HSBC Bank plc

Capital and Risk Management
Pillar 3 Disclosures as at 31 December 2010

HSBC

The world's local bank

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Certain defined terms

This document comprises the *Capital and Risk Management Pillar 3 Disclosures as at 31 December 2010* (‘*Pillar 3 Disclosures 2010*’) for HSBC Bank plc (‘the bank’) and its subsidiary undertakings (together ‘the group’). References to either ‘HSBC’ or ‘the Group’ within this document mean HSBC Holdings plc together with its subsidiaries.

Cautionary statement regarding forward-looking statements

These *Pillar 3 Disclosures 2010* contain certain forward-looking statements with respect to the financial condition, results of operations and business of the group. Statements that are not historical facts, including statements about the group’s beliefs and expectations, are forward-looking statements. Words such as ‘expects’, ‘anticipates’, ‘intends’, ‘plans’, ‘believes’, ‘seeks’, ‘estimates’, ‘potential’ and ‘reasonably possible’, variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statement.

Introduction

The bank is a subsidiary of HSBC Holdings plc. HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$ 180 billion at 31 December 2010.

The group provides a comprehensive range of banking and related financial services and divides its activities into business segments: UK Retail Banking; Continental Europe Retail Banking; Global Banking and Markets; and Private Banking.

Further details of the group’s principal activities can be found on page 4 of the HSBC Bank plc *Annual Report and Accounts 2010 (‘2010 Accounts’).*

Basel II

The Financial Services Authority of the United Kingdom (‘FSA’) supervises the group on a consolidated basis as well as certain individual businesses separately, e.g. the bank. The FSA receives capital adequacy reporting from, and sets capital requirements for these individual businesses and the group as a whole. The rules which the FSA applies are set out in its main prudential sourcebooks for the banking industry, GENPRU & BIPRU. These rules derive from the Capital Requirements Directive (‘CRD’) which implemented Basel II in the European Union (‘EU’).

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Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. Outside the EU, the rules which determine capital requirements vary and local reporting may still be on a Basel I basis.

Basel II is structured around three 'pillars': minimum capital requirements, supervisory review and market discipline.

Pillar 3 disclosures 2010

Pillar 3 complements the minimum capital requirements and the supervisory review process. Its aim is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on: the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution. Disclosures consist of both quantitative and qualitative information and are provided at the consolidated level.

Banks are required to disclose all their material risks as part of the pillar 3 framework. All material and non-proprietary information required by pillar 3 is included in the HSBC Holdings plc *Pillar 3 Disclosures 2010*. HSBC Bank plc, as a significant subsidiary of HSBC Holdings plc, is required to publish certain limited pillar 3 disclosures separately on a sub-consolidated level.

The FSA permits certain pillar 3 requirements to be satisfied by inclusion within a firm's financial statements. Where this is the case, this document provides page references to the relevant sections in the HSBC Bank plc *2010 Accounts* and HSBC Holdings plc *Annual report and Accounts 2010.*

Future Developments

The Basel Committee, following consultation, impact analysis and draft proposals during 2010, issued final proposals in December 2010 on the twin areas of capital and liquidity, the key aspects of which are set out below:

- **Risk weightings**: increased weightings for the trading book, securitisations, off-balance sheet exposures and derivatives are to be implemented by the end of 2011.

- **Quality of capital**: there is renewed emphasis on common equity as the principal component of core tier 1 equity, with increased deductions from shareholders' equity (calculated on an accounting basis) to determine the level of regulatory capital. The phasing-in periods for these new deductions will start from 1 January 2014, with full implementation by 1 January 2018.

- **Minimum ratios**: a new minimum common equity requirement of 4.5% is to be implemented from 1 January 2015. An additional capital conservation buffer of 2.5% in common equity will effectively trigger restrictions on corporate activity (such as the payment of dividends or bonuses) if breached, so that the capital structure can be rebuilt. This will be phased in between 1 January 2016 and 1 January 2019. Additional requirements from the Basel Committee for tier 1 capital of 1.5% and tier 2 capital of 2.0%, by 2019, will lift the minimum total capital requirement for banks to around 10.5%.

- **Countercyclical buffer**: the Basel Committee has finalised its proposals for a countercyclical buffer of up to 2.5% in common equity, to be built up in periods during which credit growth exceeds growth in Gross Domestic Product. It is not clear how such buffers will operate in practice, since they may be required only once every 10-20 years, and there is uncertainty over whether supervisors or the market would support the release of a buffer when the economic cycle had turned.

- **Total leverage**: the Committee has proposed a leverage ratio of 3% of total assets (not weighted for risk) to constrain aggregate size relative to the capital base. An observation period of parallel running will start in 2013, with the aim of a minimum standard becoming mandatory in 2018.

- **Liquidity and funding**: a new minimum standard, the Liquidity Coverage Ratio, has been proposed for liquidity to extend, under stressed conditions, the period during which a bank can continue to operate when it is unable to dispose of assets to repay withdrawals. Proposals are also being introduced for a Net Stable Funding Ratio. Although these have yet to be finalised, they are expected to require banks to match more accurately the maturities of liabilities to assets held. As it is not clear what secondary effects these measures may have, they will be phased in after observation periods, in 2015 and 2018 respectively.

- The Basel Committee is also considering proposals to define **Global Systemically Important Financial Institutions** ('G-SIFI's), intro-

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duce more rigorous oversight and co-ordinated assessment of their risks through international supervisory colleges, provide for higher levels of capital and liquidity resilience and require mandatory recovery and resolution plans with institution-specific crisis cooperation agreements between cross-border crisis management groups. It is proposed that the additional capital requirements could be met through a variety of instruments such as a core tier 1 surcharge, contingent capital or debt securities with specific bail-in provisions. Further measures may include liquidity surcharges, tighter large exposure restrictions, levies, and structural measures to reduce the risks that a G-SIFI poses. Studies will be completed by mid-2011 and final recommendations presented by December 2011. US regulators are conducting a related study of the relationship between bank size and systemic risk, the results of which are expected to lead to new rules requiring enhanced prudential standards, including capital, liquidity and leverage requirements

Frequency

In accordance with FSA requirements, the bank publishes its pillar 3 disclosures annually.

Media and location

The HSBC Holdings plc *Pillar 3 Disclosures 2010* and other information on the Group are available on HSBC's investor relations website: www.hsbc.com/investor-relations.

Comparison with the HSBC Bank plc *Annual Report and Accounts 2010*

The *Pillar 3 Disclosures 2010* have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards ('IFRSs'). Therefore, some information in the *Pillar 3 Disclosures 2010* is not directly comparable with the financial information in the HSBC Bank plc *2010 Accounts*. This is most pronounced for the credit risk disclosures, where credit exposure is defined as the maximum loss the group has estimated under specified Basel II parameters. This differs from similar information in the HSBC Bank plc *2010 Accounts,* which is mainly reported as at the balance sheet date and therefore does not reflect the likelihood of future drawings of committed credit lines.

Verification

The *Pillar 3 Disclosures 2010* have been verified internally but have not been audited by the group's external auditor.

Consolidation basis

The basis of consolidation for financial accounting purposes is described in *Note 1 - Basis of preparation* of the notes on the financial statements on page 90 of the HSBC Bank plc *2010 Accounts.* This differs from that used for regulatory purposes. Investments in banking associates, which are equity accounted in the financial accounting consolidation, are proportionally consolidated for regulatory purposes. Subsidiaries and associates engaged in insurance and non-financial activities are excluded from the regulatory consolidation and are deducted from regulatory capital. The regulatory consolidation does not include Special Purpose Entities ('SPEs') where significant risk has been transferred to third parties. Exposures to these SPEs are either risk-weighted as securitisation positions or deducted from capital for regulatory purposes.

Scope of Basel II permissions

Credit risk

Basel II applies three approaches of increasing sophistication to the calculation of minimum credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, to group counterparties into broad categories and to apply standardised risk weightings. The next level, the internal ratings-based ('IRB') foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of the probability that a counterparty will default ('PD'), but uses supervisory formulae and parameters to estimate exposure at default ('EAD') and loss given default ('LGD'). Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from formulae specified in the regulatory rules which incorporate these factors and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed accounting impairment allowances on the IRB portfolios.

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For credit risk, with the FSA's approval, the group has adopted the IRB advanced approach for the majority of its business, with the remainder on either IRB foundation or standardised approaches. A rollout plan is in place to extend coverage of the advanced approach over the next few years, leaving a residue of exposures on the standardised approach.

Counterparty credit risk

Counterparty credit risk is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. It arises on over the counter and securities financing transactions in both the trading and non-trading books.

Three methods for determining exposure values are defined by Basel II: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches; standardised, IRB foundation and IRB advanced.

The group uses the mark-to-market and internal model methods to measure exposure for counterparty credit risk. Its longer-term aim is to migrate more positions from the mark-to-market to the internal model method.

Market risk

Market risk is the risk that movements in market risk factors, including foreign exchange rates, commodity prices, interest rates, credit spreads and equity prices will reduce the group's income or the value of its portfolios. Market risk is measured, with FSA permission, using Value at Risk ('VAR') models or the standard market risk position risk requirement ('PRR') rules prescribed by the FSA.

The group uses both approaches for market risk. Its longer-term aim is to migrate more positions from standard market risk PRR rules to VAR.

Operational risk

Basel II includes capital requirements for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses a bank's own statistical analysis and modelling of operational risk data to determine capital requirements.

The group has adopted the standardised approach in determining its operational risk capital requirements.

Capital

Regulatory capital

The table on the following page sets out the composition of the group's regulatory capital and risk-weighted assets as at 31 December 2010.

Capital and Risk Management Pillar 3 Disclosures as at 31 December 2010

Table 1: Capital structure at 31 December

	2010	2009
	£m	£m
Composition of regulatory capital (Audited)		
Shareholders' equity [1]	**31,379**	32,248
Shareholders' equity per balance sheet	**31,825**	27,787
Preference share & related premium	**(431)**	(431)
Other equity instruments	**(1,750)**	(1,750)
Deconsolidation of special purpose entities [2, 4]	**1,735**	6,642
Non controlling interests	**382**	491
Non-controlling interests per balance sheet	**532**	641
Of which representing non-controlling interests in preference shares	**(150)**	(150)
Regulatory adjustments to the accounting basis	**748**	(562)
Unrealised (gains)/losses on available-for-sale debt securities [3, 4]	**1,545**	(109)
Own credit spread	**(170)**	(168)
Defined benefit pension fund adjustment [5]	**288**	695
Cash flow hedging reserve	**(190)**	(350)
Reserves arising from revaluation of property & unrealised gains on available-for-sale equities	**(373)**	(480)
Other regulatory adjustments	**(352)**	(150)
Deductions	**(11,428)**	(11,518)
Goodwill capitalised & intangible assets	**(10,436)**	(10,560)
50% of securitisation positions	**(679)**	(514)
50% of excess expected losses over impairment allowances	**(439)**	(616)
50% of tax credit adjustment for excess expected losses	**126**	172
Core tier 1 capital	**21,081**	20,659
Other tier 1 capital before deductions	**2,374**	2,391
Preference shares & related premium	**581**	581
Innovative tier 1 securities	**1,793**	1,810
Deductions	**(500)**	(343)
Unconsolidated investments [6]	**(626)**	(515)
50% of tax credit adjustment for excess expected losses	**126**	172
Tier 1 capital	**22,955**	22,707
Total qualifying tier 2 capital before deductions	**11,758**	11,272
Reserves arising from unrealised gains on revaluation of property & available-for-sale equities	**373**	480
Collective impairment allowances [7]	**338**	368
Perpetual subordinated debt	**2,762**	3,320
Term subordinated debt [8]	**8,285**	7,104
Total deductions other than from tier 1 capital	**(2,302)**	(2,139)
Unconsolidated investments [6]	**(1,177)**	(1,004)
50% of securitisation positions	**(679)**	(514)
50% of excess expected losses over impairment allowances	**(439)**	(616)
Other deductions	**(7)**	(5)
Total Regulatory capital	**32,411**	31,840
Risk-weighted assets (Unaudited)		
Credit and counterparty risk	**164,372**	167,259
Market risk	**12,762**	12,655
Operational risk	**24,586**	23,367
Total	**201,720**	203,281
Capital ratios (Unaudited)	**%**	%
Core tier 1 ratio	**10.5**	10.2
Tier 1 ratio	**11.4**	11.2
Total capital ratio	**16.1**	15.7

1 *Includes externally verified profits for the year to 31 December 2010. Does not include the interim dividend of £915m declared by the Board of Directors after 31 December 2010.*
2 *Mainly comprises unrealised losses on available-for-sale debt securities owned by deconsolidated special purpose entities.*
3 *Under FSA rules unrealised gains/losses on available-for-sale debt securities must be excluded from capital resources.*
4 *In December 2010, the bank agreed with the FSA that, going forward, for regulatory purposes it would consolidate one of its special purpose entities.*
5 *FSA rules permit banks to replace a liability in a defined benefit pension scheme by the additional funding that will be paid into the scheme over a 5 year period.*
6 *Mainly comprise investments in insurance entities.*
7 *Under Basel II rules collective impairment allowances on loan portfolios under the standardised approach may be included in tier 2 capital.*

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Internal assessment of capital adequacy

The group assesses the adequacy of its capital by considering the resources necessary to cover unexpected losses arising from discretionary risks, being those which it chooses to accept (such as credit risk and market risk), and from non-discretionary risks, being those which arise by virtue of its operations (such as operational risk and business risk). The group's capital management and allocation policy is underpinned by its capital management framework. The capital management framework and related policies define the Internal Capital Adequacy Assessment Process by which the Board of Directors of HSBC Bank plc ('the Board') and senior management examine the risk profile from both regulatory and economic capital viewpoints to ensure that the group's level of capital:

- remains sufficient to support the group's risk profile and outstanding commitments;
- exceeds the group's formal minimum regulatory capital requirements by an agreed margin;
- is capable of withstanding a severe economic downturn stress scenario; and
- remains consistent with the group's strategic and operational goals, and shareholder and rating agency expectations.

The regulatory and economic capital assessments rely upon the use of models that are integrated into the group's management of risk.

Economic capital is the internally calculated capital requirement which the group deems necessary to support the risks to which it is exposed. It is set at a confidence level consistent with a target credit rating of AA. Regulatory capital is the minimum level of capital which the group is required to hold in accordance with the rules set by the FSA (in the case of the bank and the consolidated group) and by local regulators (for individual subsidiary companies).

The economic capital assessment is the more risk-sensitive measure as it covers a wider range of risks and takes account of the substantial diversification of risk accruing from the group's operations. The group's economic capital models, based on those developed by HSBC, are calibrated to quantify the level of capital that is sufficient to absorb potential losses over a one-year time horizon to a 99.95 per cent level of confidence for its banking activities and to a 99.5 per cent level of confidence for its insurance activities and pension risks. The group's approach to capital management is aligned to its corporate structure, business model and strategic direction.

The group's discipline around capital allocation is maintained within established processes and benchmarks, in particular the approved annual group capital plan.

Regulatory and economic capital are the metrics by which risk is measured and linked to capital within the group's risk appetite framework. The framework, which expresses the types and quantum of risks to which the group wishes to be exposed, is approved and monitored by the Board and senior management.

The group identifies and manages risk through a defined risk management framework and continuous monitoring of the risk environment. It assesses and manages certain of these risks via the capital planning process. Risks assessed via capital and those that are not are compared below.

Risks assessed via capital

Credit (including counterparty credit), market and operational risk

The group assesses economic capital requirements for these risk types utilising the embedded operational infrastructure used for the calculation of regulatory capital requirements, together with an additional suite of models that take into account, in particular:

- the increased level of confidence required to meet the group's strategic goals (99.95 per cent); and
- internal assessments of diversification or concentration of risks within the group's portfolios.

The group's economic capital assessment consistently demonstrates a substantially lower overall capital requirement for credit risk than the regulatory equivalent, evidencing the benefits of diversification. However, the group maintains a prudent stance on capital coverage, ensuring that any model risk is mitigated.

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Interest rate risk in the banking book

Interest rate risk in the banking book ('IRRBB') is defined as the exposure of our non-trading products to interest rates.

Non-trading portfolios include positions that primarily arise from the interest rate management of future yield on assets and their funding costs, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts. IRRBB economic capital is measured as the amount of capital necessary to cover an unexpected loss in the value of our non-trading products over one year to a 99.95% level of confidence.

Insurance risk

The group operates a bancassurance model which provides insurance products for customers with whom the group has a banking relationship. Many of these insurance products are manufactured by group subsidiaries but, where the group considers it operationally more effective, third parties are engaged to manufacture and provide insurance products which the group sells through its banking network. The group works with a limited number of market-leading partners to provide these products. When manufacturing products, the group underwrites the insurance risk and retains the risks and rewards associated with writing insurance contracts.

We continue to make progress towards implementing a risk-based capital methodology for the group's insurance businesses. In the meantime, the economic capital that these businesses require is conservatively assumed to be equal to their Net Assets.

Pension risk

The group operates a number of pension plans. Some of these are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme. In situations where a funding deficit emerges, sponsoring group companies agree to make additional contributions to the plans, to address the deficit over an appropriate repayment period. Further detail of these payments can be found in *Note 7 – Employee compensation and benefits* of the Notes on the Financial Statements on page 120 of the HSBC Bank plc *2010 Accounts*. In order to fund these benefits, sponsoring group companies (and in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme's trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

Pension risk is the risk that a deficit may arise in a defined benefit plan from a number of factors, including:

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;
- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);
- a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and
- scheme members living longer than expected (known as longevity risk).

Pension risk is assessed by way of an economic capital model that takes into account potential variations in these factors, using a VAR methodology.

Residual risk

Residual risk is primarily the risk that mitigation techniques prove less effective than expected. This category also includes risks that arise from specific reputational or business events that give rise to exposures not deemed to be included in the major risk categories. The group conducts economic capital assessments of such risks on a regular, forward-looking basis to ensure that their impact is adequately covered by its capital base.

Risks not explicitly assessed via capital

Liquidity risk

Liquidity and funding risk management is described in detail on pages 47-49 of the HSBC Bank plc *2010 Accounts.*

The group uses cash-flow stress testing as part of its control processes to assess liquidity risk. The group does not manage liquidity through the explicit allocation of capital as, in common with standard industry practice, this is not considered to be an appropriate or adequate mechanism for managing these risks. However, the group recognises that a strong capital base can help to mitigate liquidity risk both by providing a capital buffer to allow an entity to

raise funds and deploy them in liquid positions and by serving to reduce the credit risk taken by providers of funds to the group.

Structural foreign exchange risk

Structural foreign exchange risk is described in detail on pages 52-53 of the HSBC Bank plc *2010 Accounts.*

The group's structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of the individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question. The group does not assign economic capital to any residual structural foreign exchange exposures, since they are managed within appropriate economic capital buffers.

Reputational risk

Details of the group's management of reputational risk can be found on page 64 of the HSBC Bank plc *2010 Accounts.*

As a banking group, the group's reputation depends upon the way in which it conducts its business, but it can also be affected by the way in which clients to whom it provides financial services conduct themselves.

Business risk

The FSA specifies that banks, as part of their internal assessment of capital adequacy process, should review their exposure to business risk.

Business risk is the potential negative impact on profits and capital as a result of the group not meeting its strategic objectives, as set out in the rolling operating plan, owing to unforeseen changes in the business and regulatory environment, exposure to economic cycles and technological changes. The group does not explicitly set aside capital against business risk as a distinct category.

Business risk is managed and mitigated through the business planning and stress testing processes, which ensure that the business model and planned activities are appropriately resourced and capitalised consistent with the commercial, economic and risk environment in which the group operates and that the potential vulnerability to the business plans are identified at an early stage so that mitigating actions can be taken proactively.

Scenario analysis and stress testing

Scenario analysis and stress testing are important mechanisms in understanding the sensitivities of the group's business and capital plans to the adverse effects of a range of plausible events of varying severity, some of which are extreme. As well as considering the potential financial impact upon plans, a key output of this tool is the consideration and establishment of management action plans for mitigating such events should they, or similar events, arise.

Regulatory capital supply is regularly assessed against demand under a range of stress scenarios, including projected global and local economic downturns. Qualitative and quantitative techniques are used to estimate the potential impact on the group's capital position under such scenarios. The group also participates, where appropriate, in standard scenario analyses requested by regulatory bodies.

As part of the group's risk appetite process, business and capital plans are supported by forecasts of the risk parameters that drive the group's capital requirements. The group carries out macro-economic stress tests which consider sensitivities of these drivers under a variety of potential economic forecasts in order to examine the possible capital positions that could arise. In any material economic downturn, proactive and structured intervention by management is both inevitable and necessary. Therefore, the group incorporates the effect of such management actions in determining whether or not it is likely to be able to withstand such an event.

Credit risk and market risk

The table on the following page sets out the group's credit and market risk-weighted assets and regulatory capital requirements as at 31 December 2010.

Capital and Risk Management Pillar 3 Disclosures as at 31 December 2010

Table 2: Credit risk – summary

	At 31 December 2010		At 31 December 2009	
Total credit risk capital requirements	**Capital required £m**	**RWA £m**	Capital required £m	RWA £m
Credit risk	**11,765**	**147,066**	11,918	148,969
Counterparty credit risk	**1,385**	**17,306**	1,463	18,290
Total	**13,150**	**164,372**	13,381	167,259
Credit risk analysis by exposure class				
Exposures under the IRB advanced approach	**7,233**	**90,416**	7,470	93,373
Retail:				
– secured on real estate property	**646**	**8,081**	601	7,509
– qualifying revolving retail	**602**	**7,520**	622	7,779
– small and medium-sized enterprises	**356**	**4,454**	310	3,883
– other retail	**531**	**6,638**	588	7,346
Total retail	**2,135**	**26,693**	2,121	26,517
Central governments and central banks	**200**	**2,496**	122	1,527
Institutions	**503**	**6,287**	579	7,231
Corporates	**3,522**	**44,023**	3,976	49,697
Securitisation positions [1]	**873**	**10,917**	672	8,401
Exposures under the foundation IRB approach	**210**	**2,629**	214	2,668
Corporates	**210**	**2,629**	214	2,668
Exposures under the Standardised approach	**4,322**	**54,021**	4,234	52,928
Institutions	**894**	**11,180**	577	7,211
Corporates	**2,150**	**26,877**	2,035	25,444
Retail	**267**	**3,337**	313	3,907
Secured on real estate property	**365**	**4,566**	322	4,027
Past due items	**57**	**716**	62	774
Collective investment undertakings	**8**	**103**	11	143
Other items than equity [2]	**497**	**6,199**	539	6,737
Equity – Institutions	**7**	**85**	11	138
Equity - Other	**77**	**958**	364	4,547
Total	**11,765**	**147,066**	11,918	148,969

Table 3: Market risk capital requirements

	At 31 December 2010		At 31 December 2009	
Market Risk	**Capital required £m**	**RWA £m**	Capital required £m	RWA £m
Interest rate position risk requirement [3]	**130**	**1,620**	**146**	**1,823**
Equity position risk requirement [3]	**4**	**52**	**7**	**89**
Commodity position risk requirement [3]	**3**	**39**	**5**	**57**
Foreign exchange position risk requirement [3]	**-**	**-**	**4**	**56**
VAR requirement	**884**	**11,051**	**850**	**10,630**
Total market risk capital requirement	**1.021**	**12,762**	**1,012**	**12,655**

Notes

1 *Excludes securitisation positions deducted from capital (which would otherwise be risk-weighted at 1,250 per cent). Securitisation positions deducted from capital are shown in Table 1.*

2 *Includes immaterial exposures to central governments & central banks, regional governments & local authorities, and administrative bodies & non-commercial undertakings, in addition to items such as tangible fixed assets, prepayments and deferred taxation.*

3 *Calculated using FSA standard market risk PRR rules.*

Terms and conditions of capital securities

Capital securities issued by the group

All capital securities included in the regulatory capital base of the group have been issued in accordance with the rules and guidance in the FSA's General Prudential Sourcebook ('GENPRU'). For regulatory purposes, the group's capital base is divided into two categories, or tiers, depending on the degree of permanence and loss absorbance exhibited. These are tier 1 and tier 2.

The main features of capital securities issued by the group are described below. The balances disclosed in the tables below are the balance sheet carrying amounts under IFRSs from the HSBC Bank plc *2010 Accounts* and are not the amounts that the instruments contribute to regulatory capital. The regulatory treatment of these instruments and the accounting treatment under IFRSs differ, for example, in the treatment of issuance costs or regulatory amortisation. Therefore, the balances disclosed will not reconcile to other amounts disclosed in this document.

Tier 1 capital

Tier 1 capital is comprised of shareholders' equity and related non-controlling interests and qualifying capital instruments such as preference shares and hybrid capital securities, after the deduction of certain regulatory adjustments.

	At 31 December	
	2010	2009
Called up share capital	**£m**	£m
HSBC Bank plc ordinary shares (of nominal value £1 each)	**797**	797

Further details of the group's called up share capital can be found in *Note 36 – Called up share capital and other equity instruments* of the Notes on the Financial Statements on Pages 182-183 of the HSBC Bank plc *2010 Accounts*.

Preference shares

Preference shares are securities which rank higher than ordinary shares for dividend payments and in the event of a winding-up, but generally carry no voting rights. To qualify as capital for regulatory purposes these instruments must have no stated maturity date but may be called and redeemed by the issuer, subject to prior notification to the FSA, and, where relevant, the consent of the local banking regulator. There must also be no obligation to pay a dividend, and (if not paid) the dividend may not cumulate. Dividends on the floating rate preference shares are generally related to interbank offer rates. The following table lists the qualifying preference shares in issue as at 31 December 2010 together with 31 December 2009 comparatives:

	At 31 December	
	2010	2009
Perpetual non-cumulative preference share capital	**£000**	£000
HSBC Bank plc non-cumulative third dollar preference shares	**172**	172

Further details of the group's preference share capital can be found in *Note 36 – Called up share capital and other equity instruments* of the Notes on the Financial Statements on Pages 182-183 of the HSBC Bank plc *2010 Accounts*.

Terms and conditions of capital securities

Hybrid capital

Hybrid capital securities are deeply subordinated securities, with some equity features that can be included as tier 1 capital. Hybrid capital securities are issues of securities for which there is no obligation to pay a coupon and if not paid, the coupon is not cumulative. Such securities do not generally carry voting rights and rank higher than ordinary shares for coupon payments and in the event of a winding-up. Coupons on the floating rate hybrid capital securities are generally related to interbank offer rates. The securities may be called and redeemed by the issuer, subject to prior notification to the FSA, and, where relevant, the consent of the local banking regulator. If not redeemed, coupons payable may step-up and become floating rate or, fixed rate for a further five years based on the relevant reference security plus a margin. The following table lists the qualifying hybrid capital securities in issue as at 31 December 2010 together with 31 December 2009 comparatives:

		At 31 December	
		2010	2009
	Hybrid Capital Securities	**£m**	£m
€900m	7.75% Non-cumulative Subordinated Notes 2040	**775**	799
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities	**700**	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities	**279**	254
		1,754	1,753

Further details of the terms of these 3 issues can be found in *Note 30 – Subordinated Liabilities* of the Notes on the Financial Statements on Pages 168-169 of the HSBC Bank plc *2010 Accounts*.

Tier 2 capital

Tier 2 capital comprises qualifying subordinated loan capital, related non-controlling interests, allowable collective impairment allowances, unrealised gains arising on the fair valuation of equity instruments held as available-for-sale and reserves arising from the revaluation of properties. Tier 2 capital is divided into two tiers: upper and lower tier 2.

Upper tier 2 capital

Upper tier 2 securities are subordinated loan capital that do not have a stated maturity date but may be called and redeemed by the issuer, subject to prior notification to the FSA, and, where relevant, the consent of the local banking regulator. Interest coupons on the floating rate upper tier 2 securities are generally related to interbank offer or mid rates and in some cases may be subject to a minimum rate payable. Upper tier 2 capital may also include, for regulatory purposes, some preference share securities not meeting the full GENPRU requirements for inclusion in the tier 1 capital base. The following table lists the qualifying upper tier 2 securities in issue as at 31 December 2010 together with 31 December 2009 comparatives. It includes perpetual debt securities which are classified as other equity instruments in the HSBC Bank plc *2010 Accounts*:

		At 31 December	
		2010	2009
	Perpetual subordinated loan capital and other Upper Tier 2 instruments	**£m**	£m
£750m	HSBC Bank plc 7.884% perpetual subordinated debt	**750**	750
£500m	HSBC Bank plc perpetual subordinated debt	**500**	500
£500m	HSBC Bank plc perpetual subordinated debt	**500**	500
US$750m	Undated Floating Rate Primary Capital Notes	**483**	462
US$500m	Undated Floating Rate Primary Capital Notes	**322**	308
US$300m	Undated Floating Rate Primary Capital Notes (Series 3)	**193**	185
£350m	7.9% Perpetual Subordinated Debt	**-**	350
£250m	7.991% Perpetual Subordinated Debt	**-**	250
	Other perpetual subordinated loan capital	**14**	14
		2,762	3,319

Further details of the terms of the HSBC Bank plc perpetual subordinated debt can be found in *Note 36 – Called up share capital and other equity instruments* of the Notes on the Financial Statements on Pages 182-183 of the HSBC Bank plc *2010 Accounts*. Further details of the group's other perpetual subordinated debt issues can be found in *Note 30 – Subordinated Liabilities* of the Notes on the Financial Statements on Pages 168-169 of the HSBC Bank plc *2010 Accounts*.

Terms and conditions of capital securities

Lower tier 2 capital

Lower tier 2 capital comprises dated subordinated loan capital repayable at par on maturity (in certain cases at a premium over par) and which have an original maturity of at least five years. Some subordinated loan capital may be called and redeemed by the issuer, subject to prior notification to the FSA, and, where relevant, the consent of the local banking regulator. If not redeemed, interest coupons payable may step-up or become floating rate related to inter-bank offer rates and in some cases may be subject to a floor. Lower tier 2 capital may also include, for regulatory purposes, some preference share or undated capital securities not meeting the full GENPRU requirements for inclusion in the capital base as either tier 1 or upper tier 2 capital. For regulatory purposes, it is a requirement that lower tier 2 securities be amortised on a straight-line basis in their final five years of maturity thus reducing the amount of capital that is recognised for regulatory purposes. The following table lists the qualifying lower tier 2 securities in issue as at 31 December 2010 together with 31 December 2009 comparatives:

		At 31 December	
		2010	2009
	Term subordinated loan capital and other Tier 2 instruments	**£m**	£m
€1,000m	Floating Rate Subordinated Loan 2017	**862**	888
€800m	Callable Subordinated Floating Rate Notes 2016	**689**	710
US$1,000m	Floating Rate Subordinated Loan 2020	**644**	-
US$977m	Floating Rate Subordinated Loan 2040	**629**	-
£600m	4.75% Subordinated Notes 2046	**592**	592
€600m	4.25% Callable Subordinated Notes 2016	**530**	557
£500m	4.75% Callable Subordinated Notes 2020	**499**	484
£500m	5.375% Subordinated Notes 2033	**469**	478
£390m	6.9% Subordinated Loan 2033	**390**	390
€500m	Callable Subordinated Floating Rate Notes 2020	**381**	394
£350m	Callable Subordinated Variable Coupon Notes 2017	**362**	375
£350m	5% Callable Subordinated Notes 2023	**353**	339
£350m	5.375% Callable Subordinated Step-up Notes 2030	**329**	327
£300m	6.5% Subordinated Notes 2023	**297**	298
£225m	6.25% Subordinated Notes 2041	**224**	224
US$300m	7.65% Subordinated Notes 2025	**220**	192
€250m	Floating Rate Subordinated Loan 2015	**215**	222
US$300	6.95% Subordinated Notes 2011	**200**	198
	Other Subordinated Liabilities less than £100m	**416**	426
		8,301	7,094

Further details of the group's term subordinated debt can be found in *Note 30 – Subordinated Liabilities* of the Notes on the Financial Statements on Pages 168-169 of the HSBC Bank plc *2010 Accounts*.

Glossary

Terms	Definition
Available-for-sale financial assets	Those non-derivative financial assets that are in terms of IFRS not classified as a) loans and receivables b) held-to-maturity investments or c) financial assets at fair value through profit or loss.
Bail-in provisions	Terms in the documentation of a capital instrument which are designed to enforce its conversion into a more permanent and loss-absorbent form of capital (usually common equity) at the point that the issuer experiences financial distress at the discretion of the regulator.
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
Basel III	In December 2010, the Basel Committee issued final rules 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'. Together these documents present the Basel Committee's reforms to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The new requirements will be phased in starting 1 January 2013 with full implementation by 1 January 2019.
BIPRU	The FSA's rules, as set out in Prudential Sourcebook for Banks, Building Societies and Investment Firms.
Capital conservation buffer	A capital buffer, prescribed by regulators under Basel III, and designed to ensure banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. Should a bank's capital levels fall within the capital conservation buffer range, capital distributions will be constrained by the regulators.
Common equity tier 1 capital and Common equity	The highest quality form of regulatory capital under Basel III. It comprises common shares issued and related share premium, retained earnings and other reserves excluding the cashflow hedging reserve, less specified regulatory adjustments.
Contingent capital	A form of capital which will convert automatically under certain conditions (e.g. breach of a defined capital ratio) into a more permanent and loss-absorbent form (usually common equity).
Core tier 1 capital	The highest quality form of regulatory capital. It comprises total shareholders' equity and related non-controlling interests, less goodwill and intangible assets, and certain other regulatory adjustments.
Countercyclical capital buffer	A capital buffer, prescribed by regulators under Basel III, which aims to ensure capital requirements take account of the macro-economic environment in which banks operate. The buffer will provide additional capital to protect the banking sector against the increased potential for future losses which arises when excess credit growth in the financial system as a whole is associated with an increase in system-wide risk.
Derivatives	A derivative is a financial instrument whose value is based on the performance of one or more underlying assets, for example bonds or currencies.
ECAI	External Credit Assessment Institution, such as Moody's Investors Service, Standard & Poor's Ratings Group or Fitch Group.
Economic capital	The internally calculated capital requirement which is deemed necessary by the group to support the risks to which it is exposed at a confidence level consistent with a target credit rating of AA.

Glossary

Terms	Definition
Expected loss ('EL') (regulatory)	A regulatory measure of the amount expected to be lost on an exposure using a 12 month time horizon and downturn loss estimates. EL is calculated by multiplying the Probability of Default (a percentage) by the Exposure at Default (an amount) and Loss Given Default (a percentage).
Exposure	A claim, contingent claim or position which carries a risk of financial loss.
Exposure at default ('EAD') and Exposure value	The amount expected to be outstanding after any credit risk mitigation, if and when a counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn commitments and contingent exposures, and is usually measured over a 12 month horizon.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
FSA	The Financial Services Authority of the United Kingdom.
GENPRU	The FSA's rules, as set out in the General Prudential Sourcebook.
Held-to-maturity	An accounting classification for investments acquired with the intention of being held until they mature.
Institutions	Under the Standardised approach, Institutions are classified as credit institutions or investment firms. Under the IRB approach, Institutions also include regional governments and local authorities, public sector entities and multilateral development banks.
Insurance risk	A risk, other than financial risk, transferred from the holder of a contract to the insurance provider. The principal insurance risk is that, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income.
Internal Capital Adequacy Assessment Process	The group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
Internal ratings-based approach ('IRB')	A method of calculating credit risk capital requirements using internal, rather than supervisory, estimates of risk parameters.
IRB advanced approach	The IRB advanced approach is a method of calculating credit risk capital requirements using internal PD, LGD and EAD models.
IRB foundation approach	The IRB foundation approach is a method of calculating credit risk capital requirements using internal PD models but supervisory estimates of LGD and conversion factors for the calculation of EAD.
Leverage ratio	A measure, prescribed by regulators under Basel III, which is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and should generally follow the accounting measure of exposure. This supplementary measure to the risk based capital requirements is intended to constrain the build-up of excess leverage in the banking sector.
Liquidity risk	The risk that the bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loss given default ('LGD')	The estimated ratio (percentage) of the economic loss on an exposure to the amount outstanding at default (EAD) upon default of a counterparty.
Probability of default ('PD')	The probability that an obligor will default within a one-year time horizon.

Glossary

Terms	Definition
Qualifying revolving retail exposures	Retail IRB exposures not exceeding €100k that are revolving, unsecured, and (to the extent they are not drawn) immediately and unconditionally cancellable, such as credit cards.
Regulatory capital	The capital which the bank holds, determined in accordance with rules established by the FSA (in the case of the bank and the consolidated group) and by local regulators (for individual group companies).
Retail IRB	Retail exposures that are treated under the IRB approach.
Risk appetite	An assessment of the types and quantum of risks to which HSBC wishes to be exposed.
Risk-weighted assets ('RWA')	Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure in accordance with the applicable rules.
Securitisation	A transaction or scheme whereby the credit risk associated with an exposure, or pool of exposures, is tranched and where payments to investors in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures. A traditional securitisation involves the transfer of the exposures being securitised to an SPE which issues securities. In a synthetic securitisation, the tranching is achieved by the use of credit derivatives and the exposures are not removed from the balance sheet of the originator.
Special Purpose Entity ('SPE')	A corporation, trust or other non-bank entity, established for a narrowly defined purpose, including for carrying on securitisation activities. The structure of the entity and activities are intended to isolate the obligations of the SPE from those of the originator and the holders of the beneficial interests in the securitisation.
Standardised approach	In relation to credit risk, a method for calculating credit risk capital requirements using ECAI ratings and supervisory risk weights. In relation to operational risk, a method of calculating the operational capital requirement by the application of defined percentage charges to the three year average gross income of eight specified business lines.
Standard market risk PRR rules	The FSA's rules regarding the calculation of market risk capital requirements for trading book exposures which are not subject to VAR model permissions. The rules divide risks into a number of standard types, within which risk is measured by the application of defined percentage charges to both net & gross exposures.
Tier 1 capital	A component of regulatory capital, comprising core tier 1 capital and other tier 1 capital. Other Tier 1 capital includes qualifying hybrid capital instruments such as non-cumulative perpetual preference shares and innovative Tier 1 securities.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated loan capital, related non-controlling interests and allowable collective impairment allowances. Tier 2 capital also includes reserves arising from unrealised gains on the fair valuation of equity instruments held as available-for-sale and on the revaluation of properties.
Value at risk ('VAR')	A technique that measures the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.

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