

Note:

This document was circulated privately by HSBC among its largest shareholders in January 2008 in order to obtain their views on proposed changes to the 2005 Share Plan (Executive Long Term Incentive Plan) following criticism of the Plan by Knight Vinke and other institutional shareholders.

January 2008

Consultation on Proposed Remuneration Arrangements

Following the investor meeting held at the ABI on 12 November 2007, I am writing to you regarding some changes that the Remuneration Committee is proposing to make to the remuneration of our Executive Directors and senior management.

In July 2007, as part of its annual review, the Remuneration Committee appointed Mercer Limited as their independent advisers and requested them to carry out a comprehensive assessment of the remuneration arrangements of the Group's senior management population. The objective was to ensure that the approach and arrangements remain fit for purpose and aligned with our business strategy. The Committee concluded from the findings of this review that, whilst the current reward strategy and structure remained generally appropriate, there were areas that required some refinement. **The Committee also concluded, in light of the peer group comparisons and changes in market conditions, that changes were necessary to make the overall package competitive.**

Therefore, we have updated our reward strategy to focus on compensation as a whole, rather than individual elements of pay and to emphasise the link between pay and performance through the provision of highly leveraged, variable remuneration. As a result, we are proposing changes to the short and long-term incentive arrangements for 2008 and onwards.

As part of the consultation process, we are now writing to our largest shareholders, the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) to gather their views on the proposed changes to the remuneration arrangements prior to finalising them. Additionally, any specific proposals relating to the changes to the long-term incentive element will be put forward for shareholder approval at the AGM in 2008 in a separate resolution.

HSBC Holdings plc

8 Canada Square, London E14 5HQ

Knight Vinke believes that the problems facing the banking industry are attributable at least in part to poor alignment of management and shareholder interests. Ultimately, shareholders are interested in stock market performance. One of our principal criticisms of this proposal is that total shareholder return (TSR) plays so small a part in determining management pay.

Current Arrangements

For reference, the current arrangements for Executive Directors, as set out in the 2006 Directors' Remuneration Report, are summarised below:

- Remuneration arrangements are benchmarked against a comparator group consisting of FTSE30 companies with significant international operations, other major European and, where appropriate, US parented banks.
- Base salaries are set at market competitive levels, with the majority of the remuneration package delivered in the form of performance-related pay (annual and long-term incentives)
- The annual bonus is based on a combination of individual performance and financial results against plan. Maximum bonus levels have been set at 250% of salary. The annual bonus payments made in 2007 based on 2006 salaries were: the Group Chairman received 140%, the Group Chief Executive 175% and the Group Finance Director 87% of salary.
- Executive Directors are eligible to receive awards of performance shares under the HSBC Share Plan.
 - The maximum annual limit under the Plan is 700% of salary. Awards made under the plan in 2007 based on 2006 salaries have been as follows: the Group Chairman received an award of performance shares of 300%, the Group Chief Executive 500% and the Group Finance Director 383% of salary.
 - 50% of the performance shares vest according to relative Total Shareholder Return (TSR) achievement and the remaining 50% according to Earnings per Share (EPS) growth over a three-year performance measurement period.

Proposed Changes

Remuneration Benchmarking Comparator Group

We have reviewed the comparator group used for remuneration benchmarking to ensure that the companies reflect the market in which we compete for executive benchmarked against a more focused comparator group on nine financial services organisations with a global presence, namely: Banco Santander, Bank of America, Barclays, BNP Paribas, Citigroup, Deutsche Bank, Royal Bank of Scotland, Standard Chartered and UBS.

Current and Proposed Remuneration Competitive Positioning

The latest available competitive benchmark data from this global comparator group shows that we are lagging behind in terms of both the structure and overall level of remuneration.

Specifically, this data shows that for HSBC's Executive Directors the current position is typically:

- Base salary is in the upper quartile;
- Total Cash (the sum of salary and bonus) is around the lower quartile, and

- Total Compensation (the sum of total cash and expected value of long-term incentives) is also around the quartile.

Based on this data, Executive Directors' salaries will not be increased in 2008.

In line with our philosophy of providing competitive total compensation, with a high proportion of remuneration in the form of variable pay, we are proposing to change the annual bonus and the HSBC Share Plan as described in this letter.

The proposed changes will give greater flexibility to position Executive Directors' total compensation appropriately within the market range of data from the comparator group, based upon performance. For example, under the proposals, we anticipate that on an expected value basis Total Cash and Total Compensation will be positioned around the median, with actual payouts being at upper quartile should the plans pay out at maximum if stretching levels of performance are achieved (see next section).

Annual Bonus

The Committee is proposing to increase the maximum annual bonus potential from 250% to 400% of salary for the Executive Directors to reflect both competitive market practice among our comparator group and our reward policy of providing highly geared variable remuneration.

To ensure further alignment with the shareholders and to reflect the practice in financial services organisations, 37.5% of the annual bonus (which equates to the increase in the annual bonus potential, i.e. from 250% to 400% at maximum) will be deferred into HSBC shares on a compulsory basis for a period of three years. This will be coupled with increased share ownership requirements (see below).

The performance level required for full payment under the annual bonus plan will be genuinely stretching. The Committee intends to provide more detailed disclosure in the Directors; Remuneration Report on the performance measures and achievement at the end of each financial year together with a commentary on the resulting payouts.

Objectives will be set and assessed using a 'balanced scorecard' approach and will include financial (e.g. revenue growth, economic profit and cost efficiency) and non financial (e.g. customer recommendation and employee engagement) measures. The proposed increase in annual bonus opportunity, with the corresponding deferral into HSBC shares, will be effective for bonuses paid in 2009 with respect to performance in the 2008 financial year.

Why is there no mention of shareholder return?

There will be no matching award of cash or shares provided on this deferred bonus. The release of deferred bonuses will be in line with the payment of bonuses under existing contractual arrangements.

Long-Term Incentives

It is the intention of the Committee to continue making awards of performance shares under the HSBC Share Plan and to maintain the overall maximum at its current level. In line with our reward philosophy of providing highly geared variable remuneration and to reflect competitive market practice in our global comparator group, we propose to

Do the sub-prime problems at HFC mean nothing to the Remuneration Committee? What matters is the output not the efforts made by management!

make awards in 2008 to Executive Directors that are closer to or at the overall permitted maximum and make changes to the performance measurement framework as summarised below:

- an update of the TSR comparator group and a change in the TSR measurement method;
- a refinement in the EPS growth measurement method and a change in the vesting schedule; and
- the introduction of Group Economic Profit as a third measure of performance.

One-third of awards will be tied to the achievement against each measure.

Awards of performance shares in 2008 will be made under the new framework shortly after the AGM in May 2008, subject to the proposed changes being approved by shareholders.

It is the Committee's intention that the calibration of the performance measures described in this letter will be reviewed annually to ensure that it remains appropriate for future awards, given economic expectations and the industry's outlook.

Update of the TSR Comparator Group and change in the TSR measurement method

The review has highlighted that the current comparator group of twenty eight major banks could be revised to better reflect our growth strategy towards emerging markets such as Latin America and Asia. Therefore, we are proposing to update the comparator group to include, in addition to large global banks, companies against which HSBC competes for business on a regional and /or local level. We believe that this modified comparator group (as set out in Worked Example 1) reflects our business strategy and our competitors for shareholder capital.

In addition, we are proposing a change to the TSR measurement method to recognise the fact that the range of market capitalisations with the modified comparator group is very wide and that only a few global banks truly match HSBC in terms of scale.

Therefore, instead of simply ranking the companies according to their individual TSR performance, we propose to use a market capitalisation weighted method to recognise the significant size differentials within the group. The proposed market capitalisation approach is described below:

1. Each company's TSR is calculated in Sterling and ranked according to its TSR performance in the comparator group over the three-year performance period.
2. The market capitalisation based on the value of the free float of each company at the beginning of the measurement period is determined. The total market capitalisation of the companies in the comparator group (excluding HSBC) is calculated and expressed in Sterling. The free float will be as calculated by Morgan Stanley Capital International (MSCI) and defined as the proportion of shares outstanding that is deemed to be available for purchase in the public equity markets by international investors¹².

This reduces the TSR related portion from 50% to 33%!

This means that HSBC is measuring itself against the largest banks, instead of measuring itself against the best performing banks!

¹² MSCI Global Investable Market Indices Methodology, December 2007, page 75

- Percentage ranking is calculated as follows: The total free-float market capitalisation of all the companies that HSBC has out-performed on a TSR basis (numerator) divided by the total market capitalisation of the companies in the comparator group as calculated in Step 2 (denominator).

We consider that this approach is more appropriate as it takes into account the following factors:

- the impact of highly volatile but smaller companies on TSR ranking;
- the market capitalisation that is based on free float for each company in the comparator group; and
- the connection between the Group's size and the absolute and relative level of shareholder value that it can potentially create.

Under the proposed method, 30% of the award vests for out-performing 50% of the total market capitalisation of the companies in the comparator group, and 100% vests for exceeding 75% or more of the total market capitalisation. There will be straight line vesting between these two points and no vesting for out-performing less than 50% of the total market capitalisation of the companies in the comparator group.

We believe that this vesting schedule provides an appropriate relationship between pay and performance. We also believe that it is in line with corporate governance guidelines in the UK where the expectation is that threshold vesting should be modest for median, with full vesting occurring for the achievement of significantly greater value creation that applicable to threshold vesting.

TSR will be measured consistently in Pounds Sterling, given the composition of our shareholder base and in line with the guidance given by the Association of British Insurers. The measurement period will start on the day following the announcement of results to ensure that HSBC's share price reflects all available market information. Please see Worked Example 1 for an illustration of three vesting scenarios under the TSR measure.

Refinement in EPS growth measurement method and change in vesting schedule

We are proposing to simplify the presentation of the EPS calculation by converting the total incremental EPS delivered to shareholders over the three year performance period (as in the existing method) into a Compound Annual Growth Rate (CAGR). **This will not affect the substance of the calculation and is explained in detail in Worked Example 2.**

We continue to believe that such a method is superior to the more commonly used point to point approach as it takes into account the Group's EPS performance over the whole of the performance period and rewards management for delivering consistent growth in earnings as illustrated in Worked Example 2. It also spreads the impact of 'fair value' volatility in profit and loss measurement under IFRS.

EPS growth targets will be expressed in absolute percentage terms without adjusting for inflation. In reviewing the appropriateness of these targets, we have taken into account recent and expected levels of inflation in the major markets in which we operate. This recognises that HSBC is operating in a global environment and hence using a UK or other country inflation index is not suitable.

None of the three factors shown on the left are relevant to the alignment of management and shareholder interests.

HSBC management continues to be eligible for 100% payouts even if there is no net increase in EPS over a 3-year performance period!

The 2005 Share Plan effectively triple counts EPS growth in Year 1, double counts it in Year 2 and single counts it in Year 3...

This is nonsense and results in perverse incentives.

We are proposing to increase the levels of EPS growth that will be required to determine vesting under the EPS element as described below (please note that, for ease of comparison, we have presented the current vesting schedule on a consistent basis with the proposed CAGR description):

- Threshold: 30% of the award will vest for compound annual growth in EPS of 5% per annum (this is an increase from 3.9%)
- Maximum: 100% of the award will vest for compound annual growth in EPS of 8.5% per annum or more (an increase from 8.2%)
- There will be no vesting below threshold
- There will be straight-line vesting between threshold and maximum

i.e. only 3% after inflation.

The definition of EPS will remain the profit attributable to shareholders (expressed in US dollars), divided by the weighted average number of ordinary shares in issue and held outside the Group during the year in question.

i.e. including one-offs.

Please see Worked Example 2 for an illustration of five vesting scenarios.

Introduction of Economic Profit as a third performance measure

It is proposed that Group Economic Profit will be used as a third measure of performance. Economic Profit will be measured annually over a three-year period and expressed as the average difference between return on invested capital and the Group's benchmark cost of capital used in our five-year strategic plan, which is currently 10%. Economic Profit will be expressed in percentage terms.

Barclays tried this and ended up paying the full amount despite 4th quartile TSR performance.

We believe that Economic Profit is a key measure of shareholder value creation as it rewards management only if the return on the capital invested in HSBC by its shareholders is in excess of the cost of that capital. Thus, Economic Profit is a complementary measure to both TSR, which is an external measure of shareholder value creation, and EPS, which is a direct measure of profits generated for shareholders.

It is proposed that the vesting schedule will be as follows:

- At threshold, vesting will start when Economic Profit exceeds 2% on average over the three-year measurement period
- 30% of the award will vest for Economic Profit being equal to 4% on average over the three-year measurement period
- At maximum, 100% of the award will vest for Economic Profit being to equal to 8% or more on an average over the three-year measurement period
- There will be straight line vesting between 2% and 4%, and between 4% and 8%
- There will be no vesting if Economic Profit is less than or equal 2%

Please see Worked Example 3 for an illustration of the vesting schedule and an illustration of four vesting scenarios.

Vesting of Long-Term Incentive Awards

Following the three-year performance period, the conditions applying to awards of performance shares under the Plan will be tested and vesting will take place shortly

afterwards. Shares released will include additional shares equivalent to the value of the dividends payable on the vested shares over the performance period, where permitted by the laws of the relevant jurisdiction.

To the extent that the performance conditions have not been met at the third anniversary, the share awarded will be forfeited.

In addition, awards will not vest unless the Remuneration Committee is satisfied that HSBC's financial performance has shown a sustained improvement in the period since the award date. In determining whether HSBC has achieved a sustained improvement in performance, the Committee will take into account all relevant factors but in particular comparisons against the comparator group in areas such as revenue growth and mix, cost efficiency, credit performance, cash return on cash invested, dividend performance and total shareholder return.

The Committee will also have discretion to take into account the impact of one off events (e.g. major sales, purchases) that significantly impact the vesting of awards.

If events occur which cause the Committee to consider that a performance condition has become unfair or impractical, the Committee continues to reserve the right, if it considers it appropriate to do so, to amend, relax or waive the condition.

Share Ownership Policy

HSBC currently operates a formal share ownership policy, expressed as a number of shares, for the Executive Directors and the senior management team. To demonstrate further alignment with shareholders and to reflect the proposed increase in the variable element of the remuneration package under the proposed reward policy, it is proposed that the share ownership requirements will be increased as follows:

- Group Chairman and Group Chief Executive: increase from 300,000 to 600,000 shares, which approximates to about four and five times salary respectively
- Group Finance Director increase from 100,000 to 200,000 shares, which approximates to about two times salary

Similar changes will be made for other senior executives. Shares currently owned, including vested share awards, and shares deferred under the annual bonus plan will be used to calculate the level of share ownership.

Executive Directors will have five years from the date of the first award under the proposed framework in 2008 to achieve their required share ownership target. It is expected that the required holdings will be built up steadily over the period of time. Individual circumstances will be taken into account in case of non-compliance with the Remuneration Committee having full discretion in determining any penalties. These might, for example, include a reduction of future awards of long-term incentives and/or an increase in the proportion of the annual bonus that is deferred into shares.

*In the past, the Committee has used its discretion to **waive** the conditions, not to make them more restrictive.*

I trust that this letter provides you with sufficient information about our proposals and the rationale for them. These arrangements, which conform to our overall remuneration principles, will be competitive when compared to other global financial services organisations, continue to support HSBC's business objectives and reflect our commitment to meeting global corporate governance standards.

The Remuneration Committee's next meeting is on 21 January 2008. If possible, I should be pleased to receive your initial views by that date. If you would like to meet to discuss our proposals in more detail, I should be happy to do this.

In the meantime, if you have any specific questions of detail, may I ask that you contact John Beadle, Head of Group Performance and Reward, at john.beadle@hsbc.com.

Mark Moody-Stuart
Chairman of the Remuneration Committee

Worked Example 1 – TSR Updated Comparator Group

The table below sets out the proposed comparator group ranked in descending market capitalisation (based on free float) order. The free float will be calculated by Morgan Stanley Capital International (MSCI) and defined as the proportion of shares outstanding that is deemed to be available for purchase in the public equity markets by international investors.

The updated comparator group consists of 26 companies. 20 of these companies (as shown in bold below) are constituents of the TSR group used for the 2005, 2006 and 2007 performance share awards.

Company	Market Capitalisation (20 December 2007, £m)	Country	Implied Weight	3yr TSR rank (quartile)
Bank of America	£93,007	United States	9.8%	4
Citigroup	£75,215	United States	7.9%	4
JP Morgan Chase & Co.	£74,632	United States	7.8%	2
Banco Santander	£66,154	Spain	6.9%	1
Wells Fargo & Co	£49,083	United States	5.2%	3
UBS	£46,459	Switzerland	4.9%	4
BBVA	£45,003	Spain	4.7%	2
BNP Paribas	£44,852	France	4.7%	2
Royal Bank of Sctl. Gp.	£43,258	United Kingdom	4.5%	4
Wachovia	£39,056	United States	4.1%	4
Unicredito Italiano	£37,747	Italy	4.0%	3
Barclays	£34,182	United Kingdom	3.6%	3
Royal Bank of Canada	£32,145	Canada	3.4%	1
Deutsche Bank	£32,031	Germany	3.4%	2
Credit Suisse	£30,843	Switzerland	3.2%	2
HBOS	£26,843	United Kingdom	2.8%	4
National Aus. Bank	£26,641	Australia	2.8%	2
Fortis	£26,563	Belgium/Netherlands	2.8%	3
Societe Generale	£26,386	France	2.8%	3
Lloyds TSB Group	£26,316	United Kingdom	2.8%	3
Standard Chartered	£24,264	United Kingdom	2.5%	1
Bradesco	£14,973	Brazil	1.6%	1
Banco Itau	£12,692	Brazil	1.3%	1
Indl.& Coml.Bk.Of China	£10,658	China	1.1%	n/a
DBS Group	£8,021	Singapore	0.8%	1
Bank of China	£5,701	China	0.6%	n/a
Total	£952,726		100%	

Top 8 banks account for 52% of the updated comparator group's total market cap.

Emerging market peers only account for 6%.

HSBC	£99,596	United Kingdom
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Source: MSCI and Datastream.

Please note that MSCI Barra have informed us that they currently base the free float of Standard Chartered on 50% of its market capitalisation when calculating their indices. From March 2008, we understand that their methodology will change so that the full value of the market capitalisation of Standard Chartered will be included in their indices as free float. The table above shows the total market capitalisation of Standard Chartered.

Market Capitalisation Weighted Method

Up to one-third of an award will be tied to the achievement against this measure.

The following describes the proposed market capitalisation weighted method:

Step 1: Each company's TSR is calculated and ranked according to its TSR performance in the comparator group over the three-year performance period.

Step 2: The market capitalisation based on free float of each company at the beginning of the measurement period is determined. The total market capitalisation of the companies in the comparator group (excluding HSBC) is calculated

Step 3: Percentage ranking is calculated as follows: The total market capitalisation of all the companies that HSBC has out-performed on a TSR basis (numerator) divided by the total market capitalisation of the companies in the comparator group as calculated in Step 2 (denominator)

Vesting will be according to the following schedule: 30% of the award relating to TSR vests for outperforming 50% of the combined market capitalisations and 100% vests for exceeding 75% or more of the combined market capitalisations, with straight line extrapolation between these two points. There will be no vesting for out-performing less than 50% of the total market capitalisation of the companies in the comparator group.

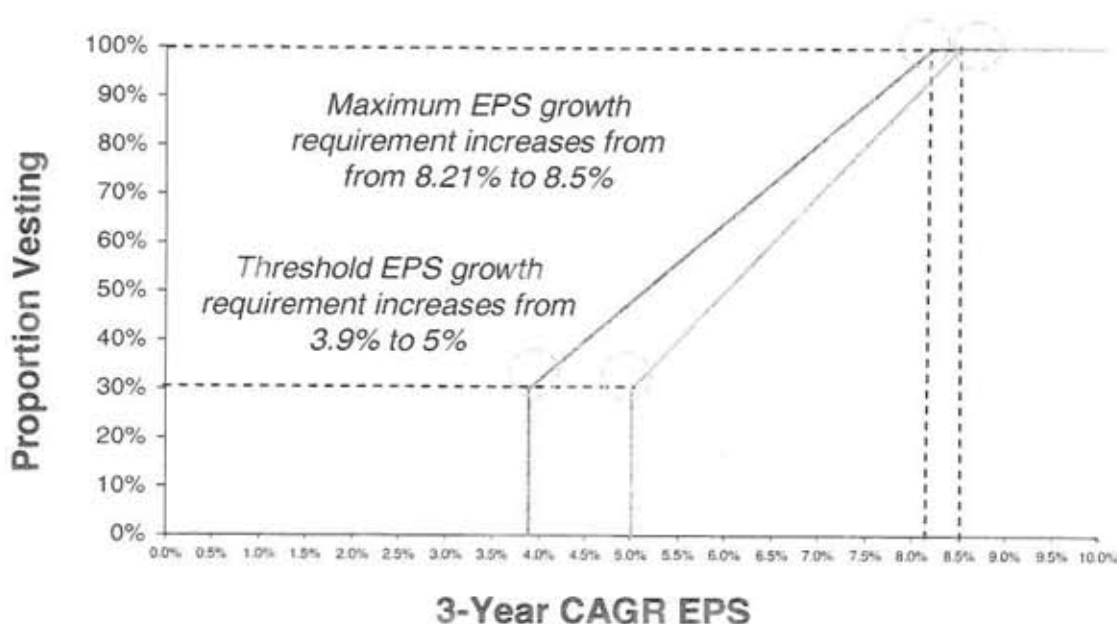
The tables below illustrate the possible levels of vesting under the different TSR scenarios for HSBC, based on the market capitalisation information on the previous page and randomly generated TSRs:

	HSBC TSR	Total Market Capitalisation excluding HSBC (£m)	Total Market Capitalisation of Companies that HSBC has out-performed (£m)	% out- performance*	Vesting
Scenario 1	38%	£952,726	£735,402	77.2%	100%
Scenario 2	23%	£952,726	£507,018	53.2%	39%
Scenario 3	15%	£952,726	£431,803	45.3%	0%

* Rounded to 1 decimal place

Worked Example 2 – EPS EPS Vesting Schedule

Up to one-third of an award will be tied to the achievement against this measure.



See how the interests of management and shareholders have not been aligned in this plan: in scenario 4 shareholders see a 30% increase in net EPS but management pay under the plan is nil and in scenario 5 with no net increase in EPS, the payout is 100%.

Measurement Method

The table below sets out the level of vesting under five scenarios.

	Year 1	Year 2	Year 3	Year 4	CAGR EPS*	Vesting
Scenario 1	100	106	110	115	5.0%	30%
Scenario 2	100	105	115	120	6.4%	58%
Scenario 3	100	118	110	126	8.5%	100%
Scenario 4	100	80	80	130	-1.6%	0%
Scenario 5	100	126	126	100	8.2%	94%

How can this be correct? It is only because Year 1 is triple counted, Year 2 double counted and Year 3 single counted...

Explanation of Approach under Scenario 1:

Base EPS = 100 (Year 1)

Total EPS achieved in Years 2 to 4 = 331, which is positive growth on a cumulative basis (steady state = 300 over 3 years)

If *i* is the Compound Annual Growth Rate (CAGR) expressed as a percentage

Total EPS achieved = $[Base\ EPS \times (1 + i/100)^2] + [Base\ EPS \times (1 + i/100)^3]$

$331 = [100 \times (1 + i/100)] + [100 \times (1 + i/100)^2] + [100 \times (1 + i/100)^3]$

CAGR EPS growth is calculated by solving for *i* above

Therefore, CAGR EPS growth = 5.0%*

* Rounded to 1 decimal point

We believe that our method is superior to the more commonly used “point to point” approach as it takes into account the Group’s EPS performance throughout the performance period and rewards management for delivering consistent growth in earnings. For example:

- There will be no payout under Scenario 4, where EPS has fallen in Years 2 and 3 when compared to the base year. Note, however, that awards may still vest when EPS falls during a performance period. For example under Scenario 3, EPS falls between Years 2 and 3 and under Scenario 5, EPS falls between Years 3 and 4.
- There will be a payout under Scenario 5 as EPS has grown in Year 2 and Year 3 when compared to the base year. This approach also recognises that the base EPS required for awards made in Year 2 and Year 3 will be higher and that significant further out-performance would be required for such vesting

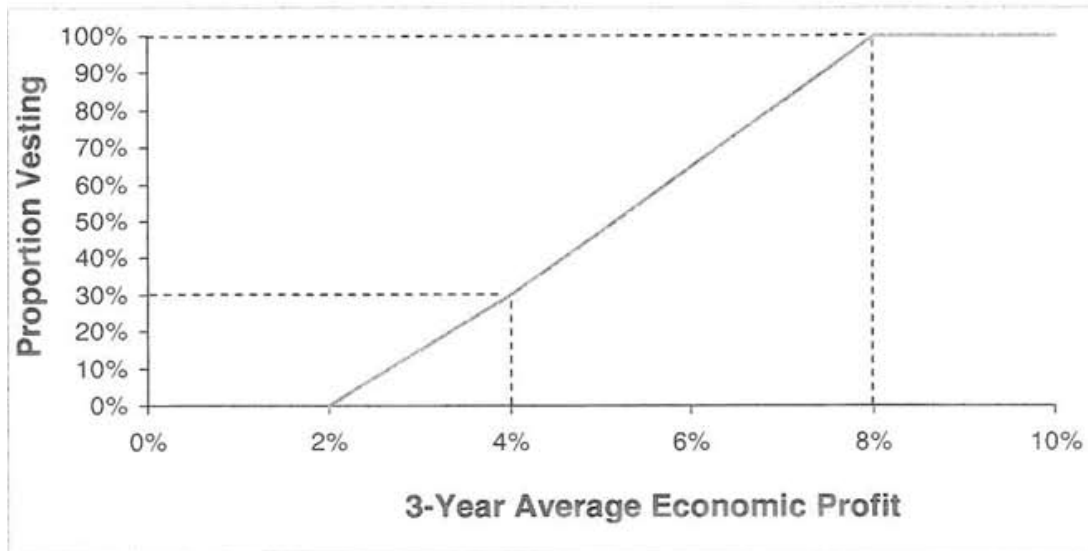
*The 2005 Share Plan effectively triple counts EPS growth in Year 1, double counts it in Year 2 and single counts it in Year 3. **The new plan has exactly the same flaw.***

What is wrong with that? Note also that year 4 starts from a low base...

Worked Example 3 – Economic Profit

Up to one-third of an award will be tied to the achievement against this measure.

Economic Profit Vesting Schedule



The cost of capital used is the benchmark cost of capital used in our five-year strategic plan, currently 10%

Measurement Method

The tables below illustrate the possible levels of vesting under the different Economic Profit scenarios for HSBC:

	3-Year Average Economic Profit (expressed in %)	Vesting
Scenario 1	2%	0%
Scenario 2	3%	15%
Scenario 3	6%	65%
Scenario 4	10%	100%