HSBC Case Study:

Supporting One of the Largest Rights Offerings in UK History

THE BANK OF NEW YORK MELLON

Background

In March 2009, HSBC successfully undertook one of the most significant rights offerings in UK history, in the midst of the current economic crisis, offering shareholders 5 new shares for every 12 shares they held at an approximate 40% discount. When the offering closed, shareholders had taken up 96.6% of HSBC's £12.5 billion ($18.63 billion) rights issue, infusing HSBC with fresh liquidity and opening the door to potential new opportunities.

There were several major reasons that seemed to enhance the success and attractiveness of HSBC's rights offering. Overall, the market is seeking a flight to quality, strength, and stability and seemed to perceive the exercise of HSBC share rights as a good investment at an attractive price. In addition, HSBC is a financial institution that has not sought or received government aid during the present financial crisis. Lastly, because the rights offering was registered with the SEC, it was made available to depositary receipt (DR) holders, which signaled HSBC's recognition of the importance of its DR investors and its determination to reward their loyalty.

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Operating Under A Compressed 10-Business Day FSA Timetable

The transaction was unique in many respects. This was the first time that the new timeline under UK's Financial Services Authority (FSA) Listing Rule 9.5.6R was employed in connection with a U.S.-registered transaction. Earlier this year, the FSA shortened the minimum subscription period for rights offerings from 21 calendar days to 10 business days. HSBC took advantage of the new regime, designed to reduce the risk to underwriters without damaging shareholder interests.

Avoiding the Need of a Prospectus Via Rule 173 - Access Equals Delivery

This corporate action employed another unique feature—use of a groundbreaking change in securities servicing, Rule 173 (known as "access equals delivery") under the U.S. Securities Act of 1933, as amended.

The use of Rule 173 facilitated the crucial execution of the 10-business day timeframe. Previously, in a corporate action of this nature, each shareholder was mailed a hard copy of the final prospectus. Now, pursuant to Rule 173, DR holders were deemed to have access to the prospectus since they were provided with a website to access the prospectus electronically. DR holders received by mail a subscription form and an instruction letter to facilitate participation.

Since this was the first known time that Rule 173 was employed by a non-U.S. company, brokers expressed some concern about not providing DR holders with a hard copy prospectus. However, DR holders retained the right to request a hard copy, as required by Rule 173.

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As the information agent, The Bank of New York Mellon was appointed to satisfy the fulfillment of hard copy requests, in addition to responding to DR investor inquiries. But owing to investors' seemingly wide acceptance of Rule 173 and electronic access to the prospectus, few requested printed copies. It is anticipated that this convenient and cost-effective new procedure will become much more commonplace, in order to accommodate the new abbreviated timeline approved for rights issues.

The Bank of New York Mellon Delivers Innovative, Customized Solutions

The Bank of New York Mellon, as depositary for HSBC, was chosen to be both the rights subscription agent and the rights information agent. By crafting innovative solutions and drawing on its expertise with various market utilities, the Bank helped to bring this major event to a highly successful conclusion.

The Bank of New York Mellon's task was to create a level playing field for DR holders and to give them a similar opportunity as UK shareholders to participate in this rights offering. As the rights offering involved a significant number of registered and beneficial holders, HSBC wanted to ensure that the maximum possible number of its DR holders had the opportunity to take advantage of this discounted rights offering. To accomplish this goal, the Bank had to manage a unique set of challenges.

The compressed 10-business day timeframe presented its own challenges. This very restrictive schedule was designed to work for the home market's infrastructure, but it did not fit as well with U.S. market practices. As a result, the rights were not traded on the New York Stock Exchange (NYSE) because it would have further compressed the offering's deadline. With this subscription period, DR holders only had seven-to-eight business days in which to decide which option to elect.

Additionally, because the rights were issued to the depositary, The Bank of New York Mellon subscribed into the local offer as the shareholder of the HSBC shares that the DRs represented. Factors such as coordinating among international time differences and custodian and depositary deadlines further shortened the compressed timeline.

To compensate for the fact that no trading was allowed in the U.S. market, The Bank of New York Mellon developed three options for DR holders:

1. They could elect to subscribe to the rights offering (i.e., exercise their ADS rights for new DRs).
2. They could elect to surrender their ADS rights and receive the underlying share rights in the local market.
3. They could elect to have The Bank of New York Mellon sell the share rights underlying their ADS rights.

Through the Global Corporate Actions Team, we have the organizational structure, strength and experience to support any rights offering and to satisfy the needs of DR issuers and holders

The DR rights of DR holders making no election lapsed. Such holders could receive compensation only if, and to the extent, that a premium was secured over the subscription price, if and when the new shares underlying the lapsed DR rights were sold in the open market by the joint global coordinators.

Participation in the rights offering was restricted in certain jurisdictions. When a need arose for certain accredited investors holding DRs in those jurisdictions to be included, The Bank of New York Mellon accommodated the process, and most notably, The Bank of New York Mellon worked with Canadian counsel and investors to certify their Accredited Investor status.

A Resounding Success

The Bank of New York Mellon supported HSBC by extending one of the largest UK rights offerings to DR holders. The market saw value in the transaction and continued to push up the original share price through the subscription period and afterwards; which resulted in a payment to all holders who took no action on their rights. The rights issue was a success by every measure. Overall, 96% of all shareholders subscribed, and 86% of DR holders chose to make an election. The new capital raised the bank's core Tier 1 capital ratio, a key measure of a bank's financial health, to 8.5%.

We interpret the strong demand for the HSBC rights offering as a positive sign from the market in these turbulent times. By registering its rights offering with the SEC, HSBC demonstrated that it was a company that respects its DR holders, who ultimately responded strongly.

We believe this may be a trend-setting development, as companies continue to use rights offerings as a capital-raising instrument. Through our Global Corporate Actions Team and experienced relationship management staff, we have the organizational structure, strength and experience to support any rights offering and to satisfy the needs of DR issuers and holders.

The Bank of New York Mellon has unmatched expertise in executing cross-border corporate actions involving depositary receipts. Last year, The Bank of New York Mellon coordinated Barclays' Open Offer, and in the first quarter of 2009, The Bank of New York Mellon handled 15 rights issues, the majority from the UK and Europe, but also from Latin America and the Middle East. The Bank of New York Mellon believes that we are well-positioned to assist companies in floating rights offerings to raise capital, and we believe the market, seeking attractive investments, has an appetite for them.

For further information, contact:

Joanne DiGiovanni
Vice President
Depositary Receipt Division
Deputy Head - Global Corporate Actions
Phone: +1 212 815 2204
joanne.digiovanni@bnymellon.com

Mark Wilson
Vice President
Depositary Receipt Division
Regional Mgr. -UK, Ireland, Scandinavia
Phone: +44 20 7964 6323
mark.wilson@bnymellon.com

Susan Mayham
Vice President
Depositary Receipt Division
Global Corporate Actions - Western Europe
Phone: +1 212 815 6917
susan.mayham@bnymellon.com

Neil Atkinson
Vice President
Depositary Receipt Division
Transaction Manager - London
Phone: +44 20 7964 6602
neil.atkinson@bnymellon.com

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