"Brief Explanation of Governance Issues (point 6)"

Concerning the HSBC 2005 Share Plan (the "Plan")

- Under the Plan, HSBC's most senior executives receive HSBC shares as part of their remuneration each year, but these shares are not immediately released. The shares are released if the Company achieves agreed performance targets (measured over the three year period following the award) and are lost if the performance targets are not met.
- A resolution to adopt the Plan was put to shareholders at the AGM in May 2005. Performance targets were summarised in the Chairman's Letter dated 31 March 2005 and other documents sent to shareholders in seeking approval for the Plan. They were also summarised in the 2004 Annual Report.

  All of these documents gave the impression that the performance targets were significantly more demanding than they are in reality.
- The full details of how the scheme works only became available to most shareholders long after the shareholders had approved the Plan – i.e., on publication of the 2005 and 2006 Annual Reports containing details of the performance targets and how they are calculated.
- As a consequence, HSBC's most senior executives stand to receive substantial performance-related pay in March 2008, despite more than $20 billion of provisions for credit and trading related losses over the past two years.

HSBC's Counter-Arguments

- HSBC has responded to this by saying that the Remuneration Committee has discretion to limit payouts and that the Plan was approved by shareholders.
- This argument entirely misses the point of performance-related schemes, which is that they should not be discretionary. Furthermore, HSBC's Remuneration Committee has in the past used its discretion to waive performance targets when these were not achieved.
- Crucially, however, most shareholders were unable to make an informed decision based on the information which was sent to them.

  We believe the Notice given to shareholders describing the Plan was both misleading and insufficient. As a result, the resolution approving the Plan is legally void and the Plan will have to be resubmitted to shareholders for approval at the next AGM.

  It is astonishing that HSBC has inaccurately described something as fundamental as the way its most senior executives are remunerated in seeking shareholder approval.

  This also illustrates that HSBC's Board of Directors may not be sufficiently independent.

Knight Vinke's six points concerning HSBC

1 Perennial stock market underperformance compared to peers.

2 Pursuit of geographic diversification instead of comparative advantage.

3 Lack of scale in key markets – UK, USA and France.

4 Good position in Hong Kong, but franchise at risk due to lack of credible China strategy.

5 Lack of credible CIBM strategy – trading assets now tie up a third of the group balance sheet.

6 Strategy unchallenged due to poor Board structure and lack of economic incentives for senior management to do so.