HSBC Bank Canada

Annual Report and Accounts 2010

HSBC

The world's local bank

Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 260 offices, including over 140 bank branches, and is the leading international bank in Canada. With around 7,500 offices in 87 countries and territories and assets of US$2,455 billion at December 31, 2010, the HSBC Group is one of the world's largest banking and financial services organizations.

Contents

Dividend record and payable dates in 2011 for our preferred shares, subject to approval by our Board of Directors, are:

Record Date	*Payable Date*
March 15	March 31
June 15	June 30
September 15	September 30
December 15	December 31

Distribution dates on our HSBC HaTS™ are June 30 and December 31.

Designation of Eligible Dividends
For the purposes of the Income Tax Act, Canada, and any similar provincial legislation, HSBC Bank Canada advises that all of its dividends paid to Canadian residents in 2006 and subsequent years are eligible dividends unless indicated otherwise.

Shareholder Information

PRINCIPAL ADDRESSES:

Vancouver:
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WEBSITE:

hsbc.ca

HSBC BANK CANADA SECURITIES ARE LISTED ON THE TORONTO STOCK EXCHANGE:

HSBC Bank Canada
Class 1 Preferred Shares – Series C (HSB.PR.C)
Class 1 Preferred Shares – Series D (HSB.PR.D)
Class 1 Preferred Shares – Series E (HSB.PR.E)

TRANSFER AGENT AND REGISTRAR:

Computershare Investor Services Inc.
Shareholder Service Department
9th Floor, 100 University Avenue
Toronto, Ontario
Canada M5J 2Y1
Tel: 1 (800) 564-6253
Fax: 1 (866) 249-7775

SHAREHOLDER CONTACT:

For change of address, shareholders are requested to write to the bank's transfer agent, Computershare Investor Services Inc., at their mailing address.

Other shareholder inquiries may be directed to our Shareholder Relations Department by writing to:

HSBC Bank Canada
Shareholder Relations
885 West Georgia Street
Vancouver, British Columbia
Canada V6C 3E9

Shareholder Relations:
Santokh Birk (604) 641-1918
Chris Young (604) 641-1976

Caution Concerning Forward-Looking Statements

This document contains forward-looking information, including statements regarding the business and anticipated actions of the bank. These statements can be identified by the fact that they do not pertain strictly to historical or current facts. Forward-looking statements often include words such as "anticipates," "estimates," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance in connection with discussions of future operating or financial performance. Examples of forward-looking statements include, but are not limited, to statements made in "Message from the President and Chief Executive Officer" on page 3, "Economic Outlook for 2011" and "Our Focus for 2011" on pages 9 and 10, "Employee future benefits" on page 16, and "Transition to IFRS" on page 18. These statements are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause such differences include legislative or regulatory developments, technological change, global capital market activity, changes in government monetary and economic policies, changes in prevailing interest rates, inflation levels and general economic conditions in geographic areas where the bank operates. Canada is an extremely competitive banking environment, and pressures on our net interest margin may arise from actions taken by individual banks or other financial institutions acting alone. Varying economic conditions may also affect equity and foreign exchange markets, which could also have an impact on our revenues. The factors disclosed above are not exhaustive, and there could be other uncertainties and potential risk factors not considered here which may affect our results and financial condition. Any forward-looking statements speak only as of the date of this document. We undertake no obligation to, and expressly disclaim any obligation to, update or alter our forward-looking statements, whether as a result of new information, subsequent events or otherwise, except as required by law.

Message from the President and Chief Executive Officer

I am pleased that the strong fundamentals underpinning HSBC Bank Canada's core businesses allowed us to continue to perform well in a year marked by an uncertain economic recovery. Our financial strength and strong liquidity position have enabled us to continue meeting our customers' needs through the challenging times. We expect the economy to show modest but continued improvement throughout 2011 and are well placed to support our clients' growth ambitions as the Canadian employment picture improves and trade with emerging markets increases.

In 2010, we continued our strategy of bringing the world to our customers through the introduction of services to complement our existing product suite. For example, we introduced HSBC Advance, a global everyday banking package for internationally minded individuals which is designed to help customers reach their financial goals more quickly. The HSBC Group expanded the network of countries where HSBC Premier is available to 47 – enhancing the services available to our customers. We also launched the HSBC International Business Awards to celebrate Canadian businesses that are thriving by doing business internationally and BUSINESS *without* BORDERS™, which offers support and resources to those doing business internationally or considering expanding beyond our borders.

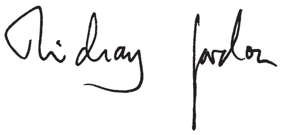
Leveraging HSBC's global expertise, we held our first Emerging Markets conference for clients in October 2010. Emerging Markets – which are growing faster than developed economies – are more closely linked than ever with the development of the global economy and represent an enormous opportunity in the longer term. The conference, which had sessions on investing and doing business in these markets was so successful that we plan to hold a series of conferences in Vancouver and Toronto looking at different markets around the world throughout 2011.

These activities have contributed to growing brand recognition in Canada and HSBC is now recognized as a financial institution that draws on its international network of expertise to advise its customers. Brand health for our commercial banking offering also showed a 25 per cent improvement over 2009 and now ranks third in Canada ahead of many of our competitors.

Being a part of the HSBC Group, the first major bank in the world to become carbon neutral, we have a long standing commitment to the environment. Continuing in our efforts to manage our business sustainably, in 2010 we installed building automation systems to reduce energy use during unoccupied times by standardizing temperature set backs in 35 branches across Canada. These installations will result in a 15 per cent reduction in energy usage and will eliminate approximately 150 tons of carbon emissions.

We were delighted HSBC was named one of Western Canada's Most Respected Corporate Cultures by Waterstone Human Capital, *Globe and Mail*'s Top 10 Employers for Young People and *Maclean's* 50 Most Socially Responsible Corporations. This is a real testament to our dedicated staff in all areas of the organization who work hard to deliver on "the world's local bank" every day. The enthusiasm they bring to the task of serving our customers is always inspiring.

I look forward to celebrating our 30th year in Canada with customers and staff in 2011.



Lindsay Gordon
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
February 21, 2011

Management's Discussion and Analysis

Five Year Financial Summary

(in $ millions, except where stated)	Years Ended December 31				
	2010	2009	2008	2007	2006
Condensed statements of income					
Net interest income	**$ 1,557**	$ 1,479	$ 1,644	$ 1,718	$ 1,545
Non-interest revenue[1]	**936**	1,097	960	893	750
Total revenue	**2,493**	2,576	2,604	2,611	2,295
Non-interest expenses[1]					
Salaries and employee benefits	**753**	732	736	750	673
Premises and equipment[2]	**175**	173	159	152	140
Other	**504**	418	458	481	376
Total non-interest expenses	**1,432**	1,323	1,353	1,383	1,189
Net operating income before provision for credit losses	**1,061**	1,253	1,251	1,228	1,106
Provision for credit losses	**335**	515	379	239	175
Income before income taxes	**726**	738	872	989	931
Provision for income taxes	**210**	207	253	347	324
Non-controlling interest in income of trust	**26**	26	26	26	26
Net income	**$ 490**	$ 505	$ 593	$ 616	$ 581
Preferred share dividends	**61**	57	20	18	18
Net income attributable to common shares	**$ 429**	$ 448	$ 573	$ 598	$ 563
Basic earnings per common share ($)	**0.86**	0.90	1.09	1.16	1.09
Financial ratios (%)[3]					
Return on average common equity	**12.1**	13.1	16.6	19.6	20.8
Return on average total assets	**0.59**	0.62	0.77	0.88	0.96
Net interest margin	**2.49**	2.40	2.59	2.91	2.97
Non-interest revenue: total revenue ratio[1]	**37.5**	42.6	36.9	34.2	32.7
Cost efficiency ratio[1]	**57.4**	51.4	52.0	53.0	51.8
Credit information					
Gross impaired credit exposures	**829**	1,022	932	420	302
Allowance for credit losses					
Balance at end of period	**625**	638	615	514	473
As a percentage of gross impaired credit exposures (%)	**75.4**	62.4	66.0	122.4	156.6
As a percentage of gross loans and acceptances outstanding (%)	**1.5**	1.5	1.2	1.0	1.1
Average balances[3]					
Assets	**$ 72,211**	$ 71,695	$ 73,952	$ 68,194	$ 58,464
Loans	**35,752**	39,644	44,331	42,351	37,818
Deposits	**53,524**	52,019	52,109	47,484	41,906
Common equity	**3,534**	3,417	3,462	3,051	2,705
Balance sheet highlights					
Total assets	**71,496**	71,337	72,049	68,130	61,448
Total loans and acceptances, net of allowance for credit losses	**40,341**	43,070	48,855	49,322	44,707
Business and government loans	**16,847**	18,442	23,067	21,322	17,819
Residential mortgage loans	**11,243**	11,359	11,869	12,920	14,016
Total deposits	**52,055**	50,207	51,962	48,878	44,174
Deposits from individuals	**21,586**	21,578	21,064	18,292	17,040
Shareholders' equity	**4,507**	4,364	4,153	3,612	3,210
Risk-based capital ratios (%)[4]					
Tier 1 capital	**13.3**	12.1	10.1	8.8	9.0
Total capital	**16.0**	14.9	12.5	11.3	11.1
Funds under management	**$ 31,501**	$ 28,174	$ 21,287	$ 26,213	$ 23,340
Custodial accounts	**8,978**	10,721	9,221	10,914	8,574
Total assets under administration	**$ 40,479**	$ 38,895	$ 30,508	$ 37,127	$ 31,914

(1) *2009 and prior periods have been restated to present certain transactions with HSBC Group companies on a gross basis. Refer to note 1(x) on page 66.*
(2) *Includes amortization of premises and equipment.*
(3) *These are non-GAAP amounts or non-GAAP measures. Please refer to the discussion outlining the use of non-GAAP measures in this document on page 5.*
(4) *Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada ("OSFI").*

HSBC Bank Canada's ("the bank", "we", "our") Management's Discussion and Analysis ("MD&A") is dated February 21, 2011, the date that our consolidated financial statements and MD&A for the year ended December 31, 2010 were approved by our Board of Directors ("the Board").

Basis of preparation of financial information. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). The financial information included in the MD&A is either at December 31, or for the years then ended. The information is derived either directly from our consolidated financial statements or from the information we have used to prepare them. Unless otherwise stated, all references to "$" mean Canadian dollars. All tabular amounts are in millions of dollars except where otherwise stated. Certain financial information that we are required to disclose as part of the MD&A is included in the table on page 4, which also includes a number of GAAP and non-GAAP measures. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP may not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. The following outlines various GAAP or non-GAAP measures which management regularly monitors, to more clearly indicate the derivation of the measure:

– *Return on average common equity* – Calculated as net income attributable to common shares divided by average common equity.

– *Return on average assets* – Calculated as net income attributable to common shares divided by average assets.

– *Net interest margin* – Calculated as net interest income divided by average interest-earning assets.

– *Cost efficiency ratio* – Calculated as non-interest expenses divided by total revenue.

– *Non-interest revenue: total revenue ratio* – Calculated as non-interest revenue divided by total revenue.

– *Average balances* – Average assets, average interest-earning assets, loans, and deposits are calculated using daily average balances for the year. Average common equity is calculated using month end balances of common equity for the year.

The sections on risk management included in this MD&A where indicated on pages 26 to 47 form an integral part of the consolidated financial statements and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2010 and the related auditors' report.

We make a number of references throughout this MD&A to "notes" which means notes to the 2010 audited consolidated financial statements, which are included with the MD&A in our Annual Report and Accounts.

Other available information. We file all of our news releases regarding material matters, interim and annual consolidated financial statements, interim and annual MD&A, Annual Reports, Annual Information Form, certifications by our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as well as other continuous disclosure documents, with SEDAR. Copies of these documents can be obtained from SEDAR's website: sedar.com and our website: hsbc.ca. Certain financial information for one of the bank's subsidiaries, HSBC Financial Corporation Limited ("HSBC Financial") can also be located on sedar.com.

Outstanding securities data. Note 12 on page 75 contains details of the number of preferred and common shares issued and outstanding at December 31, 2010. Note 10 on pages 73 and 74 contains details of the number of HSBC Canada Asset Trust Securities ("HSBC HaTS™") outstanding at December 31, 2010. Subsequent to that date and up to the date of this MD&A, there have been no issues of any form of securities.

Management's Discussion and Analysis (continued)

Overview

In Canada, we are the largest full-service global bank and seventh largest bank overall with operations across the country and total assets of more than $71 billion at December 31, 2010.

Originally established in 1981, with our head office located in Vancouver, British Columbia, we have grown organically and through strategic acquisitions, to become an integrated financial services organization. With more than 260 offices across Canada, including 145 bank branches, we provide personal and commercial banking services, global banking and market services, retail brokerage, wealth management, personal trust services and consumer finance services.

Customers are able to conduct their business conveniently through our branch network, automated banking machines, direct debit and credit cards, Internet banking and telephone call centers.

The HSBC Group

We are a member of the HSBC Group, whose parent company HSBC Holdings plc ("HSBC Holdings") is headquartered in London, UK. Our customers have access to the worldwide resources of the HSBC Group. Known as "the world's local bank", the HSBC Group is one of the largest banking and financial services organizations in the world, with an international network in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. Shares in HSBC Holdings are listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges. The shares are traded in New York in the form of American Depositary Receipts.

Through an international network linked by advanced technology, the HSBC Group provides a comprehensive range of financial services: personal financial services, insurance, commercial banking, global banking and markets, and private banking.

Complete financial and operational information for HSBC Holdings and the HSBC Group can be obtained from its website, hsbc.com, including copies of HSBC Holdings 2010 Annual Review and its 2010 Annual Report and Accounts.

Our Business Focus

Strategy

We aspire to be the leading international financial services company in Canada. We want to be the best place to bank for our customers and the best place to work for our employees. To achieve this ambition, we will execute along the following key areas of focus:

Our Customers
Customers are our foundation and our future. We will improve the customer experience by living our brand values, so that customers feel HSBC is the best place to bank.

Our Brand
We want to be the world's best financial services brand. We want a customer's perception of HSBC, wherever they are in the world, to be uniformly excellent.

Our Culture
We want to be recognized as the world's most respected and customer-driven financial services employer because we know that the motivation, or engagement, of our employees is a critical factor in business performance.

Our Global Distribution
HSBC's global reach is its key competitive advantage. In today's globalizing world, we can offer our customers an unparalleled international service and we are working to create a truly joined up network, with seamless referrals between countries, to support customers around the world.

Our Businesses
We will prioritize the allocation of our capital so that it generates the best return for shareholders in the long term. We want our businesses to be self-funding. We will focus capital investment in areas with strong growth potential in relation to risk taken.

Our Technology and Process
Our strategic imperative is to leverage technology and processes developed by the HSBC Group and use this technology to make it easier for customers to do business with us, when and where they want it. At the same time, we will improve our efficiency by simplifying our product range and automating our processing.

Our Organization
We will give responsibility for delivery of our objectives to managers and heads of customer groups and global businesses, with HSBC Group, regional and country head offices providing guidance and support.

Customer Groups

We manage and report our operations around the following customer groups: Personal Financial Services, Commercial Banking, Global Banking and Markets and Consumer Finance. We have built a culture that delivers integrated service ensuring customer needs are met across products and subsidiaries, and internationally through the HSBC Group's extensive and unparalleled worldwide network.

Personal Financial Services provides individual and self-employed customers with a wide range of banking and related financial services. Products provided include current and savings accounts, mortgages and personal loans, credit cards, and local and international payment services. We also make available a wide range of wealth management products and services through our branches and our wealth management businesses, HSBC Securities (Canada) Inc., HSBC Global Asset Management (Canada) Limited and HSBC Trust Company (Canada).

Commercial Banking provides financial services and products to small, medium-sized and middle market businesses, including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly quoted companies. In addition to direct lending, our range of products and services includes payments and cash management, treasury and capital markets, investment and merchant banking, wealth management services, trade services and leasing. We provide these services through commercial branches and subsidiary offices, and, of particular relevance to Canadian businesses, through HSBC's extensive and unparalleled network in the NAFTA countries, South America, Europe and Asia.

Global Banking and Markets serves Canadian and international corporations, institutions and governments that require both domestic and international financial services. Global Banking and Markets provides a comprehensive range of financial services including treasury and capital market services, raising public and private capital, corporate finance and advisory services, direct lending, leasing finance and deposit-taking. We also offer payments and cash management and trade services. We provide Global Banking and Market services through our principal branches and subsidiary offices, coordinated with HSBC Group's worldwide operations through one relationship manager. Our ability to leverage HSBC Group's worldwide network in providing comprehensive global banking and market services to sophisticated multinational clients is a significant competitive advantage.

Consumer Finance, through the bank's wholly-owned subsidiary, HSBC Financial, provides consumer finance products and solutions to Canadians through a network of 76 retail branches and other distribution channels. Products include real estate secured loans, personal loans, specialty insurance products and credit cards, including private-label credit cards to retail merchants.

Management's Discussion and Analysis (continued)

Highlights For 2010

2010 was another year of progress for us as we continued to execute our strategy to build our business in Canada. Particularly noteworthy accomplishments included:

Our Customers – We continued to grow our Premier customer base, attracting over 53,600 customers, of which 39 per cent were new to the bank, and now have over 205,000 Premier customers. HSBC Premier offers seamless global banking, with over 6,000 Premier branches worldwide in 47 countries and territories. In internal group surveys, the Canadian bank service quality in branches and at call centres compares favourably to other HSBC countries.

Canada continues to rank second globally within the HSBC Group in World Selection mutual fund sales (behind only the UK) out of the 26 countries globally where the service is now available. We added emerging market equity exposure to our World Selection mutual funds via the launch of a new HSBC Emerging Market Pooled Fund, bringing world class international investment options to Canadians. HSBC now has the broadest range of emerging market funds in Canada, including the HSBC Indian Equity Fund and HSBC Chinese Equity Fund, which were the top selling funds of their kind in Canada for the year.

We continued to execute on our HSBC Business Direct™ strategy, with 41,000 clients now managed through this channel.

We leveraged our global network, building relationships with target clients in resource, energy, infrastructure and financial sectors. We focused on enhanced connectivity with our clients, both internal and external – domestically and globally. This focus resulted in a significant increase in the number of clients with which HSBC dealt across all Global Markets products.

Our Brand – HSBC combines global reach with local knowledge to meet the needs of customers around the world. We offer a full range of financial services in a different way than our competitors. This means helping clients reach their goals faster through fresh ideas and innovative, global solutions.

As part of this effort in Canada, the HSBC brand is on the interiors and exteriors of the fixed links and jet bridges that carry passengers to aircraft at the Vancouver and Toronto's Pearson International Airports. This is part of a unique international branding strategy undertaken by HSBC Group to demonstrate our global presence at a local level, covering global centers such as London (Heathrow), New York (Kennedy and LaGuardia), Los Angeles (LAX) and Tokyo (Narita).

We partnered with Rogers Media, *The Globe and Mail* and The Economist Intelligence Unit to launch an exclusive, first of its kind initiative, BUSINESS without BORDERS – 'Helping businesses grow internationally', that supports HSBC's position as the leading international bank for business in Canada. The initiative will leverage the diverse channels and expertise of these three leading media companies to demonstrate to clients how HSBC is clearly the leader and best bank to deal with for their international needs and aspirations. This includes the HSBC International Business Awards program, which is designed to recognize, celebrate and promote businesses that are successfully investing, operating and growing internationally.

Our Culture – HSBC Group conducted its fourth Global People Survey. The results for Canadian employees included a very high participation rate of 83 per cent and the bank employee engagement score held up reasonably well at 68 per cent, down 3 per cent compared with the 2009 score, against a backdrop of organizational change and a relatively slow economic recovery.

We were recognized with several awards during 2010, including: regional winner (Western Canada) of Canada's 10 Most Admired Corporate Cultures by Waterstone Human Capital, *Globe and Mail*'s Top 10 Employers for Young People and *Maclean's* 50 Most Socially Responsible Corporations.

Our Global Distribution – The HSBC Group increased its international network of HSBC Premier to 47 countries and territories, offering the first truly global personal banking service for the world's mass affluent and internationally mobile consumers. We have achieved successful referral results from the re-launch of Global Links, a system which tracks and measures cross-border Commercial Banking referrals within HSBC worldwide.

Our Businesses – Executing against HSBC's strategy of being "The Best Bank for Small Business", we were named best bank overall for small businesses (with 5 to 49 employees) in Canada for the third time by the Canadian Federation of Independent Business, the leading trade association for small and medium-sized enterprises ("SMEs") in Canada.

In Personal Financial Services, we launched HSBC Advance for the internationally minded target market with a television and print campaign in business, lifestyle and cultural publications. Advance portfolios have been moved from the branch network to direct channels, allowing branch staff more time to serve high-value Premier clients.

Our Technology and Process – We continued to implement the HSBC Group's global project to streamline business processes and products around the needs of customers, and provide world class, globally consistent technology to support the HSBC business across all geographies and all customer groups. We successfully implemented an upgrade to our core banking platform, which will allow us to deliver a consistent customer experience, business model and process across the Group. We successfully implemented a new treasury risk management system in our Global Banking and Markets business.

Our Organization – Amidst a challenging year in 2010, we continued to execute our strategy, which included maintaining prudent lending standards, maintaining a strong capital base, strong liquidity and diversified income streams. We plan to continue our existing strategy of working with customers to meet their personal and business needs, while maintaining close control over credit quality.

We completed the reorganization of our front office into distinct Personal Financial Services and Commercial Banking lines, improving customer service, line of sight for management, and clear career paths for our staff. We also segmented our Personal Financial Services portfolio into Premier, Advance and Mass Market and our Commercial Banking portfolio into Commercial Real Estate, Mid-Market Commercial and Business Banking, again to provide more specialized customer support and improve service.

Economic Outlook For 2011

We expect the Canadian economy to show modest but continued improvement through 2011, with a moderate reduction in unemployment, increasing trade with emerging markets and a strong resource sector. Interest rates are expected to increase slowly, influenced by US rates and the Canadian dollar is expected to remain close to par with the US dollar.

We anticipate the regulatory environment to intensify, particularly due to global changes. With our continued focus on our key principles of a strong capital base, a diversified income stream and strong liquidity, we intend to position the bank to maximize opportunities and to stay focused on our "right to win" strategy in target segments.

Our Focus For 2011

During 2011, we plan to grow our business by focusing on the following:

Our Customers – We will focus on our customers and segments where we have a "right to win". In Personal Financial Services, we will leverage our international capabilities to enhance our premium and wealth management propositions, delivering global connectivity in key cultural segments. In Commercial Banking, we will continue our leading international banking business strategy, focusing on businesses with international needs. In Global Banking and Markets, we will continue to leverage our international presence to serve our target clients.

Our Brand – Consistent with the HSBC Group's strategy of being "the world's local bank", we will continue to invest and develop our brand and support local events and venues across Canada to help build stronger communities.

Our Culture – In order to build on our customer service excellence, we will enhance recruitment initiatives and engage employees while tying management performance more closely to our annual employee engagement survey, creating the best place to work measured by best in class engagement scores.

Our Global Distribution – We will continue to focus on opportunities and product support (information technology, marketing and product) throughout the HSBC Group to leverage and drive growth across all business lines. Specifically, we aim to improve efficiency through common business platforms and leverage Centres of Excellence and Global Resourcing Centres. We will continue to drive new leads via Global Links, our international Commercial Banking customer referral system, and align key performance metrics to drive referral business internally.

Management's Discussion and Analysis (continued)

Our Business – We will expand our small to medium enterprise customer segment, aiming to be the "The Best Bank for Small Business," investing in our HSBC Business Direct™ and Business Banking capabilities. We aim to enhance our payments and cash management capabilities, improve wealth management capabilities, and integrate and better cross-sell between HSBC entities. We will be investing in the Commercial Banking business in Eastern Canada, particularly Ontario and Quebec, to service international businesses in these provinces.

Our Technology and Process – We will continue to work on "joining up" with HSBC on a global level to build a single, modern, global business platform to meet the needs of our customers, shareholders and staff and deliver a consistent customer experience worldwide. This process will also contribute to reduction of waste through the elimination of inefficient processes and unnecessary costs, while supporting our environmental sustainability targets through a paperless system.

Our Organization – HSBC remains one of the largest, most strongly capitalized and liquid banks in the world. We will continue to ensure that our capital and liquidity exceeds the regulatory capital requirements. We will continue to operate within HSBC Group limits and guidelines, deepen management experience through HSBC Group's resources, ensure investments made meet HSBC Group's key performance metrics and leverage off HSBC Group first as we join up. We will continue to manage and mitigate our credit and operational risk by staying close to our customers.

Analysis of Financial Results For 2010

– Net income attributable to common shares was $429 million for the year ended December 31, 2010, a decrease of 4.2 per cent compared with $448 million for 2009.

– Return on average common equity was 12.1 per cent for the year ended December 31, 2010 compared with 13.1 per cent for 2009.

– The cost efficiency ratio was 57.4 per cent for the year ended December 31, 2010 compared with 51.4 per cent for 2009.

– Total assets were $71.5 billion at December 31, 2010, an increase of $0.2 billion, or 0.3 per cent, from $71.3 billion at December 31, 2009.

– Total funds under management were $31.5 billion at December 31, 2010, an increase of $3.3 billion, or 11.7 per cent, from $28.2 billion at December 31, 2009.

Overview

Net income attributable to common shares for the year ended December 31, 2010 was $429 million, a decrease of $19 million or 4.2 per cent compared with $448 million in 2009. Net income attributable to common shares for 2010 from core banking operations, which consists of Personal Financial Services, Commercial Banking and Global Banking and Markets, was $417 million, $77 million, or 15.6 per cent, lower than 2009. Net income from Consumer Finance was $12 million, an increase of $58 million, or 126.1 per cent, compared with the loss of $46 million in 2009.

While net income was down from the prior year, after excluding the impact of fair value accounting on economic hedges and changes in the market values of certain non-trading financial assets and liabilities, discussed below under non-interest revenue, income before income taxes in 2010 increased by 37.8 per cent compared to the prior year. An improvement in economic conditions and our strong business fundamentals led to good operating results for 2010, aided by reductions in credit losses. We continued to focus on generating growth through meeting our customer needs and leveraging our global capabilities, while maintaining strong capital and liquidity levels.

Net interest income

Net interest income was $1,557 million in 2010 compared with $1,479 million in 2009, an increase of $78 million, or 5.3 per cent. Net interest margin increased by 9 basis points, to 2.49 per cent, while average interest earning assets increased by $0.8 billion, to $62.4 billion. The increase in net interest income primarily resulted from a reduction in funding and liquidity costs and the positive impact of higher interest rates and a more stable interest rate environment compared to 2009. This was partially offset by a shift in asset mix from commercial loans to government securities.

Non-interest revenue

Non-interest revenue was $936 million in 2010 compared with $1,097 million in 2009, a decrease of $161 million, or 14.7 per cent. Canadian generally accepted accounting principles require that mark-to-market changes in the fair values of derivatives used as hedges for certain of the bank's non-trading assets and liabilities that do not qualify for hedge accounting are recorded in income although no economic gain or loss has arisen. This includes derivatives related to certain mortgage securitization programs where the bank does not expect to realize any gains or losses as the intent is to hold such derivatives to maturity. Similarly, changes in market values of certain other non-trading financial assets and liabilities are also required to be included in reported income, even though no economic gain or loss has resulted. These non-cash items are primarily driven by changes in market interest and foreign exchange rates or refinement of model assumptions used in valuing certain complex financial instruments. Changes in mark-to-market values can create significant inter-period volatility in the bank's reported results, but as these instruments are normally held to their maturity, there is no resulting economic gain or loss. The impact of these mark-to-market changes on non-interest revenue in the Global Banking and Markets business in 2010 was a net loss of $196 million, compared with a net gain of $69 million in 2009. The net mark-to-market loss in 2010 was primarily due to the effect of changes in interest rates on derivatives used for hedging purposes, while in 2009 these changes resulted in a net mark-to-market gain. The 2009 net mark-to-market gain also included the positive impact of the strengthening of the Canadian dollar on US$ denominated funding of US$ denominated available-for-sale ("AFS') securities where the corresponding translation gains or losses are recorded in shareholders' equity through accumulated other comprehensive income, although this was offset by the impact of tightening credit spreads on the fair value of our own debt obligations designated at fair value.

Excluding the impact of the mark-to-market changes noted above, non-interest revenue increased by $104 million, or 10.1 per cent, in 2010 compared with 2009. Other non-interest revenue was $79 million higher, mainly as a result of an increase in loan insurance revenues and an increase in fees from the Global Investor Immigration Services ("GIIS") program. Credit fees increased by $29 million resulting from pricing initiatives in the Commercial Banking business. Investment administration fees in the Personal Financial Services business were $26 million higher, driven by strong sales of investment products and improving equity markets compared to the prior year. Trading revenue in Global Banking and Markets was $9 million higher than the prior year. Although trading revenues from our rates and credit products decreased in the year, this was partially offset by an increase in foreign exchange trading revenues due to higher customer volumes. In addition, there was a $21 million recovery in 2010 of previously recorded losses on the bank's non-bank Canadian Asset-Backed Commercial Paper ("ABCP"), substantially all of which was sold in 2010, compared with $27 million of mark-to-market writedowns on ABCP recorded in 2009. Gains on AFS and other securities were $6 million higher than in 2009. Although the gains on AFS securities sold in 2009 were higher than in 2010, they were offset by a $20 million charge for other-than-temporary impairment ("OTTI") recognized in 2009 on certain mortgage-backed securities. These increases were partially offset by lower capital market fees in the Global Banking and Markets business, which decreased by $34 million reflecting a lower level of activities in underwriting, advisory, equity and debt markets in 2010 compared to 2009, and a $19 million decrease in securitization income due to lower transaction volumes and lower excess spreads.

Non-interest expenses and operating efficiency

Non-interest expenses were $1,432 million in 2010 compared with $1,323 million in 2009, an increase of $109 million, or 8.2 per cent. Salaries and employee benefits were $21 million, or 2.9 per cent, higher primarily due to increases in commissions and performance-based incentives as a result of better underlying performance and an increase in the post-retirement benefits expense. Premises and equipment costs were little changed from the prior year. Other non-interest expenses increased by $86 million, or 20.6 per cent compared to 2009, mainly due to increased marketing expenditures, higher brokerage expenses resulting from increased activity in the GIIS program and an increased usage of outside consultants and contract employees. The cost efficiency ratio for the year ended December 31, 2010 was 57.4 per cent compared to 51.4 per cent in 2009. Excluding the impact of the mark-to-market gains and losses noted above, the cost efficiency ratio increased slightly in 2010, to 53.3 per cent, compared to 52.8 per cent in 2009.

Credit quality and provision for credit losses

The provision for credit losses for 2010 was $335 million compared to $515 million for 2009. The provision for credit losses from banking operations for 2010 was $74 million lower compared to 2009, mainly in the commercial mid-market and real estate sectors, and also due to a $37 million provision related to ABCP that was recorded in 2009. The credit loss provision for the Consumer Finance business decreased by $106 million in 2010. Although conditions remain uncertain, the improvement in 2010 compared to 2009 was due to a decrease in specific provisions for credit losses on the bank's commercial loan portfolio and lower delinquencies in the Consumer Finance business, both reflecting improved economic conditions.

Gross impaired credit exposures were $829 million at December 31, 2010, or $193 million lower compared with the prior year. Total impaired exposures, net of specific allowances for credit losses, were $602 million at December 31, 2010, compared with $836 million at December 31, 2009. The total of impaired exposures includes $152 million (2009 – $214 million) of Consumer Finance and other consumer loans, for which impairment is assessed collectively. The higher level of impaired credit exposures in 2009 was driven by the deterioration of economic conditions across all business sectors that took place during 2009.

The general allowance for credit losses applicable to business and government loans in the banking portfolio was reduced by $3 million, to $217 million, compared to December 31, 2009. This arose as a result of a $1.7 billion reduction of the performing commercial loan portfolio in 2010. The general allowance applicable to Consumer Finance loans was $146 million compared to $201 million at December 31, 2009. The total allowance for credit losses as a percentage of loans and acceptances outstanding was 1.5 per cent at December 31, 2010, unchanged from December 31, 2009. The bank considers the total allowance for credit losses to be appropriate given the credit quality of its portfolios and the current credit environment.

Income taxes

The effective tax rate for 2010 was 30.0 per cent compared with 29.1 per cent in 2009. The lower tax rate in 2009 arose from the recognition of a tax refund with respect to income earned in the British Columbia international finance centre, following an audit of the 2007 and 2008 tax years.

Balance sheet

Total assets at December 31, 2010 were $71.5 billion, an increase of $0.2 billion from December 31, 2009. Liquidity was strong, with $27.9 billion of cash resources, securities and reverse repurchase agreements at December 31, 2010, compared to C$25.1 billion at December 31, 2009. However, this increase was partially offset by a $2.2 billion decrease in business and government loans and customer liabilities under acceptances, which was as a result of lower borrowing demands from clients who are de-leveraging their exposures following the effect of the worldwide recession and a reduction in our commercial real estate exposures. Net residential mortgages decreased by $0.1 billion during 2010 due to slower housing activity and strategic positioning of our mortgage book. Consumer loans and personal lines of credit in the Personal Financial Services business were up by $0.2 billion to $5.9 billion, while receivables in the Consumer Finance business decreased by $0.6 billion to $2.6 billion as a result of lower loan originations arising from credit tightening decisions.

Total deposits increased by $1.9 billion to $52.1 billion at December 31, 2010 from $50.2 billion at December 31, 2009. The main drivers for the increase were higher business deposits together with smaller increases in wholesale deposits, which are included in business and government deposits.

Total assets under administration

An increase in equity markets as well as new product sales resulted in an increase in funds under management to $31.5 billion at December 31, 2010 from $28.2 billion at December 31, 2009. Including custody and administration balances, total assets under administration were $40.5 billion, compared with $38.9 billion at December 31, 2009.

Quarterly Summary of Condensed Statements of Income

	2010				2009			
	Quarter ended				Quarter ended			
	Dec. 31	***Sept. 30***	***June 30***	***March 31***	*Dec. 31*	*Sept. 30*	*June 30*	*March 31*
					(Unaudited)			
Net interest income	**$ 388**	**$ 396**	**$ 393**	**$ 380**	$ 393	$ 368	$ 368	$ 350
Non-interest revenue[(1)]	**283**	**216**	**271**	**166**	309	222	289	277
Total revenue	**671**	**612**	**664**	**546**	702	590	657	627
Non-interest expenses [(1)]	**382**	**362**	**353**	**335**	334	323	341	325
Net operating income before provision for credit losses	**289**	**250**	**311**	**211**	368	267	316	302
Provision for credit losses	**109**	**97**	**66**	**63**	131	97	126	161
Income before income taxes	**180**	**153**	**245**	**148**	237	170	190	141
Provision for income taxes	**54**	**42**	**71**	**43**	66	48	54	39
Non-controlling interest in income of trust	**7**	**6**	**7**	**6**	7	6	7	6
Net income	**$ 119**	**$ 105**	**$ 167**	**$ 99**	$ 164	$ 116	$ 129	$ 96
Preferred share dividends	**15**	**16**	**15**	**15**	16	15	15	11
Net income attributable to common shares	**$ 104**	**$ 89**	**$ 152**	**$ 84**	$ 148	$ 101	$ 114	$ 85
Basic earnings per share ($)	**0.21**	**0.18**	**0.30**	**0.17**	0.30	0.20	0.23	0.17

(1) *2009 quarters have been restated to present certain transactions with HSBC Group companies on a gross basis. Refer to note 1(x) on page 66.*

The unaudited quarterly information contains all adjustments necessary for a fair presentation of such information. All such adjustments are of a normal and recurring nature. Most of our revenues are non-seasonal in nature, although there can be an increase in non-interest revenues in the first quarter of the year associated with personal investments arising from retirement planning activity in Canada. Other seasonal factors have a minor impact on our results in most quarters. The first quarter has the fewest number of days, and therefore net interest income may be lower compared with the other three quarters.

The credit and liquidity crisis of 2008 and 2009 affected market rates, resulting in increased credit spreads, falling interest margins and lower value from interest-free deposits. Due to the composition of the bank's portfolio, average loans re-priced downwards more quickly than deposits, which led to a reduction of net interest income up to the first quarter of 2009. Net interest income improved over the remainder of 2009 as a result of pricing initiatives on commercial loans, the stabilizing of market interest rates and the beneficial impact from lower credit spreads on the cost of wholesale funds. The interest rate environment continued to stabilize in 2010, resulting in higher interest rates and lower funding and liquidity costs, but the beneficial impact was partially offset by a shift from commercial loans to government securities as our customers deleveraged their exposures, and lower loan originations in the Consumer Finance business.

External market forces caused a considerable degree of volatility in interest and foreign exchange rates as well as changing credit spreads, which resulted in significant variability in reported non-interest revenues over the past eight quarters, particularly those relating to trading activities and mark-to-market adjustments on derivatives. After recording significant declines in 2008, Canadian equity markets experienced a considerable recovery in 2009 and 2010, which led to increases in capital market related revenues. In addition, the commercial pricing initiatives noted above also had an upward impact on credit fees earned from off-balance sheet commercial credit facilities such as Bankers' Acceptances, guarantees and letters of credit.

Management's Discussion and Analysis (continued)

Weak economic conditions in 2009 impacted the credit environment, resulting in higher levels of loan delinquency and increased provisions for credit losses in 2009. Although conditions continue to be uncertain, the lower level of credit losses in 2010 was due to a decrease in specific provisions for credit losses, reflecting improving economic conditions and lower delinquencies in the Consumer Finance business.

Over the last eight quarters, our business has been affected by a number of favourable and unfavourable items. The non-bank ABCP was restructured in the first quarter of 2009, and we recorded additional charges and write-downs on our holdings of the restructured non-bank ABCP in 2009 of $22 million in the first quarter, income of $15 million in the second quarter, and charges and write-downs of $54 million and $3 million in the third and fourth quarters respectively. In the second quarter of 2010 we sold substantially all of our holdings of non-bank ABCP and recognized a $21 million recovery of previously recorded losses. In the first quarter of 2009, we recorded a provision of $20 million in respect of a loss contingency arising from a transaction occurring in a previous year. In the second quarter of 2009, gains on AFS securities of $27 million were realized upon the sale of certain securities. OTTI losses on AFS securities of $1 million, $6 million, $12 million and $1 million were recorded in the first, second, third and fourth quarters of 2009, respectively. In 2010, the Consumer Finance business recorded non-recurring credit insurance revenues of $5 million in the second quarter and $11 million in the fourth quarter.

Analysis of financial results for the fourth quarter, 2010

Net interest income

Net interest income for the fourth quarter of 2010 was $388 million, compared with $393 million for the same quarter in 2009, a decrease of $5 million, or 1.3 per cent, primarily due to lower loan volumes in the Consumer Finance business. Average interest earning assets increased from $61.9 billion to $63.5 billion, while the net interest margin decreased to 2.42 per cent in the quarter compared with 2.52 per cent in the same quarter of 2009, due to a shift in asset mix from higher earning commercial loans to lower yielding government securities as a result of a lower demand for credit.

Net interest income from core banking operations increased by $13 million or 4.3 per cent. This was as a result of a slight increase in net interest margin to 2.07 per cent in the fourth quarter from 2.06 per cent in the same period last year, while average interest earning assets increased from $58.5 billion to $60.8 billion. The net interest margin for core banking operations benefited from a reduction in funding and liquidity costs and the positive impact of higher interest rates, although this was partially offset by a shift in asset mix from commercial loans to government securities.

Net interest income for the Consumer Finance business decreased by $18 million, or 20.2 per cent, in the fourth quarter of 2010 compared to the same quarter in 2009, mainly due to a reduction in average receivables of 21.2 per cent to $2.6 billion, as a result of credit tightening decisions.

Net interest income in the fourth quarter of 2010 decreased by $8 million or 2.0 per cent compared to the third quarter of 2010, as a result of a decrease in net interest margin from 2.50 per cent to 2.42 per cent. The decrease was primarily due to tighter spreads on personal deposits, resulting from the introduction in the fourth quarter of promotional pricing on new deposits, lower commercial loan volumes and lower Consumer Finance loan originations, as described above, partially offset by higher interest income on commercial loans resulting from the increase in the Canadian Prime rate in the fourth quarter.

Non-interest revenue

Non-interest revenue was $283 million in the fourth quarter of 2010, compared with $309 million for the same quarter in 2009, a decrease of $26 million, or 8.4 per cent. One of the main factors affecting the comparability of the periods is the impact of mark-to-market accounting adjustments, as discussed above in the analysis of the annual results. Other net mark-to-market accounting gains of $5 million in the fourth quarter of 2010 decreased by $3 million compared to the same period in 2009. Excluding the impact of these mark-to-market accounting adjustments, non-interest revenue decreased by $23 million in the fourth quarter of 2010, or 7.6 per cent from the same quarter in 2009. The other main factors contributing to the lower non-interest revenue were a $22 million decrease in capital market fees in Global Banking and Markets due to a lower level of activities in underwriting, advisory, equity and debt markets in 2010 compared to the same period in the previous year, and a $28 million decrease in securitization income due to lower transaction volumes. These reductions were partially offset by a modest increase in credit fee revenue, due to pricing initiatives in the Commercial Banking business, higher investment administration fees in the Personal Financial Services business, reflecting the increased market values of customer portfolios compared to the prior year, driven by strong sales of investment products and improving equity markets. Other non-interest revenues increased by $14 million due to higher revenues from credit insurance and the GIIS program.

Non-interest revenue in the fourth quarter of 2010 was $67 million or 31.0 per cent higher than the third quarter of 2010. Other mark-to-market accounting gains of $5 million in the fourth quarter of 2010 were $69 million higher than in the third quarter, primarily due to the effect of changes in interest rates on derivatives used for hedging purposes. Excluding the impact of these mark-to-market accounting adjustments, non-interest revenue decreased by $2 million in the fourth quarter compared to the third quarter of 2010. Capital market fees were $12 million higher due to higher client trading volumes resulting from increased equity markets and from higher structuring and advisory fees. However, this increase was offset by an $11 million decrease in securitization income due to a lower volume of transactions combined with the impact of lower spreads. Other non-interest revenue decreased by $7 million due to lower revenues in the GIIS program and lower recoveries of technology costs from other HSBC Group companies, partially offset by higher credit insurance revenue.

Non-interest expenses and operating efficiency

Non-interest expenses of $382 million in the fourth quarter of 2010 were $48 million or 14.4 per cent higher than the same period in 2009. Salaries and employee benefits were $26 million, or 14.9 per cent higher compared to the previous year, primarily due to increases in commissions and performance-based incentives as a result of better underlying performance and an increase in the post-retirement benefits expense. Other non-interest expenses were $23 million higher mainly due to increased marketing expenditures and higher brokerage expenses resulting from increased activity in the GIIS program. The cost efficiency ratio for the fourth quarter of 2010 was 56.9 per cent compared to 47.6 per cent in the same period in 2009 mainly as a reflection of the adverse swing in other mark-to-market accounting gains and losses, which is a non-cash item. Excluding the impact of this swing, the cost efficiency ratio was 57.4 per cent compared with 48.1 per cent in the fourth quarter of 2009.

Non-interest expenses in the fourth quarter of 2010 were $20 million or 5.5 per cent higher than in the third quarter of 2010. Salaries and employee benefits were $14 million higher mainly due to higher commissions and performance-based incentives for the reasons noted above and increases in termination and post-retirement benefits expenses. Marketing expenditures increased by $11 million compared to the prior quarter due to increased spending on the HSBC brand. The cost efficiency ratio improved in the fourth quarter, to 56.9 per cent from 59.2 per cent in the third quarter.

Income taxes

The effective tax rate in the fourth quarter of 2010 was 31.2 per cent, which compares to 28.7 per cent in the same quarter of 2009 and 28.6 per cent in the third quarter of 2010. The tax rate was higher in the fourth quarter of 2010 compared to the same period in 2009 primarily due to the recognition of a tax refund in 2009 with respect to income earned in the British Columbia international finance centre. The tax rate was lower in the fourth quarter of 2010 compared to the third quarter due to the recognition of certain prior year investment tax credits in the third quarter.

Impact of Estimates, Judgement Issues and Selection of Accounting Policies on Financial Statements

Inherent in the preparation of financial statements is the use of estimates. We make estimates, particularly concerning the valuation of assets, allowances for impaired loans and credit losses and the estimation of liabilities and provisions, which could affect amounts reported in our consolidated financial statements.

We set out details of how we apply certain accounting policies, including changes, in note 1 on pages 60 to 66. The following discussion sets out areas where we believe the selection and application of our accounting policies and the use of estimates and the application of judgement could have a material impact on our reported results. We believe that our estimates are appropriate in the circumstances where applied.

Credit losses and estimation of allowances for credit losses

We report loans as the amount advanced less an allowance for credit losses. Assessing the adequacy of the allowance for credit losses is inherently subjective, as it requires making estimates including the amount and timing of expected future cash flows that may be susceptible to significant change, particularly in periods where the underlying economic conditions are changing.

The allowance for credit losses consists of both specific and general impairment allowances, each of which is reviewed on a regular basis. Specific allowances are recorded on a loan-by-loan basis for those loans where we believe the ultimate collectability of all or a portion of the principal and interest is in doubt. General impairment allowances are our best estimate of incurred losses for groups of individually significant loans for which no evidence of impairment has been individually identified or for high volume groups of homogeneous loans that are not considered individually significant.

Management's Discussion and Analysis (continued)

The impaired loans and allowances sections in the MD&A on pages 38 to 40 and note 1(f) on pages 61 and 62 provide further details of the estimation of our impairment allowances.

We continually update economic factors in our assessments of potential specific loan loss allowances as well as any adjustments that may be required to the amount of the provision for general allowance for loan losses. During 2010, our delinquent loans decreased significantly, resulting in a considerable decrease in the provision for credit losses compared with 2009.

Employee future benefits

As part of employee compensation, the bank provides employees with pension and other post-retirement benefits, such as extended health care, to be paid after employees retire. All new employees participate in a defined contribution pension plan; therefore, there is a lower sensitivity toward adverse economic factors than might be the case for a defined benefit only plan. In certain cases, the amount of the final benefit may not be determined until some years into the future, particularly for defined benefit pensions, where the payment is based on a proportion of final salary and years of service. Although we contribute to several pension plans to provide for employee entitlements, the actual amount of assets required depends upon a variety of factors such as the investment return on plan assets, the rate of employee pay raises, and the number of years over which the ultimate pension is to be paid.

Due to the long-term nature of the contribution and payment periods for defined benefit plans, changes in long-term rates could have a material impact on our reported financial results. After consultation with our actuaries, we make certain assumptions regarding the long-term rate of investment return on pension plan assets, the discount rate applied to accrued benefit obligations, the rates of future compensation increases and the trends in health care costs. The assumptions we use and an analysis of the sensitivity of those assumptions on our benefits expense and accrued benefit obligations are set out in note 24 on pages 96 to 98. The most significant impact is a change in the discount rate applied to accrued benefit obligations. Under current accounting standards, the discount rate to be applied is a long-term bond rate rather than the estimated future performance of plan assets.

Funding requirements for the bank's defined benefit pension plans are based on formal actuarial valuations, which determine the cost of earnings benefits in a year, and any additional bank contributions that are required to eliminate past service deficits over time. As a result of legislative changes, with the exception of one small plan, the bank's plans are subject to annual actuarial valuations beginning in 2010. During 2010, all of the bank's plans were subject to an actuarial valuation, which resulted in annual funding requirements of $18 million, which represents an increase of $9 million over the last valuation. This increase was mainly due to lower than expected investment returns since the last valuation. Although contributions required for 2011 will not be known until the valuations are completed later in 2011, given that financial conditions in 2010 have not varied significantly from what was expected, the bank does not anticipate any significant changes to its defined benefit funding requirements in 2011.

Income taxes

In establishing the income tax provision and the amount of the net future income tax asset recorded in our consolidated financial statements, we estimate the rates at which our income will be taxed in a variety of jurisdictions in Canada as well as expectations regarding dates of reversal of temporary differences. If the actual amounts, timing, or rates differ from the estimates or our interpretations of the tax legislation differ from those of the federal and provincial tax authorities, adjustments may be necessary. Details of our income tax provisions and net future income tax assets are set out in note 25 on page 99.

Goodwill and intangible assets

We review goodwill and intangible assets, including internally generated computer software, for impairment at least annually, to ensure that the fair values are in excess of carrying values. In determining the fair value of goodwill and intangible assets, we use a variety of factors such as market comparisons, discount rates, price/earnings ratios and income estimates. The determination of values requires management judgement in the assumptions used as well as an appropriate method for determination of fair value. Any impairment in goodwill or intangible assets is charged to non-interest expense in the consolidated income statements. Although there were indicators of continuing market weakness during 2010, the carrying amount of our goodwill was not impacted by these weaknesses. In addition, the operating segments to which the goodwill relates continued to be profitable during the year and there was no indication that, at December 31, 2010, there was any impairment in the carrying value of goodwill.

Securitizations and variable interest entities

As part of our liquidity, funding and capital management processes, we pool various types of consumer loans and transfer security interests in these loans to various securitization conduits. These securitizations, which are governed by purchase and sale contracts, are generally conducted through securitization conduits which are Special Purpose Variable Interest Entities ("VIEs") and financed by investors either through commercial paper or a longer-term investment.

Accounting policies for securitizations are set out in note 1(r) on page 65. If the accounting requirements for sales treatment are met, we recognize in income, at the time of the transfer, the present value of the excess spread we expect to earn over the life of the transaction, net of any estimated credit losses and transaction costs. This requires us to make assumptions regarding the expected cash flows of the loans securitized, including the amount of credit losses, discount rates and future servicing liabilities. To the extent that cash flows including the impact of credit losses vary from our estimates, adjustments to the carrying value of retained interests may be necessary. On a regular basis, we review the carrying value of the retained interests recorded within the consolidated financial statements for OTTI. Any OTTI is recorded in our consolidated income statements as a reduction of other income.

Our obligations to cover first losses in excess of these estimated credit losses are not provided for in the balance sheet. Information on our securitizations, including our assumptions and an analysis of the sensitivity of those assumptions on income, regarding loan repayment rates, estimated credit losses and maximum obligations under first loss protection provisions, is set out in note 4 on page 71.

Fair values of financial instruments

During the normal course of our business, we make extensive use of financial instruments, including funding loans, purchasing securities and other investments, accepting deposits and entering into various derivative contracts.

All financial assets, on initial recognition, are measured at fair value in the consolidated balance sheets. Subsequent to initial recognition, loans and receivables and deposits with regulated financial institutions are measured at amortized cost using the effective interest rate method. Unrealized gains and losses, including the impact of changes in foreign exchange rates, arising on financial assets classified as AFS are recorded in other comprehensive income ("OCI"), except for OTTI losses, which are recognized in income. Financial liabilities that are held-for-trading ("HFT"), including those that we have elected to recognize at fair value, or that are derivatives, are recorded in the consolidated balance sheets at fair value. Other financial liabilities are recorded at amortized cost.

There have been no changes in the basis of calculating the fair value of financial instruments, except for changes in model assumptions and refinements in models, as appropriate, since December 31, 2009, and there have been no significant changes in the fair value of financial instruments that arose from factors other than normal economic, industry and market conditions. For financial instruments, including derivatives, valued using significant non-observable market inputs (level 3), assumptions and methodologies used in our models are continually reviewed and revised to arrive at better estimates of fair value.

Information on the fair value of financial instruments is set out in note 1(d) on pages 60 and 61 and note 17 on pages 80 to 86.

The majority of our HFT and AFS securities are either issued or guaranteed by Canadian Federal and Provincial governments. Changes in the fair value of these securities are included in accumulated other comprehensive income.

Management's Discussion and Analysis (continued)

Changes in Significant Accounting Policies in 2010

There have been no changes in accounting policies since December 31, 2009.

Future Accounting and Reporting Changes

Transition to International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board previously announced that for fiscal years commencing on or after January 1, 2011, all publicly accountable enterprises will be required to report financial results in accordance with IFRS. The purpose of adopting IFRS is to promote the comparability of worldwide financial reporting. Accordingly, all interim and annual financial reporting, including comparative figures, will be prepared and published in accordance with IFRS for accounting periods commencing January 1, 2011.

Governance

We formed an IFRS implementation steering committee to provide appropriate governance consisting of senior management, accounting policy, subject matter experts and subsidiary representatives. The IFRS implementation steering committee reports to the Audit Committee and Canadian banking regulators on a regular basis.

Our strategy and progress

Our strategy is to implement IFRS on a basis that leads to consistent policies with our parent, where possible. Our IFRS implementation project is progressing in accordance with the project plan. Prior to 2010, we completed our detailed assessment of accounting differences between Canadian GAAP and IFRS. We have not identified any material accounting differences which are not addressed by our present processes and systems. We have determined our opening IFRS balance sheet as at January 1, 2010, which is our starting point for accounting under IFRS. In addition, we have been collecting the required information and will be in a position to establish comparative 2010 figures and disclosures for the purposes of reporting in 2011 under IFRS.

Financial reporting expertise

As a result of reporting our financial results on an IFRS basis for inclusion in the HSBC Group's consolidated financial results, a number of our accounting staff are experienced in applying IFRS. During 2010, we completed our training plan to expand the knowledge base for IFRS throughout the organization utilizing both internal and external resources. Additional training will be provided on an on-going basis as required.

Impact of IFRS on our financial processes and information systems

Our financial systems are currently processing and reporting financial information on an IFRS basis. Prior to 2010, we modified certain of our accounting systems to improve the timeliness of reporting under IFRS for internal purposes, as well as laying the groundwork for implementing a fully integrated IFRS based accounting system in 2011.

Impact of IFRS on our internal controls over financial reporting and disclosure controls and procedures

We have designed internal controls over financial reporting that are operating effectively. We have determined that there will not be a significant impact on our internal controls over financial reporting or our disclosure controls and procedures resulting from the transition to IFRS.

Impact on business activities

For internal management, the bank utilizes its IFRS based results reported to HSBC Group. The expected impact on business activities from the bank's adoption of full IFRS on a stand-alone basis is not expected to be significant. We are reviewing, and modifying where applicable, loan agreements and related covenant ratios in situations where our customers are also adopting IFRS. We have not identified any other significant business impact resulting from the transition.

Communication to investors

As a wholly-owned subsidiary with no common stock held by outside shareholders, our third party investors consist of preferred shareholders, holders of HSBC HaTS™ and holders of our subordinated debt whose primary concern is the payment of dividends, interest and return of principal amounts on the due dates. During 2010, we communicated the impact of IFRS on our financial results within our Report to Shareholders as required under IFRS transition disclosure standards set by the securities and banking regulators.

Future IASB projects and our assumed impacts

Several accounting standards are in the process of being amended by the IFRS standard setter, the International Accounting Standards Board ("IASB"). We continually monitor IASB projects for developments and we do not expect the issuance of new or revised accounting standards requiring adoption during 2011.

Impact of IFRS on our capital adequacy requirements

As at December 31, 2010, the Tier 1 regulatory capital ratio declined from 13.3 per cent on a Canadian GAAP basis to 13.0 per cent on an IFRS basis and the total regulatory capital ratio declined from 16.0 per cent to 15.8 per cent. Both ratios remained well above the minimum regulatory capital ratio requirements of 7 per cent for Tier 1 capital and 10 per cent for total capital. OSFI has provided relief provisions to phase in the impact of IFRS in the calculation of regulatory capital on a straight line basis over eight quarters from January 1, 2011 to December 31, 2012. We have decided not to take advantage of this relief provision as the impact of the transition to the IFRS basis does not have a material effect on the bank's regulatory capital.

On an IFRS basis, assets securitized and sold through the Canada Mortgage and Housing Corporation ("CMHC") sponsored programs are accounted for as secured borrowings, which results in recognition of the securitized assets on the consolidated balance sheet, and therefore an increase in the regulatory asset-to-capital multiple ("ACM"). As at December 31, 2010, excluding the impact of any transitional provisions, the ACM would increase from 13.3 on a Canadian GAAP basis to 14.8 on an IFRS basis, well within the regulatory maximum of 20 times. OSFI has also provided transitional provisions for the ACM, which will allow the exclusion of all assets securitized and sold through CMHC sponsored programs prior to April 1, 2010 from the calculation of the ACM. We have decided to take advantage of this relief provision. Including the impact of this relief provision, the ACM would decrease from 14.8 to 13.6.

Impact of IFRS on our financial reporting and accounting policies

The information below is provided to allow the reader to obtain a better understanding of our IFRS transition plan and the resulting possible effect on our financial statements. These are estimates based on our current understanding, and readers are cautioned that it may not be appropriate to use such information for any other purpose.

Change in Reporting Format

Commencing with our 2011 First Quarter Interim Financial Report, the bank will change its reporting format to be similar to other entities reporting under IFRS within the HSBC Group.

Changes in Accounting Policies

IFRS is based on a conceptual framework similar to Canadian GAAP, although significant differences exist in certain matters of recognition, measurement and disclosure. As permitted under IFRS, we have taken the decision to align locally reported IFRS results with the results previously reported to our ultimate parent, HSBC Holdings plc, who adopted IFRS in 2005. In addition to aligning our reporting, we will align our accounting policies, where possible, with those of the HSBC Group's worldwide accounting policies.

The bank has determined the key areas where changes in accounting policy are expected. Set out below is an analysis and quantification of the most significant differences and their impact on Canadian GAAP shareholders' equity at January 1, 2010.

i) **Employee defined benefit plans** *(IAS 19 Employee Benefits)*

Under the bank's present accounting policy, actuarial gains and losses outside a 10 per cent corridor are recognized in the income statement over the effective average remaining service lives of employees using the "corridor method". The bank will align its accounting policy with that of its parent in which the corridor method is not used and actuarial gains and losses are recognized directly in equity. The net impact of the differential treatment of actuarial gains and losses and other related employee defined benefit plan adjustments at January 1, 2010 is a $183 million reduction in Canadian GAAP retained earnings.

Management's Discussion and Analysis (continued)

ii) Derecognition of securitized financial assets *(IAS 39 Financial Instruments)*
The bank securitizes National Housing Act – mortgage backed securities ("MBS") through programs sponsored by the CMHC. The programs involve a two step process through which insured mortgages are converted into MBS and thereafter sold.

The bank sells the MBS to the Canada Housing Trust ("CHT") through the Canada Mortgage Bond ("CMB") and Insured Mortgage Purchase Program. Under Canadian GAAP, the features of the transaction meet the derecognition criteria included within AcG-12 *Transfer of Receivables*. Therefore, the transaction is accounted for as a sale with derecognition of the MBS from the consolidated balance sheet and the recognition of a gain or loss in the consolidated income statement. Under IFRS, the terms of the transaction do not meet the derecognition criteria included within IAS 39 because the pass-through test is not met. The pass-through test requires that the bank has no obligation to pay an amount to the transferee unless the transferor collects equivalent amounts from the original assets. Therefore, the transaction is accounted for as a secured borrowing with the underlying mortgages of the securitized MBS remaining on the consolidated balance sheet and a liability recognized for the funding received.

As part of the securitization of MBS as mentioned above, the bank is obligated to enter into certain derivative transactions to isolate the CHT from prepayment and interest rate risk on mortgages in the program. The derivative represents a contractual obligation to pay the CMB coupon and principal to the holders and right to collect the MBS cash flows and is classified as a swap. Under Canadian GAAP, the derivatives are recognized and classified as held for trading with fair value adjustments recognized in the consolidated income statement. Under IFRS, the derivatives are not required to be recognized to avoid double-counting with the securitized assets that are not derecognized.

In addition to the CMHC sponsored programs, the bank also securitizes mortgages to a third party. The same accounting treatment applies to these transactions as for the sale of MBS.

The net effect of these securitization transactions is a decrease to Canadian GAAP shareholders' equity of $106 million at January 1, 2010, which represents the elimination of life-to-date securitization gains and losses realized under Canadian GAAP, less an adjustment for interest income and expense that would have otherwise been recognized under IFRS, and the elimination of mark-to-market adjustments on the related derivatives. In addition, it includes the impact of the elimination of fair value revaluation adjustments on the recognized MBS classified as AFS securities under Canadian GAAP, which are excluded from OCI under IFRS.

iii) Treatment of foreign exchange on AFS securities *(IAS 39 Financial Instruments)*
The bank owns certain foreign currency denominated AFS securities. Under Canadian GAAP, foreign exchange gains or losses on these securities are recognized in OCI, whereas under IFRS foreign exchange adjustments to these securities are recognized in the consolidated income statement. At January 1, 2010, cumulative foreign exchange losses were $99 million, resulting in a decrease to Canadian GAAP retained earnings, offset by a corresponding increase in OCI. There is no impact on total Canadian GAAP shareholders' equity.

iv) Designation of debt securities held with other financial institutions *(IAS 39 Financial Instruments)*
The bank classified certain debt securities held with other financial institutions as loans and receivables, which are measured at amortized cost under Canadian GAAP. Under IFRS, the debt securities are designated as AFS and measured at fair value. As a result of the change in designation, there is an increase to the Canadian GAAP OCI of $13 million at January 1, 2010.

v) Hedge accounting *(IAS 39 Financial Instruments)*
The bank has designated and formally documented hedging relationships under both Canadian GAAP and IFRS individually. Although the vast majority of hedging relationships qualify under both Canadian GAAP and IFRS, certain Canadian GAAP hedging relationships are not allowed under IFRS and vice versa. Therefore in the transition to IFRS, certain hedging relationships designated under Canadian GAAP will no longer qualify for hedge accounting under IFRS, while certain hedging relationships that do not qualify under Canadian GAAP will be accounted for as hedges under IFRS. In addition, different risks are being hedged in the documented cash flow hedging relationships under both Canadian GAAP and IFRS, resulting in different levels of hedge ineffectiveness.

The net effect of these changes to Canadian GAAP OCI is an increase of $66 million at January 1, 2010, with a corresponding decrease to retained earnings, which reflects the net additional hedging relationships established under IFRS. There is no impact on total Canadian GAAP shareholders' equity.

vi) Tax *(IAS12 Income taxes)*

Deferred tax liabilities and assets are generally recognized in respect of all temporary differences except where expressly prohibited, subject to an assessment of the recoverability of deferred tax assets. Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. The tax impact of all IFRS adjustments at January 1, 2010 results in an increase to Canadian GAAP shareholders' equity of $93 million.

vii) Other

In addition to the above noted differences, we have identified other less significant differences relating to goodwill, share-based shareholders' payments and other insignificant items. The net impact of these adjustments is an increase of $37 million to Canadian GAAP shareholders' equity as at January 1, 2010.

The following unaudited, condensed consolidated financial statements show the expected impacts on key line items of the above noted differences between IFRS and Canadian GAAP, assuming that the IASB does not issue any new accounting pronouncements that require adoption in 2011:

Reconciliation of Condensed Consolidated Balance Sheet

At January 1, 2010 *(Unaudited)*

	Canadian GAAP(1)	*IFRS Adjustments*(2)	*Pro-Forma IFRS*(3)
Assets			
Cash resources	$ 1,897	$ 13	$ 1,910
Securities	14,709	(565)	14,144
Securities purchased under reverse repurchase agreements	8,496	–	8,496
Loans	38,104	7,848	45,952
Other assets	8,131	95	8,226
Total assets	**$ 71,337**	**$ 7,391**	**$ 78,728**
Liabilities			
Deposits	$ 50,207	$ (152)	$ 50,055
Other liabilities	15,502	7,689	23,191
Non-controlling interest in trust and subsidiary(4)	430	(430)	–
Total liabilities	**66,139**	**7,107**	**73,246**
Subordinated debentures	**834**	**–**	**834**
Shareholders' Equity			
Capital stock	2,171	–	2,171
Retained earnings and contributed surplus	2,120	(280)	1,840
Accumulated other comprehensive income	73	134	207
Total shareholders' equity	4,364	(146)	4,218
Non-controlling interest in trust and subsidiary(4)	–	430	430
Total equity	**4,364**	**284**	**4,648**
Total liabilities and equity	**$ 71,337**	**$ 7,391**	**$ 78,728**

(1) *Per December 31, 2009 audited financial statements.*

(2) *Refer to description of IFRS adjustments and policy changes above.*

(3) *For fiscal periods commencing after January 1, 2011, we are changing our reporting format to be similar to other entities reporting under IFRS within the HSBC Group.*

(4) *Under Canadian GAAP, non-controlling interest is presented as a liability, unlike IFRS where non-controlling interest is presented as a component of total equity.*

Management's Discussion and Analysis (continued)

Reconciliation of Condensed Consolidated Statement of Income
For the year ended December 31, 2010 *(Unaudited)*

	Canadian GAAP[1]	*IFRS Adjustments*[2]	*Pro-Forma IFRS*[3]
Interest income	$ 2,147	$ 278	$ 2,425
Interest expense	590	211	801
Net interest income	**1,557**	**67**	**1,624**
Non-interest revenue	936	120	1,056
Non-interest expenses	1,432	13	1,445
Provision for credit losses	335	23	358
Income before provision for income taxes and non-controlling interest in income of trust	**726**	**151**	**877**
Provision for income taxes	210	49	259
Non-controlling interest in income of trust[4]	26	(26)	–
Net income	**$ 490**	**$ 128**	**$ 618**

Reconciliation of Condensed Consolidated Balance Sheet
At December 31, 2010 *(Unaudited)*

	Canadian GAAP[1]	*IFRS Adjustments*[2]	*Pro-Forma IFRS*[3]
Assets			
Cash resources	$ 2,686	$ 21	$ 2,707
Securities	18,098	(986)	17,112
Securities purchased under reverse repurchase agreements	7,155	–	7,155
Loans	35,969	7,695	43,664
Other assets	7,588	(176)	7,412
Total assets	**$ 71,496**	**$ 6,554**	**$ 78,050**
Liabilities			
Deposits	$ 52,055	$ (227)	$ 51,828
Other liabilities	13,965	6,862	20,827
Non-controlling interest in trust and subsidiary[4]	230	(230)	–
Total liabilities	**66,250**	**6,405**	**72,655**
Subordinated debentures	**739**	**–**	**739**
Shareholders' Equity			
Capital stock	2,171	–	2,171
Retained earnings and contributed surplus	2,274	(52)	2,222
Accumulated other comprehensive income	62	(29)	33
Total shareholders' equity	4,507	(81)	4,426
Non-controlling interest in trust and subsidiary[4]	–	230	230
Total equity	**4,507**	**149**	**4,656**
Total liabilities and equity	**$ 71,496**	**$ 6,554**	**$ 78,050**

(1) *Per December 31, 2010 audited financial statements.*

(2) *Refer to description of IFRS adjustments and policy changes above.*

(3) *For fiscal periods commencing after January 1, 2011, we are changing our reporting format to be similar to other entities reporting under IFRS within the HSBC Group.*

(4) *Under Canadian GAAP, non-controlling interest is presented as a liability, with distributions expensed through the statement of income, unlike IFRS where non-controlling interest is presented as a component of total equity, with distributions made from retained earnings.*

Off-Balance Sheet Arrangements

As part of our banking operations, we enter into a number of off-balance sheet financial transactions that have a financial impact, but may not be recognized in our consolidated balance sheets. These types of arrangements are contingent and may not necessarily, but in certain circumstances could, involve us incurring a liability in excess of amounts recorded in our consolidated balance sheets. In addition to securitizations and VIEs noted above, these arrangements also include financial and performance guarantees, documentary and commercial letters of credit, and derivative financial instruments.

Guarantees and letters of credit

We routinely issue financial and performance guarantees and documentary and commercial letters of credit on behalf of our customers to meet their banking needs. Guarantees are often provided on behalf of customers' contractual obligations, particularly providing credit facilities for customers' overseas trading transactions and in construction financings. Letters of credit are often used as part of the payment and documentation process in international trade arrangements. Although guarantees and letters of credit are financial instruments, they are considered contingent obligations and the notional amounts are not included in our consolidated financial statements, as there are no actual advances of funds. Any payments actually made under these obligations are recorded as loans to our customers. In accordance with accounting standards for financial instruments, we record the fair value of guarantees made on behalf of customers.

For credit risk management purposes, we consider guarantees and letters of credit to be part of our clients' credit facilities, which are subject to appropriate risk management procedures. Guarantees and letters of credit are considered to be part of our overall credit exposure, as set out in the analysis of our loan portfolio on page 36 of the MD&A, and as set out in note 29 on pages 104 and 105.

Derivative financial instruments

As part of our overall risk management strategy, we enter into a variety of derivatives to manage or reduce our risks in certain areas.

Forward foreign exchange transactions are transactions where we agree to exchange foreign currencies with our counterparties at a fixed rate on a future date. Interest rate swaps are agreements to exchange cash flows of differing interest rate characteristics. Other derivatives comprised equity or credit based transactions.

We use derivatives to limit our exposure to interest rate risk on loans and deposits with differing maturity dates, or foreign currency assets and liabilities of differing amounts. Mismatches in currency or maturity dates could expose us to significant financial risks if there are adverse changes in interest rates or foreign exchange rates. The use of derivatives is subject to strict monitoring and internal control procedures as set out in our risk management discussion in the MD&A on pages 26 to 47.

Our accounting policies on recording the impact of derivatives are set out in note 1(p) on pages 64 and 65. Quantitative information on our derivative instruments is set out in note 18 on pages 87 to 91.

Disclosure Controls and Procedures and Internal Control over Financial Reporting

Management's responsibility for financial information contained in our Annual Report is set out on page 54.

Disclosure controls and procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information required to be disclosed in reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws. These include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the CEO and the CFO, to allow timely decisions regarding required disclosure.

Management's Discussion and Analysis (continued)

As of December 31, 2010, management evaluated, under the supervision and with the participation of the CEO and the CFO, the effectiveness of our disclosure controls and procedures as defined by the Canadian securities regulatory authorities under National Instrument 52-109. Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures are effective as of December 31, 2010.

Internal control over financial reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with GAAP. Management is responsible for establishing and maintaining adequate internal control over financial reporting. These controls include those policies and procedures that: pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the bank; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the bank are being made only in accordance with authorizations of management and directors of the bank; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on the annual financial statements. Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis. Furthermore, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated, under the supervision of and with the participation of the CEO and the CFO, the design and effectiveness of the internal control over financial reporting as required by the Canadian securities regulatory authorities under National Instrument 52-109. This evaluation was performed using the framework and criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as at December 31, 2010.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Related Party Transactions

We enter into transactions with other HSBC affiliates as part of the normal course of business, such as banking and operational services. In particular, as a member of one of the world's largest financial services organizations, we share in the expertise and economies of scale provided by the HSBC Group. We provide and receive services or enter into transactions with a number of HSBC Group companies, including sharing in the cost of development for technology platforms used around the world and benefit from worldwide contracts for advertising, marketing research, training and other operational areas. These related party transactions are on terms similar to those offered to non-related parties and are subject to formal approval procedures that have been approved by the bank's Conduct Review Committee.

Fees are charged by HSBC Group with respect to guarantees of deposits and medium term notes, and administrative and technical services provided to us. For 2010, the total amount we expensed related to fees paid to other HSBC Group companies in respect of these transactions was $174 million (2009 – $118 million), included in non-interest expenses.

Fees are received from HSBC Group companies with respect to administrative and technical services provided by us. The total fees received for the year amounted to $167 million (2009 – $146 million) and were recorded in non-interest revenue.

Included in non-interest revenue were fees of $34 million (2009 – $20 million) received from an HSBC Group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

HSBC Group companies hold certain of our debentures and preferred and common shares. Reference should be made to notes 11 and 12 on page 74 and 75. See also note 18(b) on pages 89 and 90 relating to derivative instruments.

There are also a number of routine transactions occurring during the course of the year, none of which are individually material to our results. Reference should also be made to note 13 on page 76 and note 28 on page 103.

In 2010, we changed the presentation of certain transactions with HSBC Group companies from a net to a gross basis. Reference should be made to note 1(x) on page 66.

Dividends

Dividends on our shares declared, and unless otherwise indicated paid, and distributions per unit on our HSBC HaTS™ in each of the last three years were as follows:

	2010	2009	2008
Preferred Shares Class 1 ($ per share)			
Series C	**$ 1.275**	$ 1.275	$ 1.275
Series D	**1.250**	1.250	1.250
Series E	**1.650**	1.201	–
Preferred Shares Class 2 ($ per share)			
Series B	**0.310**	0.310	0.025[2]
HSBC HaTS™ ($ per unit)			
Series 2010[1]	**77.80**	77.80	77.80
Series 2015	**51.50**	51.50	51.50
Common Shares ($ millions)			
HSBC Bank Canada	**280**	280	270
HSBC Financial Corporation Limited	**–**	–	50

(1) *Units were redeemed on December 31, 2010.*
(2) *Declared in 2008 and paid in 2009.*

Credit Ratings

Standard & Poor's ("S&P") and DBRS® maintain credit ratings of our debt and securities. The ratings are made within the rating agencies' normal classification system for each type of debt or security.

Our credit ratings influence our ability to secure cost-efficient wholesale funding. Our investment grade ratings are unchanged from 2009 and remain among the highest assigned to the Canadian banks.

Our ratings at December 31, 2010 were as follows:

	S&P	*DBRS®*
Short-term instruments	A-1+	R-1 (high)
Deposits and senior debt	AA	AA
Subordinated debt	AA-	AA (low)
Preferred shares	P-1 (Low)[1]	Pfd-2 (high)
HSBC HaTS™	P-1 (Low)[1]	A (low)

(1) *Based on S&P's Canadian national preferred share scale. Ratings are 'A' on S&P global preferred share scale.*

Management's Discussion and Analysis (continued)

Risk Management

(Certain information within this section, where indicated, forms an integral part of the audited financial statements)

All of our business activities involve the measurement, evaluation, acceptance and management of some degree of risk, or combinations of risks. Risk management is the identification, analysis, evaluation and management of the factors that could adversely affect our resources, operations, reputation and financial results. The most important risk categories that we are exposed to include capital management, credit, liquidity and funding, market, structural, and operational risks. The management of these various risk categories is discussed below. The risk management framework established seeks an integrated evaluation of risks and their interdependencies to foster the continuous monitoring of the risk environment.

Overview

As a result of the breadth and depth of our business activities, our customer segments, our regulatory requirements and the competitive landscape, effective risk identification and management continue to be essential to the bank's ongoing success. By establishing an effective and comprehensive enterprise-wide risk management framework, the bank identifies, assesses, measures, mitigates and monitors its risk exposure and its complex interdependencies to ensure optimal shareholder return.

The bank's enterprise-wide risk management framework consists of three key elements:

– Risk Governance and Oversight,

– Risk Appetite, and

– Risk-Based Capital Management.

The bank's risk governance structure ensures full independence from our lines of business and our operations. It allows for three distinct lines of defence: the first line is the controls undertaken by lines of business and operations to own and be accountable for risks that arise from day-to-day business activities; the second line consists of control functions and/or risk sub-committees who provide independent reviews of internal controls performed by management; and, the third line is provided by Internal Audit in their assessment that material risks are identified and managed within the stated risk appetite.

The risk appetite framework is used to describe and set the quantum and types of risk that the bank is prepared to take on the basis of its core values, strategy, and risk management competencies by relating the level of the risk the bank decides to take on to the level of capital required to support it. The fundamental objective of the risk appetite is to introduce a more explicit and consistent consideration of risk and capital into the bank's strategy formulation, business planning process, and associated target setting, execution, measurement, and reporting processes.

The bank's capital management framework is used to assess the amount of capital considered adequate to cover all current and future risks. Within it the bank uses risk-based capital methodologies, models, tools and measures to determine regulatory capital requirements, economic capital and scenario analysis and stress testing. These risk management tools are also used to manage risk relative to expected losses that may impact net income. While these processes are underpinned by policies and standards covering model development, approval and ongoing review, expert panels provide sound judgement to challenge these processes with the aim of avoiding excessive reliance on quantitative risk methodologies and models.

We continue to leverage HSBC Group resources to enhance our risk management infrastructure and strengthen capabilities, examine proactively the regulatory landscape and benchmark against best practices, allowing us to keep abreast with current and future challenges.

Risk Governance and Oversight

The bank has established a risk governance framework that clearly defines the risks faced by the organization, the appetite levels for those risks, and appropriate mechanisms for monitoring them.

Risk governance is positioned at the uppermost level of the bank. The Board of Directors oversees a strong risk culture that is conservative yet competitive. Through the Audit Committee and Risk Management Committee ("RMC"), the Board of Directors provides the risk discipline and structure necessary to achieve business objectives that align with risk strategy. Extensive and timely communication between the Board and executive management ensures that key risks are identified and key information is shared regularly.

The RMC reports directly to the Audit Committee. It governs enterprise-wide risk management and provides assurance regarding the soundness and effectiveness of overall risk management initiatives. To assist the RMC in fulfilling its responsibilities, it assigns management of key risks to executive management committees.

Executive Management Committees

The bank maintains an effective committee structure as defined by corporate governance best practices. Each committee has specific, clear and attainable objectives. Representation on committees is designed to achieve efficiency and the elimination of overlap and duplication. Business and support functions provide the committees with timely and comprehensive information regarding their respective risk management initiatives and activities. The Chief Risk Officer participates on all committees, providing strategic direction, a singular point of accountability and a centralized channel for the identification and management of current and emerging risks across all areas.

Risk Management Committee

Established by the Audit Committee, the RMC provides enterprise-wide risk governance and management. It ensures the following:

– That risk identification, assessment and mitigation mechanisms are in place and effective;

– That the bank has a balanced risk-return profile; and

– That the bank's capital is adequate to support risks.

The RMC mandate includes:

– Identifying and measuring emerging risks;

– Developing appropriate risk management policies and procedures to identify, assess and control material risks on an enterprise-wide basis, including business continuity planning;

– Providing direction regarding our overall risk philosophy and appetite, including the acceptability of new, modified or unusual risk and ensuring risk appetite is appropriately aligned with local, regional and global conditions;

– Ensuring business risk is balanced against economic return;

– Monitoring adherence to risk management policies and procedures; and

– Reporting policy or major practice changes, unusual situations, significant exceptions, and new strategy or products to our Executive Committee and, where appropriate, to the Audit Committee and the Board of Directors for review, ratification and/or approval.

Credit Risk Committee

The Credit Risk Committee provides strategic oversight, ensures appropriate and prudent policies for the effective management of credit risk, and ensures risks are at acceptable levels. It regularly reviews the bank's lending guidelines and policies, assesses the quality of our credit portfolio, discusses economic conditions and risk trends, and develops proactive action plans.

Asset & Liability Committee ("ALCO")

Focusing on the management of interest rate and liquidity risk, the members of ALCO ensure the bank meets asset and liability management objectives such as efficient allocation and utilization of resources, enhancement of economic profit and management of all balance sheet risks. A subcommittee of ALCO, the Capital Governance Group is responsible for ensuring members of ALCO understand the nature and level of risks and their direct relationship to capital levels.

Operational Risk & Internal Control Committee ("ORIC")

The ORIC ensures management fully considers and effectively manages operational risk in order to reduce it to acceptable levels to safeguard the bank against potential losses. It conducts an operational risk business review to ensure business and support functions manage their exposures effectively. Reporting directly to the ORIC, two separate committees provide oversight for compliance with the New Product Due Diligence policy for Retail and Global Banking and Markets.

Management's Discussion and Analysis (continued)

Risk Management Group

The Risk Management Group is responsible for enterprise-wide risk management through effective oversight on risk identification, risk quantification, risk mitigation and monitoring activities. The Risk Management Group works in collaboration with business line and operation functions to guide them through their risk self-assessment process and risk management activities. The Risk Management Group is responsible for:

- Identifying risks and preparing a risk inventory;
- Developing risk strategy, risk policies and procedures;
- Providing independent and expert review and approval of credit proposals recommended by management;
- Developing and reviewing rating systems and risk models;
- Monitoring and managing the credit portfolio;
- Managing the operational risk self-assessment process and operational risk monitoring;
- Assessing the effectiveness of internal controls;
- Providing continuous control assessment of branch network; and
- Managing market risk.

Internal Audit

The mission of the internal audit department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations in accordance with guidelines established in the HSBC Group Audit Standards Manual. Its scope is to ensure that:

- Risks are identified and managed;
- Information is accurate, reliable, and timely;
- Information is compliant with policies, standards, and procedures; and
- Laws and regulatory issues impacting the organization are recognized and addressed appropriately.

Risk Appetite

It is fundamental that the bank operate according to a clearly defined risk appetite. The core philosophy behind our risk appetite includes the maintenance of:

- A strong balance sheet, financial results and capital position;
- Conservative liquidity management, with a diversified funding structure;
- Strong brand and accountability towards our shareholders; and,
- Strong risk management, where risk must be commensurate with returns.

Our enterprise-wide risk appetite defines the risk levels and types that the bank is willing to accept given our strategic objectives, risk principles and capital capacity. We utilize quantitative and qualitative measures across strategic and operational dimensions to establish key metrics and a rational risk assessment of the bank.

With regular monitoring and evaluation of our risk appetite, our framework provides:

- Enhanced confidence in the accuracy of the bank's risk profile;
- Improved executive management control and coordination of risk-taking and risk-mitigating activities given the capital consumption across various businesses;
- Reinforcement of the alignment of risk policies and resources with business objectives; and
- Enhancement of the effectiveness of our risk governance structure through monitoring of business performance using the risk appetite metrics.

With the risk appetite integrated into our planning process, and providing the framework for subjecting new business initiatives to a risk review, moving forward it will promote further alignment of risk and return and transparency around risk measures.

Risk-Based Capital Management

The bank has adopted and implemented the Basel II framework, which is structured around three pillars:

– Pillar 1 relates to minimum regulatory capital requirements.

– Pillar 2 refers to the internal capital adequacy assessment process ("ICAAP"), which is subject to the Supervisory Review and Evaluation Process carried on by OSFI.

– Pillar 3 relates to market discipline by publishing capital and risk management practices.

Capital adequacy regulations

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of the bank, comprising common shareholder's equity, qualifying non-cumulative preferred shares, qualifying innovative capital instruments, contributed surplus, retained earnings and certain other adjustments. Tier 2 capital includes subordinated debentures together with certain other adjustments. There are restrictions on the amount of Tier 2 capital as a percentage of total capital that qualifies in the calculation of capital adequacy.

OSFI regulates capital adequacy for Canadian federally incorporated financial institutions including banks. OSFI's regulations are based on international standards set by the Bank for International Settlements ("BIS"). Although BIS sets minimum limits for financial institutions to maintain 4 per cent and 8 per cent Tier 1 and total capital ratios (as a percentage of risk-weighted assets), respectively, OSFI recommends Canadian banks maintain minimum Tier 1 and total capital ratios of 7 per cent and 10 per cent, respectively. The bank maintained ratios that satisfied these requirements in both 2010 and 2009.

Minimum regulatory capital requirements

The bank calculates its minimum capital requirements in accordance with the Basel II framework, which aligns regulatory capital requirements with the risk profile of the bank. Of the various approaches available in the framework, the bank has adopted the Advanced Internal Ratings Based ("AIRB') approach for calculating capital requirements for credit risk. The AIRB approach allows the bank to use internal estimates for certain risk measures, including probability of default ("PD"), loss given default ("LGD"), exposure at default ("EAD") and effective maturity for calculating risk-weighted assets for credit risk. For operational risk, the bank has adopted the Standardized approach. Operational risk capital is required to cover the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Under the Standardized approach, the capital required is calculated by applying a specific factor, ranging from 12 per cent to 18 per cent, to the gross income of specific business lines.

Capital requirements for credit risk for HSBC Financial are calculated using the Standardized approach on an interim basis until OSFI's approval for the use of the AIRB for HSBC Financial's assets is obtained. Under this approach, risk weightings prescribed by OSFI are used to calculate risk-weighted assets for credit exposures.

In December 2010, the Basel Committee on Banking Supervision issued a document detailing new regulatory standards on bank capital adequacy and liquidity ("Basel III"), as endorsed in November 2010 by the G20 leaders. Implementation is to commence January 1, 2013, with full implementation expected by January 1, 2019. The goal of the reforms is to strengthen the banking sector by improving its ability to absorb losses, enhancing its risk management and governance, as well as strengthening its transparency and disclosure.

The liquidity proposals include providing supervisory expectations on the key elements of a robust framework for liquidity risk management and enhancements and standardization of liquidity monitoring and measurements.

The capital proposals significantly revise the definitions of regulatory capital, with the elimination of certain instruments that currently qualify as regulatory capital. The proposals also emphasize common equity as the predominant component of Tier 1 capital by adding a minimum common equity to risk-weighted assets ratio. The Basel III rules also call for the implementation of a capital conservation buffer, which could be drawn upon in periods of stress, as well as countercyclical capital buffer. A capital leverage ratio will also be introduced.

Management's Discussion and Analysis (continued)

The bank's core common equity is existing Tier 1 capital less non-controlling interest in subsidiaries, HSBC HaTS™ and preferred shares. At December 31, 2010 the bank's core common equity as a percentage of risk-weighted assets was 9.9 per cent (2009 – 8.5 per cent).

The components of our regulatory capital and our actual regulatory capital ratios are stated in the table below.

	2010	2009
Tier 1 capital	**$ 4,544**	$ 4,567
Tier 2 capital	**934**	1,041
Total Tier 1 and Tier 2 capital available for regulatory purposes	**$ 5,478**	$ 5,608
Total risk-weighted assets	**$ 34,152**	$ 37,674
Actual regulatory capital ratios		
Tier 1 capital	**13.3%**	12.1%
Total capital	**16.0%**	14.9%
Actual assets-to-capital multiple	**13.3x**	12.9x
Minimum regulatory capital ratios required		
Tier 1 capital	**7.0%**	7.0%
Total capital	**10.0%**	10.0%

Internal Capital Adequacy Assessment Process ("ICAAP")
ICAAP is the primary component of the bank's capital management framework. The underlying aim of the ICAAP process is to enhance the link between the bank's risk profile, its risk management systems, and its capital. Objectives include the development of sound risk management processes that identify, measure, and monitor risks to adequately assess all the key areas of capital planning to ensure sufficient capital is maintained to cover off all risks.

The ICAAP program encompasses the following key risk management components:

– Risk Identification and Inventory;

– Risk Assessment and Measurement;

– Stress Testing;

– Capital Planning and Management; and

– Risk Monitoring and Reporting.

Risk Identification and Inventory
Identifying current and emerging risks is fundamental to risk management. It is important for the organization to understand and be aware of all risks that it currently or could potentially face in its day-to-day operations.

Risk Assessment and Measurement
Risk and capital are closely linked. Two types of capital include Regulatory Capital, which is the capital the bank is required to hold as determined by the rules established by the international and local regulators. The second type is Economic Capital, which the bank defines as the resources necessary to cover unexpected losses arising from any risk, which it accepts in the form of discretionary or non-discretionary risk through its operations. This is at the core of the ICAAP process and is essential to ensure that the bank is sufficiently capitalized to mitigate all risk types that it has identified and measured on a quantitative or qualitative basis in order to arrive at a test of capital sufficiency. The principal quantitative technique used to measure risk in ICAAP is the use of economic capital models, which are calibrated to a common confidence interval on a loss distribution and measured over a one-year time horizon.

Stress Testing

A key principle under Pillar 2 of the Basel II framework includes an expectation that banks be able to demonstrate how they will meet their capital requirement through a three-to-five year period including the possibility of a severe economic downturn or business event occurring. Stress testing is a risk management technique used to evaluate the potential effects on an institution's financial condition, on a set of specified changes in risk factors corresponding to extreme but plausible events. Stress testing allows senior management to formulate management action in advance of conditions starting to reflect the stress scenarios identified. The bank's enterprise-wide stress testing exercise must determine the impact of common scenarios on an enterprise-wide basis, including the potential impact on all risk types, and on the financial results of the bank including income statement, balance sheet, capital ratios and liquidity.

Capital Planning and Management

The bank maintains a capital management policy, which is approved annually by the Board and HSBC Holdings. This policy places significant reliance on the linkage between the internal assessment of risk, the strategic business planning process and the management of capital. The principles and policies which guide the bank's internal capital planning and management activities are:

– To exceed at all times applicable regulatory capital requirements and long-term targets;

– To generate shareholder value through the efficient allocation of economic capital to support business activities including the asset base and risk positions;

– To remain consistent with our strategic and operational goals, as well as with expectations of shareholders and rating agencies;

– To provide prudent depositor security;

– To maintain a capital position commensurate with the overall risk profile and control environment; and

– To be capable of withstanding a severe economic downturn stress scenario.

As noted above, ALCO has overall responsibility for capital management. It is chaired by our CFO and includes the CEO, Chief Operating Officer, and our senior executives responsible for credit, risk management, treasury and capital management. The Capital Governance Group, also chaired by the CFO, reports to ALCO and is responsible for managing the formal governance over the bank's ICAAP.

Our Finance and Treasury departments manage compliance with our policies daily, with monthly monitoring by ALCO.

In order to maintain the most cost effective capital structure, we redeem or issue capital instruments as deemed necessary.

Risk Monitoring & Reporting

Through the governance structure, senior management and the Board regularly receive reports to monitor the bank's risk exposures and processes to ensure that business activities are operating within approved limits or guidelines, and are aligned to its risk appetite. These reports also provide a clear statement of the amounts, types, and sensitivities of the various risks in the bank's portfolios.

Market Discipline

The Pillar 3 framework provides market discipline by providing a set of risk disclosure schedules which allow market participants to assess key pieces of information on the bank's capital, risk exposures and risk assessment processes. The disclosures are made on the bank's website for the benefit of the market. These disclosures complement the minimum capital requirements (Pillar 1) and the ICAAP and supervisory review process (Pillar 2).

Management's Discussion and Analysis (continued)

Credit risk

(Information that is an integral part of the audited financial statements)

Credit risk is the risk of financial loss if a customer or counterparty fails to meet its contractual obligations. It arises principally from direct lending, trade finance and the leasing business, but also from certain off-balance sheet products such as guarantees and counterparty credit risk on derivatives, and from our holdings of certain types of securities, particularly debt securities.

The bank's credit risk management objectives are to:

- Maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;
- Partner and challenge business originators effectively in defining and implementing risk appetite and its re-evaluation under actual and scenario conditions; and
- Ensure independent, expert scrutiny and approval of credit risks, their costs and their mitigation.

Credit Culture

The bank has a strong and established credit culture and discipline that enables it to achieve and maintain high quality assets. We are dedicated to managing our credit risk exposure while enhancing risk-adjusted returns.

The pillars of our credit culture are:

- Clear policies and guidelines;
- Approval and controls;
- Credit discipline;
- Capital discipline; and
- Credit systems and methodologies.

Across all levels, the bank has established clear credit principles, policies, procedures and guidance that direct our credit activities. Credit risk management is appropriately independent from business line management. Our thorough adjudication process ensures right and timely credit decisions made through adherence to approvals and limits as well as feedback and concurrent controls.

The bank adopts a proactive approach to manage and monitor our credit portfolio through:

- The regular review of facilities;
- The implementation of a framework for the consistent articulation of risk appetite;
- Central monitoring and management of credit concentrations as it relates to industries/sectors, products, customers and customer groups; and
- Continual development and deployment of improved techniques for measuring and evaluating risk and for optimizing risk-adjusted return on capital.

Credit risk is managed in accordance with the bank's credit policy, which is established in consultation with HSBC Group and approved by the Board. Risk limits and credit authorities are delegated to senior credit management staff, who in turn delegate appropriate limits to business line managers. Credit exposures in excess of certain levels or other specific risk attributes are referred for concurrence to HSBC Group to ensure they remain within HSBC Group's global risk limits.

The bank places the highest importance on the integrity and quality of its credit portfolio and has stringent policies to avoid undue concentration of risk. Our RMC, Credit Committee and Audit Committee meet quarterly to review portfolio credit quality, geographic, product and industry distributions, large customer concentrations, adequacy of loan provisions and rating system performance. Policies relating to large customer limits and industry, product and geographic concentration are approved by the Audit Committee in line with HSBC Group policy. All new and renewed major authorized facilities, derivative exposures, "watch-list" exposures and impaired facilities are also reported quarterly to the Audit Committee. The appetite for credit risk is expressed through Commercial and Personal Lending Guidelines that conform with HSBC Group guidelines which are approved quarterly by the Audit Committee and disseminated throughout our business along with various credit manuals.

Our Credit Department reviews and adjudicates credit risk outside the business line managers' delegated lending limits and reviews branch credit decisions to ensure these decisions reflect our portfolio management objectives. We have a disciplined approach to managing credit risk through ongoing monitoring of all credit exposures at branches, with weaker quality credits being reviewed at more frequent time intervals. Problem and impaired loans are identified at an early stage and are actively managed by a separate dedicated Special Credit Management unit which possesses the relevant expertise and experience.

Exposure to banks and financial institutions involves consultation with a dedicated unit within the HSBC Group that controls and manages these exposures on a global basis. Similarly, cross border risk is also controlled globally by this unit through the imposition of country limits.

A review of all credit matters undertaken by our branch and head office credit managers is completed regularly by our internal auditors to ensure all our policies, guidelines, practices, conditions and terms are followed.

We manage real estate lending within well-defined parameters, with an emphasis on relationship and project sponsorship for all new transactions. We are actively managing the exposure level and composition of this portfolio given its concentration in our credit portfolio. Where we are dependent upon third parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

Credit risk rating framework

(Information that is an integral part of the audited financial statements)

Credit risk rating at the bank is an integral part of our credit approval and management process and is consistent with the principles of Basel II. It enables us to quantify, monitor and analyze perceived risk on a uniform and consistent basis and, accordingly, serves to create a common understanding of the risks inherent in the bank's portfolio. Credit risk is measured based on the following parameters:

– *Probability of Default ("PD")* represents the likelihood that an obligor will default on its debt obligation in the next 12 months.

– *Exposure at Default ("EAD")* is the expected amount of debt that the obligor has to pay back to the bank at the time of default.

– *Loss Given Default ("LGD")* is the percentage of the amount owed by the obligor to the bank that the bank expects to lose (including costs and time value of money) should an obligor default, after receiving all the proceeds from collection and liquidation efforts.

Under Basel II, two principal approaches are available for measuring credit risk: the AIRB approach and the Standardized Approach. Most of the bank's credit risk exposure is measured using the AIRB approach.

Under the AIRB approach, the bank's credit risk rating framework incorporates the PD of an obligor and loss severity of the bank's exposure to the obligor expressed as a product of EAD and LGD. These measures are used to calculate expected loss and minimum capital requirements. They are also used in conjunction with other inputs to inform rating assessments and other risk management decisions.

The bank's Risk Management function has developed models which estimate these parameters. These models and parameters are subject to pre-implementation and post-implementation validation and monitoring, including a variety of tests designed to ensure their ongoing accuracy and validity.

Management's Discussion and Analysis (continued)

For the wholesale business (bank, sovereign and corporate), obligor PD is determined using a twenty three-grade Customer Risk Rating scale, of which twenty one are non-default ratings and two are default ratings. The ratings in scale represent varying degrees of financial strength of the obligors, their riskiness and ability to meet contractual obligations to the bank throughout an economic cycle. Scores generated by models are mapped to different ratings each of which is mapped to a PD value range. The ratings assigned are reviewed by credit approvers to ensure that all available information is used while rating the customer. The 'mid-point' PD of the final approved Customer Risk Rating is used in the regulatory capital calculation, pricing and determination of allowances for credit losses.

Models for LGD/EAD estimation for the wholesale business were developed within HSBC Group's framework for basic principles, which permits flexibility in the application of parameters by HSBC's operating entities to suit conditions in their own jurisdictions. EAD is estimated to a 12-month horizon and is, broadly speaking, the sum of current exposures and, where applicable, an estimate for future increases in exposure. LGD is expressed as a percentage of EAD.

For all retail business, exposures are segmented into homogenous pools of accounts with similar risk characteristics. PD, LGD and EAD parameters are estimated for each pool based on observed historical loss data. The segmentation of exposures into different pools is carried out every month based on the characteristics associated with the exposures at the time of monthly review, while the risk measures applied to the exposures are based on the measures associated with the pools that have been derived using data over an entire economic cycle.

The bank's credit risk rating system is subject to prudent oversight to ensure that:

– The risk rating system is developed appropriately, based on variables that are strong indicators of risks;

– The results are reflective of actual risks and provide reasonable assurance as to the accuracy of predictions; and

– The risk rating system and process is in compliance with regulatory requirements.

To this end, appropriate internal and independent controls are implemented. Any changes to our risk rating system and its key components are subject to reviews and approval before implementation. The performance of the risk rating system and the quality of its outputs are also monitored periodically through various tests and detailed reporting. At least annually, an independent review is performed for validation purposes. The whole process is also reviewed by the Internal Audit Group to ensure both internal policies and regulatory requirements are met.

Maximum exposure to credit risk

(Information that is an integral part of the audited financial statements)

The following table presents the maximum exposure to credit risk of on-balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements. For on-balance sheet financial assets, the exposure to credit risk equals their carrying amount. For financial guarantees, the maximum exposure to credit risk is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

	2010	2009
On-balance sheet exposure		
Cash held at Bank of Canada and other regulated financial institutions	**$ 2,686**	$ 1,897
Securities		
As disclosed on balance sheet	**18,098**	14,709
Less: Equity securities not exposed to credit risk	**(112)**	(155)
Securities purchased under reverse repurchase agreements	**7,155**	8,496
Loans	**35,969**	38,104
Customers' liability under acceptances	**4,372**	4,966
Derivatives	**1,364**	1,100
Included within other assets		
Accrued interest receivable	**165**	154
Interest earning other assets	**275**	222
Due from clients, dealers and clearing corporations	**445**	815
Accounts receivable and other	**413**	477
Total on-balance sheet exposure	**$ 70,830**	$ 70,785
Off-balance sheet exposure		
Financial and performance standby letters of credit	**2,337**	2,249
Documentary and commercial standby letters of credit	**352**	228
Commitments to extend credit	**34,298**	36,229
Credit and yield enhancement	**15**	13
Total off-balance sheet exposure	**37,002**	38,719
Maximum exposure	**$ 107,832**	$ 109,504

Collateral and other credit enhancements

(Information that is an integral part of the audited financial statements)

The bank's lending policy assesses the customer's capacity to repay rather than relying excessively on the underlying collateral security. Depending on the customer's standing and the type of product, some facilities may be unsecured. Nevertheless, collateral is an important mitigant of credit risk.

The principal collateral types secured by the bank include:

– *Personal sector:* mortgages over residential properties or charges over other personal assets being financed;

– *Commercial and industrial sector:* charges over business assets such as land, buildings and equipment, inventory and receivables;

– *Commercial real estate sector:* charges over the properties being financed; and

– *Financial sector:* charges over financial instruments such as debt and equity securities in support of trading facilities.

The bank's credit risk management policies include guidelines on the acceptability of specific classes of collateral or credit risk mitigation. Valuation parameters are updated periodically depending on the nature of the collateral. Full covering corporate guarantees as well as bank and sovereign guarantees are recognized as credit mitigants for capital purposes.

The bank does not disclose the fair value of collateral held as security or other credit enhancements on loans past due. It does not disclose the value on impaired or individually assessed impaired loans, as it is not practical to do so.

Collateral held as security for financial assets other than loans is determined by the nature of the instrument. Government and other debt securities, including money market instruments, are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by a pool of financial assets.

The bank has policies in place to monitor for instances where credit exposures are supported by undesirable concentrations of collateral.

Management's Discussion and Analysis (continued)

Loan portfolio diversity

(Information that is an integral part of the audited financial statements)

Concentration of credit risk may arise when the ability of a number of borrowers or counterparties to meet their contractual obligations are similarly affected by external factors. Examples of concentration risk would include geographic, industry and environmental factors. Therefore, diversification of credit risk is a key concept by which we are guided.

In assessing the risks of our credit portfolio, we aggregate all exposure types that result in credit risk.

The following is an analysis of the constituents of our portfolio:

	2010	2009
Loans included in financial statements, net of allowances	**$ 35,969**	$ 38,104
Allowance for credit losses	**625**	638
Customers' liabilities under acceptances[1]	**4,372**	4,966
Financial and performance standby letters of credit[1]	**2,337**	2,249
Documentary and commercial letters of credit	**352**	228
Total loans	**43,655**	46,185
Impaired loans and other impaired credit exposures[1]	**(829)**	(1,022)
Total performing loans	**$ 42,826**	$ 45,163

(1) *Includes $60 million (2009 – $15 million) of impaired acceptances and letters of credit.*

The following tables, in which business and government loans include customers' liabilities under acceptances, letters of credit and guarantees, provide details of our overall performing loan portfolio including geographic and industry distribution:

Performing loan portfolio

	2010		2009	
Business and government loans[1]	**$ 23,751**	**55.5%**	$ 25,547	56.6%
Residential mortgages	**10,724**	**25.0**	10,889	24.1
Consumer finance loans	**2,481**	**5.8**	3,023	6.7
Other consumer loans	**5,870**	**13.7**	5,704	12.6
Total performing loans	**$ 42,826**	**100.0%**	$ 45,163	100.0%

(1) *Includes $432 million (2009 – $408 million) of construction and other loans secured by mortgages over residential property.*

Geographic distribution

	2010		2009	
British Columbia	**$ 17,983**	**42.0%**	$ 20,033	44.3%
Western Canada, excluding British Columbia	**8,943**	**20.9**	8,909	19.7
Ontario	**10,720**	**25.0**	11,090	24.6
Quebec and Atlantic	**5,180**	**12.1**	5,131	11.4
Total performing loans	**$ 42,826**	**100.0%**	$ 45,163	100.0%

Business and government loan portfolio by industry

	2010		2009	
Real estate	**$ 6,542**	**27.5%**	$ 8,119	31.8%
Services	**4,801**	**20.2**	4,970	19.5
Trade	**4,266**	**18.0**	4,087	16.0
Manufacturing	**2,812**	**11.8**	2,814	11.0
Energy	**2,166**	**9.1**	2,274	8.9
Hotels and hospitality	**924**	**3.9**	899	3.5
Other	**2,240**	**9.5**	2,384	9.3
Total business and government loans	**$ 23,751**	**100.0%**	$ 25,547	100.0%

Large customer concentrations are borrowing groups where approved facilities exceed 10 per cent of our regulatory capital base. At December 31, 2010, this amount was approximately $548 million (2009 – $561 million).

The following table provides details of our large customer concentrations:

		2010		2009
Large customer concentration	**$**	**3,229**	$	2,363
As a percentage of business and government loans		**13.6%**		9.2%
As a percentage of total performing loans		**7.5%**		5.2%

Credit quality of financial assets

(Information that is an integral part of the audited financial statements)

For core banking operations, the vast majority of the total loan portfolio is categorized as strong. Credit quality of the portfolio was historically stable until the latter part of 2007. Credit quality has deteriorated through the decline in this credit cycle. We expect this to continue into 2011, although there are signs that economic recovery is on the horizon. At December 31, 2010, $712 million, or 1.9 per cent, of the loan portfolio was impaired, compared to $846 million, or 2.1 per cent, at December 31, 2009, with specific and general allowances providing 67 per cent (2009 – 52 per cent) coverage of these loans. Overall credit quality remains satisfactory, reflecting our prudent lending standards. Provision levels overall remained stable compared to the prior year.

For our Consumer Finance segment, impaired loans of $117 million at December 31, 2010 were $59 million, or 33.5 per cent, lower than the $176 million at December 31, 2009. Impaired loans relative to the total receivables portfolio were 4.5 per cent at December 31, 2010, compared to 5.5 per cent at December 31, 2009. At December 31, 2010, the general allowances provided 125 per cent coverage of the impaired loans (2009 – 114 per cent). On a year over year basis, overall credit quality has improved primarily due to collection strategies, credit tightening decisions, less severe economic conditions and a declining receivables base.

The bank describes credit quality in reference to the following categories:

Category	*Our internal customer risk rating*	*Standard & Poor's equivalent risk rating*	*Moody's equivalent risk rating*
Strong	Minimal to low default risk	AAA to A–	Aaa to A3
Medium	Satisfactory to moderate default risk	BBB+ to B+	Baa1 to B1
Sub-standard	Significant default risk to special management	B to CCC	B2 to C
Impaired	Default	D	C

For core banking operations, the credit quality of financial assets is presented using EAD and will therefore not agree to the carrying values as disclosed within the consolidated balance sheets. EAD represents the outstanding or drawn amount of a credit exposure, before deducting any specific provision or amounts written off as well as an undrawn portion, which represents estimated amounts not recognized in the balance sheet that could be drawn at time of default by the credit party. EAD for the retail portfolio includes securitized exposures which are off-balance sheet under Canadian GAAP. The credit quality of financial assets in the Consumer Finance segment is presented at their carrying values included in the consolidated balance sheets.

Credit quality of non-retail portfolio

	2010 (EAD)			2009 (EAD)		
	Drawn	*Undrawn*	*Total*	*Drawn*	*Undrawn*	*Total*
Strong	**$ 24,858**	**$ 4,041**	**$ 28,899**	$ 19,330	$ 4,063	$ 23,393
Medium	**22,905**	**7,482**	**30,387**	24,916	7,633	32,549
Sub-standard	**1,072**	**114**	**1,186**	1,533	167	1,700
Impaired	**564**	**59**	**623**	723	44	767
	$ 49,399	**$ 11,696**	**$ 61,095**	$ 46,502	$ 11,907	$ 58,409

Management's Discussion and Analysis (continued)

Credit quality of retail portfolio (excluding Consumer Finance segment)

	2010 (EAD)			2009 (EAD)		
	Drawn	*Undrawn*	*Total*	*Drawn*	*Undrawn*	*Total*
Strong	**$ 10,473**	**$ 607**	**$ 11,080**	$ 11,212	$ 1,014	$ 12,226
Medium	**12,926**	**4,291**	**17,217**	12,630	2,842	15,472
Sub-standard	**836**	**99**	**935**	693	70	763
Impaired	**217**	**–**	**217**	190	–	190
	$ 24,452	**$ 4,997**	**$ 29,449**	$ 24,725	$ 3,926	$ 28,651

Credit quality of retail portfolio (Consumer Finance segment)

	2010	2009
	Drawn	*Drawn*
Strong	**$ 677**	$ 1,457
Medium	**1,378**	1,099
Sub-standard	**427**	467
Impaired	**117**	176
	$ 2,599	$ 3,199

Renegotiated loans

(Information that is an integral part of the audited financial statements)

The carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated was $85 million at December 31, 2010 (2009 – $112 million).

Loans past due but not impaired

(Information that is an integral part of the audited financial statements)

Examples of exposures considered past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; loans fully secured by cash collateral; residential mortgages in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

The aging analysis below includes past due loans on which general impairment allowances have been assessed, though at their early stage of arrears, there is normally no identifiable impairment.

	2010	2009
Past due up to 29 days	**$ 399**	$ 450
Past due 30–59 days	**127**	132
Past due 60–89 days	**57**	59
Past due 90 days and over	**33**	29
	$ 616	$ 670

Impaired loans and allowance for credit losses

(Information that is an integral part of the audited financial statements)

When impairment losses occur, we reduce the carrying amount of loans by using an allowance account with a charge to income. The allowance for credit losses consists of both specific and general allowance provisions, each of which is reviewed on a regular basis. The allowance for credit losses reduces the gross value of an asset to its net carrying value.

An allowance is maintained for credit losses which, in management's opinion, is considered adequate to absorb all credit-related losses in our portfolio (both on and off-balance sheet) including deposits with other regulated financial institutions, loans, acceptances, derivative instruments and other credit-related contingent liabilities such as letters of credit and guarantees.

Assessing the adequacy of the allowance for credit losses is inherently subjective because it requires making estimates that may be susceptible to change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

Individually significant accounts are treated as impaired as soon as there is objective evidence that an impairment loss has been incurred. The criteria used to determine that there is such objective evidence include:

– Known cash flow difficulties experienced by the borrower;

– Past due contractual payments of either principal or interest;

– Breach of loan covenants or conditions;

– The probability that the borrower will enter bankruptcy or other financial realization; and

– A significant downgrading in credit rating by an external credit rating agency.

Specific allowances are recorded on these individual accounts on an account-by-account basis to reduce their carrying value to the estimated realizable amount.

The general impairment allowance is the bank’s best estimate of incurred losses in the portfolio for those individually significant accounts for which there is no evidence of impairment. It is also applied to high-volume groups of homogenous loans that are not considered individually significant. In determining an appropriate level of general impairment, the bank applies the following methodologies:

Wholesale Business (Governments, banks and corporates) – The underlying credit metrics, including PD, LGD and EAD, for each customer are derived from the bank’s internal rating system as a basis for the general allowance. Management is able to amend these metrics for some or all borrowers where the rating system metrics do not fully reflect incurred losses. This judgemental adjustment employs an established framework and considers both internal and external indicators of credit quality.

Residential mortgages – Historic average loss rates are used to determine the general provision for residential mortgage portfolios. Management may also consider other current information.

Retail Business (Consumer finance and other consumer loans) – The basis for the general allowance for consumer finance and other consumer loan portfolios is determined based on historical delinquency movements by product type. An estimate of incurred losses in each pool is determined by tracking delinquency movement among pools of homogenous loans. These estimates can be amended should management believe they do not reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

In addition to the methodologies outlined above, the balance of the general allowance is also analyzed as a function of risk-weighted assets and is also referenced to the allowances held by our peer group.

Management's Discussion and Analysis (continued)

The following table provides details of the impaired loan portfolio:

	2010	2009
Business and government		
Real estate	$ 265	$ 439
Manufacturing	55	98
Trade	80	64
Services	91	67
Other	99	78
Total business and government loans	590	746
Personal		
Residential mortgages	87	62
Consumer finance loans	117	176
Other consumer loans	35	38
Total personal loans	239	276
Total impaired loans, acceptances and letters of credit[1]	$ 829	$ 1,022
Specific allowances	$ 227	$ 186
General allowances	398	452
Total allowance for credit losses	$ 625	$ 638
Net impaired loans and acceptances	$ 204	$ 384

(1) *Includes $60 million (2009 – $15 million) of impaired acceptances and letters of credit.*

The following table shows the coverage of specific allowances as a percentage of our related impaired loans and acceptances:

	2010	2009
Real estate	22%	8%
Manufacturing	53%	54%
Other[1]	51%	46%
Total	38%	25%

(1) *Includes business and government loans.*

The following table sets out the coverage of the general allowance as a percentage of total performing loans and risk-weighted assets.

Coverage by general allowance

	2010	2009
As a percentage of total performing loans	0.93%	1.00%
As a percentage of risk-weighted assets	1.17%	1.20%

Provisions for credit losses

(Information that is an integral part of the audited financial statements)

The following table sets out the provisions for credit losses charged to income:

	2010	2009
Specific provisions	$ 182	$ 260
Collective provisions	153	255
Total provision for credit losses	$ 335	$ 515
Specific provisions as a percentage of total loan portfolio	0.42%	0.56%

For core banking operations, the level of specific provision decreased significantly in 2010 due to lower provisions in the manufacturing and commercial real estate sectors. The level of general provisions has been stable, decreasing only slightly as a percentage of risk-weighted assets. The general impairment will be maintained at a level consistent with the underlying risk profile of the loan book and management's view of economic and other conditions that impact incurred losses in the loan portfolio.

For our Consumer Finance segment, general provisions decreased by $106 million in 2010, reflecting the improved economic conditions and credit tightening decisions.

Impaired securities

(Information that is an integral part of the audited financial statements)

Asset-backed commercial paper

At December 31, 2009, the par value of the bank's non-bank ABCP was $459 million, with a carrying amount of $256 million, which represented management's best estimate of the fair value of the restructured notes at December 31, 2009.

In 2010, the bank disposed of substantially all of these notes, at which time a recovery of the previously recorded losses of $21 million was recorded. The par value of the bank's remaining notes at December 31, 2010 was $21 million, with a carrying value of nil.

AFS securities

In 2009, certain investments in preferred shares, mutual funds and debt securities experienced significant declines in market value in relation to their original cost. As a result, a charge for OTTI of $20 million was recorded during 2009 as a loss on AFS securities. There was no similar charge in 2010.

Derivative portfolio

(Information that is an integral part of the audited financial statements)

The credit equivalent amount of derivative exposure comprises the current replacement cost of positions plus an allowance for potential future fluctuation of interest rate or foreign exchange rate derivative contracts. We enter into derivatives primarily to support our customers' requirements and to assist us in the management of assets and liabilities, particularly relating to interest and foreign exchange rate risks as noted above.

The credit equivalent amount of our derivative portfolio by product type is as follows:

	2010	2009
Interest rate contracts	**$ 554**	$ 641
Foreign exchange contracts	**1,612**	1,259
Net credit equivalent amount	**$ 2,166**	$ 1,900

A more detailed analysis of our derivative portfolios is presented in note 18 on pages 87 to 91.

Management's Discussion and Analysis (continued)

Liquidity and funding risk

(Information that is an integral part of the audited financial statements)

Liquidity risk is the risk that we do not have sufficient financial resources to meet our obligations as they fall due or will have to obtain such resources at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk, a form of liquidity risk, arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of our liquidity and funding management strategy is to ensure that all foreseeable funding commitments can be met when due, and that access to the wholesale markets is coordinated and cost-effective. We maintain a diversified funding base comprising core retail and corporate customer deposits and institutional balances, augmented with wholesale funding and portfolios of highly liquid assets which are held to enable us to respond quickly and smoothly to unforeseen liquidity requirements.

Policies and procedures

(Information that is an integral part of the audited financial statements)

The management of liquidity and funding is carried out by our Treasury Department in accordance with practices and limits approved by ALCO, the Board and HSBC Holdings. Compliance with policies is regularly monitored by ALCO.

Our liquidity and funding management process includes:

- Projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- Monitoring balance sheet liquidity ratios against internal measures;
- Maintaining a diverse range of funding sources with adequate back-up facilities;
- Managing the concentration and profile of debt maturities;
- Managing contingent liquidity commitment exposures within pre-determined caps;
- Maintaining debt financing plans;
- Monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- Maintaining liquidity and funding contingency plans.

Liquidity and funding contingency plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimizing adverse long-term implications for the business.

Primary sources of funding

(Information that is an integral part of the audited financial statements)

Current accounts and savings deposits payable on demand, on short notice, or for a fixed term form a significant part of our funding. We place considerable importance on maintaining the stability and growth of these deposits, which provide a diversified pool of funds.

We also access professional markets in order to maintain a presence in local money markets and to optimize the funding of asset maturities not naturally matched by core deposit funding. As part of our wholesale funding arrangements, we have a number of programs for fundraising activities, including asset securitizations, so that undue reliance is not placed on any one source of funding.

As part of the HSBC Group's worldwide liquidity and funding management process, we have established limits for balance sheet ratios and minimum periods of forecast positive cumulative cash flow as well as contingencies to meet cash flow needs.

Cash flows payable under financial liabilities by remaining contractual maturities are as follows:

	2010			
	On demand and due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*
Deposits	$ 34,477	$ 7,750	$ 7,392	$ 1,290
Acceptances	4,256	116	–	–
Interest bearing liabilities of subsidiaries, other than deposits	864	1,383	151	–
Derivatives	1,329	–	–	–
Securities sold under repurchase agreements	1,560	–	–	–
Securities sold short	1,262	–	–	–
Subordinated debentures(1)	8	23	102	846
Other financial liabilities	1,726	227	1,122	–
	$ 45,482	$ 9,499	$ 8,767	$ 2,136
Loan commitments	19,782	14,033	182	301
	$ 65,264	$ 23,532	$ 8,949	$ 2,437

(1) *Excludes interest payable exceeding 15 years.*

Certain balances in the above table will not agree directly to the balances in the consolidated balance sheets as the table incorporates cash flows for both principal and interest, on an undiscounted basis, except for derivatives. Furthermore, loan commitments are not recognized on the balance sheet. Derivatives have been classified as "On demand and due within three months", and not by contractual maturity, because they are typically held for short periods of time.

Cash flows payable in respect of deposits are primarily contractually repayable on demand or on short notice. However, in practice, short-term deposit balances remain stable as cash inflows and outflows broadly match. Deposits on demand and due within three months include personal savings and personal and commercial notice accounts of $28 billion.

Contractual obligations

As part of our normal business operations we have contractual obligations for payment of liabilities. Amounts included in unsecured long-term funding in the table below are wholesale term deposits with an original term to maturity of more than one year, based on contractual repayment dates. Also included are obligations related to commitments not recorded in the consolidated balance sheets, such as those relating to operating leases.

A summary of our future contractual payments due by period is as follows:

	2010				
	Less than 1 year	*1 to 2 years*	*3 to 4 years*	*After 5 years*	*Total*
Subordinated debentures(1)	$ –	$ –	$ –	$ 724	$ 724
Operating leases	57	103	82	113	355
Committed purchase obligations	102	68	27	3	200
Unsecured long-term funding(1)	47	709	483	1,524	2,763
Total contractual obligations	$ 206	$ 880	$ 592	$ 2,364	$ 4,042

(1) *Includes principal amounts only.*

Committed purchase obligations include long-term arrangements for the provision of technology and data processing services by HSBC Group companies. Not included in the table are any commitments relating to customers utilizing undrawn portions of their loan facilities. As a result of our ongoing funding and liquidity management process which we monitor regularly, we expect to be able to meet all of our funding and other commitments in the normal course of our operations despite the economic uncertainty.

Management's Discussion and Analysis (continued)

Market risk

(Information that is an integral part of the audited financial statements)

Market risk is the risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

The objective of market risk management is to identify, measure and control market risk exposures in order to optimize return on risk.

We separate exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other positions designated as HFT. Non-trading portfolios include positions that arise from the interest rate management of our retail and commercial banking assets and liabilities and financial investments designated as AFS and held to maturity.

Policies and procedures

(Information that is an integral part of the audited financial statements)

Market risk is managed through strategies in accordance with policies and risk limits set out by ALCO and approved by the Board as well as centrally by HSBC Group Risk Management. We set risk limits for each of our trading operations dependent upon the size, financial and capital resources of the operations, market liquidity of the instruments traded, business plan, experience and track record of management and dealers, internal audit ratings, support function resources and support systems. Risk limits are reviewed and set by ALCO on an annual basis at a minimum.

We use a range of tools to monitor and limit market risk exposures. These include: present value of a basis point, Value at Risk ("VaR"), foreign exchange exposure limits, maximum loss limits, options premium paid limits, and product and issuance limits.

Value at Risk

(Information that is an integral part of the audited financial statements)

VaR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VaR models used are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking account of inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

– Potential market movements are calculated with reference to data from the past two years;
– Historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
– VaR is calculated to a 99 per cent confidence level; and
– VaR is calculated for a one-day holding period.

Statistically, we would expect to see losses in excess of VaR only one per cent of the time over a one-year period.

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations:

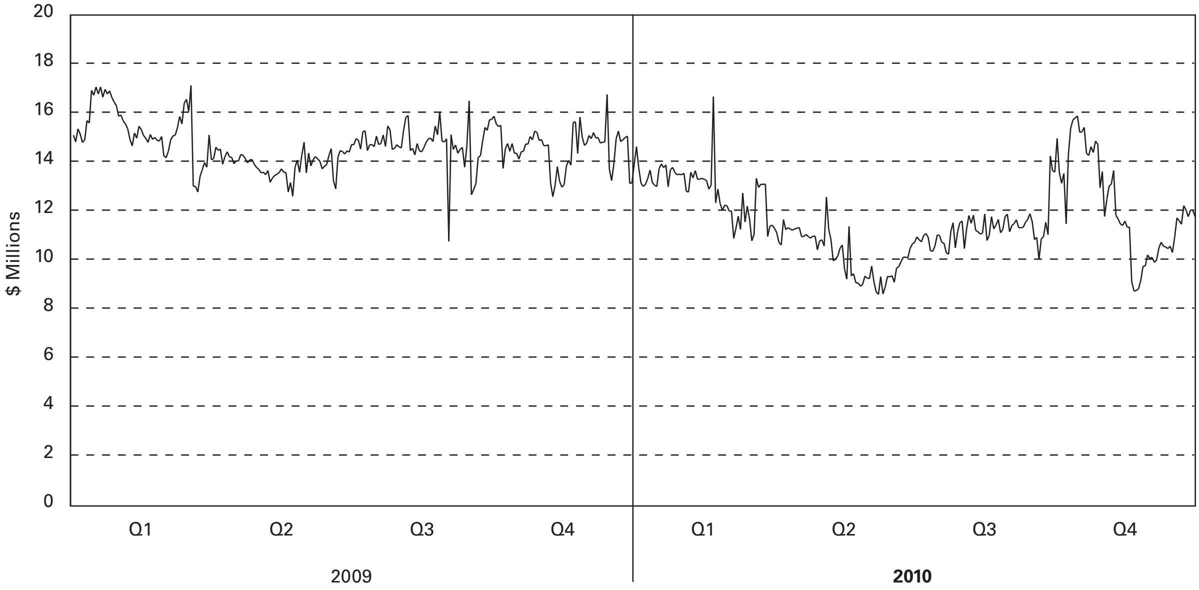
– The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
– The use of a one-day holding period assumes that all positions can be liquidated or hedged in one day, which may not fully reflect the market risk arising at times of severe illiquidity, when a one day holding period may be insufficient to liquidate or hedge all positions fully;
– The use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
– VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
– VaR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

The Group's policy regarding the VaR calculation for the banking and trading books was expanded to include Credit VaR ("CVaR") in 2010. CVaR consists of Historical Simulation Credit VaR. The bank's portfolio includes MBS issued by CMHC, and Provincial and corporate debt, which trade at a spread over Government of Canada bonds, thus generating CVaR. In addition, we monitor and continue to refine our methodologies for Idiosyncratic Credit VaR ("ICVaR"). ICVaR captures the residual market risk of a specific issuer that is not captured in the Historical Simulation Credit VaR.

VaR disclosed in the table and graph below is the bank's total VaR for both trading and non-trading financial instruments, including CVaR beginning in 2010. Comparative CVaR information for the prior year is not available. The information presented below does not include the results of HSBC Financial because the subsidiary employs other methods to measure and manage market risk.

Daily Value at Risk

(Information that is an integral part of the audited financial statements)



Summary Value at Risk information

(Information that is an integral part of the audited financial statements)

		2010		2009
End of year	**$**	**12**	$	13
Average		**12**		15
Minimum		**9**		11
Maximum	**$**	**17**	$	17

The 2009 VaR figures reflect the high market volatility in late 2008 and early 2009. The improvement in VaR in the first half of 2010 resulted from a decrease in interest rate sensitivity. The volatility in VaR from mid-September to the end of the year was due to changes in the sensitivity of our positions to interest rate and credit risk. The roll-off of the more volatile October 2008 data from the 500-day historical data set used to determine VaR positively impacted VaR in November onwards. VaR levels remained within our approved limits throughout 2010.

Management's Discussion and Analysis (continued)

Structural risk

Structural risk is the impact of interest rate and foreign exchange rate risks on assets and liabilities included in the banking book, including those in our consolidated balance sheets. We value instruments included in the banking book at cost plus accrued interest (the effective interest rate method) and changes in rates and prices will not directly impact earnings. However, to the extent that assets and liabilities are not directly matched either by interest or exchange rates, any changes in the mix of assets or liabilities will affect earnings.

Structural interest rate risk

Structural interest risk is comprised of repricing risk, yield curve risk, option risk and basis risk. It is managed through: i) gap analysis, ii) sensitivity analysis, iii) earnings-at-risk, iv) VaR, v) economic value of equity, vi) prepayment and pipeline risk monitoring, and vii) basis risk monitoring.

Gap analysis measures repricing risk of assets and liabilities both on and off-balance sheet. Repricing income risk is estimated through interest rate risk exposure buckets, or "gaps", and monitored by ALCO and the Tactical Asset and Liability Committee against prescribed limits.

Sensitivity analysis measures the impact of yield curve shifts on asset and liability maturity mismatches. Limits are established based on the impact on the present value of all net cash flows of an immediate and parallel upward shift in all relevant yield curves of 0.01 per cent.

Earnings-at-risk estimates changes in income due to changes in interest rates and volume over a period of time. Net interest income is forecasted using various interest rate and balance sheet growth scenarios to provide an analysis of spread earnings at risk due to repricing and volume change.

VaR estimates overnight losses at a prescribed confidence level. It is used to measure the risk in market traded instruments such as cash and derivative instruments, principally interest rate swaps. The bank uses derivatives to modify the interest rate characteristics of related balance sheet instruments and to hedge anticipated exposures when market conditions are considered beneficial.

Economic value of equity measures the immediate change in value of the bank under a 2.00 per cent parallel up and down shock in the interbank interest curve. It is calculated on a run-off balance sheet, and is a proxy for the change in the market value of the bank under a stress scenario.

Prepayment, pipeline and deposit option risk is estimated through customer behavioural models. Options are modeled as adjustments to contractual payments, such as relating to early repayment of consumer loans, residential mortgages, and customer preferences for demand, notice and redeemable deposits. These assumptions, which are based on historical behavioural patterns, are periodically reviewed by ALCO.

Basis risk is estimated through exposure and income gap analysis. It occurs when variable rate loans are funded with variable rate deposits that are not perfectly correlated. For example, a prime loan funded with a high interest savings deposit results in basis risk: when prime moves higher or lower both the loan and deposit rate move higher or lower but not in step. Basis risk increases when the change in the movements is widely divergent or convergent.

Foreign exchange risk

The bank is exposed to foreign exchange risk on our foreign currency-denominated asset and liability positions. We buy and sell currencies in the spot, forward, futures and options markets, on behalf of our customers and for our own account, to manage our own currency exposures arising from assets and liabilities denominated in currencies other than the Canadian dollar. Limits have been established as to the magnitude of the exposure on a currency-by-currency basis as well as maximum loss limits on any position held.

Operational risk

Operational risk is the risk of loss to us resulting from inadequate or failed internal processes and systems, human error or external events. This type of risk includes fraud, unauthorized activities, errors, and settlement risk arising from the large number of daily banking transactions occurring in the normal course of business. Also, there are a wide variety of business and event risks inherent in all business activities.

We have policies for managing operational risk and aim to minimize loss through a framework requiring all business units to identify, assess, monitor and control operational risk, including the Operational Risk and Internal Control Committee, as described above in the Risk Management section.

We manage operational risk through disciplined application and evaluation of internal controls, appropriate segregation of duties, independent authorization of transactions, and regular, systematic reconciliation and monitoring of transactions. We have a dedicated function that proactively manages our compliance process, and we maintain high ethical standards. These processes together with our control structure help ensure that our exposure to operational risk is managed. This control structure is complemented by independent and periodic reviews by our Internal Audit department.

As part of the enterprise-wide risk management process, we have established business continuity and event management practices so we can continue to service our customers' needs in the event of major business disruption. Back-up facilities in various cities across North America increase our recovery capabilities for key businesses.

In common with other HSBC Group companies, as well as other Canadian banks and large organizations, we have business continuity plans in place to deal with events that could impact banking operations, from health concerns to weather related events to power outages and beyond. We monitor emerging issues and review, test and upgrade plans to prepare for foreseen and unforeseen events.

Analysis of Financial Results and Operations by Customer Group

We report and manage our operations according to our major customer groups.

A summary of the breakdown of selected consolidated financial information and other data by major customer groups is included in note 27 on pages 101 to 103.

Personal Financial Services

Business developments and achievements for 2010 include:

– *Deposit and mortgage products* – We continue to support our customers, growing personal deposits to $26.3 billion, up by $1.1 billion or 4 per cent for the year, but experienced a decline in residential mortgages of $0.1 billion, or 1 per cent, to $11.2 billion due to a decrease in our broker mortgage business and an increased focus on lending to HSBC Premier and HSBC Advance customers.

– *Premier* – We continued to grow our HSBC Premier customer base, attracting over 53,600 customers, of which 39 per cent were new to the bank, taking our total HSBC Premier customer base to over 205,400. HSBC Premier offers seamless global banking with over 6,000 HSBC Premier branches worldwide in 47 countries. Over 65,000 HSBC Premier customers have been migrated to the new, fast and convenient virtual-service model called Premier Connect, which provides a single point of contact to HSBC Premier customers for all of their financial needs through a combination of Internet banking and telephone banking. Premier Connect will help reduce portfolio sizes for Premier Relationship Mangers, enabling them to focus on high-value HSBC Premier clients and sales growth.

– *Advance* – We launched our HSBC Advance customer proposition to the Canadian marketplace, offering a priority service to emerging mass affluent customers. HSBC Advance offers seamless global banking in over 34 countries, with a customer base that has grown to over 55,300, of which 16 per cent were new to the bank.

– *Wealth management* – We ranked fourth amongst banks in mutual fund sales, with total net sales of $923 million, significantly outselling relative to the size of our network and demonstrating the appeal to customers of bringing the world of investment opportunities to Canadians. We added emerging market equity exposure to World Selection via the launch of a new HSBC Emerging Market Pooled Fund. With our World Selection family of funds, we now have the broadest emerging market fund range in Canada.

– *Direct Bank* – Our High Rate Savings Account continues to grow, achieving $7.7 billion in deposits by year-end, an increase of $1.7 billion, or 28 per cent, for the year.

– *Product innovations* – We continued to bring innovative products to the Canadian market, launching a New Money Promotion for High Rate Savings/Tax Free High Rate Savings and HSBC Advance Savings/Tax Free HSBC Advance Savings, offering a 1 per cent bonus on new money deposited into the bank.

– *Mystery Shop Quality Assurance Scores* – In internal HSBC Group surveys, the Canadian bank service quality in branches and at call centres compares favourably to HSBC operations in other countries.

Management's Discussion and Analysis (continued)

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Personal Financial Services:

	2010	2009
Net interest income	$ 296	$ 357
Non-interest revenue	420	364
Total revenue	716	721
Non-interest expenses	657	623
Net operating income	59	98
Provision for credit losses	27	42
Income before taxes and non-controlling interest in income of trust	32	56
Provision for income taxes	9	16
Non-controlling interest in income of trust	5	5
Net income	18	35
Preferred share dividends	7	7
Net income attributable to common shares	$ 11	$ 28
Percentage of total net income	3.7%	6.9%
Average assets	$ 17,787	$ 18,290
Percentage of total average assets	24.6%	25.5%

Results for 2010 were impacted by a gain of $7 million arising from the recovery of previously recorded losses on non-bank ABCP, while 2009 included a $21 million writedown on non-bank ABCP and a $16 million loss arising from the sale of the auto business in 2008. Excluding these items, income before taxes and non-controlling interest in income of trust, was $25 million, a decrease of $68 million, or 73 per cent, compared with $93 million for 2009.

Net interest income was $296 million, a decrease of $61 million, or 17 per cent, compared with $357 million for 2009. The decrease was primarily due to continued spread compression, impacted by lower value of funds as a result of lower liquidity costs, competitive pricing and tighter margins in Guaranteed Investment Certificates and High Rate Savings Accounts, partially offset by higher personal floating loans and floating residential mortgages, improved core spreads, and the increase in the Canadian Prime Rate.

Excluding the recovery of previously recorded losses on non-bank ABCP and the auto loss, underlying non-interest revenue increased by $12 million in 2010, or 3 per cent, driven by higher revenues from the wealth management business as a result of stronger sales and higher client trading volumes, higher net GIIS revenues and an increase in foreign exchange revenue, partially offset by lower service charges due to higher waived fees than the prior year.

Non-interest expenses of $657 million increased by $34 million, or 5 per cent, compared with $623 million for 2009. The increase was largely attributable to higher commission expenses on higher variable revenues attributable to increased activity in stock markets, higher incentive compensation, expenses relating to the termination of equipment contracts, higher marketing expenses and commodity tax recoveries realized in the prior year, partially offset by lower severance costs.

The provision for credit losses was $15 million lower compared to 2009 mainly due to a $12 million allocation of a credit loss on non-bank ABCP exposures recorded in 2009 and lower collective impairments in the current year.

Commercial Banking

Business developments and achievements for 2010 include:

- *Best Bank for Small Business* – We were identified as the best bank for small business by the Canadian Federation of Independent Business for the third consecutive time. We continued to execute on our HSBC Business Direct™ strategy, with 41,000 clients managed through this channel. We launched the Global Business Banking Academy to equip our employees with necessary knowledge and skills to provide professional advice to our clients.
- *Leading International Business* – We continued to strengthen our cross border capabilities through the HSBC Group's 19 international banking centres and the creation of country desks in Mexico, New York and Shanghai. The number of successful Global Link customer referrals in and out of Canada has grown 33.7 per cent year on year. We launched the Leading International Business Academy to ensure our employees provide market leading advice to our clients on trade and international banking.

– *Business without Borders* – We partnered with Rogers Media, *The Globe and Mail* and The Economist Intelligence Unit to launch an exclusive, first of its kind initiative, BUSINESS *without* BORDERS™, 'Helping businesses grow internationally', that will firmly position HSBC as the leading international bank for business in Canada. The initiative will leverage the diverse channels and expertise of these three leading media companies and HSBC resources to demonstrate to clients that HSBC is clearly the leader and best bank to deal with for their international needs and aspirations. This includes the HSBC International Business Awards program, which is designed to recognize, celebrate and promote businesses that are successfully investing, operating and growing internationally.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Commercial Banking:

	2010	2009
Net interest income	**$ 749**	$ 692
Non-interest revenue	**385**	318
Total revenue	**1,134**	1,010
Non-interest expenses	**430**	377
Net operating income	**704**	633
Provision for credit losses	**183**	223
Income before taxes and non-controlling interest in income of trust	**521**	410
Provision for income taxes	**146**	101
Non-controlling interest in income of trust	**16**	16
Net income	**359**	293
Preferred share dividends	**21**	18
Net income attributable to common shares	**$ 338**	$ 275
Percentage of total net income	**73.3%**	58.1%
Average assets	**$ 22,088**	$ 24,249
Percentage of total average assets	**30.6%**	33.9%

Income before taxes and non-controlling interest in income of trust was $521 million, an increase of $111 million, or 27 per cent, compared with $410 million for 2009. The results for 2010 include a $7 million recovery on non-bank ABCP compared to $21 million write-down on non-bank ABCP in 2009. Excluding the impact of ABCP, income before taxes and non-controlling interest in income of trust was $514 million, an increase of $83 million, or 19 per cent compared with 2009.

Net interest income was $749 million, an increase of $57 million, or 8 per cent, compared to 2009. Net interest margin on loans increased due to the maintenance of repricing initiatives, an 11 per cent increase in deposit volumes, and a lower cost of funding. This was partially offset by the impact of lower lending volumes in the commercial real estate and Mid-Market sectors commensurate with reduced commercial borrowings by corporates broadly in the economy.

Non-interest revenue increased by $67 million, or 21 per cent, to $385 million in 2010 driven by growth of fees on banker's acceptances and other credit-related products, and foreign exchange commissions reflecting increased levels of client activity.

Non-interest expenses were $430 million, an increase of $53 million, or 14 per cent, due to higher staff remuneration and variable compensation in line with improved business results and increased marketing costs.

The provision for credit losses decreased by $40 million to $183 million due to reduced levels of impaired loans in the real estate, trade, manufacturing and service sectors as a result of improved credit and economic conditions, and also due to a $12 million allocation of a credit loss on non-bank ABCP exposures recorded in 2009.

Management's Discussion and Analysis (continued)

Global Banking and Markets

Business developments and achievements for 2010 include:

- *Revenue* – While total revenue declined by $173 million, when excluding the impact of mark-to-market accounting gains and losses arising from economic hedges, translation gains and losses on US dollar AFS securities funded with US dollar liabilities and changes in the market values of our own debt stemming from movement in the bank's credit spread, total revenue increased by $91 million, from $380 million in 2009 to $471 million in 2010 largely attributable to increased net interest income on balance sheet management activities.
- *Global Banking* – We leveraged our global network, building relationships with target clients in resource, energy, infrastructure and financial sectors. Our joined up approach resulted in HSBC maintaining its market leading position as a book runner on cross-border debt financing for Canadian corporate clients. We also continued to be active in equity capital markets and advisory.
- *Global Markets* – We focused on enhanced connectivity with our clients, both internal and external – domestically and globally. This focus resulted in a significant increase in the number of clients with which HSBC dealt across all Global Markets products.
- *Asset Management* – HSBC Global Asset Management launched the HSBC Monthly Income Fund, which is our top selling mutual fund followed by HSBC Canadian Bond Fund, HSBC Mortgage Fund, HSBC Dividend Income Fund and HSBC Chinese Equity Fund. In 2010 HSBC Global Asset Management products enjoyed very strong growth, with sales more than doubling year over year. The business consolidated its leadership in Emerging Markets product manufacturing with both the HSBC Chinese Equity Fund and HSBC Indian Equity Fund being the top selling funds in their respective categories. Also, HSBC Global Asset Management became the first asset management company in Canada to introduce a Premium series on its entire range of mutual funds which have raised in excess of $1 billion in assets since launch.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Global Banking and Markets:

	2010	2009
Net interest income	**$ 203**	$ 53
Non-interest revenue	**73**	396
Total revenue	**276**	449
Non-interest expenses	**163**	136
Net operating income	**113**	313
(Recovery of) provision for credit losses	**(7)**	12
Income before taxes and non-controlling interest in income of trust	**120**	301
Provision for income taxes	**41**	100
Non-controlling interest in income of trust	**5**	5
Net income	**74**	196
Preferred share dividends	**6**	5
Net income attributable to common shares	**$ 68**	$ 191
Percentage of total net income	**15.1%**	38.8%
Average assets	**$ 29,537**	$ 25,626
Percentage of total average assets	**40.9%**	35.7%

Income before taxes and non controlling interest in income of trust was $120 million compared with $301 million in 2009, a decrease of $181 million, or 40 percent. The results for 2010 include a $7 million recovery of previously recorded losses on non-bank ABCP compared with a $22 million write-down on non-bank ABCP in 2009, and the impact of mark-to-market accounting losses of $196 million in 2010 and gains of $69 million in 2009 arising from economic hedges, translation gains and losses on US dollar AFS securities funded with US dollar liabilities and changes in the market values of our own debt stemming from movements in the bank's credit spread. When excluding the impact of ABCP and mark-to-market items, income before taxes and non controlling interest in income of trust was $309 million in 2010 compared with $254 million in 2009, an increase of $55 million, or 22 percent.

Net interest income increased by $150 million, or 283 per cent, in 2010 to $203 million reflecting higher client spreads, lower funding and liquidity costs and increased stability in the financial markets.

Non-interest revenue excluding the impact of the mark-to-market accounting gains and losses mentioned above was $268 million compared with $327 million in 2009, a decrease of $59 million, or 18 percent. In 2010, trading revenues decreased in our rates and credit products, partially offset by an increase in foreign exchange trading revenues driven by increased customer volumes in foreign exchange products. Global Investment Banking revenues decreased mainly due to a $23 million fee recognized in 2009 as part of a transaction to raise unsecured term funding. Asset management fee revenues increased on strong funds under management growth from industry leading net mutual fund sales. Certain AFS securities were sold in 2010, resulting in a realized gain of $8 million which is a decrease from the $27 million recognized in 2009.

Non-interest expenses increased by $27 million to $163 million due to higher staff costs, investment advisory fees and general and administrative costs.

A net recovery of $7 million in the provision for credit losses was recorded in 2010 due to the release of collective impairment charges in our global banking business. The $12 million provision reported in 2009 was mainly due to an allocation of a credit loss on non-bank ABCP exposures.

Consumer Finance

Business developments and achievements for 2010 include:

- *Reduced risk in business* – We achieved significant reductions in delinquencies year over year, through our continued focus on collections and tighter collection policies and practices.
- *Cost containment* – As a result of reduced business volumes, we continued our focus on cost containment.
- *Retail* – We continued to execute on our retail strategy, exiting certain unprofitable relationships and signing up new merchants.
- *Credit Cards* – We continued to expand the credit cards business, through the launch of the HSBC Advance and HSBC BusinessVantage™ cards.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Consumer Finance:

	2010	2009
Net interest income	**$ 309**	$ 377
Non-interest revenue	**58**	19
Total revenue	**367**	396
Non-interest expenses	**182**	187
Net operating income	**185**	209
Provision for credit losses	**132**	238
Income (loss) before taxes and non-controlling interest in income of trust	**53**	(29)
Provision for (recovery of) income taxes	**14**	(10)
Non-controlling interest in income of trust	**–**	–
Net income (loss)	**39**	(19)
Preferred share dividends	**27**	27
Net income (loss) attributable to common shares	**$ 12**	$ (46)
Percentage of total net income (loss)	**7.9%**	(3.8)%
Average assets	**$ 2,799**	$ 3,530
Percentage of total average assets	**3.9%**	4.9%

Consumer Finance recorded income before taxes of $53 million in 2010, compared to a loss before taxes of $29 million in 2009.

Net interest income was $309 million, a decrease of $68 million, or 18 per cent, compared with $377 million for 2009. As a result of ongoing credit tightening decisions, we experienced lower loan volumes in our core businesses. In addition, we terminated our relationship with an unprofitable retail merchant in the fourth quarter of 2009, which also impacted net interest income. Accordingly, average receivables declined by approximately $0.7 billion, or 21 per cent, resulting in lower net interest income in 2010 when compared to 2009.

Management's Discussion and Analysis (continued)

Non-interest revenue increased by $39 million, or 205 per cent, in 2010, from $19 million in 2009. In 2010, we recorded $16 million relating to credit insurance income. In 2009, we recorded losses on AFS securities of $19 million, which were not repeated in 2010, and a $4 million charge relating to a loss guarantee on our auto portfolio. Excluding these items, non-interest revenue was flat compared to 2009.

Non-interest expense declined by $5 million, or 3 per cent, in 2010 primarily due to lower staff costs, partially offset by higher marketing expenses and the impact of the Harmonized Sales Tax.

The provision for credit losses decreased by $106 million, or 45 per cent, in 2010. The decrease was primarily due to reduced delinquencies arising from investments in credit collection processes and credit tightening decisions.

Consolidated Financial Statements

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Consolidated Financial Statements

Notes to Consolidated Financial Statements

Statement of Management's Responsibility for Financial Information

The presentation and preparation of the annual consolidated financial statements, Management's Discussion and Analysis ("MD&A") and all other information in the Annual Report is the responsibility of the management of HSBC Bank Canada ("the bank"). The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality.

In meeting its responsibility for the reliability of financial information, management relies on comprehensive internal accounting, operating and system controls. The bank's overall controls include: an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability; written communication of policies and procedures of corporate conduct throughout the bank, and careful selection and training of personnel; regular updating and application of written accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records; and a continuing program of extensive internal audit covering all aspects of the bank's operations. These controls are designed to provide reasonable assurance that financial records are reliable for preparing the consolidated financial statements and maintaining accountability for assets, that assets are safeguarded against unauthorized use or disposition and that the bank is in compliance with all regulatory requirements.

At least once a year, the Office of the Superintendent of Financial Institutions Canada, makes such examination and enquiry into the affairs of the bank as deemed necessary to ensure that the provisions of the Bank Act, having reference to the rights and interests of the depositors and the creditors of the bank, are being complied with and that the bank is in a sound financial position.

The bank's Board of Directors oversees management's responsibilities for financial reporting through the Audit Committee, which is composed of directors who are not officers or employees of the bank. The Audit Committee reviews the bank's interim and annual consolidated financial statements and MD&A and recommends them for approval by the Board of Directors. Other key responsibilities of the Audit Committee include monitoring the bank's system of internal control, monitoring its compliance with legal and regulatory requirements, considering the appointment of the Shareholders' auditors and reviewing the qualifications, independence and performance of Shareholders' auditors and internal auditors.

As at December 31, 2010, we, the bank's Chief Executive Officer and Chief Financial Officer, have certified the effectiveness of our internal control over financial reporting as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings).

The Shareholders' auditors, the bank's Chief Auditor and OSFI have full and free access to the Board of Directors and its committees to discuss audit, financial reporting and related matters.

Lindsay Gordon
President and Chief Executive Officer

Graham A. McIsaac, FCA
Chief Financial Officer

Vancouver, Canada
February 21, 2011

Independent Auditors' Report

To the Shareholders of HSBC Bank Canada

We have audited the accompanying consolidated financial statements of HSBC Bank Canada ("the Bank"), which comprise the consolidated balance sheets as at December 31, 2010 and December 31, 2009 and the consolidated statements of income, changes in shareholders' equity, comprehensive income, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

An Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of HSBC Bank Canada as at December 31, 2010 and December 31, 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Vancouver, Canada
February 21, 2011

Consolidated Balance Sheets

At December 31 *(in millions of dollars)*

	2010	2009
Assets		
Cash resources:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	**$ 513**	$ 652
Deposits with regulated financial institutions	**2,173**	1,245
	2,686	1,897
Securities: (note 2)		
Available-for-sale	**15,804**	12,682
Held-for-trading	**2,254**	1,986
Other	**40**	41
	18,098	14,709
Securities purchased under reverse repurchase agreements	**7,155**	8,496
Loans: (note 3)		
Business and government	**16,847**	18,442
Residential mortgages	**11,243**	11,359
Consumer finance loans	**2,599**	3,199
Other consumer loans	**5,905**	5,742
Allowance for credit losses	**(625)**	(638)
	35,969	38,104
Other:		
Customers' liability under acceptances	**4,372**	4,966
Derivatives (note 18)	**1,364**	1,100
Land, buildings and equipment (note 5)	**123**	142
Other assets (note 6)	**1,729**	1,923
	7,588	8,131
	$ 71,496	$ 71,337
Liabilities and Shareholders' Equity		
Deposits: (note 7)		
Regulated financial institutions	**$ 1,071**	$ 754
Individuals	**21,586**	21,578
Businesses and governments	**29,398**	27,875
	52,055	50,207
Other:		
Acceptances	**4,372**	4,966
Interest bearing liabilities of subsidiaries, other than deposits (note 8)	**2,363**	3,324
Derivatives (note 18)	**1,329**	897
Securities sold under repurchase agreements	**1,560**	2,517
Securities sold short	**1,262**	1,148
Other liabilities (note 9)	**3,079**	2,650
Non-controlling interest in trust and subsidiary (note 10)	**230**	430
	14,195	15,932
Subordinated debentures (note 11)	**739**	834
Shareholders' equity:		
Capital stock (note 12)		
Preferred shares	**946**	946
Common shares	**1,225**	1,225
Contributed surplus	**12**	7
Retained earnings	**2,262**	2,113
Accumulated other comprehensive income	**62**	73
	4,507	4,364
	$ 71,496	$ 71,337

Guarantees, commitments and contingent liabilities (note 29).

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the Board of Directors:

Samuel Minzberg
Chairman, HSBC Bank Canada

Lindsay Gordon
President and Chief Executive Officer

Consolidated Statements of Income

For the years ended December 31 *(in millions of dollars except per share amounts)*

	2010	2009
Interest income:		
Loans	**$ 1,830**	$ 1,986
Securities	**301**	275
Deposits with regulated financial institutions	**16**	14
	2,147	2,275
Interest expense:		
Deposits	**480**	637
Interest bearing liabilities of subsidiaries, other than deposits	**77**	120
Subordinated debentures	**33**	39
	590	796
Net interest income	**1,557**	1,479
Non-interest revenue:		
Deposit and payment service fees	**111**	110
Credit fees	**194**	165
Capital market fees	**119**	153
Investment administration fees	**143**	117
Foreign exchange	**48**	41
Trade finance	**24**	24
Trading revenue	**104**	95
Gains on available-for-sale and other securities (note 2(c))	**14**	8
Securitization income	**83**	102
Other	**292**	213
Other mark-to-market accounting (losses) gains, net	**(196)**	69
	936	1,097
Total revenue	**2,493**	2,576
Non-interest expenses:		
Salaries and employee benefits	**753**	732
Premises and equipment, including amortization	**175**	173
Other	**504**	418
	1,432	1,323
Net operating income before provision for credit losses	**1,061**	1,253
Provision for credit losses (note 3)	**335**	515
Income before provision for income taxes and non-controlling interest in income of trust	**726**	738
Provision for income taxes (note 25)	**210**	207
Non-controlling interest in income of trust	**26**	26
Net income	**$ 490**	$ 505
Preferred share dividends (note 12)	**61**	57
Net income attributable to common shares	**$ 429**	$ 448
Average number of common shares outstanding (000's)	**498,668**	498,668
Basic earnings per common share	**$ 0.86**	$ 0.090

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31 *(in millions of dollars)*

	2010	2009
Preferred shares: (note 12)		
Balance at beginning of year	**$ 946**	$ 696
Issued	**–**	250
Balance at end of year	**946**	946
Common shares: (note 12)		
Balance at beginning and end of year	**1,225**	1,225
	1,225	1,225
Contributed surplus:		
Balance at beginning of year	**7**	–
Stock-based compensation (note 23)	**5**	7
Balance at end of year	**12**	7
Retained earnings:		
Balance at beginning of year	**2,113**	1,950
Net income	**490**	505
Preferred share dividends (note 12)	**(61)**	(57)
Common share dividends (note 12)	**(280)**	(280)
Share issue costs	**–**	(5)
Balance at end of year	**2,262**	2,113
Accumulated other comprehensive income (loss) – available-for-sale securities:		
Balance at beginning of year	**(25)**	85
Net change in unrealized gains (losses) on available-for-sale securities, net of income taxes	**19**	(110)
Balance at end of year	**(6)**	(25)
Accumulated other comprehensive income (loss) – cash flow hedges:		
Balance at beginning of year	**98**	197
Net change in cash flow hedges, net of income taxes	**(30)**	(99)
Balance at end of year	**68**	98
Total accumulated other comprehensive income	**62**	73
Total shareholders' equity	**$ 4,507**	$ 4,364

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Comprehensive Income

For the years ended December 31 *(in millions of dollars)*

	2010	2009
Net Income	**$ 490**	$ 505
Other comprehensive income (loss) on available-for-sale securities:		
Net unrealized gains (losses) from changes in fair value (net of income taxes of $13, $(47))	**28**	(99)
Reclassification of realized gains to earnings (net of income taxes of $(5), $(7))	**(9)**	(11)
	19	(110)
Other comprehensive income (loss) on cash flow hedges:		
Unrealized losses from changes in fair value (net of income taxes of $(16), $(46))	**(30)**	(99)
Comprehensive income for the year	**$ 479**	$ 296

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended December 31 *(in millions of dollars)*

	2010	2009
Cash flows provided by operating activities:		
Net income	**$ 490**	$ 505
Adjustments to net income to determine net cash provided by operating activities:		
Amortization expense	**56**	46
Provision for credit losses (note 3)	**335**	515
Provision for impairment of available-for-sale securities	**–**	20
Future income taxes (note 25)	**6**	(56)
Net accrued interest receivable and payable	**(17)**	(24)
Trading securities	**(268)**	(907)
Derivatives, net	**122**	177
Mortgages sold with recourse	**270**	324
Securities sold short	**114**	517
Other, net	**373**	(138)
	1,481	979
Net cash flows used in financing activities:		
Deposits received (repaid)	**1,848**	(1,755)
Interest bearing liabilities of subsidiaries, other than deposits	**(961)**	(840)
Securities (purchased) sold under repurchase agreements	**(957)**	1,802
Redemption of trust units (note 10)	**(200)**	–
Redemption of subordinated debentures (note 11)	**(100)**	–
Proceeds from issue of preferred shares (note 12)	**–**	250
Dividends paid (note 12)	**(341)**	(339)
	(711)	(882)
Net cash flows (used in) provided by investing activities:		
Loans (funded) repaid, excluding securitizations	**(1,051)**	1,311
Proceeds from loans securitized (note 4)	**2,478**	3,541
Non-trading securities purchased	**(6,999)**	(8,752)
Non-trading securities sold	**1,713**	1,739
Non-trading securities matured	**2,576**	3,996
Securities sold (purchased) under reverse repurchase agreements	**1,341**	(1,814)
Net change in non-operating and other deposits with regulated financial institutions	**(915)**	177
Acquisition of land, buildings, equipment and intangibles	**(39)**	(76)
	(896)	122
(Decrease) increase in cash and cash equivalents	**(126)**	219
Cash and cash equivalents, beginning of year	**639**	420
Cash and cash equivalents, end of year	**$ 513**	$ 639
Represented by:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	**$ 513**	$ 652
Less non-operating deposits with other banks[1]	**–**	(13)
Cash and cash equivalents, end of year	**$ 513**	$ 639
Supplementary cash flow information:		
Interest paid during the year	**$ 596**	$ 843
Income taxes paid during the year	**$ 205**	$ 224

(1) *Non-operating deposits comprise cash restricted for recourse on securitization transactions.*

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009 *(all tabular amounts are in millions of dollars unless stated otherwise)*

HSBC Bank Canada ("the bank", "we", "our") is an indirectly wholly-owned subsidiary of HSBC Holdings plc ("the Parent"). In these consolidated financial statements, HSBC Group means the Parent and its subsidiary companies.

1 Significant accounting policies

These consolidated financial statements have been prepared in accordance with Section 308(4) of the Bank Act which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions Canada ("OSFI"), the consolidated financial statements are to be prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain prior period amounts have been reclassified to conform with the current year presentation. The significant accounting policies used in the preparation of these consolidated financial statements conform, in all material respects, with GAAP. They also meet the accounting requirements of OSFI.

a *Basis of consolidation*

We conduct business through a variety of corporate structures, including subsidiaries. All of the assets, liabilities, revenue and expenses of our subsidiaries are reported in the consolidated financial statements. All material intercompany transactions and balances have been eliminated.

b *Use of estimates and assumptions*

In preparing our consolidated financial statements, we make estimates and assumptions which affect the reported amounts of assets, liabilities, net income and related disclosures. The most significant assets and liabilities where we make estimates include measurement of the allowance for credit losses, financial instruments measured at fair value, other-than-temporary impairment ("OTTI") of available-for-sale ("AFS") financial assets, securitizations, pension and other employee future benefits, income taxes, goodwill and intangible assets. Accordingly, actual results could differ from these and other estimates thereby impacting our consolidated financial statements.

c *Cash resources*

Deposits with regulated financial institutions are recorded at amortized cost, except for certain instruments which are recorded as AFS or held-for-trading ("HFT"), as appropriate. Interest income on interest earning deposits is recorded on an accrual basis using the effective interest rate ("EIR") method.

d *Financial instruments*

All financial instruments, with certain exceptions, are classified into one of the following categories: held to maturity ("HTM"), loans and receivables, HFT, AFS or other financial liabilities. All financial instruments are recognized at fair value on initial recognition. Fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets and offer prices for financial liabilities. For derivatives or other financial instruments where an active market does not exist, fair values are determined using valuation techniques that refer to observable and unobservable market data including discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial instruments classified as HFT are purchased for resale generally for the short term. Subsequent to initial recognition, financial assets and liabilities classified as HFT are recorded at fair value. Gains and losses realized on disposal and unrealized gains and losses from market fluctuations are reported in trading revenue. Dividends and interest earned and interest incurred are included in interest income and expense, respectively.

Financial instruments are also permitted to be designated as HFT on initial recognition ("the fair value option"). Gains and losses on financial instruments designated as HFT arising from change in the bank's own credit spreads are included in "Other mark-to-market accounting (losses) gains, net" in the consolidated statements of income. The use of the fair value option requires that fair values of such instruments can be measured reliably. Financial instruments designated at fair value under the fair value option are accounted for in the same manner as other financial instruments classified as HFT. OSFI has imposed restrictions on the use of the fair value option whereby its use must significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring the financial instrument or recognizing gains and losses on them on a different basis, or it belongs to a group of financial instruments that are managed on a fair value basis in accordance with the bank's risk management or investment strategy, or it is an embedded derivative that is not closely related to the host contract. In addition, OSFI places restrictions on designating retail exposures using the fair value option.

d *Financial instruments (continued)*

AFS financial assets are those non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, HTM, HFT or designated at fair value. Financial instruments classified and designated as AFS are carried at fair value whereby unrealized gains and losses are included in accumulated other comprehensive income ("AOCI") until sale when the cumulative gain or loss is recognized in income. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect OTTI in value are included in non-interest revenue. Interest income from financial instruments designated as AFS is included in interest income using the EIR method.

HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables, which an entity has the positive intention and ability to hold to maturity. Financial instruments designated as HTM, loans and receivables and other financial liabilities other than those designated or classified as HFT are measured at amortized cost using the EIR method. Provisions for OTTI on assets designated as AFS or HTM are charged to income.

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal payments, plus or minus the cumulative amortization using the EIR method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Transaction costs related to trading securities or those designated as HFT are expensed as incurred. Transaction costs related to AFS and HTM securities and loans and receivables are generally capitalized and amortized over the expected life of the instrument using the EIR method.

The EIR method is used for allocating the related interest income or interest expense for financial instruments measured at amortized cost, including amortization of premiums, transaction costs and fees as well as accretion of discounts over the expected life of the instrument. The EIR is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability. The EIR is established on initial recognition of the financial asset or liability and is not subsequently revised.

e *Securities*

Securities are designated as HFT or AFS, with certain exceptions. Securities are accounted for on a trade date basis.

Non-trading securities are designated as AFS, with the exception of merchant banking investments carried at fair value. Equities that do not have quoted market values in an active market are carried at cost, as the values are not reliably measurable. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect OTTI in value are included in non-interest revenue. Interest income and dividends from these securities are included in interest income using the EIR method.

f *Loans*

Loans, including direct finance leases, are initially measured at fair value and subsequently measured at amortized cost using the EIR method, net of any unearned income and an allowance for credit losses.

Interest income is recorded on an accrual basis unless the loan is classified as an impaired loan. For credit card loans that are classified as impaired, interest income continues to be recorded on an accrual basis and is provided for in the allowance for credit losses. Loans are considered to be impaired when there is objective evidence of impairment as a result of a loss event after initial recognition of the loan. Where a payment (principal or interest) is contractually 90 days in arrears, the loan will be classified as impaired, unless the loan is secured and the collection efforts are expected to result in repayment of the loan or in restoring it to a current status within 180 days from the date it became contractually in arrears. A loan that is contractually 180 days in arrears is classified as impaired in all situations, except when it is guaranteed or insured by Federal or Provincial governments; such loans are classified as impaired if the loan is contractually 365 days in arrears.

Notes to Consolidated Financial Statements (continued)

1 Significant accounting policies *(continued)*

f *Loans (continued)*

Impaired loans are recorded at their estimated realizable amount. This is determined by discounting the expected future cash flows at the EIR inherent in the loans. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, they are measured at the fair value of any security underlying the loans, net of expected costs of realization. When a loan is classified as impaired, recognition of interest in accordance with the terms of the original loan agreement ceases, except for credit card loans. Interest income is recognized only when all allowances for credit losses have been reversed.

Non-financial assets acquired in exchange for loans as part of an orderly realization are recorded as assets held for sale, when specified criteria are met, or when the criteria are not met the assets are considered to be held for use, measured initially at fair value and accounted for in the same manner as similar assets acquired in the normal course of business. Fair values are determined by independent professional valuers who apply recognized valuation techniques. Foreclosed assets that do not meet the criteria for held for sale classification are recorded in “other assets”.

g *Allowance for credit losses*

An allowance is maintained for credit losses which, in management’s opinion, is considered adequate to absorb all incurred credit-related losses in our portfolio of both on and off-balance sheet items, including deposits with other regulated financial institutions, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees.

Assessing the adequacy of the allowance for credit losses is inherently subjective, as it requires making estimates that may be susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

The allowance for credit losses consists of specific and general allowances, each of which is reviewed on a regular basis. The allowance for credit losses reduces the gross value of an asset to its net carrying value.

Specific allowances are recorded on a loan-by-loan basis, for those loans where there is objective evidence of impairment, to reduce the carrying value of an impaired asset to its estimated realizable amount. The estimated realizable amount is determined by discounting the expected future cash flows at the EIR inherent in the loan at the date of impairment. The fair value of any collateral securing the loan, net of any expected realization costs or the observable market price for the loan may be used to measure the estimated realizable amount.

The general allowance is our best estimate of incurred losses in the portfolio for those assets that are not individually identified as being impaired. For business and government loans, the underlying credit metrics, including probability of default, loss given default and exposure at default, for each customer are derived from the bank’s internal rating systems as a basis for determining the general allowance. Management amends these metrics for some or all borrowers where they consider that the rating system metrics do not fully reflect incurred losses. This judgmental adjustment employs an established framework and references both internal and external indicators of credit quality.

For consumer loans, residential mortgages and credit cards, expected losses are estimated through analysis of historical losses, delinquency migration and write-off trends, supplemented by judgmental adjustments that employ an established framework and reference both internal and external indicators of credit quality.

The level of the general allowance is reassessed each quarter and may fluctuate as a result of changes in portfolio volumes, concentrations and risk; analysis of developing trends in probability of loss, severity of loss and exposure at default factors; and management’s current assessment of indicators that may have affected the condition of the portfolio. The balance of the general allowance is also analyzed as a function of risk-weighted assets and is also referenced to applicable industry data.

The provision for credit losses is charged to income and comprises the amounts written off during the year, net of recoveries on amounts written off in prior years, and changes in provisions.

h *Securities purchased and sold under repurchase agreements*

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the consolidated balance sheets as secured loans and borrowings and a liability is recorded in respect of the consideration received. Conversely, securities purchased under reverse repurchase agreements are not recognized on the consolidated balance sheets and an asset is recorded representing the consideration paid. Interest income on securities purchased under reverse repurchase agreements, and interest expense on securities sold under repurchase agreements are recorded using the EIR method.

i *Obligations related to securities sold short*

The bank's obligation to deliver securities sold that were not owned at the time of sale is recorded at fair value and marked to market. Adjustments to fair value and gains and losses on sale are recorded in trading revenue in the consolidated statements of income.

j *Land, buildings and equipment*

Land is carried at cost. Buildings, leasehold improvements and equipment are carried at cost, less accumulated amortization. Amortization is calculated using the straight-line method over the estimated useful life of the related asset as follows: buildings – 20 to 40 years, equipment – 3 to 5 years, purchased computer software and equipment – 3 to 5 years and leasehold improvements – lesser of lease term or estimated useful life. Gains and losses on disposal are recorded in other non-interest revenue in the year of disposal.

k *Goodwill and other intangible assets*

Goodwill, which represents the excess of the price paid for subsidiaries over the fair value of the net assets acquired, is not amortized and is recognized in other assets.

Identifiable, reliably measured other intangible assets resulting from acquisition of subsidiaries are also recognized in other assets. Intangible assets, including internally generated computer software, with definite lives are amortized over their estimated useful lives, not exceeding 15 years, except where a write-down is required to reflect impairment.

Goodwill and other intangible assets are reviewed at least annually, or more frequently if events or changes in circumstances indicate that the assets might be impaired, for indications of impairment to ensure that their fair value is greater than or equal to their carrying value. Any excess of carrying value over fair value is charged to income in the period in which impairment is determined.

l *Customers' liability under acceptances*

Acceptances represent a form of negotiable short-term debt that is issued by our customers and which we guarantee for a fee. We expect most acceptances to be settled simultaneously with the reimbursement from customers. Our exposure under acceptances is reported as a liability. Our recourse against customers is recorded as an equivalent offsetting asset. Fees earned are reported in credit fees in non-interest revenue and are recognized over the expected life of the acceptance.

m *Income taxes*

Income taxes are accounted for under the asset and liability method. Under this method, future income tax assets and liabilities are determined based on temporary differences (differences between the tax basis and accounting basis of assets and liabilities as well as any applicable operating losses and tax credit carry forwards) and are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized. Income tax expense or recovery is the sum of the provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities, adjusted for any amounts included in other comprehensive income ("OCI").

The net future income tax asset is included in other assets in the consolidated balance sheets.

Notes to Consolidated Financial Statements (continued)

1 Significant accounting policies *(continued)*

n *Employee future benefits*

The bank accrues its obligations under employee benefit plans (including pension and other post-retirement plans) and the related costs, net of plan assets. The pension plans include both defined benefit and defined contribution plans. The post-retirement plans include supplemental pension arrangements that provide pension benefits in excess of the benefits provided by the pension plans, and post-retirement, non-pension arrangements that provide certain benefits in retirement. The pension plans are funded by contributions from us or our employees, while the supplemental pension arrangements are not funded.

The costs of employee benefit plans are actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected investment performance, salary escalation, retirement ages of employees and expected health care costs.

For purposes of determining the expected return on pension plan assets, those assets are valued at their fair value.

The excess of the net actuarial gains or losses over 10 per cent of the greater of the accrued benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees covered under the plan in question.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of active employees at the date of amendment.

When an event giving rise to a settlement and a curtailment occurs, the curtailment is accounted for prior to the settlement.

The transitional asset arising from a change in accounting policy in earlier years is amortized over the expected future service period of the active employees.

o *Translation of foreign currencies*

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at prevailing year-end exchange rates. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the rates in effect at the transaction date. Realized and unrealized gains and losses from foreign currency translation are included in non-interest revenue, and presented in the consolidated statements of income, with the exception of unrealized foreign exchange gains and losses on AFS securities, which are included in AOCI, and presented in the statements of comprehensive income, until such time that they are realized and included in non-interest revenue.

Net gains or losses arising from translation of foreign denominated funding of foreign denominated AFS securities (where the corresponding translation gains or losses are recorded in equity through AOCI) are included as part of "Other mark-to-market accounting (losses) gains, net" in the consolidated statements of income.

p *Derivative instruments and hedges*

Derivative instruments are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. In the ordinary course of business, we enter into various derivative contracts, including interest rate, foreign exchange and equity forwards, futures, swaps and options. Derivative contracts are either exchange-traded contracts (including futures and options) or negotiated over-the-counter contracts (including forwards, swaps and options). We enter into such contracts for trading purposes, as well as to hedge our exposures to currency and interest rate fluctuations as part of our risk management program. Trading activities are undertaken to meet the needs of our customers, as well as on our own account to earn trading income, and on any contracts that do not qualify for hedge accounting.

Hedging derivative instruments, including derivatives which do not qualify for hedge accounting, are marked-to-market and the resulting net gains or losses are recognized in "Other mark-to-market accounting (losses) gains, net" in the consolidated statements of income.

Non-hedging derivative instruments are marked-to-market and the resulting net gains or losses are recognized in non-interest revenue in the current period, with a corresponding asset or liability recorded in the consolidated balance sheets.

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3865, *Hedges* specifies the circumstances under which hedge accounting is permissible and how hedge accounting should be applied in the financial statements.

p *Derivative instruments and hedges (continued)*

We formally document all relationships between hedging instruments and hedged items, as well as our risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to identified assets and liabilities or identified firm commitments or forecasted transactions. We also formally assess, at the hedge's inception, retrospectively and prospectively on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows attributed to the hedged risks.

Accrued interest receivable and deferred gains are recorded in other assets and accrued interest payable and deferred losses are recorded in other liabilities. Interest income or expense and amortized gains or losses are recorded in interest income or interest expense, as applicable.

Foreign exchange translation gains and losses on foreign currency-denominated derivative financial instruments used to hedge foreign currency exposures are recorded in other assets or other liabilities, and recognized in non-interest revenue, net of expenses, offsetting the respective translation gains and losses recognized on the underlying foreign currency exposures.

Realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred and recognized in income in the period in which the underlying hedged transaction is recognized in the consolidated statements of income. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, hedge accounting is discontinued and any realized or unrealized gain or loss on such derivative instrument is recognized in income.

Hedges are designated as either fair value hedges or cash flow hedges. Fair value hedges are used to manage the impact on income from changes in the fair value of fixed rate assets and liabilities caused by changes in interest rates. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk, which amounts are recorded in "Other mark-to-market accounting (losses) gains, net." Changes in fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging instrument, normally a derivative, on which fair value changes are also recorded in trading income.

Cash flow hedges are used to manage the impact on income from the effects of changes in the interest rates on variable rate assets and liabilities. In a cash flow hedging relationship, the effective portion of the change in fair value of the hedging derivative will be recognized in OCI, while the ineffective portion is recognized in "Other mark-to-market accounting (losses) gains, net." The amounts recognized in OCI will be reclassified to net income in periods in which net income is affected by the variability in the cash flows of the hedged item.

q *Trust assets under administration*

Trust assets under administration are maintained separately from our assets and are not included in the consolidated balance sheets.

r *Loan securitizations*

Groups of loans are periodically sold to various securitization conduits. Transfers of loans are treated as sales provided that control over the transferred loans has been surrendered and consideration other than beneficial interests in the transferred loans has been received in exchange. If treated as sales, the loans are removed from the consolidated balance sheets and a gain or loss is recorded in non-interest revenue based on the carrying value of the loans transferred, allocated between the assets sold and their retained interests in proportion to their fair values at the date of transfer. A gain or loss on sale is recognized when the securitized assets are transferred.

The fair values of loans sold, retained interests and recourse liabilities are determined using market values where appropriate or pricing models taking into account our best estimates of key assumptions such as expected losses, prepayments and discount rates commensurate with the risks involved, or sales of similar assets.

Retained interests, accounted for as AFS, are included in other assets and recorded at fair value. Retained interests are tested regularly for OTTI and carrying values reduced to reflect any such impairment in non-interest income. Where we continue to service the loans sold, a servicing liability or asset is recognized and amortized over the servicing period. Revenue earned in respect of servicing the assets sold is reflected in non-interest revenue as services are provided.

Notes to Consolidated Financial Statements (continued)

1 Significant accounting policies *(continued)*

s *Stock-based compensation*

We provide compensation to certain key employees in the form of share-based awards of shares of our Parent. In addition, eligible employees are invited to participate in a savings-related share option program. The bank accounts for stock-based compensation plans using the fair value based method whereby compensation cost is measured at fair value at the date of grant and recognized over the awards' vesting period in compensation expense and, where appropriate, contributed surplus. The bank recognizes a liability to the Parent upon vesting of share-based awards. The liability is marked-to market at the end of each reporting period and any resulting gain (loss) is recognized in the statements of comprehensive income.

t *Investment companies*

We carry our investments held in investment companies at fair value.

u *Variable interest entities*

Variable interest entities ("VIEs") are consolidated where the bank is determined to be the primary beneficiary. An entity is a VIE when, by design, one or both of the following conditions exist: total equity investment at risk is insufficient to permit the bank to finance its activities without additional subordinated support from others and/or as a group, the holders of the equity investment at risk lack certain essential characteristics of a controlling financial interest. The primary beneficiary is the enterprise that absorbs or receives the majority of the VIE's expected losses, expected residual returns, or both.

v *Changes in significant accounting policies in 2010*

There have been no changes in significant accounting policies since December 31, 2009.

w *Future accounting and reporting changes – Transition to International Financial Reporting Standards ("IFRS")*

Effective, for fiscal years commencing on or after January 1, 2011, all publicly accountable enterprises will be required to report financial results in accordance with IFRS. The purpose of adopting IFRS is to promote the comparability of worldwide financial reporting. Accordingly, all interim and annual financial reporting, including comparative figures, will be prepared in accordance with IFRS from January 1, 2011 onwards.

x *Change in presentation*

We provide services or enter into transactions with a number of HSBC Group companies regarding the sharing of cost of development by Canadian employees for certain technology platforms used by HSBC around the world. In previous periods, we have shown the salary and related direct expenses for these employees and the recovery of those expenditures on a net basis as a part of "Non-interest expenses, Other". Effective for 2010, we have reported the impact of these transactions on a gross basis by increasing the appropriate expense categories and reclassifying the recovery of these expenditures to "Non-interest revenue, Other". Prior periods have also been reclassified to conform to the current year's presentation. The impact of this change is as follows:

	2010	2009
Non-interest revenue		
Other	**$ 167**	$ 146
Non-interest expense		
Salaries and employee benefits	**87**	90
Premises and equipment	**2**	8
Other	**78**	48
	$ 167	$ 146

2 Securities

a *Analysis of securities*

	2010					
	Term to maturity					
	Within 1 year	*1–5 years*	*5–10 years*	*After 10 years*	*No specific maturity*	*Total fair value*
Available-for-sale securities (at fair value):						
Securities issued or guaranteed by:						
Canada	$ 3,169	$ 9,660	$ –	$ –	$ –	$ 12,829
Provinces	225	1,079	54	–	–	1,358
Foreign governments	1,027	502	–	–	–	1,529
	4,421	11,241	54	–	–	15,716
Investment funds and other	–	20	–	–	4	24
Equity securities	6	54	–	–	4	64
Total available-for-sale securities	$ 4,427	$ 11,315	$ 54	$ –	$ 8	$ 15,804
Held-for-trading securities (at fair value):						
Securities issued or guaranteed by:						
Canada	$ 665	$ 421	$ 40	$ 31	$ –	$ 1,157
Provinces	106	343	117	81	–	647
Foreign governments	–	26	–	–	–	26
	771	790	157	112	–	1,830
Others	334	18	44	3	–	399
Equity securities	–	–	–	–	25	25
Total held-for-trading securities	$ 1,105	$ 808	$ 201	$ 115	$ 25	$ 2,254

Notes to Consolidated Financial Statements (continued)

2 Securities *(continued)*

a *Analysis of securities (continued)*

	2009					
	Term to maturity					
	Within 1 year	*1–5 years*	*5–10 years*	*After 10 years*	*No specific maturity*	*Total fair value*
Available-for-sale securities (at fair value):						
Securities issued or guaranteed by:						
Canada	$ 3,113	$ 8,375	$ 294	$ –	$ –	$ 11,782
Provinces	52	354	–	–	–	406
Foreign governments	–	352	–	–	–	352
	3,165	9,081	294	–	–	12,540
Investment funds and other	–	33	–	–	8	41
Equity securities	26	74	–	–	1	101
Total available-for-sale securities	$ 3,191	$ 9,188	$ 294	$ –	$ 9	$ 12,682
Held-for-trading securities (at fair value):						
Securities issued or guaranteed by:						
Canada	$ 443	$ 704	$ 138	$ 4	$ –	$ 1,289
Provinces	55	120	13	30	–	218
	498	824	151	34	–	1,507
Others	110	60	25	256	–	451
Equity securities	–	–	–	–	28	28
Total held-for-trading securities	$ 608	$ 884	$ 176	$ 290	$ 28	$ 1,986

Other securities (not included in the above table) not designated as AFS or HFT include merchant banking investments recognized at fair value of $37 million (2009 – $38 million) and investments in equities with significant influence recognized using the equity method of $3 million (2009 – $3 million).

The total carrying value of securities includes amounts denominated in currency other than Canadian dollars of $2,550 million (Canadian equivalent) (2009 – $752 million).

Included in AFS securities issued or guaranteed by Canada are mortgage-backed securities retained by us in connection with mortgage securitizations of $1,036 million (2009 – $648 million).

b *Canadian non-bank sponsored asset-backed commercial paper (“non-bank ABCP”)*

In 2009, as part of the Montreal Accord, the bank’s holdings of non-bank ABCP were replaced with longer-term floating rate notes with maturities more closely matching the maturities of the underlying assets. The restructured notes were recorded at fair value on the balance sheet and classified as HFT.

At December 31, 2009, the par value of the bank’s restructured non-bank ABCP was $459 million, with a carrying value of $256 million. In 2009, as a result of changes in market conditions, the fair value of the restructured notes decreased by $20 million, which was recognized as a reduction in trading revenue. The fair value of the non-bank ABCP at December 31, 2009 was determined using a discounted cash flow model that estimated the fair value of the notes. The model’s assumptions were based on expected coupon rates, credit ratings and maturity dates of the underlying categories of assets. Determination of the discount rate was primarily based on interest rates on bankers’ acceptances, adjusted by factors including credit spreads on comparable instruments and liquidity premiums.

In 2010, the bank disposed of substantially all of its non-bank ABCP, at which time a recovery of the previously recorded losses of $21 million was recorded. At December 31, 2010, the par value of the bank’s remaining holdings was $21 million, with a carrying value of nil.

c *Net gains (losses) on available-for-sale securities and other securities*

	2010	2009
Available-for-sale securities		
Realized gains, net	**$ 7**	$ 27
Other-than-temporary impairment	**–**	(20)
Gains on other securities	**7**	1
Total	**$ 14**	$ 8

At December 31, 2009, certain of our AFS securities, including preferred shares and mutual fund investments, were identified as being other-than-temporarily impaired. As a result, an impairment charge of $20 million was recognized in non-interest revenue in 2009.

3 Loans

a *Loans outstanding, net of unearned income and the allowance for credit losses, are as follows:*

	2010				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	**$ 16,847**	**$ 11,243**	**$ 2,599**	**$ 5,905**	**$ 36,594**
Specific allowance at beginning of year	**185**	**1**	**–**	**–**	**186**
Provision for credit losses[1]	**179**	**2**	**–**	**1**	**182**
Write-offs, net of recoveries	**(105)**	**(1)**	**–**	**–**	**(106)**
Transfer out	**(35)**	**–**	**–**	**–**	**(35)**
Specific allowance at end of year	**224**	**2**	**–**	**1**	**227**
General allowance at beginning of year[2]	**220**	**2**	**201**	**29**	**452**
Provision for credit losses[1]	**(3)**	**–**	**132**	**24**	**153**
Write-offs, net of recoveries	**–**	**–**	**(187)**	**(20)**	**(207)**
General allowance at end of year[2]	**217**	**2**	**146**	**33**	**398**
Total allowance[2]	**441**	**4**	**146**	**34**	**625**
Net amount at end of year	**$ 16,406**	**$ 11,239**	**$ 2,453**	**$ 5,871**	**$ 35,969**

(1) *Total provision for credit losses for 2010 was $335 million (2009 – $515 million).*

(2) *Includes general allowance for customers who can utilize facilities through either direct borrowings or acceptances.*

Notes to Consolidated Financial Statements (continued)

3 Loans *(continued)*

a *Loans outstanding, net of unearned income and the allowance for credit losses, are as follows (continued):*

	2009				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	$ 18,442	$ 11,359	$ 3,199	$ 5,742	$ 38,742
Specific allowance at beginning of year	161	1	–	–	162
Provision for credit losses(1)	259	1	–	–	260
Write-offs, net of recoveries	(231)	(1)	–	–	(232)
Other	(4)	–	–	–	(4)
Specific allowance at end of year	185	1	–	–	186
General allowance at beginning of year(2)	234	1	194	24	453
Provision for credit losses(1)	(15)	1	238	31	255
Write-offs, net of recoveries	1	–	(231)	(26)	(256)
General allowance at end of year(2)	220	2	201	29	452
Total allowance(2)	405	3	201	29	638
Net amount at end of year	$ 18,037	$ 11,356	$ 2,998	$ 5,713	$ 38,104

(1) *Total provision for credit losses for 2010 was $335 million (2009 – $515 million).*
(2) *Includes general allowance for customers who can utilize facilities through either direct borrowings or acceptances.*

Total net loans includes amounts denominated in US dollars of $1,530 million (Canadian equivalent) (2009 – $1,425 million) and other foreign currencies of $65 million (Canadian equivalent) (2009 – $43 million). Included in residential mortgages are $1,177 million of National Housing Act insured mortgages (2009 – $900 million), and $398 million of mortgages insured by a third party private insurer with an “AA” rating (2009 – $466 million).

b *Total gross impaired loans and the related specific allowances are as follows:*

	Gross impaired amount		*Specific allowance*		*Net of specific allowance*	
	2010	2009	**2010**	2009	**2010**	2009
Business and government	**$ 590**	$ 746	**$ 224**	$ 185	**$ 366**	$ 561
Residential mortgages	**87**	62	**2**	1	**85**	61
Consumer finance loans	**117**	176	**–**	–	**117**	176
Other consumer loans	**35**	38	**1**	–	**34**	38
Total	**$ 829**	$ 1,022	**$ 227**	$ 186	**$ 602**	$ 836

4 Loan securitization

a *Securitization activity during the year is as follows:*

	Residential mortgages	
	2010	2009
Net securitization activity		
Securitized and sold	**$ 2,484**	$ 3,551
Net cash proceeds received	**2,478**	3,541
Retained rights to future excess interest	**88**	132
Retained servicing liability	**14**	21
Pre-tax gain on sale	**64**	99
Key assumptions at time of sale		
Prepayment rate	**18.00%**	18.00%
Excess spread	**1.68%**	1.67%
Expected credit losses	**0.00%**	0.00%
Discount rate	**3.08%**	3.23%

Servicing and other income from securitized assets was $17 million (2009 – $16 million). No material credit losses were realized on securitized assets in 2010 or 2009.

In connection with securitization, there are $nil (2009 – $13 million) of segregated deposits included in "Cash and non-interest bearing deposits with the Bank of Canada and other banks" on the consolidated balance sheets held to support the bank's obligations under first loss protection facilities under various securitization programs.

b *The outstanding securitized loans sold to unrelated third parties and removed from the consolidated balance sheets are as follows:*

	2010	2009
Residential mortgages		
Conventional	**$ –**	$ 818
Mortgage-backed securities(1)	**6,639**	6,741
	6,639	7,559

(1) *Excludes insured mortgages which were securitized and retained by the bank of $1,036 million (2009 – $648 million). These assets are classified as AFS securities.*

c *Sensitivity of assumptions*

The following table outlines key economic assumptions used in measuring fair value of retained interests at December 31. These assumptions are the weighted average for all assets at year end. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another. The impact of a 10 per cent and 20 per cent change to these assumptions is not significant.

	Residential mortgages	
	2010	2009
Fair value of retained interests	**$ 179**	$ 197
Discount rate	**3.42%**	2.99%
Prepayment rate	**18.00%**	18.26%
Expected credit losses	**0.00%**	0.01%

Notes to Consolidated Financial Statements (continued)

5 Land, buildings and equipment

	2010			2009
	Cost	Accumulated amortization	Net book value	Net book value
Land	**$ 1**	**$ –**	**$ 1**	$ 2
Buildings	**2**	**1**	**1**	14
Furniture and equipment	**76**	**36**	**40**	35
Computer equipment and software	**57**	**45**	**12**	14
Leasehold improvements	**147**	**78**	**69**	77
Total	**$ 283**	**$ 160**	**$ 123**	$ 142

Amortization for 2010 was $40 million (2009 – $35 million).

6 Other assets

	2010	2009
Accrued interest receivable	**$ 165**	$ 154
Interest earning other assets	**275**	222
Due from clients, dealers and clearing corporations	**445**	815
Future income taxes, net (note 25)	**74**	77
Goodwill and other intangible assets, net	**82**	85
Pension asset (note 24)	**99**	93
Accounts receivable and other	**589**	477
Total	**$ 1,729**	$ 1,923

Amortization of intangible assets for 2010 was $16 million (2009 – $11 million). No impairment was recorded in 2010 or 2009.

7 Deposits

	2010			
	Regulated financial institutions	Individuals	Businesses and governments	Total
Demand	**$ 1,052**	**$ –**	**$ 3,549**	**$ 4,601**
Notice	**–**	**13,367**	**11,461**	**24,828**
Fixed date	**19**	**8,219**	**14,388**	**22,626**
Total	**$ 1,071**	**$ 21,586**	**$ 29,398**	**$ 52,055**

	2009			
	Regulated financial institutions	Individuals	Businesses and governments	Total
Demand	$ 744	$ –	$ 3,301	$ 4,045
Notice	–	12,363	10,105	22,468
Fixed date	10	9,215	14,469	23,694
Total	$ 754	$ 21,578	$ 27,875	$ 50,207

Deposits denominated in US dollars amount to $7,592 million (Canadian equivalent) (2009 – $7,794 million) and in other foreign currencies amount to $1,839 million (Canadian equivalent) (2009 – $2,254 million). Certain deposits have been designated as held-for-trading (note 16).

8 Interest bearing liabilities of subsidiaries, other than deposits

		2010		2009
Broker client accounts	**$**	**864**	$	878
Medium-term notes		**1,499**		2,446
	$	**2,363**	$	3,324

Interest expense on medium term notes was $79 million for 2010 (2009 – $120 million). The weighted average interest rate was 4.26 per cent during 2010 (2009 – 3.72 per cent). Medium term notes are guaranteed by HSBC Finance Corporation, HSBC Financial Corporation Limited's ("HSBC Financial's") former parent company.

9 Other liabilities

		2010		2009
Accrued interest payable	**$**	**334**	$	340
Mortgages sold with recourse (note 21)		**1,185**		915
Payable to clients, dealers and clearing corporations		**608**		657
Pension liability (note 24)		**29**		27
Other employee future benefits liability (note 24)		**102**		95
Accounts payable and other		**821**		616
Total	**$**	**3,079**	$	2,650

10 Non-controlling interest in trust and subsidiary

		2010		2009
HSBC Canada Asset Trust	**$**	**200**	$	400
HSBC Mortgage Corporation (Canada)		**30**		30
	$	**230**	$	430

a *HSBC Canada Asset Trust*

HSBC Canada Asset Trust ("the Trust") is a closed-end trust. The Trust was established by HSBC Trust Company (Canada), our wholly-owned subsidiary, as trustee. The Trust's objective is to hold qualifying assets which will generate net income for distribution to holders of securities issued by the Trust ("HSBC HaTS™"). The Trust assets are primarily undivided co-ownership interests in pools of Canada Mortgage and Housing Corporation and Genworth Financial Mortgage Insurance Company Canada insured first mortgages originated by the bank, and Trust deposits with the bank.

Unless we fail to declare dividends on our preferred shares, the Trust will make non-cumulative, semi-annual cash distributions to the holders of the HSBC HaTS™. We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 12).

	2010			2009		
	Units		*Amount*	*Units*		*Amount*
HSBC Canada Asset Trust						
HSBC HaTS™ – Series 2010[(1)]	–	**$**	–	200,000	$	200
– Series 2015[(2)]	**200,000**		**200**	200,000		200
		$	**200**		$	400

(1) *Each Series 2010 unit was issued at $1,000 per unit to provide an effective annual yield of 7.78 per cent to December 31, 2010. The trust, having obtained regulatory approval, redeemed Series 2010 at par on the repricing date of December 31, 2010.*

(2) *Each Series 2015 unit was issued at $1,000 per unit to provide an effective annual yield of 5.149 per cent to June 30, 2015 and the six month bankers' acceptance rate plus 1.50 per cent thereafter. The units are not redeemable by the holders. The Series 2015 became redeemable by the Trust on June 30, 2010 and on any distribution date thereafter, subject to payment of a premium in certain circumstances and regulatory approval.*

Notes to Consolidated Financial Statements (continued)

10 Non-controlling interest in trust and subsidiary *(continued)*

b *HSBC Mortgage Corporation (Canada)*

The HSBC Group holds $30 million, a 100 per cent interest, of class B perpetual preferred shares issued by HSBC Mortgage Corporation (Canada) ("HMC"), a wholly-owned subsidiary. Dividends may be declared at the discretion of the directors of HMC. No dividends were paid or payable on these perpetual preferred shares for the years ended December 31, 2010 and 2009.

11 Subordinated debentures

Subordinated debentures, which are unsecured and subordinated in right of payment to the claims of depositors and certain other creditors, comprise:

Interest rate (%)	*Year of maturity*	*Foreign currency amount*	**2010**	2009
Issued to HSBC Group companies				
2.48[(1)]	2094	US$85	**$ 84**	$ 92
Issued to third parties				
4.39[(2)]	2015		**–**	100
4.94[(3)]	2021		**200**	200
4.80[(4)]	2022		**415**	402
30 day bankers' acceptance rate plus 0.50%	2083		**40**	40
			$ 655	$ 742
Total			**$ 739**	$ 834

(1) *Effective July, 2010 and until it resets in July, 2015 the interest rate is fixed at 2.478 per cent (previously 4.822 per cent).*

(2) *On January 21, 2010, the bank redeemed $100 million of its 4.39 per cent subordinated debentures due January 21, 2015, at 100 per cent of their principal amount plus accrued interest. The redemption was financed out of the general corporate funds of the bank.*

(3) *The interest rate is fixed at 4.94 per cent until March 2016 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00 per cent.*

(4) *Interest rate is fixed at 4.80 per cent until April 10, 2017 and thereafter interest is payable at an annual rate equal to the 90 day bankers' acceptance rate plus 1.00 per cent. These debentures are designated as HFT under the fair value option.*

12 Capital stock

Authorized:

Preferred – Unlimited number of Class 1 preferred shares in one or more series and unlimited number of Class 2 preferred shares in one or more series. We may, from time to time, divide any unissued Class 1 preferred shares into separate series and fix the number of shares in each series along with the associated rights, privileges, restrictions and conditions.

Common – 993,677,000 shares.

Issued and fully paid:

	2010			2009		
	Number of shares		*Amount*	*Number of shares*		*Amount*
Preferred Shares Class 1						
Series C[(1)]	**7,000,000**	**$**	**175**	7,000,000	$	175
Series D[(2)]	**7,000,000**		**175**	7,000,000		175
Series E[(3)]	**10,000,000**		**250**	10,000,000		250
Preferred shares Class 2						
Series B[(4)]	**86,450,000**		**346**	86,450,000		346
			946			946
Common Shares						
HSBC Bank Canada[(5)]	**498,668,000**	**$**	**1,225**	498,668,000	$	1,225

(1) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.10 per cent, payable quarterly, as and when declared. During 2010 and 2009, $9 million in dividends were declared and paid. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing June 30, 2010, at a declining premium up to June 30, 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.*

(2) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.00 per cent, payable quarterly, as and when declared. During 2010 and 2009, $9 million in dividends were declared and paid. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing December 31, 2010 at a declining premium up to December 31, 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.*

(3) *During 2009, the bank issued 10,000,000 non-voting, non-cumulative and redeemable shares with a par value of $25 each. Each share yields 6.60 per cent, payable quarterly, as and when declared. During 2010, $16 million (2009 – $12 million) in dividends were declared and paid. The shares are not redeemable by the bank prior to June 30, 2014. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing June 30, 2014 and on June 30th every five years thereafter at par. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.*

For each of the above shares, we may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new Series of Class 1 Preferred Shares on a share-for-share basis.

(4) *The shares, which are held by an HSBC Group company, are voting and non-cumulative. During 2010 and 2009, $27 million in dividends were declared and paid. During 2008, $2 million in dividends were declared and paid on January 15, 2009. Each share yields 7.75 per cent, payable quarterly, as and when declared. Holders are entitled to one vote for each share held.*

(5) *During 2010 and 2009, $280 million in dividends were declared and paid.*

Dividend restrictions:

We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 10).

Notes to Consolidated Financial Statements (continued)

13 Variable interest entities

a *The following table provides information regarding the bank's VIEs, in which we have a significant variable interest and including one that we consolidate:*

	2010		2009	
	Total assets	*Maximum exposure to loss*	*Total assets*	*Maximum exposure to loss*
Unconsolidated VIEs:				
Securitization vehicles managed by the bank(1)	**$ 242**	**$ 130**	$ 468	$ 218
Securitization vehicles managed by others(2)	**–**	**–**	2,280	17
Investment funds(3)	**8**	**4**	90	2
Consolidated VIEs:				
Specialized Financing Entity(4)	**350**	**–**	700	–

(1) *The maximum exposure to loss resulting from our significant variable interests in these VIEs consists mainly of the bank's ownership interests in the asset-backed commercial paper issued by these VIEs, the fair value of derivatives and the provision of credit enhancement and liquidity facilities. Included in our consolidated balance sheets is $56 million (2009 – $14 million) of asset-backed commercial paper issued by this VIE.*

(2) *The maximum exposure to loss consists mainly of segregated deposits provided as first loss protection and retained interests in securitization where we have sold loans. We have recognized this exposure in our consolidated balance sheets. The loans sold to this particular program were repurchased effective December 31, 2010.*

(3) *The maximum exposure to loss consists mainly of capital in investment funds.*

(4) *We have issued innovative Tier 1 capital under a capital trust (note 10). This trust is a VIE, but we are considered its primary beneficiary and, therefore, consolidate this structure in our consolidated balance sheets.*

b *Securitization vehicles managed by the bank*

Multi-seller conduit

We act as financial services agent for a multi-seller asset-backed commercial paper conduit program ("multi-seller conduit") and also provide a program-wide credit enhancement facility, swap facilities, liquidity facilities and securities distribution services as the lead dealer to the multi-seller conduit. From time to time, the bank in its capacity as lead dealer may hold asset-backed commercial paper issued by the conduit, which is classified as HFT. Also, the bank earns fees which are recognized in income when received.

This multi-seller conduit provides the bank's clients with alternate sources of financing through the securitization of their assets. Clients sell financial assets to the conduit and the conduit funds its purchase of such financial assets through the issuance of short-term asset-backed commercial paper to investors. Each client continues to service the financial assets they have sold to the multi-seller conduit and absorbs the first losses associated with such assets. The bank has no rights to the assets as they are owned by the multi-seller conduit.

For more detail on the liquidity facilities and program-wide credit enhancement facility outlined above, refer to the disclosure on guarantees, commitments and contingent liabilities (note 29).

HSBC Bank plc, a United Kingdom affiliate, provides a first loss subordinated program-wide credit enhancement facility under a Subordinated Program-Wide Committed Purchase Agreement ("SPWE"). The SPWE is sized to cover the majority of the expected losses of the conduit. At December 31, 2010, the authorized limit of the SPWE exceeded the conduits expected losses; as a result, the bank is not the primary beneficiary and is not required to consolidate the multi-seller conduit.

14 Principal subsidiaries

Principal subsidiaries	*Principal office address*	*Shareholders' equity*
HSBC South Point Investments (Barbados), LLP	St. Michael, Barbados	$ 1,015
HSBC Financial Corporation Limited	Toronto, Ontario	366
HSBC Securities (Canada) Inc.	Toronto, Ontario	244
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia	127
HSBC Capital (Canada) Inc.	Vancouver, British Columbia	75
HSBC Trust Company (Canada)	Vancouver, British Columbia	48
Household Trust Company	Toronto, Ontario	30
HSBC Loan Corporation (Canada)	Vancouver, British Columbia	11
HSBC Global Asset Management (Canada) Limited	Vancouver, British Columbia	10
HSBC Investment Funds (Canada) Inc.	Vancouver, British Columbia	3

15 Risk management

The risk management policies and procedures of the bank are included in the MD&A. The sections of the Risk Management section, included on pages 26 to 47 of the MD&A where indicated, relating to financial instruments including credit, market and liquidity risks form an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements (continued)

16 Classification of financial instruments

a *The carrying value of financial assets by classification is as follows:*

	2010					
	Held-for-trading	*Available-for-sale*	*Loans and receivables*	*Hedging items*	*Other*(1)	*Total*
Cash resources	**$ 41**	**$ –**	**$ 2,645**	**$ –**	**$ –**	**$ 2,686**
Securities	**2,254**	**15,804**	**–**	**–**	**40**	**18,098**
Securities purchased under reverse repurchase agreements	**–**	**–**	**7,155**	**–**	**–**	**7,155**
Loans(2)	**–**	**–**	**35,969**	**–**	**–**	**35,969**
Customers' liability under acceptances	**–**	**–**	**4,372**	**–**	**–**	**4,372**
Derivatives	**1,026**	**–**	**–**	**338**	**–**	**1,364**
Land, buildings, equipment and other assets	**–**	**–**	**1,276**	**–**	**576**	**1,852**
Total	**$ 3,321**	**$ 15,804**	**$ 51,417**	**$ 338**	**$ 616**	**$ 71,496**

	2009					
	Held-for-trading	*Available-for-sale*	*Loans and receivables*	*Hedging items*	*Other*(1)	*Total*
Cash resources	$ 310	$ –	$ 1,587	$ –	$ –	$ 1,897
Securities	1,986	12,682	–	–	41	14,709
Securities purchased under reverse repurchase agreements	–	–	8,496	–	–	8,496
Loans(2)	–	–	38,104	–	–	38,104
Customers' liability under acceptances	–	–	4,966	–	–	4,966
Derivatives	838	–	–	262	–	1,100
Land, buildings, equipment and other assets	–	–	1,642	–	423	2,065
Total	$ 3,134	$ 12,682	$ 54,795	$ 262	$ 464	$ 71,337

(1) *Included in "Other" are items that do not meet the definition of a financial instrument, as they have been excluded from the scope of CICA Handbook Section 3855.*

(2) *Net of allowance for credit losses.*

16 Classification of financial instruments *(continued)*

b *The carrying value of financial liabilities by classification is as follows:*

	2010					
	Held-for-trading	*Designated as held-for-trading*[1]	*Financial liabilities at amortized cost*	*Hedging items*	*Other*[2]	*Total*
Deposits	**$ 6**	**$ 820**	**$ 51,229**	**$ –**	**$ –**	**$ 52,055**
Acceptances	–	–	**4,372**	–	–	**4,372**
Interest bearing liabilities of subsidiaries, other than deposits	–	–	**2,363**	–	–	**2,363**
Derivatives	**1,221**	–	–	**108**	–	**1,329**
Securities sold under repurchase agreements	–	–	**1,560**	–	–	**1,560**
Securities sold short	**1,262**	–	–	–	–	**1,262**
Equity and other liabilities	–	–	**2,768**	–	**4,818**	**7,586**
Non-controlling interest in trust and subsidiary	–	–	–	–	**230**	**230**
Subordinated debentures	–	**415**	**324**	–	–	**739**
Total	**$ 2,489**	**$ 1,235**	**$ 62,616**	**$ 108**	**$ 5,048**	**$ 71,496**

	2009					
	Held-for-trading	*Designated as held-for-trading*[1]	*Financial liabilities at amortized cost*	*Hedging items*	*Other*[2]	*Total*
Deposits	$ –	$ 803	$ 49,404	$ –	$ –	$ 50,207
Acceptances	–	–	4,966	–	–	4,966
Interest bearing liabilities of subsidiaries, other than deposits	–	202	2,997	–	125	3,324
Derivatives	862	–	–	35	–	897
Securities sold under repurchase agreements	–	–	2,517	–	–	2,517
Securities sold short	1,148	–	–	–	–	1,148
Equity and other liabilities	–	–	2,353	–	4,661	7,014
Non-controlling interest in trust and subsidiary	–	–	–	–	430	430
Subordinated debentures	–	402	340	–	92	834
Total	$ 2,010	$ 1,407	$ 62,577	$ 35	$ 5,308	$ 71,337

(1) *Financial instruments designated as HFT under the fair value option.*

(2) *Included in other are subordinated debentures and interest bearing liabilities of subsidiaries other than deposits, in a fair value hedging relationship, which are adjusted for the fair value of the hedged risk, items that do not meet the definition of a financial instrument, and financial instruments that have been excluded from the scope of CICA Handbook Section 3855.*

Notes to Consolidated Financial Statements (continued)

16 Classification of financial instruments *(continued)*

c *Additional information relating to financial liabilities designated as held-for-trading under the fair value option is as follows:*

	2010			
	Contractual amount payable at maturity	*Fair value*	*Cumulative fair value loss*	*Cumulative fair value gain (loss) attributable to credit risk*
Deposits	**$ 802**	**$ 820**	**$ (18)**	**$ (5)**
Subordinated debentures	**400**	**415**	**(15)**	**18**
	$ 1,202	**$ 1,235**	**$ (33)**	**$ 13**

	2009			
	Contractual amount payable at maturity	*Fair value*	*Cumulative fair value loss*	*Cumulative fair value gain (loss) attributable to credit risk*
Deposits	$ 784	$ 803	$ (19)	$ (5)
Interest bearing liabilities of subsidiaries, other than deposits	200	202	(2)	1
Subordinated debentures	400	402	(2)	26
	$ 1,384	$ 1,407	$ (23)	$ 22

The cumulative fair value adjustment attributable to credit risk was computed by calculating the total cumulative fair value adjustment and eliminating fair value attributable to market risk.

17 Fair value of financial instruments

Fair value is the estimated amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction under no compulsion to act.

a *Methods employed in the 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 or financial instruments valued using models where all significant inputs are observable.

Level 3 – Valuation technique with significant non-observable inputs: Financial instruments valued using models where one or more significant inputs are not observable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are non-observable. For these instruments, the fair value derived is more judgmental. "Non-observable" in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (for example, historical data may be used). Furthermore, the assessment of a hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the non-observable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

17 Fair value of financial instruments *(continued)*

a *Methods employed in the determination of fair value (continued)*

The valuation models used where quoted market prices are not available incorporate certain assumptions that we anticipate would be used by a market participant to establish fair value. Where we believe that there are additional considerations not included within the valuation model, appropriate adjustments may be made.

Transaction costs are not included in the calculation of fair value. Trade origination costs such as brokerage fees are included in operating expenses. The future costs of administering the bank's over-the-counter derivative portfolio are also not included in fair value, but are expensed as incurred.

b *Analysis of fair value determination*

T-Bills, equities, government bonds, preferred shares and financial liability short positions in government bonds are valued using quoted market prices. Non-bank ABCP, certain mortgage-backed securities, certain retail structured notes and their corresponding offsetting interest rate swaps, certain swaps associated with our securitization programs, and a foreign currency-denominated bond issued with an embedded option and the related swaps are valued using a valuation technique with significant non-observable inputs. All other financial instruments are valued using a valuation technique with observable inputs.

c *Effect of changes in significant non-observable assumptions to reasonably possible alternatives*

The fair value of financial instruments are, in certain circumstances, 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 valuation of the foreign currency-denominated bond is based on observable inputs and the time value of an embedded option, which is based on normalized volatility of the bank's historical credit spreads.

Swaps associated with our securitization programs are valued using a combination of observable market data and an internal assessment of prepayment rates which are based on historical trends of underlying mortgages. A summary of the significant assumptions relating to the prepayments of mortgages is set out in note 4(c). At December 31, 2010, the effect of a 6 per cent decrease and 6 per cent increase in prepayment rates, the valuation model's significant non-observable inputs, would result in a decrease and increase in the fair value of the derivatives of approximately \$1 million and \$1 million, respectively.

d *Analysis of financial instruments not carried at fair value*

The table below provides an analysis of the fair value of financial instruments not carried at fair value in the consolidated balance sheets. Other financial instruments that are not included below are either carried at fair value or their carrying value is a reasonable approximation of their fair value due to their short-term nature or other reasons. Therefore, certain amounts will not directly agree to the balances in the consolidated balance sheets.

	2010		
	Carrying amount	*Fair value*	*Fair value over (under) carrying amount*
Loans	**$ 35,969**	**$ 36,234**	**$ 265**
Deposits	**51,229**	**51,691**	**462**
Interest bearing liabilities of subsidiaries, other than deposits	**2,363**	**2,386**	**23**
Subordinated debentures	**324**	**314**	**(10)**

Notes to Consolidated Financial Statements (continued)

17 Fair value of financial instruments *(continued)*

d *Analysis of financial instruments not carried at fair value (continued)*

	2009		
	Carrying amount	*Fair value*	*Fair value over (under) carrying amount*
Loans	$ 38,104	$ 38,367	$ 263
Deposits	49,404	49,986	582
Interest bearing liabilities of subsidiaries, other than deposits	3,122	3,069	(53)
Subordinated debentures	432	426	(6)

e *Methods and assumptions used in estimating fair value of financial instruments not carried at fair value*

The determination of fair values of financial instruments for which there are no quoted market values requires that a number of assumptions be made for which there exists a significant degree of subjectivity. Methods and assumptions used to estimate the fair value of the financial instruments are:

- Cash resources, acceptances, securities purchased under reverse repurchase agreements, other assets, securities sold under repurchase agreements and other liabilities are assumed to approximate their carrying values, due to their short-term nature.
- Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, fair values are determined using quoted market prices of similar securities or the use of valuation models.
- For floating rate loans, potential adjustments for credit spread changes are not considered when estimating fair values. Therefore, fair values are assumed to be equal to carrying value.
- Demand and floating rate deposits are assumed to be equal to their carrying value. The fair values of fixed rate deposits are estimated using a discounted cash flow calculation at current rates for deposits with similar terms and risks. Certain deposits are considered either trading liabilities or are designated as HFT using the fair value option.
- The fair value of debentures is determined by reference to current market prices for debt with similar terms and risks. The carrying value of certain deposits is adjusted due to being designated as HFT under the fair value option or is subject to a fair value hedging relationship.

f *Fair value hierarchy*

	2010			
	Fair Value Measurements Using[1]			
	Level 1	*Level 2*	*Level 3*	*Assets/ liabilities at fair value*
Assets				
Cash resources				
Deposits with regulated financial institutions	$ –	$ 41	$ –	$ 41
	–	41	–	41
Securities				
Available-for-sale securities				
Securities issued or guaranteed by:				
Canada	11,392	1,437	–	12,829
Provinces	1,358	–	–	1,358
Foreign governments	1,529	–	–	1,529
Others	–	–	20	20
Investment funds	–	4	–	4
Equity securities	64	–	–	64
	14,343	1,441	20	15,804
Held-for-trading securities				
Securities issued or guaranteed by:				
Canada	1,157	–	–	1,157
Provinces	647	–	–	647
Foreign governments	26	–	–	26
Others	1	398	–	399
Equity securities	25	–	–	25
	1,856	398	–	2,254
Others				
Derivatives	–	1,280	84	1,364
	$ 16,199	$ 3,160	$ 104	$ 19,463
Liabilities				
Deposits				
Individuals	–	207	45	252
Businesses and governments	–	6	568	574
	–	213	613	826
Other				
Derivatives	–	1,153	176	1,329
Securities sold short	1,161	101	–	1,262
	1,161	1,254	176	2,591
Subordinated debentures	–	415	–	415
	$ 1,161	$ 1,882	$ 789	$ 3,832

(1) *There were no significant transfers between Levels 1 and 2.*

Notes to Consolidated Financial Statements (continued)

17 Fair value of financial instruments *(continued)*

f *Fair value hierarchy (continued)*

	2009			
	Fair Value Measurements Using(1)			
	Level 1	*Level 2*	*Level 3*	*Assets/ liabilities at fair value*
Assets				
Cash resources				
Deposits with regulated financial institutions	$ –	$ 310	$ –	$ 310
	–	310	–	310
Securities				
Available-for-sale securities				
Securities issued or guaranteed by:				
Canada	10,686	1,096	–	11,782
Provinces	406	–	–	406
Foreign governments	–	352	–	352
Others	–	–	35	35
Investment funds	–	6	–	6
Equity securities	101	–	–	101
	11,193	1,454	35	12,682
Held-for-trading securities				
Securities issued or guaranteed by:				
Canada	1,289	–	–	1,289
Provinces	218	–	–	218
Others	76	119	256	451
Equity securities	28	–	–	28
	1,611	119	256	1,986
Others				
Derivatives	–	1,040	60	1,100
	$ 12,804	$ 2,923	$ 351	$ 16,078
Liabilities				
Deposits				
Individuals	–	148	119	267
Businesses and governments	–	–	536	536
	–	148	655	803
Other				
Interest bearing liabilities of subsidiaries, other than deposits	–	202	–	202
Derivatives	–	808	89	897
Securities sold short	1,099	49	–	1,148
	1,099	1,059	89	2,247
Subordinated debentures	–	402	–	402
	$ 1,099	$ 1,609	$ 744	$ 3,452

(1) *There were no significant transfers between Levels 1 and 2.*

17 Fair value of financial instruments *(continued)*

g *Changes in the fair value measurement for instruments categorized as Level 3*

The followings table presents the changes in fair value measurements for instruments included in Level 3 of the fair value hierarchy set out in Section 3862 as described in note 1:

As at December 31, 2010

	Fair value January 1, 2010	*Total realized/ unrealized gains (losses) included in earnings*[(1)]	*Total unrealized gains (losses) included in other compre-hensive income*	*Acquisition of assets/ issuances of liabilities*	*Disposal of assets/ settle-ments of liabilities and others*	*Transfer into Level 3*[(1)]	*Transfer out of Level 3*[(1)]	*Fair value December 31, 2010*	*Changes in unrealized gains (losses) included in earnings for assets and liabilities for positions still held*
Assets									
Securities									
Available-for-sale securities									
Mortgage-backed securities	**$ 35**	**$ (2)**	**$ –**	**$ –**	**$ (13)**	**$ –**	**$ –**	**$ 20**	**$ –**
Held-for-trading securities									
Asset-backed securities[(2)]	**256**	**21**	**–**	**–**	**(277)**	**–**	**–**	**–**	**–**
Other									
Derivatives, net of derivative-related liabilities[(3)]	**(29)**	**(63)**	**–**	**–**	**–**	**–**	**–**	**(92)**	**(63)**
	$ 262	**$ (44)**	**$ –**	**$ –**	**$ (290)**	**$ –**	**$ –**	**$ (72)**	**$ (63)**
Liabilities									
Deposits									
Individual	**(119)**	**9**	**–**	**(19)**	**60**	**(7)**	**31**	**(45)**	**(2)**
Businesses and governments	**(536)**	**(32)**	**–**	**–**	**–**	**–**	**–**	**(568)**	**(32)**
	$ (655)	**$ (23)**	**$ –**	**$ (19)**	**$ 60**	**$ (7)**	**$ 31**	**$ (613)**	**$ (34)**

(1) *Transfers in and out of Level 3 are assumed to occur at the end of the period. For an asset or a liability that transfers into Level 3 during the period, the entire change in fair value for the period is excluded from the "Total realized/unrealized gains (losses) included in earnings" column on the reconciliation, whereas for transfers out of Level 3 during the period, the entire change in fair value for the period is included in the said column of the reconciliation.*

(2) *Refer to note 2(b).*

(3) *Net derivatives as at December 31, 2010 included derivative assets of $84 million (2009 – $60 million) and derivative liabilities of $176 million (2009 – $89 million). The total amount reported for realized gains included in earnings mostly arises from changes in interest rates, which are observable inputs. See note 17(c) for sensitivity information relating to changes in assumptions for Level 3 inputs. Total realized/unrealized gains (losses) are included in "Other mark-to-market accounting (losses) gains, net" on the consolidated statements of income.*

Notes to Consolidated Financial Statements (continued)

17 Fair value of financial instruments *(continued)*

g *Changes in the fair value measurement for instruments categorized as Level 3 (continued)*

As at December 31, 2009

	Fair value January 1, 2009	Total realized/ unrealized gains (losses) included in earnings[1]	Total unrealized gains (losses) included in other compre-hensive income	Acquisition of assets/ issuances of liabilities	Disposal of assets/ settle-ments of liabilities and others	Transfer into Level 3[1]	Transfer out of Level 3[1]	Fair value December 31, 2009	Changes in unrealized gains (losses) included in earnings for assets and liabilities for positions still held
Assets									
Securities									
Available-for-sale securities									
Asset-backed securities[2]	$ 181	$ –	$ –	$ –	$ (181)	$ –	$ –	$ –	$ –
Mortgage-backed securities	46	(20)	11	–	(2)	–	–	35	(20)
	$ 227	$ (20)	$ 11	$ –	$ (183)	$ –	$ –	$ 35	$ (20)
Held-for-trading securities									
Asset-backed securities[2]	31	(20)	–	266	(21)	–	–	256	(20)
Other									
Derivatives, net of derivative-related liabilities[3]	(223)	194	–	–	–	–	–	(29)	195
	$ 35	$ 154	$ 11	$ 266	$ (204)	$ –	$ –	$ 262	$ 155
Liabilities									
Deposits									
Individual	(179)	7	–	(27)	80	–	–	(119)	3
Businesses and governments	–	4	–	(540)	–	–	–	(536)	4
	$ (179)	$ 11	$ –	$ (567)	$ 80	$ –	$ –	$ (655)	$ 7

(1) *Transfers in and out of Level 3 are assumed to occur at the end of the period. For an asset or a liability that transfers into Level 3 during the period, the entire change in fair value for the period is excluded from the "Total realized/unrealized gains (losses) included in earnings" column on the reconciliation, whereas for transfers out of Level 3 during the period, the entire change in fair value for the period is included in the said column of the reconciliation.*

(2) *Refer to note 2(b).*

(3) *Net derivatives as at December 31, 2010 included derivative assets of $84 million (2009 – $60 million) and derivative liabilities of $176 million (2009 – $89 million). The total amount reported for realized gains included in earnings mostly arises from changes in interest rates, which are observable inputs. See note 17(c) for sensitivity information relating to changes in assumptions for Level 3 inputs. Total realized/unrealized gains (losses) are included in "Other mark-to-market accounting (losses) gains, net" on the consolidated statements of income.*

18 Derivative instruments

In the ordinary course of business, we enter into various derivative contracts such as foreign exchange contracts, interest rate swaps, forward rate agreements and financial futures contracts whose notional principal is not included in the consolidated balance sheet. Derivative instruments are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. Derivatives are used for both trading and balance sheet management ("BSM") purposes. Trading related activity includes transactions undertaken on our behalf or for our customers ("Trading"). BSM derivatives are used by us to manage exposures to interest rate and foreign currency fluctuations, and may include certain hedging positions that BSM may not qualify for formal hedge accounting. Where appropriate, customer related trading transactions may be used as part of the BSM program.

A derivative qualifies as a hedge if the hedging relationship is designated and formally documented at inception, detailing the particular risk management objective and strategy for the hedge, and the specific risk exposure or exposures being hedged, as well as how effectiveness of the hedge is being assessed. In addition, changes in the fair value of the derivative must be highly effective in offsetting either changes in the fair value of on-balance sheet items or changes in the amount of future cash flows. The effectiveness of these hedging relationships is evaluated at inception of the hedge and on an ongoing basis, both retrospectively and prospectively using quantitative statistical measures of correlation. Accounting policies relating to derivatives are set out in note 1(p). Where a non-trading derivative has been designated and functions effectively as a hedge, the existing accounting treatment will continue as described in note 1(p).

We strictly adhere to our formalized risk management policies and procedures. Risk limits are determined for each portfolio of derivative instruments based on product, currency, interest rate repricing and market volatility. All limits are monitored on a daily basis. Derivative instruments are subject to both market and credit risk. Market risk is the risk that the fair value of derivatives will fluctuate due to changes in interest or foreign exchange rates, and equity markets. Market risk is managed on a consolidated basis. Credit risk for derivative instruments is not equal to the notional amount of the principal as it is with assets recorded on the consolidated balance sheets. The credit risk for derivatives is principally the replacement cost of any contract with a positive market value plus an estimate for future fluctuation risk. Credit risk for derivatives is managed using our risk management policies.

a *An analysis of the derivative portfolio and related credit exposure is as follows:*

	2010			
	Notional amount(1)	*Fair value*	*Credit equivalent amount*(2)	*Risk-weighted balance*(3)
Interest rate contracts				
Futures	**$ 19,671**	**$ –**	**$ –**	**$ –**
Swaps	**43,831**	**427**	**551**	**126**
Forward rate agreements	**50**	**–**	**–**	**–**
Caps	**400**	**–**	**3**	**1**
	63,952	**427**	**554**	**127**
Foreign exchange contracts				
Spot contracts	**858**	**1**	**9**	**1**
Forward contracts	**34,891**	**564**	**965**	**142**
Currency futures	**1**	**–**	**–**	**–**
Currency swaps and options	**8,564**	**372**	**638**	**255**
	44,314	**937**	**1,612**	**398**
Total	**$ 108,266**	**$ 1,364**	**$ 2,166**	**$ 525**

(1) *Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure.*

(2) *Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by OSFI in its capital adequacy guidelines.*

(3) *Risk-weighted balance represents the amount of regulatory capital required to support the derivative activities. It is estimated by risk weighting the credit equivalent amounts according to the credit worthiness of the counterparties using factors prescribed by OSFI in its capital adequacy guidelines.*

Notes to Consolidated Financial Statements (continued)

18 Derivative instruments *(continued)*

a *An analysis of the derivative portfolio and related credit exposure is as follows (continued):*

	2009			
	Notional amount(1)	*Fair value*	*Credit equivalent amount*(2)	*Risk-weighted balance*(3)
Interest rate contracts				
Futures	$ 1,366	$ –	$ –	$ –
Swaps	28,169	480	633	228
Forward rate agreements	50	–	–	–
Caps	400	5	8	1
	29,985	485	641	229
Foreign exchange contracts				
Spot contracts	879	1	9	2
Forward contracts	26,307	393	725	113
Currency futures	–	–	–	–
Currency swaps and options	7,565	221	525	267
	34,751	615	1,259	382
Total	$ 64,736	$ 1,100	$ 1,900	$ 611

(1) *Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure.*

(2) *Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by OSFI in its capital adequacy guidelines.*

(3) *Risk-weighted balance represents the amount of regulatory capital required to support the derivative activities. It is estimated by risk weighting the credit equivalent amounts according to the credit worthiness of the counterparties using factors prescribed by OSFI in its capital adequacy guidelines.*

Interest rate and currency futures are exchange-traded. All other contracts are over-the-counter.

18 Derivative instruments *(continued)*

b *The following tables summarize the notional amounts by remaining term to maturity of the derivative portfolio:*

	2010								
	Trading				*BSM*				
	Under 1 year	*1–5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1–5 years*	*Over 5 years*	*Total BSM*	*Total*
Interest rate contracts									
Futures	**$ 2,507**	**$ –**	**$ –**	**$ 2,507**	**$ 15,706**	**$ 1,458**	**$ –**	**$ 17,164**	**$ 19,671**
Swaps	**5,925**	**5,513**	**1,055**	**12,493**	**10,837**	**18,851**	**1,650**	**31,338**	**43,831**
Forward rate agreements	**50**	**–**	**–**	**50**	**–**	**–**	**–**	**–**	**50**
Caps	**–**	**400**	**–**	**400**	**–**	**–**	**–**	**–**	**400**
	8,482	**5,913**	**1,055**	**15,450**	**26,543**	**20,309**	**1,650**	**48,502**	**63,952**
Foreign exchange contracts									
Spot contracts	**858**	**–**	**–**	**858**	**–**	**–**	**–**	**–**	**858**
Forward contracts	**33,580**	**1,311**	**–**	**34,891**	**–**	**–**	**–**	**–**	**34,891**
Currency futures	**1**	**–**	**–**	**1**	**–**	**–**	**–**	**–**	**1**
Currency swaps and options	**3,157**	**2,572**	**1,780**	**7,509**	**–**	**1,055**	**–**	**1,055**	**8,564**
	37,596	**3,883**	**1,780**	**43,259**	**–**	**1,055**	**–**	**1,055**	**44,314**
Total	**$ 46,078**	**$ 9,796**	**$ 2,835**	**$ 58,709**	**$ 26,543**	**$ 21,364**	**$ 1,650**	**$ 49,557**	**$108,266**

Notes to Consolidated Financial Statements (continued)

18 Derivative instruments *(continued)*

b *The following tables summarize the notional amounts by remaining term to maturity of the derivative portfolio (continued):*

	2009								
	Trading				*BSM*				
	Under 1 year	*1–5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1–5 years*	*Over 5 years*	*Total BSM*	*Total*
Interest rate contracts									
Futures	$ 940	$ 171	$ 255	$ 1,366	$ –	$ –	$ –	$ –	$ 1,366
Swaps	1,086	11,898	2,249	15,233	4,864	7,472	600	12,936	28,169
Forward rate agreements	–	50	–	50	–	–	–	–	50
Caps	–	–	400	400	–	–	–	–	400
	2,026	12,119	2,904	17,049	4,864	7,472	600	12,936	29,985
Foreign exchange contracts									
Spot contracts	879	–	–	879	–	–	–	–	879
Forward contracts	24,602	1,694	11	26,307	–	–	–	–	26,307
Currency futures	–	–	–	–	–	–	–	–	–
Currency swaps and options	2,299	2,521	755	5,575	–	947	1,043	1,990	7,565
	27,780	4,215	766	32,761	–	947	1,043	1,990	34,751
Total	$ 29,806	$ 16,334	$ 3,670	$ 49,810	$ 4,864	$ 8,419	$ 1,643	$ 14,926	$ 64,736

Derivative transactions with HSBC Group companies

Included in the above tables are a number of derivative transactions with HSBC Group companies incurred in the normal course of business at market terms and conditions. At December 31, 2010, the tables included notional amounts of $8,933 million (2009 – $6,340 million) relating to interest rate derivatives and $18,802 million (2009 – $12,497 million) relating to foreign currency derivatives.

18 Derivative instruments *(continued)*

c *The following tables summarize the fair values of the bank's derivative portfolio at December 31 segregated between derivatives that are in a favourable or receivable position and those in an unfavourable or payable position. Fair values of derivative instruments are determined using a valuation technique with observable inputs.*

	2010						
	Trading			*BSM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	**$ 111**	**$ (111)**	**$ –**	**$ 316**	**$ (232)**	**$ 84**	**$ 84**
Caps	**–**	**–**	**–**	**–**	**–**	**–**	**–**
	111	**(111)**	**–**	**316**	**(232)**	**84**	**84**
Foreign exchange contracts							
Spot contracts	**1**	**(2)**	**(1)**	**–**	**–**	**–**	**(1)**
Forward contracts	**564**	**(652)**	**(88)**	**–**	**–**	**–**	**(88)**
Currency swaps and options	**296**	**(291)**	**5**	**76**	**(41)**	**35**	**40**
	861	**(945)**	**(84)**	**76**	**(41)**	**35**	**(49)**
Total	**$ 972**	**$ (1,056)**	**$ (84)**	**$ 392**	**$ (273)**	**$ 119**	**$ 35**

	2009						
	Trading			*BSM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	$ 227	$ (193)	$ 34	$ 253	$ (25)	$ 228	$ 262
Caps	5	(5)	–	–	–	–	–
	232	(198)	34	253	(25)	228	262
Foreign exchange contracts							
Spot contracts	1	(6)	(5)	–	–	–	(5)
Forward contracts	393	(453)	(60)	–	–	–	(60)
Currency swaps and options	221	(214)	7	–	(1)	(1)	6
	615	(673)	(58)	–	(1)	(1)	(59)
Total	$ 847	$ (871)	$ (24)	$ 253	$ (26)	$ 227	$ 203

Notes to Consolidated Financial Statements (continued)

19 Interest rate sensitivity

The following table provides an analysis of the interest rate sensitivity position based on contractual repricing dates of assets and liabilities:

	2010									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	$ 41	$ 1,444	$ 304	1.9	$ 361	2.1	$ –	–	$ 536	$ 2,686
Securities	2,229	4,463	2,239	1.2	9,040	2.4	54	2.9	73	18,098
Securities purchased under reverse repurchase agreements	–	7,155	–	1.0	–	–	–	–	–	7,155
Loans	23,334	3,918	2,458	4.1	5,983	8.5	102	5.7	174	35,969
Acceptances	–	–	–	–	–	–	–	–	4,372	4,372
Other assets	275	–	–	2.1	–	–	–	–	2,941	3,216
Total assets	25,879	16,980	5,001		15,384		156		8,096	71,496
Deposits	21,207	7,512	7,030	1.1	6,927	3.6	997	3.6	8,382	52,055
Acceptances	–	–	–	–	–	–	–	–	4,372	4,372
Interest bearing liabilities of subsidiaries, other than deposits	1,014	–	1,349	4.0	–	–	–	–	–	2,363
Securities sold under repurchase agreements	–	1,560	–	1.0	–	–	–	–	–	1,560
Other liabilities	1,264	–	–	1.0	–	–	–	–	4,406	5,670
Non-controlling interest in subsidiaries	–	–	–	–	200	5.1	–	–	30	230
Subordinated debt	40	–	–	1.6	84	2.5	615	4.7	–	739
Shareholders' equity	–	–	–	–	600	5.7	–	–	3,907	4,507
Total liabilities and shareholders' equity	23,525	9,072	8,379		7,811		1,612		21,097	71,496
On-balance sheet gap	2,354	7,908	(3,378)		7,573		(1,456)		(13,001)	–
Off-balance sheet positions	–	(4,678)	295		2,833		1,550		–	–
Total interest rate gap	$ 2,354	$ 3,230	$ (3,083)		$ 10,406		$ 94		$(13,001)	$ –

19 Interest rate sensitivity *(continued)*

The following table provides an analysis of the interest rate sensitivity position based on contractual repricing dates of assets and liabilities:

	2009									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	$ 310	$ 585	$ –	1.0	$ 319	3.2	$ –	–	$ 683	$ 1,897
Securities	1,958	2,534	2,374	0.5	7,767	2.6	–	–	76	14,709
Securities purchased under reverse repurchase agreements	–	8,496	–	0.3	–	–	–	–	–	8,496
Loans	26,311	1,100	3,080	3.5	7,037	8.5	182	5.4	394	38,104
Acceptances	–	–	–	–	–	–	–	–	4,966	4,966
Other assets	222	–	–	2.0	–	–	–	–	2,943	3,165
Total assets	28,801	12,715	5,454		15,123		182		9,062	71,337
Deposits	18,623	9,506	7,357	0.9	6,295	3.3	536	6.7	7,890	50,207
Acceptances	–	–	–	–	–	–	–	–	4,966	4,966
Interest bearing liabilities of subsidiaries, other than deposits	878	449	649	1.7	1,348	4.6	–	–	–	3,324
Securities sold under repurchase agreements	–	1,079	1,438	0.4	–	–	–	–	–	2,517
Other liabilities	1,150	–	–	0.3	–	–	–	–	3,545	4,695
Non-controlling interest in subsidiaries	–	–	200	7.8	–	–	200	5.1	30	430
Subordinated debt	–	140	92	3.9	–	–	602	4.8	–	834
Shareholders' equity	–	–	–	–	600	5.7	346	7.8	3,418	4,364
Total liabilities and shareholders' equity	20,651	11,174	9,736		8,243		1,684		19,849	71,337
On-balance sheet gap	8,150	1,541	(4,282)		6,880		(1,502)		(10,787)	–
Off-balance sheet positions	–	(1,707)	(903)		2,075		535		–	–
Total interest rate gap	$ 8,150	$ (166)	$ (5,185)		$ 8,955		$ (967)		$(10,787)	$ –

Notes to Consolidated Financial Statements (continued)

20 Financial assets pledged and collateral accepted

a *Financial assets pledged to secure liabilities*

	2010	2009
Securities	**$ 621**	$ 493
Loans	**1,671**	4,000
	$ 2,292	$ 4,493

In the ordinary course of business, we pledge assets recorded on our consolidated balance sheets to secure our liabilities held with the Bank of Canada, clearing and payment systems and depositories. In addition, we also pledge assets in relation to borrowing, securities lending and securities sold under repurchase agreements.

These transactions are conducted under terms that are usual and customary to financial institutions asset pledging to the above mentioned parties and to standard securities lending and repurchase agreements.

b *Collateral accepted as security*

The fair value of assets accepted as collateral that we are permitted to sell or repledge in the absence of default is $7,694 million (2009 – $9,160 million). The fair value of any such collateral that has been sold or repledged is $980 million (2009 – $727 million). We are obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to financial institutions' asset pledging to the above mentioned parties and to standard securities borrowing and reverse repurchase agreements.

21 Financial assets not qualifying for derecognition

a *Mortgages sold with recourse*

We have agreed to repurchase any mortgage purchased from the bank by the HSBC Mortgage Mutual Fund if any principal and interest payments due are more than 90 days in arrears. Total mortgages sold with recourse at December 31, 2010 were $1,185 million (2009 – $915 million) and are included in other liabilities.

b *Securities lending*

We have lent securities which we have agreed to repurchase at notice from other banks or customers. The other banks or customers have agreed to return lent securities at our request under terms and conditions that are usual and customary to standard securities lending agreements. The total securities lent at December 31, 2010 were $119 million (2009 – $133 million) and are included in other liabilities.

c *Repurchase agreements*

We have lent securities which we have agreed to repurchase at a specified future date under terms and conditions that are usual and customary to standard repurchase agreements. Total securities at December 31, 2010 which we have agreed to repurchase at a specified future date were $1,560 million (2009 – $2,517 million) and are separately disclosed in the consolidated balance sheets.

22 Net operating income

Net operating income is stated after the following items of income, expense, gains and losses:

		2010		2009
Income				
Interest earned on financial instruments not held-for-trading	**$**	**2,105**	$	2,237
Fees earned on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments		**218**		189
Fees earned on trust and other fiduciary activities where we hold or invest assets on behalf of our customers		**148**		121
Expense				
Interest expense on financial instruments not held-for-trading	**$**	**531**	$	743
Fee expense on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments		**33**		15
Fee expense relating to trust and other fiduciary activities where we hold or invest assets on behalf of our customers		**10**		9
Gains (losses) recognized				
Securitized loans sold to third parties	**$**	**64**	$	99
Financial instruments held-for-trading		**115**		188
Financial liabilities designated as held-for-trading		**–**		(114)
Hedging items				
Ineffectiveness:				
Cash flow hedges		**(6)**		(9)
Fair value hedges		**(2)**		1
Economic hedges[1]		**(197)**		97

(1) *Gains (losses) on hedging derivatives that do not qualify for hedge accounting under GAAP.*

23 Stock-based compensation

a *Savings-Related Share Option Schemes*

Options were previously granted to certain of our employees under the HSBC Group Share Option Plan and Employee Share Option Plan until both plans were terminated in 2005. All employees are now invited to participate in the HSBC Savings-Related Share Option Scheme ("Savings-Related Share Option Scheme"). The Savings-Related Share Option Scheme permits employees to enter into savings contracts to save up to the equivalent of £250 per month, with the option to use the savings to acquire shares. The options are exercisable within six months following either the first, third or the fifth anniversary of the commencement of the savings contract depending on conditions set at the date of grant. The exercise price is at a 20 per cent discount to the market value at the date of grant. Since the shares have been granted directly by the Parent, the corresponding offset to compensation expense is an increase to contributed surplus, representing a contribution of capital from the Parent.

b *Share Award Schemes*

Eligible employees may receive grants of ordinary shares of the Parent subject to certain vesting conditions ("Share Award Schemes"). These Share Award Schemes can be either performance or non-performance shares awards of the Parent. Performance related share awards generally vest after three years from date of grant, based on certain performance targets. Non-performance related share awards are released to the recipients based on continued service, typically at the end of a 31 month vesting period from date of grant. These share awards are purchased in the open market at time of vesting. As the shares and awards are in ordinary shares of the Parent traded on the London Stock Exchange, individual share information disclosed below in Canadian dollars has been converted from Pounds Sterling at the date of issue of options or at the date of funding of share purchases. The cost of these shares purchased is recorded as compensation expense over the vesting period.

Notes to Consolidated Financial Statements (continued)

23 Stock-based compensation *(continued)*

c *The following table presents information for each plan*

	2010	2009
Savings-Related Share Option Scheme (1, 3 or 5 year vesting period)		
Total options granted (shares)	**639,713**	4,377,137
Fair value per option granted (in dollars)	**$ 2.14–2.67**	$ 2.36–2.62
Total compensation expense recognized	**$ 5**	$ 7
Significant assumptions used to calculate fair value:		
Risk free interest rate	**0.7%–2.9%**	0.7%–2.4%
Expected life (years)	**1–5**	1–5
Expected volatility	**30%**	30%–50%
Achievement Awards		
Total compensation expense recognized	**$ 16**	$ 22

24 Employee future benefits

We sponsor a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to eligible employees.

The bank measures its accrued benefit obligations and the fair value of plan assets for accounting purposes at September 30, except for HSBC Financial's employee benefit plans for which a measurement date of December 31 is used.

The following table presents information related to our defined benefit plans:

	Pension benefits		*Non-pension benefits*	
	2010	2009	**2010**	2009
Accrued benefit obligations				
Balance at beginning of year	**$ 404**	$ 365	**$ 108**	$ 105
Current service cost	**11**	11	**4**	4
Interest cost	**26**	24	**6**	6
Benefits paid	**(20)**	(20)	**(3)**	(3)
Settlements	**(2)**	(2)	**–**	–
Actuarial loss (gain)	**56**	25	**17**	(4)
Employee contributions	**1**	1	**–**	–
Balance at end of year	**$ 476**	$ 404	**$ 132**	$ 108
Plan assets				
Fair value at beginning of year	**$ 341**	$ 314	**$ –**	$ –
Actual return on plan assets	**29**	19	**–**	–
Bank contributions	**25**	29	**3**	3
Employee contributions	**1**	1	**–**	–
Benefits paid	**(20)**	(20)	**(3)**	(3)
Special termination benefits paid	**(1)**	–	**–**	–
Settlements	**(2)**	(2)	**–**	–
Fair value at end of year	**$ 373**	$ 341	**$ –**	$ –
Funded status				
Funded status – deficit	**$ (103)**	$ (63)	**$ (132)**	$ (108)
Bank contributions after measurement date	**3**	2	**–**	–
Unamortized net actuarial loss	**182**	142	**42**	27
Unamortized past service costs	**7**	9	**(14)**	(16)
Unamortized transitional (asset) obligation	**(18)**	(22)	**2**	2
Accrued benefit asset (liability)	**71**	68	**(102)**	(95)
Valuation allowance	**(1)**	(2)	**–**	–
Accrued benefit asset (liability), net of valuation allowance	**$ 70**	$ 66	**$ (102)**	$ (95)

The accrued benefit asset (liability), net of valuation allowance, is included in the consolidated balance sheets:

	Pension benefits		*Non-pension benefits*	
	2010	2009	**2010**	2009
Other assets (note 6)	**$ 99**	$ 93	**$ –**	$ –
Other liabilities (note 9)	**(29)**	(27)	**(102)**	(95)
Total	**$ 70**	$ 66	**$ (102)**	$ (95)

Effective December 1, 2004, we amended our post-retirement, non-pension arrangements. Eligible employees who retired between January 1, 2005 and December 31, 2007 had the option of participating in the existing plan at the time or in Retiree Benefit Choices, a flexible benefit plan. Eligible employees retiring after January 1, 2008 participate only in Retiree Benefit Choices.

Included in the accrued benefit obligations and fair value of pension plan assets at year end are the following amounts in respect of plans with accrued benefit obligations in excess of fair value of assets:

	2010	2009
Accrued benefit obligations	**$ 368**	$ 304
Fair value of plan assets	**259**	230
Funded status – deficit at measurement date	**109**	74
Bank contributions after measurement date	**3**	2
Funded status – deficit at end of year	**$ 106**	$ 72

The distribution of the pension plan assets is shown below:

	Percentage of pension plan assets (%)	
	2010	2009
Equity securities	**66**	67
Debt securities	**32**	32
Other	**2**	1
Total	**100**	100

The expense for employee future benefits is as follows:

	Pension benefits		*Non-pension benefits*	
	2010	2009	**2010**	2009
Service cost	**$ 11**	$ 11	**$ 4**	$ 4
Interest cost	**26**	24	**6**	6
Actual return on plan assets	**(29)**	(19)	**–**	–
Actuarial loss (gain) on accrued benefit obligation	**56**	25	**17**	(4)
Settlement termination benefits	**1**	–	**–**	–
Settlement loss	**1**	1	**–**	–
Costs arising in the year	**66**	42	**27**	6
Differences between costs arising in the year and costs recognized in the year in respect of:				
– Actual and expected return on plan assets	**6**	(3)	**–**	–
– Actuarial (gain) loss	**(48)**	(18)	**(16)**	5
– Amendments	**1**	1	**(2)**	(2)
– Amortization of transitional (asset) obligation	**(3)**	(3)	**1**	1
Net benefit plan expense recognized before change in valuation allowance	**22**	19	**10**	10
Decrease in valuation allowance	**–**	(2)	**–**	–
Net benefit plan expense	**22**	17	**10**	10
Defined contribution plan expense	**19**	19	**–**	–
Total expense	**$ 41**	$ 36	**$ 10**	$ 10

Notes to Consolidated Financial Statements (continued)

24 Employee future benefits *(continued)*

The total cash payments for employee future benefits for 2010, consisting of cash contributed by the bank to our funded pension plans, cash paid directly to beneficiaries for our unfunded pension arrangements and payments to third party service providers in respect of our post-retirement, non-pension arrangements were $43 million (2009 – $50 million).

The most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at December 31, 2009. The next actuarial valuations for funding purposes of these plans are required as at December 31, 2010 with the exception of one plan that is required at December 31, 2012. The post-retirement, non-pension actuarial valuation was conducted as at July 1, 2009.

The significant actuarial assumptions adopted in measuring the accrued benefit obligations, and determining the net benefit plan expense, were as follows:

	Pension benefits (%)		*Non-pension benefits (%)*	
	2010	2009	**2010**	2009
Accrued benefit obligations				
Discount rate	**5.25 – 5.50**	6.25	**5.25 – 5.50**	6.25
Rate of compensation increase	**3.50 – 3.80**	3.50 – 3.80	**n/a**	n/a
Net benefit plan expense				
Discount rate	**6.25**	6.50 – 7.00	**6.25**	6.25 – 6.50
Expected long-term rate of return on plan assets	**6.50 – 7.00**	6.75 – 7.00	**n/a**	n/a
Rate of compensation increase	**3.80 – 4.00**	3.80 – 4.00	**0.00 – 3.50**	0.00 – 3.50

In 2010, for measurement purposes, a 6.90 – 8.50 per cent health care cost trend rate was assumed grading down to 4.90 – 5.00 per cent in 2015 – 2017 and thereafter (2009 – 7.30 – 9.00 per cent grading down to 4.90 – 5.00 per cent in 2015 – 2017 and level thereafter).

The expected average remaining service lives of the active employees under the pension plans is 13 years and 19 years (11 years and 16 years for HSBC Financial's plans) under the post-retirement, non-pension arrangements.

Sensitivity of Assumptions

The following table shows the sensitivity of the accrued benefit obligations at the end of 2010, as well as the net benefits expense for 2010, to changes in the significant actuarial assumptions. The sensitivities in each key variable have been calculated independently of changes in other key variables.

	Pension benefits		*Non-pension benefits*	
	Accrued benefit obligation	*Benefits expense*	*Accrued benefit obligation*	*Benefits expense*
Expected rate of return on plan assets (%)	–	6.50 – 7.00	–	–
Impact of 1% increase	$ –	$ (3)	$ –	$ –
Impact of 1% decrease	$ –	$ 3	$ –	$ –
Discount rate (%)	5.25 – 5.50	5.25 – 6.25	5.25 – 5.50	5.25 – 6.25
Impact of 1% increase	$ (67)	$ (4)	$ (21)	$ (1)
Impact of 1% decrease	$ 83	$ 4	$ 25	$ 1
Rate of compensation increase (%)	3.50 – 3.80	3.50 – 3.80	n/a	n/a
Impact of 0.25% increase	$ 8	$ –	$ –	$ –
Impact of 0.25% decrease	$ (8)	$ –	$ –	$ –
Assumed overall health care cost trend (%)	–	–	6.90 – 8.00	7.30 – 8.00[(1)]
Impact of 1% increase	$ –	$ –	$ 11	$ 1
Impact of 1% decrease	$ –	$ –	$ (9)	$ (1)

(1) *For measurement purposes, a 6.90 – 8.50 per cent health care cost trend rate in 2010 was assumed grading down to 4.90 – 5.00 per cent in 2015 – 2017 and thereafter.*

25 Income taxes

a *Components of the provision for income taxes reported in the consolidated statements of income are:*

	2010	2009
Current income taxes:		
Federal	**$ 124**	$ 133
Provincial	**80**	85
Foreign	**–**	45
	204	263
Future income taxes:		
Federal	**4**	(34)
Provincial	**2**	(22)
	6	(56)
Total provision for income taxes	**$ 210**	$ 207

b *The provision for income taxes shown in the consolidated statements of income is at a rate that is different than the combined federal and provincial statutory income tax rate for the following reasons:*

	2010 (%)	2009 (%)
Combined federal and provincial income tax rate	**29.5**	31.1
Adjustments resulting from:		
Adjustment for tax exempt income	**(0.2)**	(0.3)
Substantively enacted tax rate changes	**–**	(0.1)
Additional financial institution taxes	**0.2**	0.1
Other, net	**0.5**	(1.7)
Effective tax rate	**30.0**	29.1

c *The components of the net future income tax asset reported in other assets (note 6) are as follows:*

	2010	2009
Future income tax assets:		
Allowance for credit losses	**$ 84**	$ 82
Other available deductions	**104**	106
Other	**21**	12
	209	200
Future income tax liabilities:		
Leases	**63**	63
Deferred charges	**17**	12
Securitization-related	**43**	43
Building and equipment	**12**	5
	135	123
Net future income tax asset	**$ 74**	$ 77

Notes to Consolidated Financial Statements (continued)

26 Capital management

a *Objectives, policies and processes*

Our objectives in managing our financial capital resources include: generating shareholder value while supporting business activities including the asset base and risk positions; providing prudent depositor security; and exceeding applicable regulatory requirements and long-term internal targets.

The bank's capital management principles and related policies define the Internal Capital Adequacy Assessment Process by which management examines the bank's risk profile from both regulatory and economic capital viewpoints and ensures a level of capital:

- To exceed at all times applicable regulatory capital requirements and long term targets;
- To generate shareholder value through the efficient allocation of economic capital to support business activities including the asset base and risk positions;
- To remain consistent with our strategic and operational goals, as well as with shareholders' and rating agencies' expectations;
- To provide prudent depositor security;
- To maintain a capital position commensurate with the overall risk profile and control environment; and,
- To be capable of withstanding a severe economic downturn stress scenario.

Our approach includes using appropriate risk and financial metrics and targets in assessing capital adequacy in the context of its current position and various possible scenarios. In addition, in order to maintain the most cost effective capital structure, we redeem or issue capital instruments as deemed necessary.

b *Capital managed and capital ratio regulations*

The bank calculates its capital in accordance with the Basel II framework which aligns regulatory capital requirements with the risk profile of the bank.

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of the bank, comprising common shareholder's equity, qualifying non-cumulative preferred shares, qualifying innovative capital instruments, contributed surplus, retained earnings and certain other adjustments. Tier 2 capital includes subordinated debentures together with certain other adjustments. There are restrictions on the amount of Tier 2 capital as a percentage of total capital that qualifies in the calculation of capital adequacy.

OSFI considers financial institutions to be well-capitalized if they maintain a Tier 1 capital ratio (as a percentage of risk-weighted assets) of 7 per cent and a total regulatory capital ratio of 10 per cent. The bank maintained ratios that exceeded these requirements in both 2010 and 2009.

In addition to regulatory capital ratios, banks are expected to meet an assets-to-capital multiple test. The assets-to-capital multiple is calculated by dividing a bank's total assets, including specified off-balance sheet items, by its total capital. The bank met the assets-to-capital multiple test in both 2010 and 2009.

26 Capital management *(continued)*

c *Regulatory capital*

		2010		2009
Tier 1 capital				
Common shares	**$**	**1,225**	$	1,225
Contributed surplus		**12**		7
Retained earnings		**2,262**		2,113
Non-cumulative preferred shares		**946**		946
Non-controlling interests in trust and subsidiary(1)		**230**		430
Securitization-related deductions and other		**(116)**		(139)
Goodwill		**(15)**		(15)
Total Tier 1 capital	**$**	**4,544**	$	4,567
Tier 2 capital				
Subordinated debentures	**$**	**739**	$	834
Other		**205**		230
Securitization-related deductions		**(10)**		(23)
Total Tier 2 capital	**$**	**934**	$	1,041
Total capital available for regulatory purposes	**$**	**5,478**	$	5,608

(1) *Includes $200 million of HSBC HaTS™ (2009 – $400 million).*

27 Segmented information

a *Customer groups*

We manage and report our operations according to our main customer groups. Various estimates and allocation methodologies are used in the preparation of the customer groups' financial information. We allocate expenses directly related to earning revenue to the groups that earned the related revenue. Expenses not directly related to earning revenue, such as overhead expenses, are allocated to customer groups using appropriate allocation formulas. Customer group net interest income reflects internal funding charges and credits on the groups' assets, liabilities and capital, at market rates, taking into account relevant terms and currency considerations. The offset of the net impact of these charges and credits is reflected in Global Banking and Markets.

A description of each customer group is as follows:

Personal Financial Services provides services to individuals by offering a comprehensive range of financial products and services, which include retail banking, asset management, full service and discount brokerage and trust and advisory services.

Commercial Banking meets the needs of Canadian commercial and corporate clients by offering commercial and corporate banking, asset management, mergers and acquisitions ("M&A") advisory, merchant banking, treasury and trade finance.

Global Banking and Markets provides a comprehensive range of financial services to an international group of HSBC's large multinational clients as well as client sales, service and distribution, balance sheet management, and proprietary trading. The focus is on entities that have a need for global value added products by offering the following services: corporate banking, asset management, M&A advisory, treasury and trade finance.

Consumer Finance provides Canadian consumers a wide range of consumer finance products including real estate secured loans, unsecured personal loans, specialty insurance products and private label credit cards to retail merchants.

The accounting policies of the segments are generally consistent with those followed in the preparation of the consolidated financial statements as disclosed in note 1.

Notes to Consolidated Financial Statements (continued)

27 Segmented information *(continued)*

a *Customer groups (continued)*

	2010				
	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Consumer Finance*	*Total*
Net interest income	**$ 296**	**$ 749**	**$ 203**	**$ 309**	**$ 1,557**
Non-interest revenue	**420**	**385**	**73**	**58**	**936**
Total revenue	**716**	**1,134**	**276**	**367**	**2,493**
Non-interest expenses	**657**	**430**	**163**	**182**	**1,432**
Net operating income	**59**	**704**	**113**	**185**	**1,061**
Provision for (recovery of) credit losses	**27**	**183**	**(7)**	**132**	**335**
Income before undernoted	**32**	**521**	**120**	**53**	**726**
Provision for income taxes	**9**	**146**	**41**	**14**	**210**
Non-controlling interest in income of trust	**5**	**16**	**5**	**–**	**26**
Net income	**$ 18**	**$ 359**	**$ 74**	**$ 39**	**$ 490**
Preferred share dividends	**7**	**21**	**6**	**27**	**61**
Net income attributable to common shares	**$ 11**	**$ 338**	**$ 68**	**$ 12**	**$ 429**
Average assets	**$ 17,787**	**$ 22,088**	**$ 29,537**	**$ 2,799**	**$ 72,211**

	2009				
	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Consumer Finance*	*Total*
Net interest income	$ 357	$ 692	$ 53	$ 377	$ 1,479
Non-interest revenue	364	318	396	19	1,097
Total revenue	721	1,010	449	396	2,576
Non-interest expenses	623	377	136	187	1,323
Net operating income	98	633	313	209	1,253
Provision for credit losses	42	223	12	238	515
Income (loss) before undernoted	56	410	301	(29)	738
Provision for (recovery of) income taxes	16	101	100	(10)	207
Non-controlling interest in income of trust	5	16	5	–	26
Net income (loss)	$ 35	$ 293	$ 196	$ (19)	$ 505
Preferred share dividends	7	18	5	27	57
Net income (loss) attributable to common shares	$ 28	$ 275	$ 191	$ (46)	$ 448
Average assets	$ 18,290	$ 24,249	$ 25,626	$ 3,530	$ 71,695

27 Segmented information *(continued)*

b *Geographic*

Assets are allocated on the basis of the location of ultimate risk. Liabilities are allocated on the basis of the residence status of the bearer of the deposit, bankers' acceptances or other liability.

	2010			
	Assets		*Liabilities*	
	Amount	*Per cent*	*Amount*	*Per cent*
Canada	**$ 68,226**	**95.5**	**$ 62,643**	**93.5**
United States	**1,318**	**1.8**	**691**	**1.0**
Other countries	**1,952**	**2.7**	**3,655**	**5.5**
Total	**$ 71,496**	**100.0**	**$ 66,989**	**100.0**

	2009			
	Assets		*Liabilities*	
	Amount	*Per cent*	*Amount*	*Per cent*
Canada	$ 69,220	97.0	$ 62,865	93.9
United States	1,281	1.8	545	0.8
Other countries	836	1.2	3,563	5.3
Total	$ 71,337	100.0	$ 66,973	100.0

28 Related party transactions

Fees are charged by HSBC Group companies with respect to guarantees of deposits and medium term notes, and administrative and technical services provided to us. The total fees paid for the year amounted to $174 million (2009 – $118 million) and were recorded in non-interest expenses.

Fees are received from HSBC Group companies with respect to administrative and technical services provided by us. The total fees received for the year amounted to $167 million (2009 – $146 million) and were recorded in non-interest revenue.

Included in non-interest revenue were fees of $34 million (2009 – $20 million) received from an HSBC Group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

HSBC Group companies hold certain debentures, preferred shares and common shares (notes 11 and 12). See also note 18(b) relating to derivative instruments.

A certain company within the HSBC Group had agreed to provide a standby borrowing facility of up to US$500 million to the bank at market rates and conditions. This facility was not renewed in 2010.

In addition to the above related party transactions, transactions of a routine nature are completed with the HSBC Group, none of which are material to these financial statements.

Notes to Consolidated Financial Statements (continued)

29 Guarantees, commitments and contingent liabilities

a *Credit-related*

In the normal course of business, we enter into various off-balance sheet commitments and contingent liability contracts. The primary purpose of these contracts is to make funds available for the financing needs of customers. The policy for requiring collateral security with respect to these contracts and the types of collateral security held is generally the same as those for loans advanced.

Financial and performance standby letters of credit represent irrevocable assurances that payments will be made in the event that a customer cannot meet its obligations to third parties and they carry the same credit risk, recourse and collateral security requirements as loans extended to customers. Documentary and commercial letters of credit are instruments issued on behalf of a customer authorizing a third party to draw drafts on the bank up to a certain amount subject to specific terms and conditions. We are at risk for any drafts drawn that are not ultimately settled by the customer, and the amounts are collateralized by the goods to which they relate. Commitments to extend credit represent unutilized portions of authorizations to extend credit in the form of loans and customers' liability under acceptances.

The credit instruments reported below represent the maximum amount of additional credit that we could be obligated to extend should contracts be fully utilized.

	2010	2009
Financial and performance standby letters of credit	**$ 2,337**	$ 2,249
Documentary and commercial letters of credit	**352**	228
Commitments to extend credit	**34,298**	36,229
Credit and yield enhancement	**15**	13
	$ 37,002	$ 38,719

b *Long-term lease commitments*

Future minimum lease payments for all lease commitments under long-term leases of premises are as follows:

2011	$ 57
2012	53
2013	50
2014	45
2015	37
2016 (and thereafter)	113
	$ 355

The total rental expense charged in respect of premises for 2010 was $78 million (2009 – $66 million).

c *Litigation and legal proceedings*

We are subject to a number of legal proceedings arising in the normal course of our business. We do not expect the outcome of any of these proceedings, in aggregate, to have a material effect on our consolidated financial position or our results of operations.

d *Contingent liabilities*

During 2004, the Canada Revenue Agency ("CRA") issued Notices of Reassessments with respect to a specific material issue relating to the 1996-2001 taxation years. We have filed Notices of Objections. In 2010 the bank received a proposed reassessment in respect of certain transactions with its parent relating to the 2004 and 2005 taxation years. The bank intends to challenge CRA's proposal. The ultimate resolution of these issues is indeterminate at this stage. However, we believe that adequate provisions to cover these matters are reflected in the consolidated balance sheets at December 31, 2010 and 2009.

e *Backstop liquidity facilities*

Backstop liquidity facilities are provided to asset-backed commercial paper conduit programs ("programs") administered by the bank and third parties, as an alternative source of financing in the event that such programs are unable to access commercial paper markets, or in limited circumstances, when predetermined performance measures of the financial assets owned by these programs are not met. Generally, these facilities have a term of up to 364 days. The terms of the backstop liquidity facilities do not require us to advance money to these programs in the event of bankruptcy or to purchase non-performing or defaulted assets. None of the backstop liquidity facilities provided to programs administered by the bank have been drawn upon. No amounts were drawn on backstop liquidity facilities provided to programs administered by third parties at December 31, 2010 or 2009. Undrawn commitments in respect of backstop liquidity facilities are included in the amounts in note 29(a) above.

f *Credit enhancements*

The bank provides partial program-wide credit enhancement to the multi-seller conduit program administered by it to protect commercial paper investors in the event that the collections on the underlying assets and any draws on the transaction specific credit enhancement and liquidity backstop facilities are insufficient to repay the maturing asset-backed commercial paper issued by such multi-seller conduit program. Each of the asset pools funded by this multi-seller conduit program is structured to achieve a high investment grade credit profile through the provision of transaction specific credit enhancement provided by the seller of each asset pool to this multi-seller conduit program. The term of this program-wide credit enhancement is 12 months.

HSBC Group International Network*

Services are provided by around 7,500 offices in 87 countries and territories:

Europe	Offices
Armenia	7
Austria	1
Belgium	2
Channel Islands	39
Czech Republic	3
France	402
Georgia	1
Germany	16
Greece	21
Hungary	1
Ireland	7
Isle of Man	3
Italy	2
Kazakhstan	10
Luxembourg	7
Malta	47
Monaco	3
Netherlands	1
Poland	17
Russia	7
Slovakia	2
Spain	4
Sweden	2
Switzerland	31
Turkey	336
United Kingdom	1,350

Asia-Pacific	Offices
Australia	39
Bangladesh	13
Brunei Darussalam	12
China	175
Cook Islands	1
Hong Kong Special Administrative Region	324
India	132
Indonesia	198
Japan	11
Korea, Republic of	14
Macau Special Administrative Region	7
Malaysia	56
Maldives	1
New Zealand	11
Pakistan	11
Philippines	26
Singapore	24
Sri Lanka	16
Taiwan	50
Thailand	2
Vietnam	17

Americas	Offices
Argentina	179
Bahamas	5
Bermuda	13
Brazil	1,353
British Virgin Islands	3
Canada	272
Cayman Islands	11
Chile	8
Colombia	23
Costa Rica	35
El Salvador	89
Guatemala	1
Honduras	77
Mexico	1,202
Nicaragua	1
Panama	74
Paraguay	6
Peru	23
United States of America	524
Uruguay	16
Venezuela	1

Middle East and Africa	Offices
Algeria	2
Angola	1
Bahrain	9
Egypt	88
Iraq	17
Israel	1
Jordan	6
Kenya	1
Kuwait	1
Lebanon	8
Libya	1
Mauritius	12
Nigeria	1
Oman	8
Palestinian Autonomous Area	1
Qatar	7
Saudi Arabia	103
South Africa	5
United Arab Emirates	31

Associated companies are included in the network of offices.

HSBC Bank Canada Bank Branches and Subsidiaries

British Columbia:
Abbotsford
Burnaby (3)
Campbell River
Chilliwack
Coquitlam
Cranbrook
Kamloops
Kelowna (2)
Langley
Maple Ridge
Nanaimo
New Westminster
North Vancouver (2)
Penticton
Port Coquitlam
Prince George
Richmond (4)
Surrey (4)
Vancouver (16)
Vernon
Victoria (4)
West Bank
West Vancouver
White Rock

Alberta:
Calgary (10)
Edmonton (6)
Lethbridge
Medicine Hat
Red Deer
St. Albert

Saskatchewan:
Regina
Saskatoon

Manitoba:
Winnipeg (2)

Ontario:
Aurora
Barrie
Brampton (2)
Burlington
Hamilton
Kanata
Kingston
Kitchener
London
Markham (5)
Milton
Mississauga (4)
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Oshawa
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* *At February 28, 2011*

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*** At March 1, 2011*

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