KNIGHT VINKE

OPEN LETTER TO THE SHAREHOLDERS OF HSBC HOLDINGS PLC

New York, 16th October 2007

Dear Fellow Shareholder,

On 4th September 2007 we wrote to Stephen Green, Group Chairman, requesting that the Board conduct an independent review of HSBC's strategy and governance to address long term underperformance of its shares relative to that of its peers.

We also contacted Simon Robertson, HSBC's Senior Independent Director, to present the evidence and analysis underlying our request for an independent review. Our analysis was conducted with the involvement of a leading firm of international management consultants over several months.

On 19th September, *45 minutes before the meeting arranged to discuss the evidence,* we received faxes from Messrs. Green and Robertson rejecting the request for an independent review on the grounds that the Board had already met earlier in the year to discuss strategy. The assertion made was that HSBC has a clear strategy and that this is supported by shareholders.

This may well be the case but we question whether the Board (and shareholders who were consulted) received a truly independent and objective picture of the Group's poor competitive position in most of its key markets.

We also question whether the Board was given (or was otherwise able to obtain) independent information it would have needed for an impartial assessment of the value to shareholders of alternative strategies.

We have, of course, seen the "new" strategy which was communicated to shareholders in March this year. This emphasised HSBC's commitment to invest in emerging markets (but without changing the long-standing aim of deriving 50% of income from emerging markets and 50% from OECD markets) and to benefit from the increase in world trade and from the fact that we are all living longer. We believe, however, that this "new" strategy fails to address the main reasons for HSBC's perennial underperformance compared to the majority of its peers.

Given the Board's unwillingness to take our proposals seriously, we decided to take our evidence and analysis to more than 40 of HSBC's largest shareholders, in several cases meeting them more than once.

The responses we received were far more supportive than we had been led by HSBC to expect. For the record, only two shareholders refused to meet with us. Most of the rest agreed that there are real areas of concern to be addressed by the Board concerning strategy, execution and/or governance, some of which they had not been aware of before. We have seen some of the letters that institutional shareholders have sent to HSBC supporting our initiative as well as some of HSBC's responses. We also know that many institutional shareholders have asked to meet with the Board and management privately to discuss the issues raised by our analysis.

Needless to say, the real challenge will be to find the right answers. However, the starting point must be for the Board to accept the validity and legitimacy of shareholders' concerns in the first place, to accept that the review carried out at the beginning of the year may not have been sufficient, and to start acting independently. This is what we – and the many shareholders of HSBC who support us – are seeking at this stage.

We are now making our report available to all interested parties. You should note that we have amended the report to incorporate the many helpful and constructive comments and suggestions made by some of HSBC's largest shareholders. The following is a summary of the key points of the report.

Share Price Performance

- It is uncontested that HSBC has underperformed its chosen peer group of 28 leading banks in terms of total shareholder return (TSR) for a very long time. HSBC has been a third quartile performer for all but two periods going back to 1994 (i.e., over 2 years, 3 years, 4 years etc.) and a fourth quartile performer against its 22 largest emerging markets competitors, which would have been part of the peer group prior to 2005.

- Over the past 12 months, HSBC's performance has been better, but our evidence suggests that this is due to its emerging markets exposure and not due to its strategy of diversifying its income globally during the recent market turmoil. There is no evidence to suggest that diversified global banks have systematically outperformed during 2007.

Strategy

In retail and commercial banking there are significant cost and revenue advantages in securing local scale. In investment banking and capital markets the benefits generally accrue to global players. HSBC fails to capture advantages in either of these areas because it is pursuing a global strategy in retail and commercial banking and a regional (emerging markets focused) strategy in investment banking. It is the only major bank to be doing so.

Retail and commercial banking

- Approximately 70% of HSBC's 2006 profits before tax came from retail and commercial banking. HSBC has for years been misallocating capital in this area by seeking to diversify the geographic source of its earnings rather than aiming for critical mass in selected markets where it has real comparative advantage.

- HSBC is not a top three player in any of its key retail markets except for Hong Kong, and its profitability compared with that of its local peers has been weak as a consequence. HSBC's return on assets is lower than the local market average in the U.K., the U.S., France, Mexico, Brazil and India to name but a few. In many of these markets the issue is simply lack of scale.

- Over the past few weeks HSBC has proposed (or is pushing ahead with) new initiatives in Korea, Vietnam, Japan, Georgia, the Czech Republic and Peru. In none of these markets is it obvious that HSBC has any comparative advantage at all. These initiatives simply add to the number of subscale businesses in the Group.

- HSBC's obsession with diversification has also resulted in a substantial portfolio of minority stakes in companies which it does not fully control.

Investment banking and capital markets (CIBM)

- In investment banking and capital markets HSBC is not a leading player globally, or in any geographic market or in any key product area.

- Over the past 15 years HSBC has repeatedly attempted to build a leading business in these areas, both organically and by acquisition, but has failed.

- We are convinced that HSBC's recent decision to compete on a regional basis (i.e., focusing on emerging markets) will result in further massive value destruction.

- As demonstrated by HSBC's weak position in China's 2006 capital markets league tables (24th with respect to IPOs and 20th with respect to debt issuance – according to Thomson Financial), even emerging market issuers need to deal with global firms.

India and China

- India and China pose a particular conundrum for HSBC, whose roots in Asia, it might be argued, give it a particular advantage. In fact, the answer is not as straightforward as some might think.

- Whilst recognizing that India and China are tantalizing prospects, the fact is that HSBC has chosen to compete in retail banking against domestic competitors which already have scale and critical mass as well as government sponsorship and legal protection.

- HSBC may have to recognize that in these two markets, the issue is not government protection but the difficulties of acquiring sufficient scale (as elsewhere). Even if the restrictions on acquiring domestic banks were lifted, it may make no sense for HSBC to do so given the high multiples at which these banks trade and the limited synergies that are likely to arise from integrating these retail franchises with HSBC's existing retail activities.

- In these markets the real opportunity may only be available to full service investment banks operating in the capital markets, and not in retail banking. HSBC's weak position in investment banking and capital markets limits its ability to compete in the part of the market which is growing fastest and has the fewest restrictions on foreign companies.

- This leads us to ask ourselves if HSBC really has a differentiated strategy in these markets. If so, this needs to be articulated.

Other

- HSBC needs to recognize that its strong capital position, which has been fungible in the past, may no longer be such an advantage in the future, particularly in light of the requirement to incorporate and capitalize its regional businesses separately for local regulatory purposes.

- HSBC's Hong Kong business is already incorporated and the decision to incorporate its Chinese business has already been taken. The Indian businesses will also be incorporated before the end of 2009.

- That means that HSBC may well have no surplus capital at all.

Questions for the Board

We believe that the time has come for the Board to 'grasp the nettle' and ask itself some difficult questions.

- Does it make sense for HSBC to continue allocating capital to acquire an ever growing number of subscale local banks or should it not aim to build critical mass where it has true competitive advantage? Shouldn't HSBC decide which of its retail and commercial banking businesses are truly core and scale these up rather than pursuing diversification (beyond what might be optimal) for its own sake?

- If HSBC is to secure real value from its investment in its OECD businesses, it will either have to grow them, organically or by acquisition, or it should consider selling them to others who can benefit from local consolidation. Given the size of these retail banking businesses, the decision to retain and grow them will require HSBC to allocate significantly more capital to the developed markets than is currently being suggested. The Board must take a view on this and communicate its position clearly.

- Buying minority stakes in listed emerging market companies could be regarded as buying 'options' for the very long term. Just how many such 'options' should HSBC be holding, particularly when the capital used to acquire them cannot be counted towards HSBC's capital base for regulatory purposes?

- If HSBC is unable to build or acquire a leading global capital markets platform, should it not consider liquidating the majority of this business which absorbs half of the Group's balance sheet rather than carrying on with a strategy that has little prospect of success? Or should HSBC not merge with a competitor which truly has global scale?

- If the future of the Group is really in China, how does HSBC plan to become a leading player – without diluting its shareholders by overpaying for acquisitions – when the restrictions are finally lifted?

  We estimate that, without a significant change in strategy, "joining up the pieces" will add no more than 3% to HSBC's total value. The Emperor needs to be told that he is not wearing any clothes: there are almost no synergies associated with being the 'world's local bank'.

Governance

- In most major UK companies, a challenge to a failed strategy may come from one of at least three different quarters: from the Chairman, from the non-executives directors or from the ranks of senior management.

- In the case of HSBC, the Chairman (who is responsible for strategy and governance) is not independent and the management compensation arrangements (as embodied in the 2005 Share Plan) do not align the interests of management and shareholders.

- This places the non-executive directors in an unusually difficult position.

Conclusions

In our view, there are a number of different strategies which could deliver significantly more value for shareholders than the strategy which HSBC has chosen to follow today (which is really little different from that which was followed in the past).

Although we have avoided being prescriptive to date, we believe that our analysis inescapably leads to the conclusion that, in order to unlock the very substantial value of the Group, the Board needs to consider some radical alternatives.

In the mean time, HSBC should call a halt to the strategy of diversifying earnings for its own sake.

Yours sincerely

Eric Knight

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Knight Vinke Asset Management LLC

Copies of Knight Vinke's report "HSBC – Issues and Recommendations" may be obtained on request by e-mail to hermitage@kvamllc.com.