mis-selling of these products has occurred under the FSA's criteria. On 31 January 2013, the FSA announced the findings from their review of pilot cases completed by the banks. Following its review, the FSA clarified the eligibility criteria to ensure the programme is focused on those small businesses that were unlikely to understand the risks associated with those products. HSBC has also been working with the FSA and an independent 'skilled person' adviser to clarify the standards against which it should assess sales, and how redress should be calculated (for example, when it would be appropriate to assume a customer would have taken an alternative interest rate product).

The extent to which HSBC is required to pay redress depends on the responses of contacted and other customers during the review period and the facts and circumstances of each individual case. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress related to this programme.

Brazilian labour, civil and fiscal claims

Within 'legal proceedings and regulatory matters' above are labour, civil and fiscal litigation provisions of US$506m (2011: US$481m) which includes provisions in respect of labour and overtime litigation claims brought by past employees against HSBC operations in Brazil following their departure from the bank. The main assumptions involved in estimating the liability are the expected number of departing employees, individual salary levels and the facts and circumstances of each individual case.

33 Subordinated liabilities

HSBC

	At 31 December	
	2012	2011
	US$m	US$m
Subordinated liabilities		
At amortised cost	**29,479**	30,606
– subordinated liabilities	**25,119**	25,543
– preferred securities	**4,360**	5,063
Designated at fair value (Note 28)	**21,559**	21,611
– subordinated liabilities	**16,863**	17,503
– preferred securities	**4,696**	4,108
	51,038	52,217
Subordinated liabilities		
HSBC Holdings	**20,569**	21,456
Other HSBC	**30,469**	30,761
	51,038	52,217

Subordinated liabilities are capital securities which have been included in the capital base of HSBC and were issued in accordance with the rules and guidance in the FSA's General Prudential Sourcebook ('GENPRU'). Where applicable, these capital securities may be called and redeemed by HSBC subject to prior notification to the FSA and, where relevant, the consent of the local banking regulator. If not redeemed at the first call date, interest coupons payable may step-up or become floating rate related to interbank rates, and in some cases may be subject to a floor.

Interest rates on the floating rate capital securities are generally related to interbank offered rates. On the remaining capital securities, interest is payable at fixed rates of up to 10.176%.

The balance sheet amounts disclosed below are presented on an IFRSs basis and do not reflect the amount that the instruments contribute to regulatory capital. The IFRSs accounting and regulatory treatments differ due to the inclusion of issuance costs and regulatory amortisation.

HSBC's subordinated liabilities

Tier 1 capital securities

Tier 1 capital securities are perpetual subordinated securities on which investors are entitled, subject to certain conditions, to receive distributions which are non-cumulative. Such securities do not generally carry voting rights but rank above ordinary shares for coupon payments and in the event of a winding-up.

HSBC has the following qualifying tier 1 capital securities in issue which are accounted for as liabilities:

		First call date	At 31 December 2012 US$m	2011 US$m
Tier 1 capital securities guaranteed by HSBC Holdings[1]				
€600m	8.03% non-cumulative step-up perpetual preferred securities[2]	Jun 2012	**–**	776
US$1,250m	4.61% non-cumulative step-up perpetual preferred securities	Jun 2013	**1,250**	1,163
€1,400m	5.3687% non-cumulative step-up perpetual preferred securities	Mar 2014	**1,933**	1,693
£500m	8.208% non-cumulative step-up perpetual preferred securities	Jun 2015	**806**	771
€750m	5.13% non-cumulative step-up perpetual preferred securities	Mar 2016	**1,033**	872
US$900m	10.176% non-cumulative step-up perpetual preferred securities, series 2	Jun 2030	**891**	891
			5,913	6,166
Tier 1 capital securities guaranteed by HSBC Bank plc[1]				
£300m	5.862% non-cumulative step-up perpetual preferred securities	Apr 2020	**480**	378
£700m	5.844% non-cumulative step-up perpetual preferred securities	Nov 2031	**1,131**	1,084
			1,611	1,462

1 *See paragraph below, 'Guaranteed by HSBC Holdings or HSBC Bank plc'.*
2 *In June 2012, HSBC redeemed these securities at par.*

Guaranteed by HSBC Holdings or HSBC Bank plc

The five capital securities guaranteed, on a subordinated basis, by HSBC Holdings and the two capital securities guaranteed, on a subordinated basis, by HSBC Bank are non-cumulative step-up perpetual preferred securities issued by Jersey limited partnerships. The proceeds of the issues were on-lent to the respective guarantor by the limited partnerships in the form of subordinated notes. The above preferred securities qualify as tier 1 capital for HSBC Group and the two capital securities guaranteed by HSBC Bank also qualify as tier 1 capital for HSBC Bank (on a solo and consolidated basis).

These preferred securities, together with the guarantee, are intended to provide investors with rights to income and capital distributions, and distributions upon liquidation of the relevant issuer that are equivalent to the rights that they would have had if they had purchased non-cumulative perpetual preference shares of the relevant issuer.

There are limitations on the payment of distributions if such payments are prohibited under UK banking regulations or other requirements, if a payment would cause a breach of HSBC's capital adequacy requirements, or if HSBC Holdings or HSBC Bank has insufficient distributable reserves (as defined) respectively.

HSBC Holdings and HSBC Bank have individually covenanted that if prevented under certain circumstances from paying distributions on the preferred securities in full, they will not pay dividends or other distributions in respect of its ordinary shares, or effect repurchases or redemptions of its ordinary shares, until the distribution on preferred securities has been paid in full.

With respect to preferred securities guaranteed by HSBC Holdings – if (i) HSBC's total capital ratio falls below the regulatory minimum ratio required, or (ii) the Directors expect that, in view of the deteriorating financial condition of HSBC Holdings, that (i) will occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Holdings which have economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

With respect to preferred securities guaranteed by HSBC Bank – if (i) any of the two issues of preferred securities are outstanding in April 2049 or November 2048, respectively, or (ii) the total capital ratio of HSBC Bank on a solo and

Notes on the Financial Statements (continued)

consolidated basis falls below the regulatory minimum ratio required, or (iii) in view of the deteriorating financial condition of HSBC Bank, the Directors expect (ii) to occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Bank having economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

Upper tier 2 capital securities

Upper tier 2 capital securities are perpetual subordinated securities on which there is an obligation to pay coupons. Such securities rank below lower tier 2 securities for coupon payments and in the event of a winding-up.

HSBC has the following qualifying upper tier 2 securities in issue:

		First call date	At 31 December 2012 US$m	At 31 December 2011 US$m
HSBC Bank plc				
US$750m	Undated floating rate primary capital notes	Jun 1990	**750**	750
US$500m	Undated floating rate primary capital notes	Sep 1990	**499**	500
US$300m	Undated floating rate primary capital notes, series 3	Jun 1992	**301**	300
			1,550	1,550
The Hongkong and Shanghai Banking Corporation Ltd				
US$400m	Primary capital undated floating rate notes	Aug 1990	**405**	406
US$400m	Primary capital undated floating rate notes (second series)	Dec 1990	**402**	403
US$400m	Primary capital undated floating rate notes (third series)	Aug 1991	**400**	400
			1,207	1,209
Other HSBC subsidiaries				
	Other perpetual subordinated loan capital less than US$100m		**21**	21

Lower tier 2 capital securities

Lower tier 2 capital securities are dated securities on which there is an obligation to pay coupons. In accordance with the FSA's GENPRU, the capital contribution of lower tier 2 securities is amortised for regulatory purposes on a straight-line basis in their final five years before maturity.

HSBC has the following qualifying lower tier 2 securities in issue:

		First call date	Maturity date	At 31 December 2012 US$m	At 31 December 2011 US$m
HSBC Bank plc					
£350m	Callable subordinated variable coupon notes[1]	Jun 2012	Jun 2017	**–**	550
£500m	4.75% callable subordinated notes[2]	Sep 2015	Sep 2020	**844**	759
£350m	5.00% callable subordinated notes[3]	Mar 2018	Mar 2023	**630**	533
£300m	6.50% subordinated notes	–	Jul 2023	**483**	463
£350m	5.375% callable subordinated step-up notes[4]	Nov 2025	Nov 2030	**630**	493
£500m	5.375% subordinated notes	–	Aug 2033	**925**	678
£225m	6.25% subordinated notes	–	Jan 2041	**362**	346
£600m	4.75% subordinated notes	–	Mar 2046	**958**	917
€500m	Callable subordinated floating rate notes[5]	Sep 2015	Sep 2020	**606**	550
US$300m	7.65% subordinated notes	–	May 2025	**394**	374
				5,832	5,663
Hang Seng Bank Limited					
US$300m	Callable subordinated floating rate notes[1]	Jul 2012	Jul 2017	**–**	300
				–	300
HSBC Bank Australia Limited					
AUD200m	Callable subordinated floating rate notes	Nov 2015	Nov 2020	**207**	203
AUD42m	Callable subordinated floating rate notes[6]	Mar 2013	Mar 2018	**44**	42
				251	245
HSBC Bank Malaysia Berhad					
MYR500m	4.35% subordinated bonds	Jun 2017	Jun 2022	**164**	158
MYR500m	5.05% subordinated bonds	Nov 2022	Nov 2027	**168**	162
				332	320

		First call date	Maturity date	At 31 December 2012 US$m	2011 US$m
HSBC USA Inc.					
US$200m	7.808% capital securities	Dec 2006	Dec 2026	**200**	200
US$200m	8.38% capital securities	May 2007	May 2027	**200**	200
US$150m	9.50% subordinated debt	–	Apr 2014	**152**	154
US$150m	7.75% Capital Trust pass through securities	Nov 2016	Nov 2026	**150**	150
US$750m	5.00% subordinated notes	–	Sep 2020	**745**	744
US$250m	7.20% subordinated debentures	–	Jul 2097	**214**	214
	Other subordinated liabilities each less than US$150m			**302**	394
				1,963	2,056
HSBC Bank USA, N.A.					
US$1,000m	4.625% subordinated notes	–	Apr 2014	**1,002**	1,009
US$500m	6.00% subordinated notes	–	Aug 2017	**516**	505
US$1,250m	4.875% subordinated notes	–	Aug 2020	**1,263**	1,259
US$1,000m	5.875% subordinated notes	–	Nov 2034	**1,151**	951
US$750m	5.625% subordinated notes	–	Aug 2035	**864**	712
US$700m	7.00% subordinated notes	–	Jan 2039	**694**	681
				5,490	5,117
HSBC Finance Corporation					
US$1,000m	5.911% trust preferred securities[7]	Nov 2015	Nov 2035	**995**	994
US$2,939m	6.676% senior subordinated notes[8]	–	Jan 2021	**2,180**	2,177
				3,175	3,171
HSBC Bank Brazil S.A.					
BRL383m	Subordinated certificates of deposit	–	Feb 2015	**289**	206
BRL500m	Subordinated floating rate certificates of deposit	–	Dec 2016	**464**	268
	Other subordinated liabilities each less than US$150m[9]			**491**	1,156
				1,244	1,630
HSBC Mexico, S.A.					
MXN1,818m	Non-convertible subordinated obligations[10]	–	Sep 2018	**139**	130
MXN2,273m	Non-convertible subordinated obligations[10]	–	Dec 2018	**173**	162
US$300m	Non-convertible subordinated obligations[10,11]	–	Jun 2019	**240**	232
				552	524
HSBC Bank Canada					
CAD400m	4.80% subordinated notes	Apr 2017	Apr 2022	**438**	417
CAD200m	4.94% subordinated debentures	–	Mar 2021	**201**	195
CAD39m	Floating rate debentures	–	Nov 2083	**39**	39
				678	651
Other HSBC subsidiaries					
	Other subordinated liabilities each less than US$200m[9]			**650**	676
				650	676
Total of subordinated liabilities issued by HSBC subsidiaries				**30,469**	30,761
Amounts owed to third parties by HSBC Holdings (page 480)				**20,569**	21,456
				51,038	52,217

1 *In June2012 and July 2012, HSBC redeemed its £350m callable subordinated variable coupon note and its US$300m callable subordinated floating rate notes respectively at par.*
2 *The interest rate payable after September 2015 is the sum of the three-month sterling Libor plus 0.82%.*
3 *The interest rate payable after March 2018 is the sum of the gross redemption yield of the then prevailing five-year UK gilt plus 1.80%.*
4 *The interest rate payable after November 2025 is the sum of the three-month sterling Libor plus 1.50%.*
5 *The interest margin increases by 0.5% from September 2015.*
6 *In February 2013, HSBC gave notice that it will call and redeem the notes at par in March 2013.*
7 *The distributions change in November 2015 to three-month dollar Libor plus 1.926%.*
8 *Approximately 25% of the senior subordinated notes is held by HSBC Holdings.*
9 *Some securities included here are ineligible for inclusion in the capital base of HSBC in accordance with guidance in FSA's GENPRU.*
10 *These securities are ineligible for inclusion in the capital base of HSBC in accordance with FSA's GENPRU.*
11 *Approximately US$60m of the subordinated obligations are held by HSBC Holdings.*

Notes on the Financial Statements (continued)

33 – Subordinated liabilities / 34 – Maturity analysis

HSBC Holdings

	At 31 December 2012 US$m	2011 US$m
Subordinated liabilities:		
– at amortised cost	**11,907**	12,450
– designated at fair value (Note 28)	**14,618**	15,398
	26,525	27,848

HSBC Holdings' subordinated liabilities

		First call date	Maturity date	At 31 December 2012 US$m	2011 US$m
Amounts owed to third parties[1]					
US$1,400m	5.25% subordinated notes	–	Dec 2012	**–**	1,438
US$488m	7.625% subordinated notes	–	May 2032	**579**	578
US$222m	7.35% subordinated notes	–	Nov 2032	**258**	257
US$2,000m	6.5% subordinated notes	–	May 2036	**2,034**	2,048
US$2,500m	6.5% subordinated notes	–	Sep 2037	**3,202**	2,634
US$1,500m	6.8% subordinated notes	–	Jun 2038	**1,486**	1,486
£250m	9.875% subordinated bonds[2]	Apr 2013	Apr 2018	**442**	445
£900m	6.375% callable subordinated notes[3]	Oct 2017	Oct 2022	**1,648**	1,416
£650m	5.75% subordinated notes	–	Dec 2027	**1,210**	926
£650m	6.75% subordinated notes	–	Sep 2028	**1,041**	997
£750m	7.0% subordinated notes	–	Apr 2038	**1,264**	1,205
£900m	6.0% subordinated notes	–	Mar 2040	**1,431**	1,369
€1,000m	5.375% subordinated notes	–	Dec 2012	**–**	1,327
€1,600m	6.25% subordinated notes	–	Mar 2018	**2,118**	2,073
€1,750m	6.0% subordinated notes	–	Jun 2019	**2,882**	2,388
€700m	3.625% callable subordinated notes[4]	Jun 2015	Jun 2020	**974**	869
				20,569	21,456
Amounts owed to HSBC undertakings					
€600m	8.03% subordinated step-up cumulative notes[5]	Jun 2012	Jun 2040	**–**	775
US$1,250m	4.61% fixed/floating subordinated notes	Jun 2013	Jun 2043	**1,264**	1,223
€1,400m	5.3687% fixed/floating subordinated notes	Mar 2014	Dec 2043	**1,952**	1,791
£500m	8.208% subordinated step-up cumulative notes	Jun 2015	Jun 2040	**806**	771
€750m	5.13% fixed/floating subordinated notes	Mar 2016	Dec 2044	**1,043**	941
US$900m	10.176% subordinated step-up cumulative notes	Jun 2030	Jun 2040	**891**	891
				5,956	6,392
				26,525	27,848

1 *Amounts owed to third parties represent securities included in the capital base of HSBC as lower tier 2 securities in accordance with guidance in the FSA's GENPRU.*
2 *In February 2013, HSBC Holdings gave notice that it will call and redeem the bonds at par in April 2013.*
3 *The interest rate payable after October 2017 is the sum of the three-month sterling Libor plus 1.3%.*
4 *The interest rate payable after June 2015 is the sum of the three-month Euribor plus 0.93%.*
5 *In June 2012, HSBC Holdings redeemed its €600m 8.03% subordinated step-up cumulative notes at par.*

34 Maturity analysis of assets, liabilities and off-balance sheet commitments

The table on page 486 provides an analysis of consolidated total assets, liabilities and off-balance sheet commitments by residual contractual maturity at the balance sheet date. Asset and liability balances are included in the maturity analysis as follows:

- except for reverse repos, repos and debt securities in issue, trading assets and liabilities (including trading derivatives) are included in the 'Due less than one month' time bucket, and not by contractual maturity because trading balances are typically held for short periods of time;
- financial assets and liabilities with no contractual maturity (such as equity securities) are included in the 'Due over five years' time bucket. Undated or perpetual instruments are classified based on the contractual notice period which the counterparty of the instrument is entitled to give. Where there is no contractual notice period, undated or perpetual contracts are included in the 'Due over five years' time bucket;
- non financial assets and liabilities with no contractual maturity (such as property, plant and equipment, goodwill and intangible assets, current and deferred tax assets and liabilities and retirement benefit liabilities) are included in the 'Due over five years' time bucket;
- financial instruments included within assets and liabilities of disposal groups held for sale are classified on the basis of the contractual maturity of the underlying instruments and not on the basis of the disposal transaction; and
- liabilities under insurance contracts are included in the 'Due over five years' time bucket. Liabilities under investment contracts are classified in accordance with their contractual maturity. Undated investment contracts are classified based on the contractual notice period investors are entitled to give. Where there is no contractual notice period, undated contracts are included in the 'Due over five years' time bucket.

Loan and other credit-related commitments are classified on the basis of the earliest date they can be drawn down.

Notes on the Financial Statements (continued)

34 - Maturity analysis

Maturity analysis of assets and liabilities

	At 31 December 2012								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial assets									
Cash and balances at central banks	141,532	–	–	–	–	–	–	–	141,532
Items in the course of collection from other banks	7,303	–	–	–	–	–	–	–	7,303
Hong Kong Government certificates of indebtedness	22,743	–	–	–	–	–	–	–	22,743
Trading assets	382,654	12,506	9,829	248	3,169	405	–	–	408,811
– Reverse repos	92,525	12,506	9,829	248	3,169	405	–	–	118,682
– Other trading assets	290,129	–	–	–	–	–	–	–	290,129
Financial assets designated at fair value	437	576	425	526	239	2,462	3,545	25,372	33,582
Derivatives	354,222	65	252	22	227	596	1,127	939	357,450
– Trading	353,803	–	–	–	–	–	–	–	353,803
– Non-trading	419	65	252	22	227	596	1,127	939	3,647
Loans and advances to banks	104,397	22,683	5,859	2,292	5,032	6,238	2,027	4,018	152,546
– Reverse repos	28,833	3,101	2,071	356	963	138	–	–	35,462
– Other loans and advances to banks	75,564	19,582	3,788	1,936	4,069	6,100	2,027	4,018	117,084
Loans and advances to customers	221,242	69,709	47,507	29,659	71,928	59,100	194,147	304,331	997,623
– Personal	49,042	8,578	7,242	6,763	9,547	17,696	66,684	241,329	406,881
– Corporate and commercial	138,999	49,166	35,463	19,334	53,766	38,070	119,330	55,910	510,038
– Financial	33,201	11,965	4,802	3,562	8,615	3,334	8,133	7,092	80,704
Of which:									
– Reverse repos	19,847	10,640	2,310	1,050	554	250	–	–	34,651
Financial investments	28,085	51,339	33,996	14,072	26,478	61,443	93,127	112,561	421,101
Assets held for sale	4,953	298	515	125	669	519	1,079	9,964	18,122
Accrued income	2,776	2,325	739	493	542	164	217	1,284	8,540
Other financial assets	13,383	3,486	1,759	337	745	332	372	3,170	23,584
Total financial assets	1,283,727	162,987	100,881	47,774	109,029	131,259	295,641	461,639	2,592,937
Non financial assets	–	–	–	–	–	–	–	99,601	99,601
Total assets	1,283,727	162,987	100,881	47,774	109,029	131,259	295,641	561,240	2,692,538

	At 31 December 2012								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial liabilities									
Hong Kong currency notes in circulation	22,742	–	–	–	–	–	–	–	22,742
Deposits by banks	79,100	12,029	1,957	437	2,155	1,695	9,440	616	107,429
– Repos	6,593	4,645	711	–	–	–	–	–	11,949
– Other deposits by banks	72,507	7,384	1,246	437	2,155	1,695	9,440	616	95,480
Customer accounts[1]	1,193,736	67,638	34,010	11,939	16,019	7,034	8,985	653	1,340,014
– Personal	539,792	35,260	21,939	7,900	11,100	4,687	3,916	307	624,901
– Corporate and commercial	473,370	24,018	9,044	2,925	3,354	1,069	1,193	305	515,278
– Financial	180,574	8,360	3,027	1,114	1,565	1,278	3,876	41	199,835
Of which: repos	22,446	3,869	1,047	345	567	344	–	–	28,618
Items in the course of transmission to other banks	7,131	7	–	–	–	–	–	–	7,138
Trading liabilities	240,212	29,003	4,707	1,820	5,197	3,867	9,736	10,021	304,563
– Repos	96,690	27,002	3,319	985	2,227	–	–	–	130,223
– Debt securities in issue	380	2,001	1,388	835	2,970	3,867	9,736	10,021	31,198
– Other trading liabilities	143,142	–	–	–	–	–	–	–	143,142
Financial liabilities designated at fair value	427	81	2,068	2,163	1,605	2,916	28,902	49,558	87,720
– Debt securities in issue: covered bonds	–	–	–	–	–	–	4,633	–	4,633
– Debt securities in issue: otherwise secured	–	8	2,023	–	22	2,040	228	221	4,542
– Debt securities in issue: unsecured	392	49	1	2,117	1,357	690	23,495	15,933	44,034
– Subordinated liabilities and preferred securities	–	–	–	–	–	–	21	21,538	21,559
– Other	35	24	44	46	226	186	525	11,866	12,952
Derivatives	352,696	75	43	29	2,408	628	1,212	1,795	358,886
– Trading	352,195	–	–	–	–	–	–	–	352,195
– Non-trading	501	75	43	29	2,408	628	1,212	1,795	6,691
Debt securities in issue	23,738	12,368	6,355	2,840	27,992	11,992	29,100	5,076	119,461
– Covered bonds	–	–	1,133	422	757	2,328	1,920	486	7,046
– Otherwise secured	14,598	1,894	–	184	753	1,634	5,779	950	25,792
– Unsecured	9,140	10,474	5,222	2,234	26,482	8,030	21,401	3,640	86,623
Liabilities of disposal groups held for sale	2,475	242	433	254	188	166	45	–	3,803
Accruals	3,369	4,173	907	521	1,200	232	419	842	11,663
Subordinated liabilities	32	44	–	10	–	1,481	1,516	26,396	29,479
Other financial liabilities	19,837	4,881	2,115	519	867	599	1,409	2,190	32,417
Total financial liabilities	1,945,495	130,541	52,595	20,532	57,631	30,610	90,764	97,147	2,425,315
Non financial liabilities	–	–	–	–	–	–	–	84,094	84,094
Total liabilities	1,945,495	130,541	52,595	20,532	57,631	30,610	90,764	181,241	2,509,409

Notes on the Financial Statements (continued)

34 – Maturity analysis

Maturity analysis of assets and liabilities (continued)

	At 31 December 2011								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial assets									
Cash and balances at central banks	129,902	–	–	–	–	–	–	–	129,902
Items in the course of collection from other banks	8,208	–	–	–	–	–	–	–	8,208
Hong Kong Government certificates of indebtedness	20,922	–	–	–	–	–	–	–	20,922
Trading assets	318,031	7,432	1,712	225	3,033	18	–	–	330,451
– Reverse repos	67,428	7,432	1,712	225	3,033	18	–	–	79,848
– Other trading assets	250,603	–	–	–	–	–	–	–	250,603
Financial assets designated at fair value	595	565	687	595	139	2,748	4,145	21,382	30,856
Derivatives	343,980	155	275	136	423	606	605	199	346,379
– Trading	342,914	–	–	–	–	–	–	–	342,914
– Non-trading	1,066	155	275	136	423	606	605	199	3,465
Loans and advances to banks	123,370	25,288	5,460	2,573	14,441	3,120	3,346	3,389	180,987
– Reverse repos	35,372	3,854	–	1,047	135	1,301	201	–	41,910
– Other loans and advances to banks	87,998	21,434	5,460	1,526	14,306	1,819	3,145	3,389	139,077
Loans and advances to customers	211,680	70,941	45,294	28,769	53,251	63,518	186,601	280,375	940,429
– Personal	47,609	8,314	6,912	5,975	7,674	19,005	66,525	221,851	383,865
– Corporate and commercial	123,130	49,856	34,082	17,304	38,875	39,467	112,270	56,061	471,045
– Financial	40,941	12,771	4,300	5,490	6,702	5,046	7,806	2,463	85,519
Of which:									
– Reverse repos	23,704	10,450	2,306	3,710	–	250	1,000	–	41,420
Financial investments	25,546	50,070	39,698	14,879	21,902	45,266	90,953	111,730	400,044
Assets held for sale	4,922	5,767	4,427	3,233	2,934	7,223	7,064	2,238	37,808
Accrued income	2,787	2,479	765	393	361	231	339	1,596	8,951
Other financial assets	8,878	3,403	2,084	785	2,771	513	140	5,466	24,040
Total financial assets	1,198,821	166,100	100,402	51,588	99,255	123,243	293,193	426,375	2,458,977
Non financial assets	–	–	–	–	–	–	–	96,602	96,602
Total assets	1,198,821	166,100	100,402	51,588	99,255	123,243	293,193	522,977	2,555,579

	At 31 December 2011								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial liabilities									
Hong Kong currency notes in circulation	20,922	–	–	–	–	–	–	–	20,922
Deposits by banks	84,091	12,056	2,145	1,406	1,673	1,681	8,938	832	112,822
– Repos	16,301	336	–	979	–	–	–	–	17,616
– Other deposits by banks	67,790	11,720	2,145	427	1,673	1,681	8,938	832	95,206
Customer accounts[1]	1,054,843	84,853	35,792	16,650	22,052	12,982	25,362	1,391	1,253,925
– Personal	488,966	40,522	19,917	6,433	14,057	6,214	12,260	723	589,092
– Corporate and commercial	405,015	32,088	12,754	9,148	3,933	5,484	8,272	599	477,293
– Financial	160,862	12,243	3,121	1,069	4,062	1,284	4,830	69	187,540
Of which: repos	13,299	6,921	3,444	5,330	1,412	379	–	–	30,785
Items in the course of transmission to other banks	8,745	–	–	–	–	–	–	–	8,745
Trading liabilities	228,365	7,757	1,782	726	6,794	4,185	8,418	7,165	265,192
– Repos	77,900	6,056	716	–	2,160	6	–	–	86,838
– Debt securities in issue	2,098	1,701	1,066	726	4,634	4,179	8,418	7,165	29,987
– Other trading liabilities	148,367	–	–	–	–	–	–	–	148,367
Financial liabilities designated at fair value	39	22	2,846	430	5,923	4,575	24,857	47,032	85,724
– Debt securities in issue: covered bonds	–	–	–	–	2	–	2,263	374	2,639
– Debt securities in issue: otherwise secured	–	–	–	–	–	2,164	2,013	109	4,286
– Debt securities in issue: unsecured	–	–	2,802	385	3,115	2,093	20,091	16,786	45,272
– Subordinated liabilities and preferred securities	–	–	–	–	2,765	1	17	18,828	21,611
– Other	39	22	44	45	41	317	473	10,935	11,916
Derivatives	339,092	103	68	19	144	389	1,202	4,363	345,380
– Trading	338,788	–	–	–	–	–	–	–	338,788
– Non-trading	304	103	68	19	144	389	1,202	4,363	6,592
Debt securities in issue	31,806	15,900	4,920	5,577	15,926	14,438	36,120	6,326	131,013
– Covered bonds	4	627	383	52	1,548	2,277	4,133	1,119	10,143
– Otherwise secured	17,869	5,293	273	387	392	704	3,894	2,171	30,983
– Unsecured	13,933	9,980	4,264	5,138	13,986	11,457	28,093	3,036	89,887
Liabilities of disposal groups held for sale	16,412	1,164	462	225	2,536	343	297	561	22,000
Accruals	3,141	4,921	1,142	443	707	415	384	646	11,799
Subordinated liabilities	129	–	–	300	381	10	3,026	26,760	30,606
Other financial liabilities	12,403	5,415	2,419	835	1,576	814	626	1,823	25,911
Total financial liabilities	1,799,988	132,191	51,576	26,611	57,712	39,832	109,230	96,899	2,314,039
Non financial liabilities	–	–	–	–	–	–	–	75,447	75,447
Total liabilities	1,799,988	132,191	51,576	26,611	57,712	39,832	109,230	172,346	2,389,486

1 *Includes US$366,203m (2011: US$387,655m) insured by guarantee schemes*

Notes on the Financial Statements (continued)

34 – Maturity analysis

Maturity analysis of off-balance sheet commitments received

	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
At 31 December 2012									
Loan and other credit-related commitments	**2,455**	**3**	**8**	**5**	**8**	**25**	**75**	**98**	**2,677**
At 31 December 2011									
Loan and other credit-related commitments	5,280	2	36	3	6	19	508	143	5,997

Maturity analysis of off-balance sheet commitments given

	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
At 31 December 2012									
Loan and other credit-related commitments	**408,815**	**43,394**	**8,389**	**5,191**	**37,751**	**11,598**	**45,910**	**18,421**	**579,469**
Of which:									
– Personal	**153,255**	**6,999**	**704**	**185**	**19,049**	**1,216**	**1,616**	**8,159**	**191,183**
– Corporate and commercial	**225,899**	**34,368**	**6,365**	**4,951**	**15,412**	**9,488**	**37,179**	**8,593**	**342,255**
– Financial	**29,661**	**2,027**	**1,320**	**55**	**3,290**	**894**	**7,115**	**1,669**	**46,031**
At 31 December 2011									
Loan and other credit-related commitments	373,426	47,187	20,076	35,673	38,368	32,230	78,831	29,113	654,904
Of which:									
– Personal	246,570	7,569	2,124	4,848	4,431	7,507	12,262	7,706	293,017
– Corporate and commercial	114,741	36,866	15,289	19,589	25,890	20,767	57,853	18,281	309,276
– Financial	12,115	2,752	2,663	11,236	8,047	3,956	8,716	3,126	52,611

Maturity analysis of assets, liabilities and off-balance sheet commitments

	At 31 December 2012								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial assets									
Cash at bank and in hand:									
– balances with HSBC undertakings	353	–	–	–	–	–	–	–	353
Derivatives	3,768	–	–	–	–	–	–	–	3,768
Loans and advances to HSBC undertakings	6,275	2,395	3,992	–	15	35	635	28,328	41,675
Financial investments	23	–	8	–	–	–	–	1,177	1,208
Other financial assets	4	–	–	–	–	–	–	–	4
Total financial assets	10,423	2,395	4,000	–	15	35	635	29,505	47,008
Non financial assets	–	–	–	–	–	–	–	92,476	92,476
Total assets	10,423	2,395	4,000	–	15	35	635	121,981	139,484
Financial liabilities									
Amounts owing to HSBC undertakings	3,576	19	980	–	–	–	1,333	6,948	12,856
Financial liabilities designated at fair value	–		–	–	–	–	1,258	21,937	23,195
– Debt securities in issue	–	–	–	–	–	–	1,258	7,319	8,577
– Subordinated liabilities and preferred securities	–	–	–	–	–	–	–	14,618	14,618
Derivatives	760	–	–	–	–	–	–	–	760
Debt securities in issue	–	–	–	–	–	1,646	–	1,045	2,691
Accruals	223	171	190	21	–	–	–	–	605
Subordinated liabilities	–	–	–	–	–	–	–	11,907	11,907
Total financial liabilities	4,559	190	1,170	21	–	1,646	2,591	41,837	52,014
Non financial liabilities	–	–	–	–	–	–	–	443	443
Total liabilities	4,559	190	1,170	21	–	1,646	2,591	42,280	52,457
Off-balance sheet commitments given									
Undrawn formal standby facilities, credit lines and other commitments to lend	1,200	–	–	–	–	–	–	–	1,200

Notes on the Financial Statements (continued)

Maturity analysis of assets, liabilities and off-balance sheet commitments (continued)

	At 31 December 2011								
	Due less than 1 month US$m	Due between 1 and 3 months US$m	Due between 3 and 6 months US$m	Due between 6 and 9 months US$m	Due between 9 months and 1 year US$m	Due between 1 and 2 years US$m	Due between 2 and 5 years US$m	Due over 5 years US$m	Total US$m
Financial assets									
Cash at bank and in hand:									
– balances with HSBC undertakings	316	–	–	–	–	–	–	–	316
Derivatives	3,568	–	–	–	–	–	–	–	3,568
Loans and advances to HSBC undertakings	5,518	973	4,028	366	1,312	–	1,994	13,857	28,048
Financial investments	22	–	9	–	–	–	–	1,047	1,078
Other financial assets	1	–	–	–	–	–	–	–	1
Total financial assets	9,425	973	4,037	366	1,312	–	1,994	14,904	33,011
Non financial assets	–	–	–	–	–	–	–	90,851	90,851
Total assets	9,425	973	4,037	366	1,312	–	1,994	105,755	123,862
Financial liabilities									
Amounts owing to HSBC undertakings	1,101	–	64	–	–	–	1,314	–	2,479
Financial liabilities designated at fair value	–	–	–	–	2,765	–	1,177	17,209	21,151
– Debt securities in issue	–	–	–	–	–	–	1,177	4,576	5,753
– Subordinated liabilities and preferred securities	–	–	–	–	2,765	–	–	12,633	15,398
Derivatives	1,067	–	–	–	–	–	–	–	1,067
Debt securities in issue	–	–	–	–	–	–	1,612	1,001	2,613
Accruals	200	167	188	20	–	–	–	–	575
Subordinated liabilities	–	–	–	–	–	–	–	12,450	12,450
Other financial liabilities	885	–	–	–	–	–	–	–	885
Total financial liabilities	3,253	167	252	20	2,765	–	4,103	30,660	41,220
Non financial liabilities	–	–	–	–	–	–	–	459	459
Total liabilities	3,253	167	252	20	2,765	–	4,103	31,119	41,679
Off-balance sheet commitments given									
Undrawn formal standby facilities, credit lines and other commitments to lend	1,810	–	–	–	–	–	–	–	1,810

35 Foreign exchange exposures

Structural foreign exchange exposures

HSBC's structural foreign exchange exposures are represented by the net asset value of its foreign exchange equity and subordinated debt investments in subsidiaries, branches, joint ventures and associates with non-US dollar functional currencies. Gains or losses on structural foreign exchange exposures are recognised in other comprehensive income. HSBC's management of its structural foreign exchange exposures is discussed on page 268.

In its separate financial statements, HSBC Holdings recognises its foreign exchange gains and losses on structural foreign exchange exposures in the income statement.

Net structural foreign exchange exposures

	At 31 December	
	2012	2011
	US$m	US$m
Currency of structural exposure		
Pound sterling	**27,305**	22,668
Euro	**23,945**	22,400
Chinese renminbi	**19,060**	21,234
Hong Kong dollars	**14,466**	4,828
Brazilian reais	**6,279**	6,097
Mexican pesos	**5,948**	5,319
Canadian dollars	**5,024**	4,848
Indian rupees	**3,967**	3,967
Swiss francs	**2,925**	2,133
UAE dirhams	**2,807**	2,650
Saudi riyals	**2,219**	1,965
Malaysian ringgit	**2,165**	1,829
Turkish lira	**1,787**	1,565
Australian dollars	**1,602**	1,455
Korean won	**1,520**	1,411
Taiwanese dollars	**1,513**	1,457
Indonesian rupiah	**1,317**	1,235
Argentine pesos	**1,054**	984
Egyptian pounds	**699**	692
Vietnamese dong	**762**	686
Singapore dollars	**874**	670
Philippine pesos	**787**	663
Thailand baht	**653**	484
Qatari rial	**599**	608
Others, each less than US$500m	**4,169**	4,167
Total	**133,446**	116,015

Shareholders' equity would decrease by US$2,562m (2011: US$2,146m) if euro and sterling foreign currency exchange rates weakened by 5% relative to the US dollar.

36 Assets charged as security for liabilities and collateral accepted as security for assets

Financial assets pledged to secure liabilities

	Assets pledged at 31 December	
	2012	2011
	US$m	US$m
Treasury bills and other eligible securities	**4,381**	5,185
Loans and advances to banks	**22,074**	19,247
Loans and advances to customers	**81,333**	81,570
Debt securities	**198,671**	210,255
Equity shares	**6,255**	6,916
Other	**1,090**	1,003
	313,804	324,176

The table above shows assets over which a legal charge has been granted to secure liabilities. The amount of such assets may be greater than the book value of assets utilised as collateral for funding purposes or to cover liabilities. This is the case for securitisations and covered bonds where the amount of liabilities issued, plus any mandatory over-collateralisation, is less than the book value of financial assets available for funding or collateral purposes in the relevant pool of assets. This is also the case where financial assets are placed with a custodian or settlement agent, which has a floating charge over all the financial assets placed to secure any liabilities under settlement accounts.

These transactions are conducted under terms that are usual and customary to collateralised transactions, including, where relevant, standard securities lending and repurchase agreements.

Collateral accepted as security for assets

The fair value of assets accepted as collateral that HSBC is permitted to sell or repledge in the absence of default is US$295,709m (2011: US$302,285m). The fair value of any such collateral that has been sold or repledged was US$202,662m (2011: US$188,682m). HSBC is obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

37 Non-controlling interests

	At 31 December	
	2012	2011
	US$m	US$m
Non-controlling interests attributable to holders of ordinary shares in subsidiaries	**5,159**	4,656
Preferred securities issued by subsidiaries	**2,728**	2,712
	7,887	7,368

Preferred securities issued by subsidiaries

Preferred securities are securities for which there is no obligation to pay a dividend and, if not paid, the dividend may not be cumulative. Such securities do not generally carry voting rights but rank higher than ordinary shares for dividend payments and in the event of a winding-up. These securities have no stated maturity date but may be called and redeemed by the issuer, subject to prior notification to the FSA and, where relevant, the consent of the local banking regulator. Dividends on the floating rate preferred securities are generally related to interbank offer rates.

Included in the capital base of HSBC are non-cumulative preferred securities classified as tier 1 capital and cumulative preferred securities classified as tier 2 capital in accordance with the rules and guidance in the FSA's GENPRU.

HSBC's subsidiaries have the following preferred securities in issue:

			At 31 December	
		First call date	**2012** **US$m**	2011 US$m
HSBC USA Inc.				
US$150m	Depositary shares each representing 25% interest in a share of adjustable-rate cumulative preferred stock, series D	Jul 1999	**150**	150
US$150m	Cumulative preferred stock	Oct 2007	**150**	150
US$518m	Floating rate non-cumulative preferred stock, series F	Apr 2010	**518**	518
US$374m	Floating rate non-cumulative preferred stock, series G	Jan 2011	**374**	374
US$374m	6.50% non-cumulative preferred stock, series H	Jul 2011	**374**	374
HSBC Finance Corporation				
US$575m	6.36% non-cumulative preferred stock, series B	Jun 2010	**559**	559
HSBC Bank Canada				
CAD175m	Non-cumulative redeemable class 1 preferred shares, series C	Jun 2010	**176**	171
CAD175m	Non-cumulative class 1 preferred shares, series D	Dec 2010	**176**	171
CAD250m	Non-cumulative 5 year rate reset class 1 preferred shares, series E	Jun 2014	**251**	245
			2,728	2,712

38 Called up share capital and other equity instruments

Issued and fully paid

	At 31 December 2012 US$m	2011 US$m
HSBC Holdings ordinary shares[1]	**9,238**	8,934

	Number	US$m
HSBC Holdings ordinary shares of US$0.50 each		
At 1 January 2012	**17,868,085,646**	**8,934**
Shares issued under HSBC employee share plans	**238,587,766**	**119**
Shares issued in lieu of dividends	**369,335,252**	**185**
At 31 December 2012	**18,476,008,664**	**9,238**
At 1 January 2011	17,686,155,902	8,843
Shares issued under HSBC employee share plans	11,354,577	6
Shares issued in lieu of dividends	170,575,167	85
At 31 December 2011	17,868,085,646	8,934

	Number	US$m
HSBC Holdings non-cumulative preference shares of US$0.01 each		
At 1 January 2012 and 31 December 2012[2]	**1,450,000**	**–**
At 1 January 2011 and 31 December 2011	1,450,000	–

1 *All HSBC Holdings ordinary shares in issue confer identical rights in respect of capital, dividends, voting and otherwise.*
2 *Included in the capital base of HSBC as tier 1 capital in accordance with the rules and guidance in GENPRU.*

Dividends on the HSBC Holdings non-cumulative dollar preference shares in issue ('dollar preference shares') are paid quarterly at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the dollar preference shares if payment of the dividend would cause HSBC Holdings not to meet the applicable capital adequacy requirements of the FSA or the profit of HSBC Holdings available for distribution as dividends is not sufficient to enable HSBC Holdings to pay in full both dividends on the dollar preference shares and dividends on any other shares that are scheduled to be paid on the same date and that have an equal right to dividends. HSBC Holdings may not declare or pay dividends on any class of its shares ranking lower in the right to dividends than the dollar preference shares nor redeem nor purchase in any manner any of its other shares ranking equal with or lower than the dollar preference shares unless it has paid in full, or set aside an amount to provide for payment in full, the dividends on the dollar preference shares for the then-current dividend period. The dollar preference shares carry no rights to conversion into ordinary shares of HSBC Holdings. Holders of the dollar preference shares will only be entitled to attend and vote at general meetings of shareholders of HSBC Holdings if the dividend payable on the dollar preference shares has not been paid in full for four consecutive dividend payment dates. In such circumstances, holders of the dollar preference shares will be entitled to vote on all matters put to general meetings until such time as HSBC Holdings has paid a full dividend on the dollar preference shares. HSBC Holdings may redeem the dollar preference shares in whole at any time on or after 16 December 2010, subject to prior notification to the FSA.

HSBC Holdings non-cumulative preference shares of £0.01 each

The one non-cumulative sterling preference share of £0.01 in issue ('sterling preference share') has been in issue since 29 December 2010 and is held by a subsidiary of HSBC Holdings. Dividends on the sterling preference share are paid quarterly at the sole and absolute discretion of the Board. The sterling preference share carries no rights of conversion into ordinary shares of HSBC Holdings and no rights to attend and vote at general meetings of shareholders of HSBC Holdings. HSBC Holdings may redeem it in whole at any time at the option of the Company.

Other equity instruments

Other equity instruments which have been included in the capital base of HSBC were issued in accordance with the rules and guidance in the FSA's GENPRU. These securities may be called and redeemed by HSBC subject to prior notification to the FSA. If not redeemed at the first call date interest coupons remain unchanged.

Notes on the Financial Statements (continued)

38 – Called up share capital and other equity instruments

Tier 1 capital securities

Tier 1 capital securities are perpetual subordinated securities on which coupon payments may be deferred at the discretion of HSBC Holdings. While any coupon payments are unpaid or deferred, HSBC Holdings will not declare, pay dividends or make distributions or similar periodic payments in respect of, or repurchase, redeem or otherwise acquire any securities of lower or equal rank. Such securities do not generally carry voting rights but rank higher than ordinary shares for coupon payments and in the event of a winding-up.

At HSBC Holdings' discretion, and subject to certain conditions being satisfied, the capital securities may be exchanged on any coupon payment date for non-cumulative preference shares to be issued by HSBC Holdings and which would rank *pari passu* with the dollar and sterling preference shares in issue. The preference shares will be issued at a nominal value of US$0.01 per share and a premium of US$24.99 per share, with both such amounts being subscribed and fully paid.

HSBC has the following qualifying tier 1 capital securities in issue which are accounted for in equity:

		First call date	At 31 December 2012 US$m	2011 US$m
US$2,200m	8.125% perpetual subordinated capital securities	Apr 2013	**2,133**	2,133
US$3,800m	8.00% perpetual subordinated capital securities, Series 2	Dec 2015	**3,718**	3,718
			5,851	5,851

Shares under option

Details of the options outstanding to subscribe for HSBC Holdings ordinary shares under the HSBC Holdings Group Share Option Plan, the HSBC Share Plan and HSBC Holdings savings-related share option plans are given in Note 7.

Aggregate options outstanding under these plans

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2012	**159,703,771**	**2013 to 2018**	**£3.3116 – 7.9911**
	31,637,840	**2013 to 2018**	**HK$37.8797 – 94.5057**
	2,180,263	**2013 to 2018**	**€3.6361 – 9.5912**
	6,488,894	**2013 to 2018**	**US$4.8876 – 12.0958**
31 December 2011	216,078,250	2012 to 2017	£3.3116 – 7.9911
	45,422,511	2012 to 2017	HK$37.8797 – 94.5057
	3,176,265	2012 to 2017	€3.6361 – 9.5912
	9,752,066	2012 to 2017	US$4.8876 – 12.0958
31 December 2010	249,242,968	2011 to 2016	£3.3116 – 8.4024
	47,428,892	2011 to 2016	HK$37.8797 – 94.5057
	3,128,508	2011 to 2016	€3.6361 – 9.5912
	10,899,415	2011 to 2016	US$4.8876 – 12.0958

HSBC France plan

When it was acquired in 2000, HSBC France and certain of its subsidiary companies, including HSBC Private Bank France, operated employee share option plans under which options could be granted over their respective shares. There were outstanding options over the shares of HSBC Private Bank France, a subsidiary of HSBC France. On exercise of those options, the HSBC Private Bank France shares were exchangeable for HSBC Holdings ordinary shares at the ratio of 2.099984 HSBC Holdings ordinary shares for each HSBC Private Bank France share.

On 31 October 2011, HSBC Private Bank France merged with HSBC France. Options held over shares of HSBC Private Bank France were converted into options over shares of HSBC France, at an exchange ratio of 7 HSBC France shares for 45 HSBC Private Bank France shares. The options outstanding at 31 October 2011 were adjusted to reflect the option exchange ratio. On exercise of these options, HSBC France shares would have been exchanged for HSBC Holdings ordinary shares in the ratio of 13.499897 HSBC Holdings ordinary shares for each HSBC France share.

During 2011 and 2012 there were no HSBC Private Bank France shares issued and no shares were exchanged for HSBC Holdings ordinary shares. During 2012, 22,645 options over HSBC France shares lapsed (2011: 141,525). At 31 December 2012 no options over HSBC France shares were outstanding.

At 31 December 2012, The CCF Employee Benefit Trust 2001 (Private Banking France) held 989,502 (2011: 989,502) HSBC Holdings ordinary shares.

HSBC France options outstanding over HSBC Holdings ordinary shares

	Number of HSBC France shares exchangeable for HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2012	**–**	**2012**	**€142.84**
31 December 2011[1]	22,645	2012	€142.84
31 December 2010	287,100	2011 to 2012	€20.80 – 22.22

1 *These options replaced the options over shares in HSBC Private Bank France which were outstanding on 31 October 2011 prior to the merger taking place.*

HSBC Finance

Upon the acquisition of HSBC Finance in 2003, all outstanding options over, and rights to receive, HSBC Finance common shares were converted into options over, and rights to receive, HSBC Holdings ordinary shares in the same ratio as the share exchange offer for the acquisition of HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share). The exercise price payable for each option was adjusted using the same ratio.

During 2012, 2,053,838 (2011: nil) options were exercised over HSBC Holdings ordinary shares and 2,053,838 (2011: nil) HSBC Holdings ordinary shares were delivered from The HSBC (Household) Employee Benefit Trust 2003. During 2012, options over 375,700 (2011: 8,688,288) HSBC Holdings ordinary shares lapsed. At 31 December 2012 no options over HSBC Holdings ordinary share were outstanding.

At 31 December 2012, The HSBC (Household) Employee Benefit Trust 2003 held a total of 281,477 (2011: 2,335,315) HSBC Holdings ordinary shares and 1,455 (2011: 1,455) ADSs. Each ADS represents five HSBC Holdings ordinary shares.

Options outstanding over HSBC Holdings ordinary shares under the HSBC Finance share plan

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2012	**–**	**2012**	**US$9.29**
31 December 2011	2,429,538	2012	US$9.29
31 December 2010	11,117,826	2011 to 2012	US$9.29 – 18.62

HSBC Bank Bermuda plans

Upon the acquisition of HSBC Bank Bermuda Limited ('HSBC Bank Bermuda') in 2004, all outstanding options over HSBC Bank Bermuda shares were converted into options to acquire HSBC Holdings ordinary shares using an exchange ratio calculated by dividing US$40 (being the consideration paid for each HSBC Bank Bermuda Share) by the average price of HSBC Holdings ordinary shares over the five-day period to the completion of the acquisition. The exercise price payable for each option was adjusted using the same exchange ratio.

During 2011 and 2012 there were no options exercised over HSBC Holdings ordinary shares and no shares were delivered from the HSBC (Bank of Bermuda) Employee Benefit Trust 2004. During 2012, options over 880,983 (2011: 2,108,830) HSBC Holdings ordinary shares lapsed.

At 31 December 2012, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 2,108,830 (2011: 2,108,830) HSBC Holdings ordinary shares which may be used to satisfy the exercise of employee options.

Options outstanding over HSBC Holdings ordinary shares under the HSBC Bank Bermuda share plan

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2012	**149,924**	**2013**	**US$9.32 – 10.33**
31 December 2011	1,030,907	2012 to 2013	US$9.32 – 15.99
31 December 2010	2,339,033	2011 to 2013	US$9.32 – 15.99

Maximum obligation to deliver HSBC Holdings ordinary shares

At 31 December 2012, the maximum obligation to deliver HSBC Holdings ordinary shares under all of the above option arrangements, together with GPSP awards and restricted share awards granted under the HSBC Share Plan and/or the HSBC Share Plan 2011, was 364,082,766 (2011: 538,265,410). The total number of shares at 31 December 2012 held by employee benefit trusts that may be used to satisfy such obligations to deliver HSBC Holdings ordinary shares was 18,009,459 (2011: 31,840,893).

39 Notes on the statement of cash flows

Other non-cash items included in profit before tax

	HSBC			HSBC Holdings	
	2012 US$m	2011 US$m	2010 US$m	**2012 US$m**	2011 US$m
Depreciation, amortisation and impairment	**2,531**	3,135	2,801	**457**	1
Gains arising from dilution of interests in associates	**–**	(208)	(188)	**–**	–
Revaluations on investment property	**(72)**	(118)	(93)	**–**	–
Share-based payment expense	**988**	1,162	812	**55**	57
Loan impairment losses gross of recoveries and other credit risk provisions	**9,358**	13,553	15,059	**–**	–
Provisions	**5,732**	2,199	680	**–**	–
Impairment of financial investments	**519**	808	105	**–**	–
Charge/(credit) for defined benefit plans	**476**	(140)	526	**–**	–
Accretion of discounts and amortisation of premiums	**246**	(513)	(815)	**23**	19
	19,778	19,878	18,887	**535**	77

Change in operating assets

	HSBC			HSBC Holdings	
	2012 US$m	2011 US$m	2010 US$m	**2012 US$m**	2011 US$m
Change in loans to HSBC undertakings	**–**	–	–	**(3,451)**	(4,548)
Change in prepayments and accrued income	**557**	1,907	457	**(5)**	96
Change in net trading securities and net derivatives	**(36,829)**	27,058	60,337	**(507)**	(1,001)
Change in loans and advances to banks	**1,083**	2,618	5,213	**–**	–
Change in loans and advances to customers	**(72,619)**	(30,853)	(79,283)	**–**	–
Change in financial assets designated at fair value	**(2,698)**	(583)	154	**–**	–
Change in other assets	**(6,015)**	(7,559)	(145)	**(48)**	(36)
	(116,521)	(7,412)	(13,267)	**(4,011)**	(5,489)

Change in operating liabilities

	HSBC			HSBC Holdings	
	2012 US$m	2011 US$m	2010 US$m	**2012 US$m**	2011 US$m
Change in accruals and deferred income	**78**	(800)	716	**10**	258
Change in deposits by banks	**(5,393)**	2,238	(14,288)	**–**	–
Change in customer accounts	**90,071**	48,401	68,691	**–**	–
Change in debt securities in issue	**(11,552)**	(14,388)	(1,495)	**86**	(45)
Change in financial liabilities designated at fair value	**2,549**	5,468	5,659	**2,464**	(475)
Change in other liabilities	**13,317**	3,093	(17,011)	**391**	(152)
	89,070	44,012	42,272	**2,951**	(414)

Cash and cash equivalents

	HSBC			HSBC Holdings	
	2012	2011	2010	**2012**	2011
	US$m	US$m	US$m	**US$m**	US$m
Cash at bank with HSBC undertakings	**–**	–	–	**353**	316
Cash and balances at central banks	**141,532**	129,902	57,383	**–**	–
Items in the course of collection from other banks	**7,303**	8,208	6,072	**–**	–
Loans and advances to banks of one month or less	**148,232**	169,858	189,197	**–**	–
Treasury bills, other bills and certificates of deposit less than three months	**25,379**	26,226	28,087	**–**	–
Less: items in the course of transmission to other banks	**(7,138)**	(8,745)	(6,663)	**–**	–
	315,308	325,449	274,076	**353**	316

Interest and dividends

	HSBC			HSBC Holdings	
	2012	2011	2010	**2012**	2011
	US$m	US$m	US$m	**US$m**	US$m
Interest paid	**(18,412)**	(23,125)	(21,405)	**(2,661)**	(2,392)
Interest received	**61,112**	66,734	63,696	**1,759**	1,559
Dividends received	**766**	602	563	**13,709**	6,874

The amount of cash and cash equivalents not available for use by HSBC at 31 December 2012 was US$32,368m (2011: US$39,345m), of which US$20,464m (2011: US$25,819m) related to mandatory deposits at central banks.

Disposal of subsidiaries and businesses

	US cards business US$m	**US branch network US$m**	**Other disposals US$m**	**Total US$m**
Assets				
Loans and advances to banks	**–**	**–**	**799**	**799**
Loans and advances to customers	**26,748**	**2,091**	**3,632**	**32,471**
Financial investments	**–**	**–**	**924**	**924**
Prepayments and accrued income	**572**	**–**	**53**	**625**
Goodwill and intangible assets	**318**	**7**	**276**	**601**
Other assets	**369**	**68**	**1,618**	**2,055**
Total assets excluding cash and cash equivalents	**28,007**	**2,166**	**7,302**	**37,475**
Liabilities				
Deposits by banks	**–**	**–**	**385**	**385**
Customer accounts	**–**	**13,199**	**5,986**	**19,185**
Liabilities under insurance contracts	**–**	**–**	**1,080**	**1,080**
Other liabilities	**161**	**7**	**1,012**	**1,180**
Total liabilities	**161**	**13,206**	**8,463**	**21,830**
Aggregate net assets at date of disposal, excluding cash and cash equivalents	**27,846**	**(11,040)**	**(1,161)**	**15,645**
Non-controlling interests disposed	**–**	**–**	**(81)**	**(81)**
Gain on disposal including costs to sell	**3,148**	**864**	**355**	**4,367**
Add back: costs to sell	**72**	**15**	**56**	**143**
Selling price	**31,066**	**(10,161)**	**(831)**	**20,074**
Satisfied by:				
Cash and cash equivalents received/(paid) as consideration	**31,066**	**(10,091)**	**(542)**	**20,433**
Cash and cash equivalents sold	**–**	**(70)**	**(321)**	**(391)**
Cash consideration received/(paid) up to 31 December 2012	**31,066**	**(10,161)**	**(863)**	**20,042**
Cash still to be received at 31 December 2012	**–**	**–**	**32**	**32**
Total cash consideration	**31,066**	**(10,161)**	**(831)**	**20,074**

Notes on the Financial Statements (continued)

The completed US branch network disposal represents the sale of 195 US branches that were held for sale at 31 December 2011. HSBC received a total cash consideration of US$20,905m during 2012, which is included in the cash flow statement under the line 'Net cash inflow from disposal of US branch network and US cards business on page 375. For further details refer to page 471.

40 Contingent liabilities, contractual commitments and guarantees

	HSBC		HSBC Holdings	
	2012	2011	**2012**	2011
	US$m	US$m	**US$m**	US$m
Guarantees and contingent liabilities				
Guarantees	**80,364**	75,672	**49,402**	49,402
Other contingent liabilities	**209**	259	**–**	–
	80,573	75,931	**49,402**	49,402
Commitments				
Documentary credits and short-term trade-related transactions	**13,359**	13,498	**–**	–
Forward asset purchases and forward forward deposits placed	**419**	87	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend	**565,691**	641,319	**1,200**	1,810
	579,469	654,904	**1,200**	1,810

The above table discloses the nominal principal amounts of commitments excluding capital commitments, which are separately disclosed below, and guarantees and other contingent liabilities, which are mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit. Contingent liabilities arising from legal proceedings and regulatory matters against Group companies are disclosed in Note 43. Nominal principal amounts represent the amounts at risk should the contracts be fully drawn upon and clients default. The amount of the loan commitments shown above reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements.

Guarantees

HSBC provides guarantees and similar undertakings on behalf of both third-party customers and other entities within the HSBC Group. These guarantees are generally provided in the normal course of HSBC's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which HSBC could be required to make at 31 December 2012, were as follows:

	At 31 December 2012		At 31 December 2011	
	Guarantees in favour of third parties US$m	**Guarantees by HSBC Holdings in favour of other HSBC Group entities US$m**	Guarantees in favour of third parties US$m	Guarantees by HSBC Holdings in favour of other HSBC Group entities US$m
Guarantee type[1]				
Financial guarantees[2]	**32,036**	**36,800**	26,830	36,800
Credit-related guarantees[3]	**12,957**	**12,602**	12,494	12,602
Other guarantees	**35,371**	**–**	36,348	–
	80,364	**49,402**	75,672	49,402

1 *The balances have been grouped by major category of guarantee, revised from prior periods to present financial guarantees separately.*
2 *Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.*
3 *Credit related guarantees are contracts that have similar features to financial guarantee contracts but fail to meet the definition of a financial guarantee contracts under IAS 39.*

The amounts disclosed in the above table are nominal principal amounts and reflect HSBC's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with HSBC's overall credit risk management policies and procedures.

Approximately half of the above guarantees have a term of less than one year. Guarantees with terms of more than one year are subject to HSBC's annual credit review process.

Financial Services Compensation Scheme

At 31 December 2012, HSBC recognised an accrual of US$157m in respect of its share of the estimated Financial Services Compensation Scheme ('FSCS') levy (31 December 2011: US$87m).

The FSCS confirmed in February 2013 that the first of three annual instalments of approximately £363m (US$587m) will be levied in total on participating financial institutions in Scheme Year 2013/14 to repay the balance of the loan principal that is not expected to be recovered. The accrual recognised at 31 December 2012 represents HSBC's share of the interest on the borrowings outstanding and also its share of the principal to be levied over each of the next three years. The interest rate to be applied on outstanding borrowings increased from 12-month Libor plus 30 basis points to 12-month Libor plus 100 basis points from 1 April 2012.

Commitments

In addition to the commitments disclosed on page 500, at 31 December 2012 HSBC had US$607m (2011: US$715m) of capital commitments contracted but not provided for and US$197m (2011: US$272m) of capital commitments authorised but not contracted for.

Associates

HSBC's share of associates' contingent liabilities amounted to US$46,148m at 31 December 2012 (2011: US$34,311m). No matters arose where HSBC was severally liable.

41 Lease commitments

Finance lease commitments

HSBC leases land and buildings (including branches) and equipment from third parties under finance lease arrangements to support its operations.

	At 31 December 2012			At 31 December 2011		
	Total future minimum payments US$m	**Future interest charges US$m**	**Present value of finance lease commitments US$m**	Total future minimum payments US$m	Future interest charges US$m	Present value of finance lease commitments US$m
Lease commitments:						
– no later than one year	**81**	**(21)**	**60**	98	(26)	72
– later than one year and no later than five years	**153**	**(71)**	**82**	216	(99)	117
– later than five years	**196**	**(34)**	**162**	362	(92)	270
	430	**(126)**	**304**	676	(217)	459

At 31 December 2012, future minimum sublease payments of US$244m (2011: US$413m) are expected to be received under non-cancellable subleases at the balance sheet date.

Operating lease commitments

At 31 December 2012, HSBC was obligated under a number of non-cancellable operating leases for properties, plant and equipment on which the future minimum lease payments extend over a number of years.

	At 31 December 2012		At 31 December 2011	
	Land and buildings US$m	**Equipment US$m**	Land and buildings US$m	Equipment US$m
Future minimum lease payments under non-cancellable operating leases:				
– no later than one year	**943**	**23**	1,130	18
– later than one year and no later than five years	**2,495**	**23**	2,656	18
– later than five years	**2,246**	**–**	2,496	–
	5,684	**46**	6,282	36

Notes on the Financial Statements (continued)

At 31 December 2012, future minimum sublease payments of US$14m (2011: US$17m) are expected to be received under non-cancellable subleases at the balance sheet date.

In 2012, US$1,166m (2011: US$973m; 2010: US$888m) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, of which US$1,149m (2011: US$952m; 2010: US$869m) related to minimum lease payments, US$17m (2011: US$20m; 2010: US$18m) to contingent rents, and US$0.4m (2011: US$1m; 2010: US$1m) to sublease payments.

The contingent rent represents escalation payments made to landlords for operating, tax and other escalation expenses.

Finance lease receivables

HSBC leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	At 31 December 2012			At 31 December 2011		
	Total future minimum payments US$m	**Unearned finance income US$m**	**Present value US$m**	Total future minimum payments US$m	Unearned finance income US$m	Present value US$m
Lease receivables:						
– no later than one year	**3,712**	**(379)**	**3,333**	3,766	(459)	3,307
– later than one year and no later than five years	**8,414**	**(966)**	**7,448**	8,618	(1,055)	7,563
– later than five years	**5,277**	**(951)**	**4,326**	5,969	(1,204)	4,765
	17,403	**(2,296)**	**15,107**	18,353	(2,718)	15,635

At 31 December 2012, unguaranteed residual values of US$253m (2011: US$267m) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to US$3m (2011: US$25m). No contingent rents were received in 2012 (2011: nil).

42 Special purpose entities

HSBC enters into certain transactions with customers in the ordinary course of business which involve the establishment of special purpose entities ('SPE's) to facilitate or secure customer transactions. HSBC structures that utilise SPEs are authorised centrally when they are established, to ensure appropriate purpose and governance. The activities of SPEs administered by HSBC are closely monitored by senior management.

SPEs are assessed for consolidation in accordance with the accounting policy set out in Note 1e.

Total consolidated assets held by SPEs by balance sheet classification

	Conduits US$bn	**Securitisations US$bn**	**Money market funds US$bn**	**Non-money market investment funds US$bn**	**Total US$bn**
At 31 December 2012					
Cash	**0.6**	**–**	**–**	**0.2**	**0.8**
Trading assets	**–**	**0.5**	**–**	**1.5**	**2.0**
Financial assets designated at fair value	**0.1**	**–**	**–**	**7.4**	**7.5**
Derivatives	**–**	**–**	**–**	**0.2**	**0.2**
Loans and advances to banks	**–**	**1.5**	**–**	**–**	**1.5**
Loans and advances to customers	**11.3**	**7.0**	**–**	**–**	**18.3**
Financial investments	**25.0**	**–**	**–**	**–**	**25.0**
Other assets	**1.4**	**–**	**–**	**1.6**	**3.0**
	38.4	**9.0**	**–**	**10.9**	**58.3**

	Conduits US$bn	Securit-isations US$bn	Money market funds US$bn	Non-money market investment funds US$bn	Total US$bn
At 31 December 2011					
Cash	0.8	0.3	–	0.3	1.4
Trading assets	0.1	0.5	0.2	0.4	1.2
Financial assets designated at fair value	0.1	–	–	6.5	6.6
Derivatives	–	0.1	–	–	0.1
Loans and advances to banks	–	1.2	–	–	1.2
Loans and advances to customers	10.5	8.0	–	–	18.5
Financial investments	25.8	–	–	–	25.8
Other assets	1.6	–	–	–	1.6
	38.9	10.1	0.2	7.2	56.4

HSBC's maximum exposure to SPEs

The following table shows the total assets of the various types of SPEs and the amount of funding provided by HSBC to these SPEs. The table also shows HSBC's maximum exposure to the SPEs and, within that exposure, the liquidity and credit enhancements provided by HSBC. The maximum exposures to SPEs represent HSBC's maximum possible risk exposure that could occur as a result of the Group's arrangements and commitments to SPEs. The maximum amounts are contingent in nature, and may arise as a result of drawdowns under liquidity facilities, where these have been provided, and any other funding commitments, or as a result of any loss protection provided by HSBC to the SPEs. The conditions under which such exposure might arise differ depending on the nature of each SPE and HSBC's involvement with it.

Total assets of consolidated and unconsolidated SPEs and HSBC's funding and maximum exposure

	Consolidated SPEs				Unconsolidated SPEs		
	Total assets US$bn	Funding provided by HSBC US$bn	Liquidity and credit enchance-ments US$bn	HSBC's maximum exposure US$bn	Total assets US$bn	Funding provided by HSBC US$bn	HSBC's maximum exposure US$bn
At 31 December 2012							
Conduits	**38.4**	**28.9**	**32.4**	**43.1**	**–**	**–**	**–**
Securities investment conduits	**26.6**	**28.8**	**18.1**	**28.8**	**–**	**–**	**–**
Multi-seller conduits	**11.8**	**0.1**	**14.3**	**14.3**	**–**	**–**	**–**
Securitisations	**9.0**	**2.6**	**–**	**4.7**	**6.8**	**–**	**–**
Money market funds	**–**	**–**	**–**	**–**	**64.2**	**1.7**	**1.7**
Constant net asset value funds	**–**	**–**	**–**	**–**	**51.7**	**0.8**	**0.8**
Other	**–**	**–**	**–**	**–**	**12.5**	**0.9**	**0.9**
Non-money market investment funds	**10.9**	**10.2**	**–**	**10.2**	**303.3**	**5.9**	**5.9**
Other	**–**	**–**	**–**	**–**	**20.0**	**5.2**	**5.3**
	58.3	**41.7**	**32.4**	**58.0**	**394.3**	**12.8**	**12.9**
At 31 December 2011							
Conduits	38.9	27.7	37.1	48.5	–	–	–
Securities investment conduits	27.9	27.4	22.1	33.5	–	–	–
Multi-seller conduits	11.0	0.3	15.0	15.0	–	–	–
Securitisations	10.1	1.6	0.1	3.8	8.1	–	–
Money market funds	0.2	0.2	–	0.2	73.9	0.9	0.9
Constant net asset value funds	–	–	–	–	54.4	0.7	0.7
Other	0.2	0.2	–	0.2	19.5	0.2	0.2
Non-money market investment funds	7.2	6.9	–	6.9	260.8	1.7	1.7
Other	–	–	–	–	19.4	3.7	4.6
	56.4	36.4	37.2	59.4	362.2	6.3	7.2

Notes on the Financial Statements (continued)

Conduits

HSBC sponsors and manages two types of conduits: securities investment conduits ('SIC's) and multi-seller conduits.

Securities investment conduits

Solitaire, HSBC's principal SIC, holds asset-backed securities ('ABS's) on behalf of HSBC. At 31 December 2012, Solitaire held US$10.0bn of ABSs (2011: US$10.6bn). These are included within the disclosures of ABS 'held through consolidated SPEs' on page 187. HSBC's other SICs, Mazarin, Barion Funding Limited ('Barion') and Malachite Funding Limited ('Malachite'), evolved from the restructuring of HSBC's sponsored structured investment vehicles ('SIV's) in 2008.

Solitaire

During the year Solitaire redeemed the commercial paper ('CP') held by third parties, and is currently funded entirely by CP issued to HSBC. Although HSBC continues to provide a liquidity facility, Solitaire has no need to draw on it so long as HSBC purchases the CP issued, which it intends to do for the foreseeable future. Accordingly, there were no amounts drawn under the liquidity facility provided by HSBC at 31 December 2012 (2011: US$9.3bn).

At 31 December 2012, HSBC held US$13.0bn of CP, which represented HSBC's maximum exposure. At 31 December 2011, maximum exposure of US$15.6bn was represented by liquidity facility including undrawn amounts.

Mazarin

HSBC is exposed to the par value of Mazarin's assets through the provision of a liquidity facility equal to the lower of the amortised cost of issued senior debt and the amortised cost of non-defaulted assets. At 31 December 2012, this amounted to US$8.4bn (2011: US$9.5bn). First loss protection is provided through the capital notes issued by Mazarin, which are substantially all held by third parties.

At 31 December 2012, HSBC held 1.3% of Mazarin's capital notes (2011: 1.3%) which have a par value of US$17m (2011: US$17m) and a carrying amount of nil (2011: nil).

Barion and Malachite

HSBC's primary exposure to these SICs is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2012, this amounted to US$7.4bn (2011: US$8.4bn). First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

At 31 December 2012, HSBC held 3.7% of the capital notes issued by these vehicles (2011: 3.7%) which have a par value of US$36m (2011: US$35m) and a carrying amount of US$1.7m (2011: US$1.1m).

Multi-seller conduits

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for HSBC's clients.

HSBC's maximum exposure is equal to the transaction-specific liquidity facilities offered to the multi-seller conduits. First loss protection is provided by the originator of the assets, and not by HSBC, through transaction-specific credit enhancements. A layer of secondary loss protection is provided by HSBC in the form of programme-wide enhancement facilities.

The following table sets out the weighted average life of the asset portfolios for the above mentioned conduits.

Weighted average life of portfolios

Weighted average life (years)	Solitaire	Other SICs	Total SICs	Total multi-seller conduits
At 31 December 2012	**6.1**	**4.5**	**5.2**	**2.8**
At 31 December 2011	5.9	4.1	4.9	2.0

Securitisations

HSBC uses SPEs to securitise customer loans and advances that it has originated in order to diversify its sources of funding for asset origination and for capital efficiency purposes. The loans and advances are transferred by HSBC to the SPEs for cash, and the SPEs issue debt securities to investors to fund the cash purchases.

HSBC's maximum exposure is the aggregate of any holdings of notes issued by these vehicles and the reserve account positions intended to provide credit support under certain pre-defined circumstances to senior note holders.

In addition, HSBC uses SPEs to mitigate the capital absorbed by some of the customer loans and advances it has originated. Credit derivatives are used to transfer the credit risk associated with these customer loans and advances to an SPE, using securitisations commonly known as synthetic securitisations by which the SPE writes credit default swap protection to HSBC. The SPE is funded by the issuance of notes with the cash held as collateral against the credit default protection. From a UK regulatory perspective, the credit protection issued by the SPE in respect of the customer loans allows the risk weight of the loans to be replaced by the risk weight of the collateral in the SPE and as a result mitigates the capital absorbed by the customer loans. Any notes issued by the SPE and held by HSBC attract the appropriate risk weight under the relevant regulatory regime. These SPEs are consolidated when HSBC is exposed to the majority of risks and rewards of ownership.

Money market funds

HSBC has established and manages a number of money market funds which provide customers with tailored investment opportunities within narrow and well-defined objectives.

HSBC's maximum exposure to money market funds is represented by HSBC's investment in the units of each fund, which at 31 December 2012 amounted to US$1.7bn (2011: US$1.1bn).

Non-money market investment funds

HSBC has established a large number of non-money market investment funds to enable customers to invest in a range of assets, typically equities and debt securities.

HSBC's maximum exposure to non-money market investment funds is represented by its investment in the units of each fund which at 31 December 2012 amounted to US$16.1bn (2011: US$8.6bn).

Other

HSBC also establishes SPEs in the normal course of business for a number of purposes, for example, structured transactions for customers, to provide finance to public and private sector infrastructure projects, and for asset and structured finance transactions.

In certain transactions HSBC is exposed to risk often referred to as gap risk. Gap risk typically arises in transactions where the aggregate potential claims against the SPE by HSBC pursuant to one or more derivatives could be greater than the value of the collateral held by the SPE and securing such derivatives. HSBC often mitigates such gap risk by incorporating in the SPE transaction features which allow for deleveraging, a managed liquidation of the portfolio, or other mechanisms including trade restructuring or unwinding the trade. Following the inclusion of such risk reduction mechanisms, HSBC has, in certain circumstances, retained all or a portion of the underlying exposure in the transaction. In these circumstances, HSBC assesses whether the exposure retained causes a requirement under IFRSs to consolidate the SPE. When this retained exposure represents ABSs, it has been included in 'Nature of HSBC's exposures' on page 259.

Third-party sponsored SPEs

Through standby liquidity facility commitments, HSBC has exposure to third-party sponsored SIVs, conduits and securitisations under normal banking arrangements on standard market terms. These exposures are not considered significant to HSBC's operations.

Additional off-balance sheet arrangements and commitments

Additional off-balance sheet commitments such as financial guarantees, letters of credit and commitments to lend are disclosed in Note 41.

Leveraged finance transactions

Loan commitments in respect of leveraged finance transactions are accounted for as derivatives where it is HSBC's intention to sell the loan after origination. Further information is provided on page 190.

43 Legal proceedings and regulatory matters

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions 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 and regulatory matters as at 31 December 2012 (see Note 32).

Securities litigation

As a result of an August 2002 restatement of previously reported consolidated financial statements and other corporate events, including the 2002 settlement with 46 State Attorneys General relating to real estate lending practices, Household International (now HSBC Finance) and certain former officers were named as defendants in a class action law suit, Jaffe v Household International Inc, et al No 2. C 5893 (N.D.Ill, filed 19 August 2002). The complaint asserted claims under the US Securities Exchange Act of 1934. Ultimately, a class was certified on behalf of all persons who acquired and disposed of Household International common stock between 30 July 1999 and 11 October 2002. The claims alleged that the defendants knowingly or recklessly made false and misleading statements of material fact relating to Household's Consumer Lending operations, including collections, sales and lending practices, some of which ultimately led to the 2002 State settlement agreement, and facts relating to accounting practices evidenced by the restatement.

A jury trial concluded in April 2009, which was decided partly in favour of the plaintiffs. Following post-trial briefing, the District Court ruled that various legal challenges to the verdict, including as to loss causation and other matters, would not be considered until after a second phase of the proceedings addressing issues of reliance and the submission of claims by class members had been completed. The District Court ruled on 22 November 2010 that claim forms should be mailed to class members to ascertain which class members may have claims for damages arising from reliance on the misleading statements found by the jury. The District Court also set out a method for calculating damages for class members who filed claims. As previously reported, lead plaintiffs, in court filings in March 2010, estimated that damages could range 'somewhere between US$2.4bn to US$3.2bn to class members', before pre-judgement interest.

In December 2011, the report of the court-appointed claims administrator to the District Court stated that the total number of claims that generated an allowed loss was 45,921, and that the aggregate amount of these claims was approximately US$2.23bn. Defendants filed legal challenges asserting that the presumption of reliance was defeated as to the class and raising various objections with respect to compliance with the claims form requirements as to certain claims.

In September 2012, the District Court rejected defendants' arguments that the presumption of reliance generally had been defeated either as to the class or as to particular institutional claimants. In addition, the District Court has made various rulings with respect to the validity of specific categories of claims, and held certain categories of claims valid, certain categories of claims invalid, and directed further proceedings before a court-appointed Special Master to address objections regarding certain other claim submission issues. In light of those rulings and through various agreements of the parties, currently there is approximately US$1.37bn in claims as to which there remain no unresolved objections relating to the claims form submissions. In addition, approximately US$800m in claims remain to be addressed before the Special Master with respect to various claims form objections, with a small portion of those potentially subject to further trial proceedings. Therefore, based upon proceedings to date, the current range of a possible final judgement, prior to imposition of pre-judgement interest (if any), is between approximately US$1.37bn and US$2.17bn. With the imposition of pre-judgement interest calculated through 31 December 2012, the top-end of a possible final judgement is approximately US$2.7bn. The District Court may wait for a resolution of all disputes as to all claims before entering final judgement, or the District Court may enter a partial judgement on fewer than all claims pending resolution of disputes as to the remaining claims. Post-verdict legal challenges remain to be addressed by the District Court.

Despite the jury verdict and the various rulings of the District Court, HSBC continues to believe that it has meritorious grounds for appeal of one or more of the rulings in the case, and intends to appeal the District Court's final judgement, partial or otherwise. Upon final judgement, partial or otherwise, HSBC Finance will be required to provide security for the judgement in order to suspend its execution while the appeal is on-going by either depositing cash in an interest-bearing escrow account or posting an appeal bond in the amount of the judgement (including any pre-judgement interest awarded).

Given the complexity and uncertainties associated with the actual determination of damages, including the outcome of any appeals, there is a wide range of possible damages. HSBC believes it has meritorious grounds for appeal on matters of both liability and damages and will argue on appeal that damages should be nil or a relatively insignificant amount. If the Appeals Court rejects or only partially accepts HSBC's arguments, the amount of damages, based upon the claims submitted and the potential application of pre-judgement interest may lie in a range from a relatively insignificant amount to somewhere in the region of US$2.7bn (or higher should plaintiffs successfully cross-appeal certain issues related to the validity of specific claims).

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, including certain former employees and the former auditor of Madoff Securities.

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$8.4bn, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, HSBC estimates 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$4bn.

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. Certain suits (which included four US putative 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.

In November 2011, the US District Court Judge overseeing three related putative class actions in the Southern District of New York dismissed all claims against the HSBC defendants on *forum non conveniens* grounds, but temporarily stayed this ruling as to one of the actions against the HSBC defendants – the claims of investors in Thema International Fund plc – in light of a proposed amended settlement agreement, pursuant to which, subject to various conditions, the HSBC defendants had agreed to pay from US$52.5m up to a maximum of US$62.5m. In December 2011, the court lifted this temporary stay and dismissed all remaining claims against the HSBC defendants, and declined to consider preliminary approval of the settlement. In light of the court's decisions, HSBC terminated the settlement agreement. The Thema plaintiff contests HSBC's right to terminate. Plaintiffs in all three actions have filed notices of appeal to the US Court of Appeals for the Second Circuit. Briefing in that appeal was completed in September 2012; oral argument is expected in early 2013.

In November and December 2012, HSBC settled two of the individual claims commenced by investors in Thema International Fund plc against HSBC in the Irish High Court.

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) sought US$9bn in damages and additional recoveries from HSBC and the various co-defendants. It sought 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 Judge dismissed the trustee's various common law claims on the grounds that the trustee lacks standing to assert them. In December 2011, the trustee filed a notice of appeal to the US Court of Appeals for the Second Circuit. Briefing in that appeal was completed in April 2012, and oral argument was held in November 2012. A decision is expected in 2013.

The District Court returned the remaining claims to the US Bankruptcy Court for further proceedings. 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. Between September 2011 and April 2012, the HSBC defendants and certain other defendants moved again to withdraw the case from the Bankruptcy Court. The District Court granted those withdrawal motions as to certain issues, and briefing and oral arguments on the merits of the withdrawn issues are now complete. The District Court has issued rulings on two of the withdrawn issues, but decisions with respect to all other issues are still pending and are expected in early 2013.

The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the grounds that the HSBC defendants actually or constructively knew of Madoff's fraud. HSBC has not been served with the trustee's English action.

Between October 2009 and April 2012, Fairfield Sentry Limited, Fairfield Sigma Limited and Fairfield Lambda 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. The actions in the US are currently stayed in the Bankruptcy Court pending developments in related appellate litigation in the BVI.

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. 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.

US mortgage-related investigations

In April 2011, HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and HSBC Finance and HSBC North America Holdings Inc. ('HNAH') entered into a similar consent order with the Federal Reserve Board following completion of a broad horizontal review of industry residential mortgage foreclosure practices. These consent orders require prescribed actions to address the deficiencies noted in the joint examination and described in the consent orders. HSBC Bank USA, HSBC Finance and HNAH continue to work with the Office of the Comptroller of the Currency and the Federal Reserve Board to align their processes with the requirements of the consent orders and are implementing operational changes as required.

These consent orders required an independent review of foreclosures (the 'Independent Foreclosure Review') pending or completed between January 2009 and December 2010 to determine if any customer was financially injured as a result of an error in the foreclosure process. As required by the consent orders, an independent consultant was retained to conduct that review.

On 28 February 2013, HSBC Bank USA entered into an agreement with the Office of the Comptroller of the Currency, and HSBC Finance and HNAH entered into an agreement with the Federal Reserve Board, pursuant to which the Independent Foreclosure Review will cease and we will make a cash payment of US$96m into a fund that will be used to make payments to borrowers that were in active foreclosure during 2009 and 2010, and in addition, will provide other assistance (e.g. loan modifications) to help eligible borrowers. These actions form HSBC's portion of a larger agreement announced by the Federal Reserve Board and the Office of the Comptroller of the Currency in January 2013 involving HSBC and twelve other mortgage servicers subject to foreclosure consent orders pursuant to which the mortgage servicers would pay, in the aggregate, in excess of US$9.3bn in cash payments and other assistance to help eligible borrowers. Pursuant to these agreements, the Independent Foreclosure Reviews will cease and be replaced by a broader framework under which all eligible borrowers will receive compensation regardless of whether they filed a request for independent review of their foreclosure and regardless of whether the borrower was financially injured as a result of an error in the foreclosure process. Borrowers who receive compensation will not be required to execute a release or waiver of rights and will not be precluded from pursuing litigation concerning foreclosure or other mortgage servicing practices. For participating servicers, including HSBC Bank USA and HSBC Finance, fulfilment of the terms of these agreements will satisfy the Independent Foreclosure Review requirements of these consent orders. These consent orders do not preclude additional enforcement actions against HSBC Bank USA, HSBC Finance or HNAH by bank regulatory, governmental or law enforcement agencies, such as the US Department of Justice ('DoJ') or State Attorneys General, which could include the imposition of civil money penalties and other sanctions relating to the activities that are the subject of the consent orders. Pursuant to the agreement with the Office of the Comptroller of the Currency, however, the Office of the Comptroller of the Currency has agreed that it will not assess civil money penalties or initiate any further enforcement action with respect to past mortgage servicing and foreclosure-related practices addressed in the consent orders, provided the terms of the agreement are fulfilled. The Office of the Comptroller of the Currency's agreement not to assess civil money penalties is further conditioned on HSBC North America making payments or providing borrower assistance pursuant to any agreement that may be entered into with the DoJ in connection with the servicing of residential mortgage loans within two years. The Federal Reserve Board has agreed that any assessment of civil money penalties by the Federal Reserve Board will reflect a number of adjustments, including amounts expended in consumer relief and payments made pursuant to any agreement that may be entered into with the DoJ in connection with the servicing of residential mortgage loans. In addition, the agreement does not preclude private litigation concerning these practices.

Separate from the consent orders and settlement related to the Independent Foreclosure Review discussed above, it has been announced that the five largest US mortgage servicers (not including HSBC Group companies) have reached a settlement with the DoJ, the US Department of Housing and Urban Development and State Attorneys General of 49 states with respect to foreclosure and other mortgage servicing practices. HNAH, HSBC Bank USA and HSBC Finance have had discussions with US bank regulators and other governmental agencies regarding a potential resolution, although the timing of any settlement is not presently known. HSBC recognised provisions of US$257m in 2011 to reflect the estimated liability associated with a proposed settlement of this matter. Any such settlement, however, may not completely preclude other enforcement actions by state or federal agencies, regulators or law enforcement bodies related to foreclosure and other mortgage servicing practices, including, but not limited to matters relating to the securitisation of mortgages for investors. In addition, such a settlement would not preclude private litigation concerning these practices.

Participants in the US mortgage securitisation market that purchased and repackaged whole loans have been the subject of lawsuits and governmental and regulatory investigations and inquiries, which have been directed at groups within the US mortgage market, such as servicers, originators, underwriters, trustees or sponsors of securitisations, and at particular participants within these groups. As the industry's residential mortgage foreclosure issues continue, HSBC Bank USA has taken title to an increasing number of foreclosed homes as trustee on behalf of various securitisation trusts. As nominal record owner of these properties, HSBC Bank USA has been sued by municipalities and tenants alleging various violations of law, including laws regarding property upkeep and tenants' rights. While HSBC believes and continues to maintain that the obligations at issue and the related liability are properly those of the servicer of each trust, HSBC continues to receive significant and adverse publicity in connection with these and similar matters, including foreclosures that are serviced by others in the name of 'HSBC, as trustee'.

HSBC Bank USA and HSBC Securities (USA) Inc. have been named as defendants in a number of actions in connection with residential mortgage-backed securities ('RMBS') offerings, which generally allege that the offering documents for securities issued by securitisation trusts contained material misstatements and omissions, including statements regarding the underwriting standards governing the underlying mortgage loans. These include an action filed in September 2011 by the Federal Housing Finance Agency ('FHFA'). This action is one of a series of similar actions filed against 17 financial institutions alleging violations of federal and state securities laws in connection with the sale of private-label RMBS purchased by Fannie Mae and Freddie Mac, primarily from 2005 to 2008. This action, along with all of the similar FHFA RMBS actions, was transferred to a single judge, who directed the defendant in the first-filed matter to file a motion to dismiss. In May 2012, the District Court filed its decision denying the motion to dismiss FHFA's securities law claims and granting the motion to dismiss FHFA's negligent misrepresentation claims. The District Court's ruling will form the basis for rulings on the other matters, including the action filed against HSBC Bank USA and HSBC Securities (USA) Inc. Subsequently, the defendant in the first-filed matter sought leave to appeal to the US Court of Appeals for the Second Circuit on certain issues raised in the motion to dismiss. The District Court and the Court of Appeals granted the request for leave to appeal, and this appeal is pending before the Court of Appeals. In December 2012, the District Court directed the parties to schedule mediation with the Magistrate Judge assigned to this action. However, mediation has not yet been scheduled.

In 2012, HSBC Finance received notice of several claims from claimants related to its activities as sponsor and the activities of its subsidiaries as originators in connection with RMBSs purchased between 2005 and 2007. The claims are currently being evaluated and discussions continue to be held with the claimants, but it has not been concluded that these claims are procedurally or substantively valid. In December 2010 and February 2011, HSBC Bank USA has received subpoenas from the SEC seeking production of documents and information relating to its involvement and the involvement of its affiliates in specified private label RMBS transactions as an issuer, sponsor, underwriter, depositor, trustee, custodian or servicer. HSBC Bank USA has also had preliminary contacts with other government authorities exploring the role of trustees in private label RMBS transactions. In February 2011, HSBC Bank USA also received a subpoena from the US Attorney's Office, Southern District of New York seeking production of documents and information relating to loss mitigation efforts with respect to residential mortgages in the State of New York. In January 2012, HSBC Securities (USA) Inc. was served with a Civil Investigative Demand from the Massachusetts State Attorney General seeking documents, information and testimony related to the sale of RMBS to public and private customers in the State of Massachusetts from January 2005 to the present.

HSBC expects this level of focus will continue and, potentially, intensify, so long as the US real estate markets continue to be distressed. As a result, HSBC Group companies may be subject to additional claims, litigation and governmental and regulatory scrutiny related to its participation in the US mortgage securitisation market, either individually or as a member of a group. HSBC is unable to estimate reliably the financial effect of any action or litigation relating to these matters. As situations develop it is possible that any related claims could be significant.

Anti-money laundering and sanctions-related

In October 2010, HSBC Bank USA entered into a consent cease and desist order with the Office of the Comptroller of the Currency and the indirect parent of that company, HNAH, entered into a consent cease and desist order with the Federal Reserve Board (the 'Orders'). These Orders required improvements to establish an effective compliance risk management programme across the Group's US businesses, including various issues relating to US Bank Secrecy Act ('BSA') and anti-money laundering ('AML') compliance. Steps continue to be taken to address the requirements of the Orders to ensure compliance, and that effective policies and procedures are maintained.

In addition, in December 2012, HSBC, HNAH and HSBC Bank USA entered into agreements to achieve a resolution with US and UK government agencies that have investigated HSBC's conduct related to inadequate compliance with anti-money laundering, BSA and sanctions laws, including the previously reported investigations by the DoJ, the Federal Reserve, the Office of the Comptroller of the Currency and the US Department of Treasury's Financial Crimes Enforcement Network ('FinCEN') in connection with AML/BSA compliance, including cross-border transactions involving our cash handling business in Mexico and banknotes business in the US, and the DoJ, the New York County District Attorney's Office, the Office of Foreign Assets Control ('OFAC'), the Federal Reserve and the Office of the Comptroller of the Currency regarding historical transactions involving Iranian parties and other parties subject to OFAC economic sanctions. As part of the resolution, HSBC entered into a deferred prosecution agreement among HSBC, HSBC Bank USA, the DoJ, the United States Attorney's Office for the Eastern District of New York, and the United States Attorney's Office for the Northern District of West Virginia (the 'US DPA'), and a deferred prosecution agreement with the New York County District Attorney, and consented to a cease and desist order and, along with HNAH, consented to a monetary penalty order with the Federal Reserve. In addition, HSBC Bank USA entered into the US DPA, an agreement and consent orders with the Office of the Comptroller of the Currency, and a consent order with FinCEN. HSBC also entered into an undertaking with the UK Financial Services Authority ('FSA') to comply with certain forward-looking obligations with respect to anti-money laundering and sanctions requirements over a five-year term.

Under these agreements, HSBC and HSBC Bank USA made payments totalling US$1,921m to US authorities and will continue to cooperate fully with US and UK regulatory and law enforcement authorities and take further action to strengthen their compliance policies and procedures. Over the five-year term of the agreement with the DoJ and FSA, an independent monitor (who will, for FSA purposes, be a 'skilled person' under Section 166 of the Financial Services and Markets Act ('FSMA')) will evaluate HSBC's progress in fully implementing these and other measures it recommends, and will produce regular assessments of the effectiveness of HSBC's compliance function. If HSBC fulfils all of the requirements imposed by the US DPA and other agreements, the DOJ's charges against it will be dismissed at the end of the five-year period. The US DPA remains subject to certain proceedings before the United States District Court for the Eastern District of New York. The DoJ or the New York County District Attorney's Office may prosecute HSBC in relation to the matters which are the subject of the US DPA if HSBC breaches the terms of the US DPA.

Steps continue to be taken to address the requirements of the US DPA and the FSA undertaking to ensure compliance, and that effective policies and procedures are maintained. In addition, the settlement with regulators does not preclude private litigation relating to, among other things, HSBC's compliance with applicable anti-money laundering, BSA and sanctions laws.

In July 2012, HSBC Mexico paid a fine imposed by the Mexican National Banking and Securities Commission amounting to 379m Mexican pesos (approximately US$28m), in connection with non-compliance with anti-money laundering systems and controls.

US tax and broker-dealer investigations

HSBC continues to cooperate in ongoing investigations by the DoJ and the US Internal Revenue Service regarding whether certain Group companies and employees acted appropriately in relation to certain customers who had US tax reporting requirements. In connection with these investigations, HSBC Private Bank Suisse SA, with due regard for Swiss law, has produced records and other documents to the DoJ and is cooperating with the investigation. Other HSBC entities are also cooperating with the relevant US authorities, including with respect to US-based clients of an HSBC Group company in India.

In April 2011, HSBC Bank USA received a summons from the US Internal Revenue Service directing HSBC Bank USA to produce records with respect to US-based clients of an HSBC Group company in India. HSBC Bank USA has cooperated fully by providing responsive documents in its possession in the US to the US Internal Revenue Service.

Also in April 2011, HSBC Bank USA received a subpoena from the SEC directing HSBC Bank USA to produce records in the US related to, among other things, HSBC Private Bank Suisse SA's cross-border policies and procedures and adherence to US broker-dealer and investment adviser rules and regulations when dealing with US resident clients. HSBC Bank USA continues to cooperate with the SEC. HSBC Private Bank Suisse SA has also produced records and other documents to the SEC and is cooperating with the SEC's investigation.

Based on the facts currently known in respect of each of these investigations, there is a high degree of uncertainty as to the terms on which the ongoing investigations will be resolved and the timing of such resolution, including the amounts of any fines and/or penalties. As matters progress, it is possible that any fines and/or penalties could be significant.

Investigations and reviews into the setting of London interbank offered rates, European interbank offered rates and other benchmark interest and foreign exchange rates

Various regulators and competition and enforcement authorities around the world including in the UK, the US, Canada, the EU, Switzerland and Asia, are conducting investigations and reviews related to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest and foreign exchange rates. Several of these panel banks have reached settlements with various regulatory authorities. As certain HSBC entities are members of such panels, HSBC and/or its subsidiaries have been the subject of regulatory demands for information and are cooperating with those investigations and reviews. Based on the facts currently known, there is a high degree of uncertainty as to the resolution of these regulatory investigations and reviews, including the timing. The potential impact and size of any fines or penalties that could be imposed on HSBC cannot be measured reliably.

In addition, HSBC and other panel banks have been named as defendants in private lawsuits filed in the US with respect to the setting of Libor, including putative class action lawsuits which have been consolidated before the US District Court for the Southern District of New York. The complaints in those actions assert claims against HSBC and other panel banks under various US laws including US antitrust laws, the US Commodities Exchange Act, and state law. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing and potential impact on HSBC.

44 Related party transactions

Related parties of the Group and HSBC Holdings include subsidiaries, associates, joint ventures, post-employment benefit plans for HSBC employees, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Holdings, being the Directors and Group Managing Directors of HSBC Holdings.

Compensation of Key Management Personnel

	HSBC		
	2012 US$m	2011 US$m	2010 US$m
Short-term employee benefits	**37**	34	39
Post-employment benefits	**1**	2	3
Other long-term employee benefits	**10**	7	1
Share-based payments	**43**	53	49
	91	96	92

Transactions, arrangements and agreements involving related parties

Particulars of advances (loans and quasi-loans), credits and guarantees entered into by subsidiaries of HSBC Holdings during 2012 with Directors, disclosed pursuant to section 413 of the Companies Act 2006, are shown below:

	At 31 December	
	2012 US$m	2011 US$m
Advances and credits	**7**	8

Particulars of transactions with related parties, disclosed pursuant to the requirements of IAS 24, are shown below. The disclosure of the year-end balance and the highest amounts outstanding during the year in the table below is considered to be the most meaningful information to represent the amount of the transactions and the amount of outstanding balances during the year.

	2012		2011	
	Balance at 31 December US$m	**Highest amounts outstanding during year US$m**	Balance at 31 December US$m	Highest amounts outstanding during year US$m
Key Management Personnel[1]				
Advances and credits	**153**	**242**	112	120
Guarantees	**8**	**12**	12	12

1 *Includes Key Management Personnel, close family members of Key Management Personnel and entities which are controlled or jointly controlled by Key Management Personnel or their close family members.*

Some of the transactions were connected transactions, as defined by the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited but were exempt from any disclosure requirements under the provisions of those rules. The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Shareholdings, options and other securities of Key Management Personnel

	At 31 December 2012 (000s)	2011 (000s)
Number of options held over HSBC Holdings ordinary shares under employee share plans	**358**	545
Number of HSBC Holdings ordinary shares held beneficially and non-beneficially	**14,713**	15,384
Number of HSBC Holdings 6.5% Subordinated Notes 2036 held beneficially and non-beneficially	**300**	300
Number of HSBC Bank 2.875% Notes 2015 held beneficially and non-beneficially	**5**	–
	15,376	16,229

Transactions with other related parties of HSBC

Associates and joint ventures

The Group provides certain banking and financial services to associates and joint ventures, including loans, overdrafts, interest and non-interest bearing deposits and current accounts. Details of the interests in associates and joint ventures are given in Note 22. Transactions and balances during the year with associates and joint ventures were as follows:

	2012		2011	
	Highest balance during the year[1] US$m	**Balance at 31 December[1] US$m**	Highest balance during the year[1] US$m	Balance at 31 December[1] US$m
Amounts due from joint ventures:				
– subordinated	**5**	**1**	6	5
– unsubordinated	**391**	**210**	459	441
Amounts due from associates:				
– unsubordinated	**3,554**	**2,736**	3,117	2,569
	3,950	**2,947**	3,582	3,015
Amounts due to joint ventures	**135**	**1**	195	133
Amounts due to associates	**854**	**264**	587	475
	989	**265**	782	608
Commitments	**326**	**45**	184	92

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

Post-employment benefit plans

At 31 December 2012, US$5bn (2011: US$4.6bn) of HSBC post-employment benefit plan assets were under management by HSBC companies. Fees of US$20m (2011: US$20m) were earned by HSBC companies for these management services provided to its post-employment benefit plans. HSBC's post-employment benefit plans had placed deposits of US$285m (2011: US$1.2bn) with its banking subsidiaries, on which interest payable to the schemes amounted to US$1.9m (2011: US$3m). The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

HSBC Bank (UK) Pension Scheme entered into swap transactions with HSBC as part of the management of the inflation and interest rate sensitivity of its liabilities. At 31 December 2012, the gross notional value of the swaps was US$31bn (2011: US$25bn), the swaps had a positive fair value of US$5.2bn (2011: positive fair value of US$5.6bn) to the scheme and HSBC had delivered collateral of US$7.1bn (2011: US$6.9bn) to the scheme in respect of these swaps, on which HSBC earned no interest (2011: nil). All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

In order to satisfy diversification requirements, there are special collateral provisions for the swap transactions between HSBC and the scheme. The collateral agreement stipulates that the scheme never posts collateral to HSBC. Collateral is posted to the scheme by HSBC at an amount that provides the Trustee with a high level of confidence that would be sufficient to replace the swaps in the event of default by HSBC Bank plc. With the exception of the special collateral arrangements detailed above, all other aspects of the swap transactions between HSBC and the scheme are on substantially the same terms as comparable transactions with third-party counterparties.

In December 2011, HSBC Bank plc made a £184m (US$286m) contribution to the HSBC Bank (UK) Pension Scheme. Following the contribution the Scheme purchased asset-backed securities from HSBC at an arm's length value, determined by the Scheme's independent third-party advisers.

In December 2011 HSBC International Staff Retirements Benefits Scheme ('ISRBS') purchased asset-backed securities from HSBC at an arm's length value of US$34m, determined by the Scheme's independent third party advisers. This followed an agreement by HSBC Asia Holdings BV to make a contribution of the same amount to ISRBS. No gain or loss arose on the transaction.

ISRBS entered into swap transactions with HSBC to manage the inflation and interest rate sensitivity of the liabilities and selected assets. At 31 December 2012, the gross notional value of the swaps was US$1.8bn (2011: US$1.7bn) and the swaps had a net positive fair value of US$328m to the scheme (2011: US$297m). All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

HSBC Holdings

Details of HSBC Holdings' principal subsidiaries are shown in Note 25. Transactions and balances during the year with subsidiaries were as follows:

	2012		2011	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	US$m	**US$m**	US$m	US$m
Assets				
Cash at bank	**429**	**353**	471	316
Derivatives	**4,122**	**3,768**	4,220	3,568
Loans and advances	**41,675**	**41,675**	28,821	28,048
Financial investments	**1,208**	**1,208**	2,093	1,078
Investments in subsidiaries	**92,234**	**92,234**	93,008	90,621
Total related party assets	**139,668**	**139,238**	128,613	123,631
Liabilities				
Amounts owed to HSBC undertakings	**12,856**	**12,856**	3,129	2,479
Derivatives	**1,536**	**760**	1,181	1,067
Subordinated liabilities:				
– at amortised cost	**2,493**	**1,696**	2,609	2,437
– designated at fair value	**4,271**	**4,260**	4,627	3,955
Total related party liabilities	**21,156**	**19,572**	11,546	9,938
Guarantees	**49,560**	**49,402**	49,527	49,402
Commitments	**1,811**	**1,200**	2,753	1,810

1 *The disclosure of the year-end balance and the highest month-end balance during the year is considered the most meaningful information to represent transactions during the year. The above outstanding balances arose in the ordinary course of business and were on substantially the same terms, including interest rates and security, as for comparable transactions with third-party counterparties. There were no exceptions (2011: US$63m) in respect of loans to HSBC subsidiaries from HSBC Holdings made at an agreed zero per cent interest rate.*

Some employees of HSBC Holdings are members of the HSBC Bank (UK) Pension Scheme, which is sponsored by a separate Group company. HSBC Holdings incurs a charge for these employees equal to the contributions paid into the scheme on their behalf. Disclosure in relation to the scheme is made in Note 7.

45 Events after the balance sheet date

On 7 January 2013, Industrial Bank Co., Ltd. ('Industrial Bank'), a principal associate, completed a private placement of additional share capital to a number of third parties, thereby diluting the Group's equity holding from 12.8% to 10.9%. As a result of this and other factors, the Group considers it is no longer in a position to exercise significant influence over Industrial Bank and ceased to account for the investment as an associate from that date, giving rise to an accounting gain of HK$9.5bn or US$1.2bn. Thereafter, the holding is recognised as an available-for-sale financial investment.

The disposal of the second tranche of shares in Ping An was completed on 6 February 2013. A description of this disposal is provided in Note 26.

On 19 February 2013, we announced an agreement to sell HSBC Bank Panama S.A., recorded as part of our Latin America segment, to Bancolombia S.A. for a total consideration of US$2.1bn in cash. The transaction is subject to regulatory approvals and other conditions and is expected to complete by the third quarter of 2013. The assets and liabilities of these operations were not classified as held for sale at 31 December 2012 as the sale was not yet considered highly probable at that time.

On 28 February 2013, HSBC Bank USA entered into an agreement with the Office of the Comptroller of the Currency, and HSBC Finance and HNAH entered into an agreement with the Federal Reserve Board in relation to the Independent Foreclosure Review. Additional information is provided in Note 43.

A fourth interim dividend for 2012 of US$0.18 per ordinary share (a distribution of approximately US$3,327m) was declared by the Directors after 31 December 2012.

These accounts were approved by the Board of Directors on 4 March 2013 and authorised for issue.