2011

Consolidated Financial Statements
HSBC Bank Bermuda Limited

HSBC

HSBC BANK BERMUDA LIMITED

Consolidated Financial Statements and Audit Report for the year ended 31 December 2011

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Independent Auditors' Report

To the Board of Directors and Shareholder of
HSBC Bank Bermuda Limited

We have audited the accompanying consolidated financial statements of HSBC Bank Bermuda Limited and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as at 31 December 2011, and the consolidated income statement, and consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statement present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2011, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Chartered Accountants
Hamilton, Bermuda
22 February 2012

Consolidated Income Statement
for the year ended 31 December 2011

	Notes	**2011 US$000**	2010 US$000
Interest income		287,240	251,569
Interest expense		(22,776)	(14,795)
Net interest income	3	264,464	236,774
Fee income		146,538	239,483
Fee expense		(21,758)	(22,035)
Net fee income	3	124,780	217,448
Dealing profits		32,732	30,262
Gains less losses from financial investments	12	5,257	5,312
Dividend income		297	543
Net earned insurance premiums	4	-	86,629
Other operating income		966	6,899
Total operating income		428,496	583,867
Net insurance claims and underwriting expenses incurred	5	-	(43,496)
Net operating income before loan impairment charges		428,496	540,371
Loan impairment charges	11	(37,855)	(10,757)
Net operating income		390,641	529,614
Employee compensation and benefits	6,7	(148,274)	(192,752)
General and administrative expenses		(65,702)	(98,814)
Depreciation and impairment of property, plant and equipment	14,17	(22,657)	(16,879)
Total operating expenses		(236,633)	(308,445)
Operating profit		154,008	221,169
Gains less losses on disposal of property, plant and equipment and subsidiary investments	18	807	33,305
Share of loss in associates	16	(562)	(497)
Profit before tax		154,253	253,977
Tax expense	8	(2,391)	(6,947)
Profit for the year		151,862	247,030
Less: Profit from discontinued operations (net of income tax)	19	-	(26,701)
Profit for the year from continuing operations		151,862	220,329

The accompanying notes are an integral part of the Consolidated Financial Statements

Consolidated Statement of Comprehensive Income
for the year ended 31 December 2011

	Notes	**2011 US$000**	2010 US$000
Profit for the year		151,862	247,030
Other comprehensive expense			
Available-for-sale valuation losses		(35,539)	(2,489)
Exchange differences arising from net investments in foreign operations		-	(26,008)
Actuarial losses on defined benefit plans	*6*	(13,472)	(7,643)
Other movements		1,158	5,945
Other comprehensive expense for the year		(47,853)	(30,195)
Total comprehensive income for the year		104,009	216,835

The accompanying notes are an integral part of the Consolidated Financial Statements

Consolidated Balance Sheet
at 31 December 2011

	Notes	2011 US$000	2010 US$000
ASSETS			
Cash and balances at central banks		33,753	29,025
Items in the course of collection from other banks		526	522
Derivatives	9	12,981	7,922
Loans and advances to banks	10	4,438,287	4,890,172
Loans and advances to customers	11	3,598,052	3,237,846
Financial investments	12	6,444,106	3,055,509
Assets held for sale	19	42,228	266,916
Prepayments and accrued income		60,710	50,621
Deferred tax assets	8	53	67
Other assets		19,952	17,527
Interests in associates	16	1,181	1,743
Property, plant and equipment	14	198,969	237,619
Goodwill	15	29,866	51,342
Total assets		14,880,664	11,846,831
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		67,506	34,519
Customer accounts		12,929,931	9,707,014
Items in the course of transmission to other banks		7,335	10,642
Derivatives	9	16,145	8,196
Liabilities held for sale	19	-	34,119
Accruals and deferred income		61,296	63,495
Current tax liabilities		1,175	16,960
Other liabilities		36,383	37,324
Retirement benefit liabilities	6	67,013	51,497
Total liabilities		13,186,784	9,963,766
Equity			
Called up share capital	29	30,027	30,027
Share premium	29	388,652	388,652
Other reserves		5,981	43,982
Retained earnings		1,269,220	1,420,404
Total equity		1,693,880	1,883,065
Total liabilities and equity		14,880,664	11,846,831

The accompanying notes are an integral part of the Consolidated Financial Statements

John D. Campbell
Chairman

Philip Butterfield

Philip M. Butterfield
Director

Consolidated Statement of Cash Flows

for the year ended 31 December 2011

	2011 US$000	2010 US$000
Cash flows from operating activities		
(Loss) profit before tax, interest and dividends	(110,508)	16,660
Interest received	273,663	242,522
Interest paid	(22,534)	(17,568)
Adjustments for:		
Non-cash items in profit before tax, interest and dividends	49,450	20,140
Change in loans and advances to customers	(360,206)	(181,968)
Change in net derivatives	2,890	2,053
Change in other operating assets	22,539	260,038
Change in deposits by banks	32,987	(91,213)
Change in customer accounts	3,222,916	1,486,213
Change in other operating liabilities	(21,971)	(16,517)
Net gain from investing activities	(246,889)	(35,241)
Tax paid	(18,176)	(5,266)
Net cash flows from operating activities	2,824,161	1,679,853
Cash flows from investing activities		
Dividends received	297	543
Purchase of financial investments	(7,586,259)	(1,167,716)
Proceeds from the sale and maturity of financial investments	4,138,581	820,545
Purchase of property, plant and equipment	(2,374)	(21,268)
Proceeds from the sale of property, plant and equipment	1,072	5,759
Net cash inflow from disposal of subsidiaries	252,146	336,226
Change in assets held for sale	224,688	(251,806)
Net cash flows used in investing activities	(2,971,849)	(277,717)
Cash flows from financing activities		
Dividends paid	(292,040)	(140,300)
Net cash flows used in financing activities	(292,040)	(140,300)
Net (decrease) increase in cash and cash equivalents	(439,728)	1,261,836
Cash and cash equivalents at the beginning of the year	4,909,077	3,668,670
Effect of exchange rate changes on cash and cash equivalents	(4,118)	(21,429)
Cash and cash equivalents at the end of the year	4,465,231	4,909,077
Cash and cash equivalents comprise		
Cash and balances at central banks	33,753	29,025
Items in the course of collection from other banks	526	522
Loans and advances to banks	4,438,287	4,890,172
Items in the course of transmission to other banks	(7,335)	(10,642)
Total cash and cash equivalents	4,465,231	4,909,077

The accompanying notes are an integral part of the Consolidated Financial Statements

Consolidated Statement of Changes in Equity
for the year ended 31 December 2011
(In US dollar thousands)

	Called up share capital	Share premium	Other reserves: Available-for-sale fair value reserve	Other reserves: Foreign exchange reserve	Other reserves: Share based payment reserve	Other reserves: Other reserves	Retained earnings	Total equity
At 1 January 2010	**30,027**	**388,652**	**43,181**	**26,655**	**4,866**	**61**	**1,316,619**	**1,810,061**
Comprehensive income, net of income tax								
Profit for the year	-	-	-	-	-	-	247,030	247,030
Available-for-sale valuation losses	-	-	(2,489)	-	-	-	-	(2,489)
Exchange differences arising from net investments in foreign operations	-	-	-	(26,008)	-	-	-	(26,008)
Actuarial losses on defined benefit plans	-	-	-	-	-	-	(7,643)	(7,643)
Other movements	-	-	-	-	-	1,247	4,698	5,945
Total comprehensive income, net of income tax	-	-	(2,489)	(26,008)	-	1,247	244,085	216,835
Transactions with the shareholder recorded directly in equity								
Dividends	-	-	-	-	-	-	(140,300)	(140,300)
Share based plan movements	-	-	-	-	(3,531)	-	-	(3,531)
Total transactions with the shareholder recorded directly in equity	-	-	-	-	(3,531)	-	(140,300)	(143,831)
At 31 December 2010	**30,027**	**388,652**	**40,692**	**647**	**1,335**	**1,308**	**1,420,404**	**1,883,065**
Comprehensive income, net of income tax								
Profit for the year	-	-	-	-	-	-	151,862	151,862
Available-for-sale valuation losses	-	-	(35,539)	-	-	-	-	(35,539)
Actuarial losses on defined benefit plans	-	-	-	-	-	-	(13,472)	(13,472)
Other movements	-	-	-	-	-	(1,308)	2,466	1,158
Total comprehensive income, net of income tax	-	-	(35,539)	-	-	(1,308)	140,856	104,009
Transactions with the shareholder recorded directly in equity								
Dividends	-	-	-	-	-	-	(292,040)	(292,040)
Share based plan movements	-	-	-	-	(1,154)	-	-	(1,154)
Total transactions with the shareholder recorded directly in equity	-	-	-	-	(1,154)	-	(292,040)	(293,194)
At 31 December 2011	**30,027**	**388,652**	**5,153**	**647**	**181**	**-**	**1,269,220**	**1,693,880**

The accompanying notes are an integral part of the Consolidated Financial Statements

1 Basis of preparation

(a) General

Effective 3 May 2010, The Bank of Bermuda Limited changed its legal name to HSBC Bank Bermuda Limited. HSBC Bank Bermuda Limited (the 'Bank') was established in 1889 and incorporated in 1891. The address of its registered office is 6 Front Street, Hamilton HM11, Bermuda. The consolidated financial statements of the Bank for the year ended 31 December 2011 comprise the Bank and its subsidiaries (together referred to as the 'group') and the group's interests in associates. The Bank is domiciled in Bermuda and provides retail and corporate banking, investment, trust, custody and fund administration services to international and local clients. The immediate parent company of the Bank is HSBC Asia Holdings BV. The ultimate parent company is HSBC Holdings plc ('HSBC'). Copies of the financial statements of HSBC Holdings plc may be obtained from its registered office at 8 Canada Square, London, England, E14 5HQ, or from the HSBC website, www.hsbc.com.

These consolidated financial statements are authorised for issue by the Board of Directors on 22 February 2012.

The consolidated financial statements are presented in US dollars, which is the presentational currency of the group. The functional currency of the group is primarily Bermuda dollars. Bermuda dollars are translated into US dollars at par. All amounts and figures are rounded to the nearest thousand, except where explicitly stated.

The group has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ('IFRSs'). IFRSs comprise accounting standards issued by the International Accounting Standards Board ('IASB') and its predecessor body, as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

Certain reclassifications have been made to the 2010 comparative financial information in order to conform to the current year presentation.

These consolidated financial statements are presented in accordance with IAS 1 'Presentation of Financial Statements'. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of the group's net income, financial position and cash flows for the years ended 31 December 2011 and 31 December 2010 have been made. In accordance with IFRS 8 'Operating Segments', no segment information has been presented as the shares of the group are not publicly traded.

During 2011, the group adopted a number of interpretations and amendments which had an insignificant effect on the consolidated financial statements.

(b) Basis of consolidation

Entities that are controlled by the Bank are consolidated. Subsidiaries are consolidated from the date the group gains control, until the date that control ceases. The acquisition method of accounting is used when subsidiaries are acquired. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the consolidated income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregation of the consideration transferred, the amount of non-controlling interest and the fair value of the acquirer's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. In a business combination achieved in stages, the previously held equity interest is remeasured at the acquisition-date fair value with resulting gain or loss recognised in the consolidated income statement or other comprehensive income as appropriate. In the event that the fair value of net assets acquired is in excess of the aggregation of the consideration transferred, the amount of non-controlling interest and the fair value of the previously held equity interest, the difference is recognised immediately in the consolidated income statement.

All intra-group transactions are eliminated on consolidation. The consolidated financial statements of the group include the attributable share of the results of any interests in associates.

(c) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from estimates upon which financial information is prepared. Management believes that the critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, goodwill impairment, fair value of assets held for sale, liabilities under insurance contracts issued, the valuation of financial instruments, the impairment of available-for-sale financial assets and deferred tax assets.

Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in these notes on the consolidated financial statements.

(d) Future accounting developments – Standards and Interpretations issued by the IASB

(i) IFRS 9 'Financial Instruments'

In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued additions to IFRS 9 relating to financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

The standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively. If the standard is adopted prior to 1 January 2015, an entity will be exempt from the requirement to restate prior period comparative information.

The group is currently assessing the impact of this new IFRS.

(ii) IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of Interests in Other Entities'

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements' ('IFRS 10'), IFRS 11 'Joint Arrangements' ('IFRS 11') and IFRS 12 'Disclosure of Interests in Other Entities' ('IFRS 12'). The standards are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are to be applied retrospectively.

Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on rights and obligations than on legal form, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

The group is currently assessing the impact of these new IFRSs, however they are not expected to have a significant impact on these consolidated financial statements.

(iii) IFRS 13 'Fair Value Measurement'

In May 2011, the IASB issued IFRS 13 'Fair Value Measurement' ('IFRS 13'). This standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

The group is currently assessing the impact of this new IFRS however it is not expected to have a significant impact on these consolidated financial statements.

(iv) IAS 19 'Employee Benefits'

In June 2011, the IASB issued amendments to IAS 19 'Employee Benefits' ('IAS 19 revised'). The revised standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IAS 19 revised must be applied retrospectively.

The most significant amendment to IAS 19 for the group is the replacement of interest cost and expected return on plan assets with a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement will be presented in other comprehensive income. The effect of this change is to increase the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

The group is currently assessing the effect of this new standard.

2 Significant accounting policies

(a) Interest income and expense

Interest income and expense for all interest-bearing financial instruments is recognised in 'Interest income' and 'Interest expense' in the consolidated income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(b) Non-interest income

(i) *Fee income*

Fee income is earned from a diverse range of services provided by the group to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third-party, such as the arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and is recorded in 'Interest income' (Note 2a).

(ii) *Dealing profits*

Dealing profits comprise exchange differences on translation of monetary assets and liabilities denominated in foreign currencies and commissions earned on foreign exchange trading transactions. Dealing profits also include gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting.

(iii) *Dividend income*

Dividend income is recognised net of withholding taxes when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(c) Cash and cash equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months maturity from the date of acquisition, and include cash and balances at central banks, loans and advances to banks and items in the course of collection from or in transmission to other banks.

(d) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the group, which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value through profit and loss. Loans and advances are recognised when cash is advanced to borrowers. They are initially recorded at fair value plus any net directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses.

When the group purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date ("reverse repo" or "stock borrowing"), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the group's consolidated financial statements.

(e) Impairment of loans and advances

Losses for impaired loans are recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the consolidated income statement. The carrying amount of impaired loans on the consolidated balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

(i) Individually assessed loans and advances

The factors considered in determining that a loan is individually significant for the purposes of assessing impairment include:

- the size of the loan;
- the number of loans in the portfolio;
- the importance of the individual loan relationship, and how this is managed; and
- whether volumes of defaults and losses are sufficient to enable a collective assessment methodology to be applied.

Loans considered as individually significant are typically to corporate and commercial customers and are for larger amounts, which are managed on an individual relationship basis. Retail lending portfolios are generally assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogeneous loans.

For all loans that are considered individually significant, the group assesses, on a case-by-case basis at each balance sheet date, whether there is any objective evidence that a loan is impaired. The criteria used by the group 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 realisation; and
- a significant downgrading in credit rating by an external credit rating agency.

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the group and the likelihood of other creditors continuing to support the customer;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

- the realisable value of security (or other collateral) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain and make payments in the relevant currency if loans are not in local currency; and
- when available, the secondary market price for the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly, and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(ii) Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss arises from individual loan impairment at the balance sheet date, which will only be identified in the future.

The collective impairment loss is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio.

Homogeneous groups of loans and advances

For homogeneous groups of loans that are not considered individually significant, allowances are determined on a portfolio basis. Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan assessment is impracticable. Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group.

Historical loss rate experience and other historical data, including an evaluation of current economic conditions, are considered to calculate the appropriate level of allowance to cover inherent loss. Loss rates are regularly benchmarked against actual outcomes to ensure they remain appropriate.

(iii) Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

(iv) Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was initially recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the consolidated income statement.

(v) Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets 'held for sale' and no depreciation is provided in respect of these assets. Assets acquired are recorded at fair value less estimated disposal costs at the date of exchange. Any subsequent decrease in the fair value of the acquired assets is recorded as an impairment loss and included in the consolidated income statement. Any subsequent increase in the fair value of the acquired assets, to the extent this does not exceed the cumulative impairment loss, is recognised in the consolidated income statement.

(vi) Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once the minimum number of payments required under the new arrangements have been received. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

(f) Financial investments

Treasury bills, debt securities and equity securities intended to be held on a continuing basis are classified as 'available-for-sale' securities. Financial investments are recognised on the trade date when the group enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

Available-for-sale financial assets are initially measured at fair value plus directly attributable transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in the 'Available-for-sale fair value reserve', until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative unrealised gains or losses previously recognised in other comprehensive income are recognised in the consolidated income statement as 'Gains less losses from financial investments'.

Interest income is recognised on available-for-sale debt securities using the effective interest method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of fixed maturity investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the consolidated income statement when the right to receive payment has been established.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the consolidated income statement, is removed from other comprehensive income and recognised in the consolidated income statement.

Impairment losses for available-for-sale securities are recognised within 'Gains less losses from financial investments' in the consolidated income statement.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the consolidated income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed through the consolidated income statement up to the amount of the impairment loss previously recognised in the consolidated income statement;

- For an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the consolidated income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the consolidated income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

(g) Valuation of financial instruments

For available-for-sale securities that are quoted in active markets, fair values are determined by reference to the current quoted bid prices. Where independent prices are not available, fair values may be determined using valuation techniques with reference to observable market data. These include comparison to similar instruments where market observable prices exist, discounted cash flow analysis and other valuation techniques commonly used by market participants. Fair values of financial instruments may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data, where current prices or observable market data are not available.

A three level fair value hierarchy, which reflects the significance of observable market inputs, is used when estimating fair values:

- *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 and financial instruments valued using models where all significant inputs are observable.
- *Level 3 - valuation technique with significant unobservable inputs*: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

(h) Securities lending and borrowing

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of the securities to counterparties is not normally reflected on the consolidated balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

(i) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, the group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, the group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The group also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised, in which case, it is released to the income statement immediately.

Hedge effectiveness testing

To qualify for hedge accounting, the group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by an entity to assess hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80% to 125%.

Hedge ineffectiveness is recognised in the income statement in 'Dealing profits'.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in 'Dealing profits'.

(j) Derecognition of financial assets and financial liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when the group has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- the group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, is cancelled, or expires.

(k) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(l) Subsidiaries and associates

The group classifies investments in entities which it controls as subsidiaries.

Interests in associates, which include entities the group has significant influence over but are not subsidiaries, are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and adjusted thereafter for the post-acquisition change in the group's share of net assets.

Profits on transactions between the group and its associates are eliminated to the extent of the group's interests in the associates. Losses are also eliminated to the extent of the group's interests in the associates unless the transaction provides evidence of an impairment of the asset transferred.

(m) Property, plant and equipment

Land and buildings are stated at historical cost except land and buildings held at 1 March 2004, the date of transition to IFRSs. The cost of these land and buildings is the fair value at the transition date. Depreciation is calculated using the straight-line method to write off the cost less residual value of the assets over the estimated useful lives as follows:

Freehold land	not depreciated
Buildings	lesser of 50 years or the remaining useful lives
Leasehold improvements	lesser of life of the lease or the remaining useful lives
Equipment, fixtures and fittings	3 – 7 years

Property, plant and equipment are subject to impairment review if there are events or changes in circumstances indicating that the carrying amounts may not be recoverable.

(n) Goodwill

Goodwill that arises from business combinations is measured as described in Note 1 (b).

Goodwill is tested annually for impairment, is carried at cost less accumulated impairment losses and is subject to impairment review if there are events or changes in circumstances indicating that the carrying amounts may not be recoverable. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill on the acquisition of associates is included in 'Interests in associates'. At the date of disposal of a business, attributable goodwill is included in the group's share of net assets in the calculation of the gain or loss on disposal.

(o) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When the group is a lessee under finance leases, the leased assets are capitalised and included in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments.

All other leases are classified as operating leases. When acting as lessor, the group includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the assets are thereby impaired. When the group is the lessee, leased assets are not recognised on the consolidated balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income', respectively.

(p) Income tax

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is also recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantially enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the group intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the consolidated balance sheet and the amount attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group, relate to income taxes levied by the same taxation authority and a legal right to offset exists in the group.

(q) Pension and other post-employment benefits

The group operates defined contribution pension plans and defined benefit pension plans, as well as a post-employment healthcare benefits plan.

(i) Defined contribution pension plans

Payments to the defined contribution pension plans are charged as an expense as they fall due. The group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

(ii) Defined benefit pension plans

The costs recognised for funding defined benefit pension plans are determined using the Projected Unit Credit Method, with annual actuarial valuations performed on each plan. Actuarial differences that arise are recognised directly in retained earnings and presented in the consolidated statement of comprehensive income in the period they arise. Past service costs are recognised immediately to the extent the benefits are vested, and are otherwise recognised on a straight-line basis over the average service period until the benefits vest. The current service costs and any past service costs together with the expected return on plan assets less the unwinding of the discount on the plan liabilities are charged to operating expenses under 'Employee compensation and benefits'. Actuarial gains and losses on defined benefit plans are recognised in other comprehensive income in the period in which they arise.

The net defined benefit pension liability recognised in the consolidated balance sheet represents the present value of the defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any resulting asset from this is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

(iii) Post-employment healthcare benefits plan

The costs of providing other post-employment benefits such as post-employment healthcare are accounted for on the same basis as defined benefit pension plans.

(r) Share-based payments

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the 'Share-based payment reserve' in equity. The vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined using appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions include service conditions and performance conditions; any other features of a share-based payment arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the estimated number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

(s) Foreign currencies

(i) Transactions and balances

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the consolidated income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised directly in other comprehensive income if the gain or loss on the non-monetary item is recognised directly in other comprehensive income. Any exchange component of a gain or loss on a non-monetary item is recognised directly in the consolidated income statement if the gain or loss on the non-monetary item is recognised in the consolidated income statement.

(ii) Group entities

The results and financial positions of all group entities (none of which has the currency of a hyperinflationary economy) that have functional currencies different from the presentation currency are translated into the presentation currency as follows:

– assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
– income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated using exchange rates at the dates of the transactions); and
– all resulting exchange differences are recognised as a separate component of other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are recognised in the 'Foreign exchange reserve' in other comprehensive income. When a foreign operation is sold, such exchange differences are recognised in the consolidated income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(t) Customer accounts

Customer accounts are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

(u) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and for which a reliable estimate can be made of the amount of the obligation.

(v) Insurance contracts

Prior to the disposal of HSBC Insurance (Bermuda) Limited in 2010, the group issued contracts to affiliates that contain insurance risk, financial risk or a combination thereof. An insurance contract is defined as a contract under which the insurer accepts significant insurance risk from another party, by agreeing to compensate that party on the occurrence of a specified uncertain future event. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant. Insurance contracts were accounted for as follows:

(i) Premiums

Gross insurance premiums for general insurance business were reported as income over the term of the insurance contract attributable to the risks borne during the accounting period. The unearned premium or the proportion of the business underwritten in the accounting period relating to the period of risk after the balance sheet date was calculated on a daily or monthly pro rata basis.

Reinsurance premiums were accounted for in the same accounting period as the premiums for the direct insurance to which they relate.

(ii) Claims and reinsurance recoveries

Gross insurance claims for general insurance business included paid claims and movements in outstanding claims reserves. The outstanding claims reserves were based on the estimated ultimate cost of all claims that had occurred but not settled at the balance sheet date, whether reported or not, together with related claims handling costs. Reserves for claims incurred but not reported ('IBNR') were adjusted annually based on actuarial valuations, using appropriate statistical techniques.

The benefits to which the group was entitled under its reinsurance contracts held were recognised as reinsurance assets. Amounts recoverable from or due to reinsurers were measured consistently with the reinsured insurance contracts and with the terms of each reinsurance contract. Reinsurance recoveries were accounted for in the same period as the related claim.

(iii) Liabilities under insurance contracts

Outstanding claims liabilities for non-life insurance contracts were based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claim-handling costs and a reduction for the expected value of salvage and other recoveries. Liabilities for claims incurred but not reported were made on an estimated basis, using appropriate statistical techniques.

(w) Fiduciary activities

The group commonly acts as trustee and in other fiduciary capacities resulting in the holding or placing of assets on behalf of individuals, trusts, post-employment benefit plans and other institutions. The assets and liabilities and income and expenditure arising from these assets and liabilities are excluded from the consolidated financial statements, as they are not assets of the group. The group earns a fee for acting in these capacities.

(x) Financial guarantee contracts

Liabilities under financial guarantee contracts which are not classified as insurance contracts are recorded initially at their fair value which is generally the fee received or receivable and are amortised over the lives of the contracts. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations. Financial guarantee contracts are included in 'Other liabilities'.

(y) Trading assets and liabilities

Treasury bills, debt securities, equity securities, loans, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase or sell the financial instruments, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the consolidated income statement. Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in the consolidated income statement in 'Dealing profits'.

(In US dollar thousands) 31 December 2011

3 Net interest income and net fee income

(a) Analysis of net interest income is as follows:

	2011	2010
Interest income		
Financial investments	65,646	67,655
Loans and advances to banks	28,894	15,095
Loans and advances to customers	192,700	168,819
	287,240	251,569
Interest expense		
Deposits by banks	(205)	(276)
Customer accounts	(22,571)	(14,519)
	(22,776)	(14,795)
Net interest income	264,464	236,774

(b) Analysis of net fee income is as follows:

	2011	2010
Custody and fund administration fees	18,842	21,171
Trust fees	26,722	104,564
Banking fees	41,092	39,322
Management fees	37,591	40,409
Other fees	22,291	34,017
Fee income	146,538	239,483
Fee expense	(21,758)	(22,035)
Net fee income	124,780	217,448

4 Net earned insurance premiums

Analysis of net earned insurance premiums is as follows:

	2011	2010
Gross written insurance premiums	-	48,846
Movement in unearned insurance premiums	-	43,212
Gross earned insurance premiums	-	92,058
Gross written insurance premiums ceded to reinsurers	-	(2,487)
Reinsurers' share of movement in unearned premiums	-	(2,942)
Reinsurers' share of gross earned premiums	-	(5,429)
Net earned insurance premiums	-	86,629

All net earned insurance premiums in 2010 related to HSBC Insurance (Bermuda) Limited ('the Captive') which was disposed of effective 1 July 2010 as disclosed in Note 18.

(In US dollar thousands) 31 December 2011

5 Net insurance claims and underwriting expenses incurred

There were no net insurance claims and underwriting expenses incurred in 2011. All net insurance claims and underwriting expenses were incurred in 2010 and related to insurance operations which were disposed of as disclosed in Note 18. The analysis of net insurance claims and underwriting expenses incurred during 2010 is as follows:

	2010		
	Gross	Reinsurance	Net
Non-life insurance			
Current period claims reported	(44,422)	-	(44,422)
Previous periods claims reported	20,405	(15)	20,390
Current period claims paid	(8,785)	-	(8,785)
Previous periods claims paid	(7,620)	-	(7,620)
Underwriting expenses	(3,059)	-	(3,059)
Total insurance claims and underwriting expenses incurred	(43,481)	(15)	(43,496)

6 Employee compensation and benefits

Post-employment benefit plans

Income statement charge

	2011	2010
Defined contribution pension plans	7,347	10,282
Defined benefit pension plans	220	549
Post-employment healthcare benefits plan	3,429	3,973
Total post-employment benefit income statement charge	10,996	14,804

(a) Defined contribution pension plans

The group provides non-contributory defined contribution pension plans to its employees in Bermuda and in the majority of its locations. Employees are able to make additional voluntary payments to the defined contribution pension plans.

The group's expense for the defined contribution pension plans in 2011 was $7,347 (2010: $10,282), of which $6,981 (2010: $8,005) relates to the Bermuda-based plan.

(b) Defined benefit pension plans

HSBC has a funded defined benefit pension plan for certain of its employees in Europe, known as the 'Sterling area' plan. This plan is divided into four regional subsets, namely Isle of Man, Guernsey, Jersey and a fourth subset covering international managers ('Plan B').

The group continues to assume responsibility for the entire Plan B which consists of fourteen individuals (2010: fourteen) and of thirty four individuals (2010: thirty four) previously employed by the Bank of Bermuda (Isle of Man) Limited. The net surplus at 31 December 2011 and 31 December 2010 relates only to the components of the plan over which the group maintains current and future legal responsibility.

The group also has an interest in a funded defined benefit plan relating to eleven individuals (2010: eleven) in Bermuda and the Cayman Islands.

All the group's defined benefit plans are closed plans not subject to new membership from current employees.

Actuarial valuation of the assets and liabilities of the group's defined benefit pension plans are carried out annually to determine their financial position and to ensure that benefit obligations are adequately funded. The group's pension expense for the defined benefit pension plans in 2011 was $220 (2010: expense of $549).

(In US dollar thousands) 31 December 2011

The weighted average principal actuarial financial assumptions used to calculate the defined benefit plans at 31 December are:

	Rate of increase for pensions in payment and deferred pensions	Inflation assumption	Discount Rate	Rate of pay increase
	%	%	%	%
2011	3.2	3.6	4.8	3.6
2010	3.4	4.1	5.4	4.8

The net surplus amount recognised in the consolidated balance sheet in respect of the Sterling area plan is as follows:

	2011	2010
Equities	7,181	7,554
Bonds	8,844	7,593
Property and other	1,776	766
Fair value of plan assets	17,801	15,913
Present value of defined benefit obligations	(17,550)	(15,535)
Net surplus	251	378

The weighted average expected rate of return on assets for 2011 was 5.3% (2010: 6.1%). The basis used to determine the percentage expected rate of return on assets was market conditions at the date of the actuarial valuation. The changes in the present value of the defined benefit obligation in respect of the group's pension plan are presented below.

	2011	2010
At 1 January	15,535	15,702
Current service cost	383	165
Interest cost	905	815
Actuarial (gains) losses	(16)	275
Benefits paid	(661)	(566)
Exchange and other movements	1,404	(856)
At 31 December	17,550	15,535

The changes in the fair value of the group's pension plan assets are presented below.

	2011	2010
At 1 January	15,913	14,961
Expected return	1,027	832
Contributions by the group	1,550	1,078
Actuarial (losses) gains	(314)	430
Benefits paid	(661)	(566)
Exchange and other movements	286	(822)
At 31 December	17,801	15,913

The actual return on plan assets for the year ended 31 December 2011 was a gain of $712 (2010: gain of $1,262).

The total net expense recognised in the consolidated income statement in 'Employee compensation and benefits' in respect of the pension plans comprises:

	2011	2010	2009
Current service cost	(383)	(165)	(184)
Interest cost	(905)	(815)	(850)
Expected return on plan assets	1,027	832	773
Other movements	41	(401)	-
Total net expense	(220)	(549)	(261)

(In US dollar thousands) 31 December 2011

An actuarial loss of $301 (2010: gain of $189) was included in the consolidated statement of comprehensive income for the defined benefit pension plans. The cumulative amount of actuarial losses recognised in the consolidated statement of comprehensive income is $2,685 (2010: $2,384).

Summary

	2011	**2010**	**2009**	**2008**	**2007**
Defined benefit obligations	(17,550)	(15,535)	(15,702)	(12,571)	(5,626)
Fair value of plan assets	17,801	15,913	14,961	11,392	6,115
Net surplus (deficit)	251	378	(741)	(1,179)	489
Actuarial gains (losses) on plan liabilities	16	(275)	(968)	303	119
Actuarial gains (losses) on plan assets	(314)	430	1,669	(3,984)	329
Exchange and other movements	(3)	34	(118)	594	-
Total net actuarial gains (losses)	(301)	189	583	(3,087)	448

(c) Post-employment healthcare benefits plan

The group provides a non-contributory unfunded post-employment healthcare benefits plan for certain Bermuda-based retired employees. To qualify, employees must have a minimum of 15 years of successive service at the date of retirement. Independent, qualified actuaries carry out an actuarial assessment of the liabilities of the plan on an annual basis using the RP-2000 Fully Generational Mortality Improvement Projection table. The liabilities are evaluated by discounting the expected future claims to a net present value.

The latest actuarial assessment was carried out in October 2011 in accordance with IAS 19 'Employee Benefits'. At 31 December 2011, the estimated present value of the post-employment healthcare benefit obligation was $67,264 (2010: $51,875). The main financial assumptions used to estimate the obligation at 31 December 2011 are current and ultimate healthcare claims trend rate of 9.00% and 4.75% per annum respectively (2010: 9.00% and 4.75%) and a discount rate of 4.75% (2010: 5.66%) per annum.

The changes in the present value of the post-employment healthcare benefit obligations are as follows:

	2011	2010
At 1 January	51,875	41,137
Current service cost	1,746	1,720
Interest cost	2,832	2,378
Contributions by employees	1,496	1,075
Actuarial losses	13,171	7,832
Benefits paid	(2,707)	(2,142)
Plan amendments	(168)	(125)
Curtailments	(981)	-
At 31 December	67,264	51,875

The total net expense recognised in the consolidated income statement within 'Employee compensation and benefits' in respect of the post-employment healthcare benefits plan is comprised of:

	2011	2010
Current service cost	(1,746)	(1,720)
Interest cost	(2,832)	(2,378)
Plan amendments	168	125
Curtailments	981	-
Total net expense	(3,429)	(3,973)

Total net actuarial results recognised in the consolidated statement of comprehensive income in 2011 in respect of the post-employment healthcare benefits plan are a loss of $13,171 (2010: loss of $7,832). The total cumulative net actuarial loss to date, which has been recognised in the consolidated statement of comprehensive income, is $13,674 (2010: $503).

(In US dollar thousands) 31 December 2011

The net deficits and the experience adjustments on plan liabilities expressed as an amount and as a percentage of the net deficit for the current and previous annual period are as follows:

	2011	2010
Net obligation	67,264	51,875
Experience adjustments on plan liabilities expressed as an amount	(13,171)	(7,832)
Experience adjustments on plan liabilities expressed as a percentage	(19.6%)	(15.1%)

The actuarial assumptions related to the healthcare cost trend rates may have a significant effect on the amounts recognised. A one-percentage point change in assumed healthcare cost trend rates would have the following effects on amounts recognised in 2011:

	1% increase	1% decrease
Effect on the aggregate of the current service cost and interest cost	1,187	(883)
Effect on present value of the benefit obligation	14,098	(11,376)

7 Share-based payments

During 2011, $4,951 was charged to the consolidated income statement in respect of share-based payment transactions settled in equity (2010: $6,503). This expense, which was computed from the fair values of the share-based payments on transaction dates, arose under employee share awards made in accordance with the group's reward structures. All share plans are based on ordinary $0.50 par value shares in the ultimate parent company HSBC Holdings plc. All exercise prices and fair values of shares and options presented below are exact amounts (not rounded or shown to the nearest thousand).

Calculation of fair values

Fair values of share options/awards, measured at the date of grant of the option/award, are calculated using a Black-Scholes model. When modelling options/awards with vesting dependent on HSBC's Total Shareholder Return ('TSR') over a period, the TSR performance targets are incorporated into the model using Monte Carlo simulation. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

The significant weighted average assumptions used to estimate the fair value of the options granted were as follows:

	1-year Savings-related share option plan	3-year Savings-related share option plan	5-year Savings-related share option plan
2011			
Risk-free interest rate[1] (%)	0.8	1.7	2.5
Expected life[2] (years)	1	3	5
Expected volatility[3] (%)	25	25	25
Share price at grant date ($)	10.47	10.47	10.47
2010			
Risk-free interest rate[1] (%)	0.7	1.9	2.9
Expected life[2] (years)	1	3	5
Expected volatility[3] (%)	30	30	30
Share price at grant date ($)	10.60	10.60	10.60

[1] *The risk-free rate was determined using a similar yield curve to the UK gilts yield curve.*

[2] *The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historical observable data and is not a single input parameter but a function of various behavioural assumptions.*

[3] *Expected volatility is estimated by considering both historic average HSBC Holdings plc share price volatility and implied volatility for traded options over HSBC Holdings plc shares of similar maturity to those of the employee options.*

Expected dividends are incorporated into the valuation model for share options and awards, where applicable. The expected US dollar denominated dividend yield was determined to be 4.5 per cent, in line with consensus analyst forecast (2010: 4.5%).

The HSBC share plan

The HSBC share plan was adopted by HSBC Holdings plc in 2005. Under this plan, performance share awards, restricted share awards and share option awards may be made. The aim of the HSBC share plan is to align the interests of executives with the creation of shareholder value and recognise individual performance and potential. Awards are also made under this plan for recruitment and retention purposes.

Restricted share awards

Restricted shares are awarded to employees on the basis of their performance, potential and retention requirements, to aid retention or as a part-deferral of annual bonuses. Shares are awarded without corporate performance conditions and generally vest between one and three years from the date of award, providing the employees have remained continually employed by the group for this period.

	2011 Number of awards (000s)	2010 Number of awards (000s)
Outstanding at 1 January	1,821	2,097
Granted in the year[1]	319	260
Transferred out from group companies	(457)	(69)
Exercised in the year	(371)	(450)
Forfeited in the year	(43)	(17)
Outstanding at 31 December	1,269	1,821

[1] *Additions during the year include reinvested scrip dividends.*

The weighted average fair value of shares awarded by HSBC for restricted share awards in 2011 was $9.01 (2010: $12.78).

Savings-related share option plans

Savings-related share option plans invite eligible employees to enter into savings contracts to save up to three hundred and fifty (2010: four hundred) dollars per month, with the option to use the savings to acquire shares. The aim of the plans is to align the interests of all employees with the creation of shareholder value. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or fifth anniversaries of the commencement of three-year or five-year savings contracts, respectively. The exercise price is set at a 20 percent discount to the average market value immediately preceding the date of invitation.

	2011		2010	
	Number of options (000s)	**Weighted average exercise price**	Number of options (000s)	Weighted average exercise price
Outstanding at 1 January[1]	984	6.33	1,196	6.63
Granted in the year[2]	119	6.81	211	7.24
Transferred (out) in from group companies	(468)	5.15	7	8.05
Exercised in the year	(43)	6.16	(201)	5.20
Forfeited in the year	(133)	8.01	(229)	9.57
Outstanding at 31 December	459	7.18	984	6.33

[1] *Opening weighted average exercise price adjusted for rights issue.*
[2] *Additions during the year include reinvested scrip dividends.*

The weighted average fair value of options granted during the year was $2.04 (2010: $2.55).

The exercise price range and weighted average remaining contractual life for options outstanding at the balance sheet date were as follows:

	2011	2010
Exercise price range from lowest to highest price ($)	4.58 - 8.76	4.83 - 9.44
Weighted average remaining contractual life (years)	1.4	1.8
Number of options exercisable at year end (in thousands)	23	458
Weighted average exercise price of options exercisable at year end ($)	11.14	8.99

HSBC Holdings plc group share option plan

The HSBC Holdings plc group share option plan was a long-term incentive plan under which certain HSBC employees between 2000 and 2005 were awarded share options. The aim of the plan was to align the interests of those higher performing employees with the creation of shareholder value. This was achieved by setting certain TSR targets which would normally have to be attained in order for the awards to vest. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. The options granted after May 2005 are made under the HSBC share plan.

	2011		2010	
	Number of options (000s)	**Weighted average exercise price**	Number of options (000s)	Weighted average exercise price
Outstanding at 1 January[1]	79	12.11	118	11.09
Transferred out from group companies	(39)	11.26	(1)	3.63
Exercised in the year	-	-	(1)	4.58
Forfeited in the year	(14)	2.95	(37)	9.22
Outstanding at 31 December	26	18.48	79	12.11

[1] *Opening weighted average exercise price adjusted for rights issue.*

The number of options, weighted average exercise price, and weighted average remaining contractual life of options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

	2011	2010
Exercise price range from lowest to highest price ($)	6.02 - 8.40	7.82 - 9.98
Weighted average remaining contractual life (years)	1.00	1.12
Number of options exercisable at year end (in thousands)	26	79

(In US dollar thousands) 31 December 2011

8 Tax expense

Under current Bermuda law the group is not required to pay any corporate taxes in Bermuda on either income or capital gains. The group's income tax expense relates to income from operations and is attributable to the income tax expense of certain overseas subsidiaries. Overseas subsidiary undertakings and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

	2011	2010
Current tax		
Current overseas tax charge	2,391	41,379
Deferred tax		
Origination and reversal of temporary differences	-	(34,432)
Tax expense	2,391	6,947

	2011	2010
Analysis of tax expense		
Taxation at Bermuda corporation tax rate of 0%	-	-
Impact of overseas profits in principal locations taxed at different rates	2,828	22,360
Non taxable income	-	(15,871)
Prior period adjustments	(430)	472
Other items	(7)	(14)
Tax expense	2,391	6,947

	2011	2010
Deferred tax movement		
At 1 January	67	(33,687)
Charge to profit for the year	-	34,432
Movement arising from subsidiary reclassified as held for sale	-	(405)
Exchange differences and other movements	(14)	(273)
Deferred tax assets at 31 December	53	67
Comprising:		
- Accelerated capital allowances	-	11
- Other items	53	56
Deferred tax assets at 31 December	53	67

(In US dollar thousands) 31 December 2011

9 Derivatives

Derivatives are financial instruments that derive their value from the price of an underlying item such as equities, bonds, interest rates, foreign exchange rates, credit spreads, commodities and equity or other indices. Derivatives enable users to increase, reduce or alter exposure to credit or market risks. The group makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks (Note 26).

Derivatives are carried at fair value and shown in the consolidated balance sheet gross. Asset values represent the cost to the group of replacing all transactions with a fair value in the group's favour assuming that the entire group's relevant counterparties default at the same time, and that transactions can be replaced instantaneously. Liability values represent the cost to the group's counterparties of replacing all their transactions with the group with a fair value in their favour if the group were to default. 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.

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of offset exists and the cash flows are intended to be settled on a net basis. Changes in the values of derivatives are recognised in 'Dealing profits' unless they qualify as hedges for accounting purposes.

(a) Use of derivatives

The group uses derivatives for two primary purposes: to create risk management solutions for clients and to manage and hedge the group's own risks. For accounting purposes, derivative instruments are classified as held either for trading or hedging. Derivatives that are held as hedging instruments are formally designated as hedges as defined in IAS 39. All other derivative instruments are classified as held for trading. The held for trading classification includes two types of derivative instruments: those used in sales and trading activities, and those instruments that are used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with matching deals being utilised to achieve this where necessary. When entering into derivative transactions, the group employs the same credit risk management procedures to assess and approve potential credit exposures as are used for traditional lending.

With respect to derivative contracts, the notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

(b) Trading derivatives

The derivative transactions of the group relate to foreign exchange and interest rate sales trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks.

As mentioned above, other derivatives classified as held for trading may include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting.

Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Dealing profits'.

The total of all outstanding contract amounts of derivatives held for trading purposes at 31 December 2011, which are exclusively foreign exchange rate products, amounts to $1,567,899 (2010: $966,922).

The following table summarises the fair values of exchange rate derivatives, comprised of foreign exchange forward and spot contracts, and interest rate swap contracts held for trading purposes:

	2011		2010	
	Assets	**Liabilities**	Assets	Liabilities
Forward contracts	12,643	13,213	7,896	8,193
Spot contracts	206	48	26	3
Trading Derivatives	12,849	13,261	7,922	8,196

(In US dollar thousands) 31 December 2011

A three level fair value hierarchy, which reflects the availability of observable market inputs, is used when estimating fair values. All derivatives are considered Level 2 as they are based upon observable market inputs. There was no netting of derivative assets and liabilities at 31 December 2011 or 31 December 2010. Total exposure to HSBC Group counterparties at 31 December 2011 amounted to $8,266 (2010: $7,064) and cash collateral was $NIL (2010: $NIL). Where the group receives collateral from customers related to outstanding derivative contracts, these comprise cash and cash equivalents, securities and mortgage interests over property. Credit concentrations with large counterparties are controlled though counterparty limits. Credit exposures, incorporating derivative exposures, to single names are capped and monitored by senior management as detailed in Note 26.

(c) Hedging

The group uses derivatives, principally interest rate swaps, for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the group to optimise the overall cost of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

Fair value hedges

The group's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the hedging period.

The fair values of outstanding derivatives designated as fair value hedges at 31 December 2011 were assets of $132 (2010: $NIL) and liabilities of $2,884 (2010: $NIL). The notional value of fair values hedges as 31 December 2011 was $496,590 (2010: $NIL).

	2011	2010
Gains (losses) arising from the change in fair value of fair value hedges		
- on hedging instruments	(1,719)	-
- on hedged items attributable to the hedged risk	1,672	-
Net loss	(47)	-

10 Loans and advances to banks

	2011		2010	
Maturity analysis:	**Amortised cost**	**Fair value**	Amortised cost	Fair value
One year or less	4,358,287	4,358,287	4,890,172	4,890,172
More than one year	80,000	80,000	-	-
	4,438,287	4,438,287	4,890,172	4,890,172

There are no impairment losses included in loans and advances to banks (2010: $NIL) and there are no netting agreements or collateral held in respect of loans and advances to banks (2010: $NIL).

Credit rating analysis of loans and advances to banks	**2011**	2010
AAA	47,176	512,537
AA	-	183,852
AA-	2,481,292	1,725,089
A+	1,195,404	1,412,052
A	354,892	675,835
A-	10,000	50,000
BBB+	-	10,000
BBB	237,500	137,500
BBB-	-	75,000
Not rated	75,566	-
Cash and cash equivalents	36,457	108,307
	4,438,287	4,890,172

Collateral is held for the group's securities lending activity, for which the bank normally accepts collateral in the form of cash, US government or federal agency securities, letters of credit or OECD debt instruments approved by the group.

(In US dollar thousands) 31 December 2011

11 Loans and advances to customers

The group has the following concentration of loans and advances to customers in Bermuda and Cayman.

Where customers have both a borrowing and a deposit relationship with the group, loans and deposits are presented gross:

	2011	2010
Personal		
Residential mortgages	1,749,057	1,707,755
Other personal	453,023	519,568
Total loans to individuals	2,202,080	2,227,323
Corporate		
Commercial, industrial and international trade	177,766	102,725
Commercial real estate	557,045	529,269
Government	264,674	20,802
Other commercial	373,149	298,131
Total commercial	1,372,634	950,927
Non-bank financial institutions	71,025	77,668
Total corporate	1,443,659	1,028,595
Gross loans and advances to customers	3,645,739	3,255,918
Allowance for losses on loans and advances	(47,687)	(18,072)
Loans and advances to customers	3,598,052	3,237,846

Gross loans with variable rates are $3,003,052 (2010: $2,798,258) and fixed rates are $642,687 (2010: $457,660).

The following table provides an analysis of remaining contractual maturities and measurement bases of loans and advances to customers:

	2011		2010	
Maturity analysis:	**Amortised cost**	**Fair value**	Amortised cost	Fair value
One year or less	551,490	551,484	474,912	474,909
More than one year	3,046,562	2,967,998	2,762,934	2,685,372
	3,598,052	3,519,482	3,237,846	3,160,281

The loan fair values disclosed above are based on weighted average estimated remaining maturities and are determined using a valuation technique supported by observable market rates. Additional information about the interest rate risk exposure pertaining to loans and advances to customers is presented in Note 24.

The following tables provide further analyses of customer loans and related allowances and collateral types at 31 December:

	2011			2010		
Loans and advances to customers:	**Gross**	**Allowance**	**Net**	Gross	Allowance	Net
Not past due or impaired	3,268,511	(4,342)	3,264,169	2,879,914	(4,265)	2,875,649
Past due less than 30 days	136,589	(181)	136,408	176,415	(256)	176,159
Past due between 30 and 60 days	45,367	(62)	45,305	36,393	(50)	36,343
Past due between 60 and 90 days	18,304	(24)	18,280	20,205	(29)	20,176
Impaired	176,968	(43,078)	133,890	142,991	(13,472)	129,519
Total	3,645,739	(47,687)	3,598,052	3,255,918	(18,072)	3,237,846

(In US dollar thousands) 31 December 2011

Allowances for loans and advances to customers:	2011 Specifically provided	2011 Collectively provided	2011 Total allowance	2010 Specifically provided	2010 Collectively provided	2010 Total allowance
Not past due or impaired	-	(4,342)	(4,342)	-	(4,265)	(4,265)
Past due less than 30 days	-	(181)	(181)	-	(256)	(256)
Past due between 30 and 60 days	-	(62)	(62)	-	(50)	(50)
Past due between 60 and 90 days	-	(24)	(24)	-	(29)	(29)
Impaired	(41,347)	(1,731)	(43,078)	(11,880)	(1,592)	(13,472)
Total	(41,347)	(6,340)	(47,687)	(11,880)	(6,192)	(18,072)

Gross loans and advances to customers by type of collateral:	2011 Mortgage interest	2011 Assets other than mortgage interest	2011 Unsecured	2010 Mortgage interest	2010 Assets other than mortgage interest	2010 Unsecured
Not past due or impaired	2,336,610	266,336	665,565	2,321,097	89,681	469,136
Past due less than 30 days	119,053	3,631	13,905	130,085	649	45,681
Past due between 30 and 60 days	41,736	124	3,507	31,179	567	4,647
Past due between 60 and 90 days	16,376	90	1,838	17,520	473	2,212
Impaired	158,027	3,338	15,603	126,777	670	15,544
Total	2,671,802	273,519	700,418	2,626,658	92,040	537,220

The group holds collateral against loans and advances to customers in the form of mortgage interests over property, other charges over real and financial assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated in circumstances where a loan is showing signs of potential impairment or is individually assessed as impaired.

Collateral held is shown in the table below:

2011	Uncollateralised	Fully collateralised	Partially collateralised	*Collateral value*	Total Loans
Personal					
Residential mortgages	10,635	1,483,490	254,932	*226,307*	1,749,057
Other personal	160,006	289,196	3,821	*3,114*	453,023
Total loans to individuals	170,641	1,772,686	258,753	*229,421*	2,202,080
Corporate					
Commercial, industrial and international trade	49,449	103,946	24,371	*16,902*	177,766
Commercial real estate	21,123	519,045	16,877	*5,712*	557,045
Government	229,674	35,000	-	-	264,674
Other commercial	187,965	46,812	138,372	*133,296*	373,149
Total commercial	488,211	704,803	179,620	*155,910*	1,372,634
Non-bank financial institutions	41,566	29,459	-	-	71,025
Total corporate	529,777	734,262	179,620	*155,910*	1,443,659
Gross loans and advances to customers	700,418	2,506,948	438,373	*385,331*	3,645,739

(In US dollar thousands) 31 December 2011

	2010				
	Uncollateralised	Fully collateralised	Partially collateralised	*Collateral value*	Total Loans
Personal					
Residential mortgages	20,350	1,685,452	1,953	*1,675*	1,707,755
Other personal	180,916	321,764	16,888	*12,250*	519,568
Total loans to individuals	201,266	2,007,216	18,841	*13,925*	2,227,323
Corporate					
Commercial, industrial and international trade	28,072	64,044	10,609	*7,784*	102,725
Commercial real estate	72,317	456,952	-	-	529,269
Government	802	20,000	-	-	20,802
Other commercial	195,444	49,652	53,035	*49,597*	298,131
Total commercial	296,635	590,648	63,644	*57,381*	950,927
Non-bank financial institutions	39,319	37,291	1,058	*819*	77,668
Total corporate	335,954	627,939	64,702	*58,200*	1,028,595
Gross loans and advances to customers	537,220	2,635,155	83,543	*72,125*	3,255,918

The group adheres to HSBC policy direction and monitors credit concentration risk in accordance with local regulatory requirements. A substantial portion of the loans and advances to customers is due from residents of Bermuda and is secured by residential, or commercial property in Bermuda. Additional analysis of credit concentration is provided above.

The group regularly reviews loans and advances to customers and allocates a risk rating against each loan or advance based on performance criteria. The breakdown of loans and advances to customers by risk category at 31 December 2011 is 90.8% (2010: 91.0%) performing, 4.4% (2010: 4.6%) substandard and 4.8% (2010: 4.4%) non-performing.

At 31 December 2011, the group held $12,600 (2010: $NIL) of assets obtained by taking possession of collateral held as security.

The following table provides an analysis of the movements in allowance for impairment losses on loans and advances to customers during the year:

	Individually assessed loans	**Collectively assessed loans**	**Total**
Opening balance at 1 January 2010	5,429	6,368	11,797
Uncollectible amounts written off during the year	(232)	(5,115)	(5,347)
Recoveries	-	865	865
Impairment charges during the year	6,683	4,074	10,757
Balance at 31 December 2010	11,880	6,192	18,072
Uncollectible amounts written off during the year	(3,403)	(5,859)	(9,262)
Recoveries	138	884	1,022
Impairment charges during the year	32,732	5,123	37,855
Balance at 31 December 2011	41,347	6,340	47,687

(In US dollar thousands) 31 December 2011

Renegotiated loans that would otherwise have been past due or impaired totalled $293,421 at 31 December 2011 (2010: $156,507).

Renegotiated loans are shown in the table below:

Renegotiated loans and advances to customers	**2011**			
	Neither past due nor impaired	**Past due but not impaired**	**Impaired**	**Total**
Personal				
Residential mortgages	42,251	23,873	6,831	72,955
Other personal	17,481	9,229	18,499	45,209
Total loans to individuals	59,732	33,102	25,330	118,164
Corporate				
Commercial, industrial and international trade	1,721	491	7,875	10,087
Commercial real estate	157,755	802	2,696	161,253
Other commercial	2,683	1,234	-	3,917
Total corporate	162,159	2,527	10,571	175,257
Total renegotiated loans and advances to customers	221,891	35,629	35,901	293,421

	2010			
	Neither past due nor impaired	Past due but not impaired	Impaired	Total
Personal				
Residential mortgages	14,263	2,551	4,575	21,389
Other personal	-	-	4,382	4,382
Total loans to individuals	14,263	2,551	8,957	25,771
Corporate				
Commercial, industrial and international trade	-	-	9,702	9,702
Commercial real estate	120,034	1,000	-	121,034
Total corporate	120,034	1,000	9,702	130,736
Total renegotiated loans and advances to customers	134,297	3,551	18,659	156,507

Of the total renegotiated loans and advances $NIL (2010: $NIL) relates to loans that were derecognised for accounting purposes and a new asset recognised following renegotiation. On derecognition, an impairment charge of the difference between the previous carrying value of the derecognised loan and the new loan recorded at fair value is recognised.

(In US dollar thousands) 31 December 2011

12 Financial investments

The following tables provide an analysis of the group's financial investments, all classified as available-for-sale securities with the exception of $100,079 (2010: $31,093) trading assets related to structured certificates of deposit.

	2011		2010	
	Amortised cost	**Fair value**	Amortised cost	Fair value
Treasury and other eligible bills	2,474,233	2,473,597	-	-
Debt securities – fixed rate	2,380,045	2,379,938	1,716,461	1,744,612
Debt securities – floating rate	1,580,471	1,558,409	1,287,884	1,275,116
Equity securities	7,421	32,162	11,007	35,781
Total financial investments	6,442,170	6,444,106	3,015,352	3,055,509

Maturities analysis of debt securities	**2011**	2010
One year or less	3,318,167	1,100,412
More than one year	3,093,777	1,919,316
	6,411,944	3,019,728

Credit rating analysis of debt securities	**2011**	2010
AAA	2,600,957	1,451,601
AA+	2,496,364	163,831
AA	-	420,409
AA-	1,094,261	245,198
A+	96,721	424,172
A	34,987	250,089
A-	88,654	45,023
BBB+	-	13,173
BBB	-	6,232
	6,411,944	3,019,728

Total gains or losses included in profit and loss for the period are presented in the consolidated income statement in 'Gains less losses from financial investments'. Where debt securities are rated by Standard & Poor's ("S&P"), this rating is used. If the debt security is not rated by S&P, the Fitch rating is used. All securities guaranteed by the U.S. Government are assigned the U.S. Government's sovereign rating.

(In US dollar thousands) 31 December 2011

Financial investments by country and sector

Country	Sovereign	Bank	Corporate	Asset backed	Equities	Total
	2011					
Australia	219,938	45,082	-	-	-	265,020
Belgium	-	-	-	-	38	38
Bermuda	94,894	-	-	-	2,180	97,074
Canada	158,370	122,834	-	139,969	-	421,173
Cayman Islands	-	-	-	-	19,564	19,564
Denmark	-	15,257	-	-	-	15,257
France	118,948	77,096	-	-	-	196,044
Germany	391,881	225,718	-	-	-	617,599
Ireland	-	19,730	-	-	-	19,730
Japan	-	68,208	-	-	-	68,208
Netherlands	-	123,646	-	-	-	123,646
New Zealand	347,009	-	-	-	-	347,009
Norway	-	49,880	-	-	-	49,880
Supranational	-	382,799	-	-	-	382,799
Sweden	-	50,175	-	-	-	50,175
United Kingdom	593,866	679,933	-	-	10,108	1,283,907
United States	1,896,769	299,260	90,519	200,163	272	2,486,983
	3,821,675	2,159,618	90,519	340,132	32,162	6,444,106

Financial investments by country and sector

Country	Sovereign	Bank	Corporate	Asset backed	Equities	Total
	2010					
Australia	77,323	89,088	-	-	-	166,411
Belgium	-	-	-	-	31	31
Bermuda	15,402	-	-	-	2,473	17,875
Canada	162,097	24,088	-	-	-	186,185
Cayman Islands	-	-	-	-	20,773	20,773
Denmark	-	26,387	-	-	-	26,387
Finland	-	76,297	-	-	-	76,297
France	178,702	141,625	-	-	-	320,327
Germany	-	163,173	-	-	-	163,173
Hong Kong	-	-	-	-	9	9
Ireland	-	39,336	-	-	-	39,336
Netherlands	-	61,431	-	-	-	61,431
Norway	25,914	-	-	-	-	25,914
Sweden	20,632	50,158	-	-	-	70,790
United Kingdom	299,003	560,233	-	-	12,000	871,236
United States	35,971	653,158	92,287	227,423	495	1,009,334
	815,044	1,884,974	92,287	227,423	35,781	3,055,509

Supranational entities are formed by two or more central governments to promote economic development for the member countries.

Debt securities amounting to $50,180 (2010: $46,719) are pledged to third parties in security lending agreements. The group is carrying all financial investments at fair value. During the year the group received proceeds of $4,138,581 (2010: $820,545) from the sale or maturity of financial investments and realised a net gain of $5,257 (2010: $5,312). The group monitors interest rate sensitivity under varying interest rate scenarios as summarised in Note 26.

(In US dollar thousands) 31 December 2011

13 Fair values of financial investments carried at fair value

A three level fair value hierarchy, which reflects the significance of observable market inputs, is used when estimating fair values and is summarised in the chart below:

	2011			
Fair value hierarchy summary by sector	**Level 1**	**Level 2**	**Level 3**	**Total**
Sovereign	-	3,821,675	-	3,821,675
Bank	-	2,159,618	-	2,159,618
Corporate	-	90,519	-	90,519
Asset backed	-	340,132	-	340,132
Equities	356	-	31,806	32,162
	356	6,411,944	31,806	6,444,106

	2010			
Fair value hierarchy summary by sector	Level 1	Level 2	Level 3	Total
Sovereign	-	815,044	-	815,044
Bank	-	1,884,974	-	1,884,974
Corporate	-	92,287	-	92,287
Asset backed	-	227,423	-	227,423
Equities	3,539	-	32,242	35,781
	3,539	3,019,728	32,242	3,055,509

Level 3 securities comprise equity securities. The following table shows a reconciliation of equities from the beginning balance to the ending balance for fair value measurements in Level 3 of the fair value hierarchy:

	2011	2010
At 1 January	32,242	32,280
Purchases	513	51,442
Sales	(2,515)	(52,324)
Total gains or losses:		
in profit or loss	(1,852)	(1,652)
in other comprehensive income	3,418	2,496
At 31 December	31,806	32,242

(In US dollar thousands) 31 December 2011

14 Property, plant and equipment

	Land and buildings	Equipment, fixtures and fittings	Total
Cost			
Cost at 1 January 2011	221,289	90,634	311,923
Additions at cost	52	2,322	2,374
Disposals and write-offs	(171)	(1,828)	(1,999)
Reclassified as assets held for sale	(31,325)	(2,441)	(33,766)
Other movements	-	(317)	(317)
Cost at 31 December 2011	189,845	88,370	278,215
Accumulated depreciation			
Accumulated depreciation at 1 January 2011	31,473	42,831	74,304
Depreciation charge for the year	5,196	10,031	15,227
Disposals and write-offs	(68)	(860)	(928)
Reclassified as assets held for sale	(7,396)	(1,644)	(9,040)
Other movements	-	(317)	(317)
Accumulated depreciation at 31 December 2011	29,205	50,041	79,246
Net book value at 31 December 2011	160,640	38,329	198,969

	Land and buildings	Equipment, fixtures and fittings	Total
Cost			
Cost at 1 January 2010	218,090	83,183	301,273
Additions at cost	8,290	12,978	21,268
Disposals and write-offs	(5,695)	(1,646)	(7,341)
Reclassified as assets held for sale	(675)	(3,001)	(3,676)
Other movements	1,279	(880)	399
Cost at 31 December 2010	221,289	90,634	311,923
Accumulated depreciation			
Accumulated depreciation at 1 January 2010	26,167	37,417	63,584
Depreciation charge for the year	5,465	9,185	14,650
Disposals and write-offs	(469)	(953)	(1,422)
Reclassified as assets held for sale	(162)	(2,399)	(2,561)
Other movements	472	(419)	53
Accumulated depreciation at 31 December 2010	31,473	42,831	74,304
Net book value at 31 December 2010	189,816	47,803	237,619

During 2011 the group reassessed the useful life of buildings, changing the estimated useful life from a maximum of 40 years to a maximum of 50 years. The annual impact of this change in estimate amounts to approximately $869. Leasehold improvements have been reclassified from 'Land and buildings' to 'Equipment, fixtures and fittings' and prior year comparative information has been reclassified to conform to the current year presentation.

(In US dollar thousands) 31 December 2011

15 Goodwill

	2011	2010
Cost		
At 1 January	51,342	239,893
Disposals	(21,476)	(19,507)
Assets held for sale (Note 19)	-	(169,044)
At 31 December	29,866	51,342

Note 18 presents information about subsidiary undertakings disposed of during the years ended 31 December 2011 and 31 December 2010. Note 19 presents information about the discontinued operations of a subsidiary disposed during the year ended 31 December 2010.

Goodwill is reviewed for impairment annually and was determined not to be impaired at 31 December 2011 or 31 December 2010.

16 Group entities

(a) Principal subsidiary undertakings

	Country of incorporation or registration	**Bank's interest in equity capital (%)**
Bermuda International Securities Limited	Bermuda	100
Bermuda Trust Company Limited	Bermuda	100
HSBC Global Asset Management (Bermuda) Limited	Bermuda	100
HSBC Institutional Trust Services (Bermuda) Limited	Bermuda	100
HSBC Securities Services (Bermuda) Limited	Bermuda	100
HSBC Bank (Cayman) Limited	Cayman	100

All of the above entities prepare their financial statements up to 31 December. Please refer to Note 18 for details of acquisitions and disposals during 2011.

(b) Principal associates

Movement in investments in associates

	2011	2010
At 1 January	1,743	2,240
Share of loss	(562)	(497)
At 31 December	1,181	1,743

Summarised aggregate financial information on associates at 31 December

	2011	2010
Assets	3,533	4,829
Liabilities	1,214	1,272
Operating income	6,927	7,159
Loss for the year	(1,124)	(994)

Associates are accounted for using the equity method.

(In US dollar thousands) 31 December 2011

17 Impairment of assets other than financial instruments

During 2011, the group obtained an independent market valuation for each major building owned and compared the carrying cost to the appraisal and the assets value in use where appropriate. As a result, an impairment loss on two buildings, classified as 'assets held for sale', was recognised in the amount of $7,430 (2010: $2,229). The impairment has been included in the consolidated income statement as part of 'Depreciation and impairment of property, plant and equipment'.

18 Investments

(a) Acquisitions

The group did not purchase any subsidiary undertakings in 2011 or 2010.

(b) Disposals

(i) During the year ended 31 December 2011

The group made the following disposal to an HSBC affiliated entity for net cash proceeds of $222,691. The attributable gain has been included in the 'Gains less losses on disposal of property, plant and equipment and subsidiary investments' in the group's consolidated income statement as follows:

Location	Subsidiary / Business	Cash and cash equivalents in subsidiaries	Net asset value	Attributable gain
British Virgin Islands	HSBC International Trustee Limited	43,663	219,985	2,706

The group made the following disposal to a third party entity for net cash proceeds of $24,935. The attributable loss has been included in the 'Gains less losses on disposal of property, plant and equipment and subsidiary investments' in the group's consolidated income statement as follows:

Location	Subsidiary / Business	Cash and cash equivalents in subsidiaries	Net asset value	Attributable loss
Bermuda	HSBC Insurance Holdings (Bermuda) Limited (and related business)	2,797	27,153	(2,218)

(ii) During the year ended 31 December 2010

The group made the following disposal to an HSBC affiliated entity for total cash proceeds of $400,000. The attributable gain has been included in the 'Gains less losses on disposal of property, plant and equipment and subsidiary investments' in the group's consolidated income statement as follows:

Location	Subsidiary / Business	Cash and cash equivalents in subsidiaries	Net asset value	Attributable gain
Bermuda	HSBC Insurance (Bermuda) Limited ('the Captive')	63,774	377,890	30,670

During the year ended 31 December 2010, the group also liquidated its subsidiary in the Isle of Man.

(In US dollar thousands) 31 December 2011

19 Assets held for sale

	Property, plant and equipment	Discontinued operations of subsidiary	Total
Assets			
At 1 January 2010	15,110	-	15,110
Transfers in	513	-	513
Disposals	(513)	-	(513)
Reduction in value through impairment (Note 17)	(2,229)	-	(2,229)
Subsidiary assets reclassified as held for sale	-	254,035	254,035
Assets held for sale 31 December 2010	12,881	254,035	266,916
Disposal of subsidiary	-	(254,035)	(254,035)
Reduction in value through impairment (Note 17)	(7,430)	-	(7,430)
Transfers in	37,326	-	37,326
Disposals	(549)	-	(549)
Assets held for sale 31 December 2011	42,228	-	42,228
Liabilities			
At 1 January 2010	-	-	-
Subsidiary liabilities reclassified as held for sale	-	34,119	34,119
Liabilities held for sale at 31 December 2010	-	34,119	34,119
Disposal of subsidiary	-	(34,119)	(34,119)
Liabilities held for sale at 31 December 2011	-	-	-

(a) Assets held for sale – Property, plant and equipment

At 31 December 2011, assets held for sale is comprised of two office buildings, a mixed use property, three condominiums and land, in the process of being sold by the group. The assets were recorded at the lower of net book value and fair value less costs to sell, which amounted to $42,228 (2010: $12,881).

(b) Assets and liabilities held for sale – Discontinued operations of subsidiary

Effective 1 January 2011 the group disposed of HSBC International Trustee Limited to an HSBC affiliated entity for total cash proceeds of $222,691 which is the estimated fair value of the business at sale date. Note 18 presents detailed information about the disposal of this subsidiary which resulted in a gain of $2,706.

The 'Consolidated income statement for the year ended 31 December 2010' has been presented to show the discontinued operations separately from continuing operations and the assets and liabilities of the discontinued operations have been separately included in assets and liabilities held for sale, respectively, in the 'Consolidated balance sheet at 31 December 2010'. The results and impact of the discontinued operations of the subsidiary are summarised below:

	2010
Results from discontinued operations	
Net operating income	87,516
Total operating expenses	(56,281)
Profit before tax	31,235
Tax expense	(4,534)
Profit from discontinued operations (net of income tax)	26,701
Cash flows used in discontinued operations	
Net cash flows from operations	22,243
Net cash flows used in investing operations	(171)
Net cash flows used in financing activities	(32,000)
Net cash flows for the year	(9,928)

(In US dollar thousands) 31 December 2011

	2010
Net assets of discontinued operations of subsidiary	
Cash and cash equivalents	43,663
Financial investments	12,065
Prepayments and accrued income	17,989
Other assets	10,672
Property, plant and equipment	602
Goodwill	169,044
Assets held for sale	254,035
Accruals and deferred income	25,727
Provisions and other liabilities	8,392
Liabilities held for sale	34,119
Net assets and liabilities	219,916
Net intercompany assets with group	2,775
Reserves included in comprehensive income	(2,706)
Net asset value prior to realising post-acquisition reserves	219,985

20 Provisions

	2011	2010
At 1 January	-	4,495
Increases in provisions	74	3,522
Provisions recovered	-	(721)
Provisions utilised	(74)	(6,070)
Transfer to assets held for sale	-	(1,226)
At 31 December	-	-

‘Provisions’ for 2011 and 2010 are comprised entirely of legal provisions related to ongoing legal proceedings.

(In US dollar thousands) 31 December 2011

21 Contingent liabilities, contractual commitments and guarantees

The table below discloses the nominal principal amounts of third party off-balance sheet transactions. Contingent liabilities and commitments are credit-related instruments, which include letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of future liquidity requirements.

	2011	2010
Guarantees and contingent liabilities in favour of third parties		
Standby letters of credit which are financial guarantees	165,014	245,452
Standby letters of credit related to particular transactions	1,531	-
Guarantees in the form of irrevocable letters of credit	166,545	245,452
Financial and other guarantees	28,500	2,500
Other contingent liabilities	3,676	3,655
	198,721	251,607
Commitments		
Documentary credits and short-term trade-related transactions	1,804	3,235
Undrawn revolving underwriting facilities	280,472	316,494
Undrawn formal standby facilities, credit lines and other commitments to lend		
– one year or less	263,918	239,064
– more than one year	327,602	372,469
	873,796	931,262

At 31 December 2011 approximately 61% (2010: 67%) of the above guarantees have an original contractual term of less than one year. Guarantees with a term of more than one year are subject to the group's annual credit review process.

When the group has given a guarantee on behalf of a customer, it will have the right to recover from that customer any amounts paid under the guarantee. At 31 December 2011, the group holds collateral amounting to $79,001 (2010: $133,587), which could be used to recover amounts paid under the above guarantees.

22 Lease commitments

At 31 December 2011, the group was obligated under a number of non-cancellable operating leases for properties, plant and equipment, for which the future minimum lease payments extend over a number of years as follows:

	2011		2010	
Annual commitments under non-cancellable operating leases expiring:	**Land and buildings**	**Equipment**	Land and buildings	Equipment
Not later than one year	1,794	107	1,920	168
Later than one year and not later than five years	6,623	112	6,455	105
Later than five years	12,043	-	13,759	-
	20,460	219	22,134	273

During the year $2,957 (2010: $3,187) was recognised within 'General and administrative expenses' in respect of lease agreements.

(In US dollar thousands) 31 December 2011

23 Maturity analysis of financial assets and financial liabilities

The following is an analysis of financial assets and financial liabilities by remaining contractual maturities at the date of the consolidated balance sheet:

31 December 2011	**On demand**	**Due within one year**	**Due between one and five years**	**Due after five years**	**Undated**	**Total**	**Fair Value**
Financial assets							
Cash and balances at central banks	33,753	-	-	-	-	33,753	33,753
Items in the course of collection from other banks	526	-	-	-	-	526	526
Derivatives	-	12,789	192	-	-	12,981	12,981
Loans and advances to banks	1,060,879	3,297,408	67,000	13,000	-	4,438,287	4,438,287
Loans and advances to customers	209,579	341,911	923,842	2,122,720	-	3,598,052	3,519,482
Financial investments	-	3,318,167	2,256,874	836,903	32,162	6,444,106	6,444,106
Total at 31 December 2011	1,304,737	6,970,275	3,247,908	2,972,623	32,162	14,527,705	14,449,135
Financial liabilities							
Deposits by banks	67,506	-	-	-	-	67,506	67,506
Customer accounts	10,372,421	2,516,159	41,104	247	-	12,929,931	12,933,595
Items in course of transmission to other banks	7,335	-	-	-	-	7,335	7,335
Derivatives	-	13,210	1,710	1,225	-	16,145	16,145
Total at 31 December 2011	10,447,262	2,529,369	42,814	1,472	-	13,020,917	13,024,581

31 December 2010	On demand	Due within one year	Due between one and five years	Due after five years	Undated	Total	Fair Value
Financial assets							
Cash and balances at central banks	29,025	-	-	-	-	29,025	29,025
Items in the course of collection from other banks	522	-	-	-	-	522	522
Derivatives	-	7,400	515	7	-	7,922	7,922
Loans and advances to banks	666,505	4,116,167	107,500	-	-	4,890,172	4,890,172
Loans and advances to customers	175,438	299,474	726,714	2,036,220	-	3,237,846	3,160,281
Financial investments	-	1,100,412	1,541,873	377,444	35,780	3,055,509	3,055,509
Total at 31 December 2010	871,490	5,523,453	2,376,602	2,413,671	35,780	11,220,996	11,143,431
Financial liabilities							
Deposits by banks	34,519	-	-	-	-	34,519	34,519
Customer accounts	7,240,682	2,416,039	49,955	338	-	9,707,014	9,709,833
Items in course of transmission to other banks	10,642	-	-	-	-	10,642	10,642
Derivatives	-	7,685	505	6	-	8,196	8,196
Total at 31 December 2010	7,285,843	2,423,724	50,460	344	-	9,760,371	9,763,190

Financial instruments included within 'Prepayments and accrued income', 'Other assets', 'Accruals and deferred income', 'Provisions', 'Other liabilities' and 'Retirement benefit liabilities' have not been included in the analysis above as they do not have contractual maturities. Fair values for 'Loans and advances to customers' and 'Customer accounts' are based on weighted average estimated remaining maturities determined using a valuation technique supported by observable market rates.

(In US dollar thousands) 31 December 2011

24 Interest rate analysis of financial instruments

The table below discloses the mismatch of the dates on which interest on financial assets and financial liabilities are next reset to market rate on a contractual basis, or if earlier, the dates on which the instruments mature. Contractual terms may not be representative of the behaviour of financial assets and liabilities and the group therefore manages interest rate risk based on the behavioural characteristics of the relevant financial assets and liabilities.

31 December 2011	Due within three months	Due between three and six months	Due between six months and one year	Due between one and five years	Due after five years	Non-interest bearing	Total	Range of weighted average effective interest rates
Financial assets								
Cash and balances at central banks	-	-	-	-	-	33,753	33,753	
Items in the course of collection from other banks	-	-	-	-	-	526	526	
Derivatives	-	-	-	-	-	12,981	12,981	
Loans and advances to banks	4,100,787	337,500	-	-	-	-	4,438,287	0.37-0.86%
Loans and advances to customers	2,716,126	852,487	29,439	-	-	-	3,598,052	4.82-5.56%
Financial investments	4,394,193	577,372	237,368	1,086,504	116,507	32,162	6,444,106	1.30-2.18%
Total at 31 December 2011	11,211,106	1,767,359	266,807	1,086,504	116,507	79,422	14,527,705	
Financial liabilities								
Deposits by banks	67,506	-	-	-	-	-	67,506	0.52-0.77%
Customer accounts	11,980,403	592,009	309,728	47,626	165	-	12,929,931	0.69-0.94%
Items in course of transmission to other banks	-	-	-	-	-	7,335	7,335	
Derivatives	-	-	-	-	-	16,145	16,145	
Total at 31 December 2011	12,047,909	592,009	309,728	47,626	165	23,480	13,020,917	
Interest rate sensitivity gap	(836,803)	1,175,350	(42,921)	1,038,878	116,342	55,942	1,506,788	
Cumulative interest rate sensitivity gap	(836,803)	338,547	295,626	1,334,504	1,450,846			

(In US dollar thousands) 31 December 2011

31 December 2010	Due within three months	Due between three and six months	Due between six months and one year	Due between one and five years	Due after five years	Non-interest bearing	Total	Range of weighted average effective interest rates
Financial assets								
Cash and balances at central banks	-	-	-	-	-	29,025	29,025	
Items in the course of collection from other banks	-	-	-	-	-	522	522	
Derivatives	-	-	-	-	-	7,922	7,922	
Loans and advances to banks	4,692,672	102,500	95,000	-	-	-	4,890,172	0.36-0.59%
Loans and advances to customers	2,589,617	648,229	-	-	-	-	3,237,846	4.86-5.46%
Financial investments	1,342,656	232,379	277,092	1,136,509	31,093	35,780	3,055,509	1.98-2.17%
Total at 31 December 2010	8,624,945	983,108	372,092	1,136,509	31,093	73,249	11,220,996	
Financial liabilities								
Deposits by banks	34,519	-	-	-	-	-	34,519	0.21-0.53%
Customer accounts	9,125,179	323,575	207,967	49,955	338	-	9,707,014	0.52-0.73%
Items in course of transmission to other banks	-	-	-	-	-	10,642	10,642	
Derivatives	-	-	-	-	-	8,196	8,196	
Total at 31 December 2010	9,159,698	323,575	207,967	49,955	338	18,838	9,760,371	
Interest rate sensitivity gap	(534,753)	659,533	164,125	1,086,554	30,755	54,411	1,460,625	
Cumulative interest rate sensitivity gap	(534,753)	124,780	288,905	1,375,459	1,406,214			

Financial instruments included within ‘Prepayments and accrued income’, Other assets’, ‘Accruals and deferred income’, ‘Provisions’, ‘Other liabilities’ and ‘Retirement benefit liabilities’ have not been included in the analysis above and are all considered non-interest bearing.

(In US dollar thousands) 31 December 2011

25 Foreign currency exposures

(a) Balance sheet denominated in foreign currency

The group recognises that changes in foreign exchange rates can result in changes to profit and loss and other comprehensive income. In order to effectively mitigate this risk, the group matches assets and liabilities by currency to the greatest extent possible.

	2011	2010
Assets		
US and Bermuda dollars	11,396,739	8,781,292
Euro	989,226	1,065,071
Pound sterling	967,352	999,768
Japanese yen	392,341	241,831
Canadian dollars	383,697	232,740
New Zealand dollars	358,603	100,887
Australian dollars	241,944	148,493
Other currencies, each less than US$100m	150,762	276,749
Total assets	14,880,664	11,846,831
Liabilities and equity		
US and Bermuda dollars	11,342,072	8,819,215
Euro	1,002,784	1,064,337
Pound sterling	997,392	999,449
Japanese yen	383,560	241,713
Canadian dollars	389,430	232,527
New Zealand dollars	361,316	100,887
Australian dollars	249,450	146,053
Other currencies, each less than US$100m	154,660	242,650
Total liabilities and equity	14,880,664	11,846,831

At 31 December 2011, assets and liabilities in all currencies other than US and Bermuda dollars are matched to within 3% (2010: 1%) of each currency total and to within 0.4% (2010: 0.3%) of total assets. The group therefore considers that the overall risk of changes in foreign exchange rates to profit and loss and equity is not significant.

(b) Structural currency exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiary undertakings and associates. Gains or losses on structural foreign currency exposures are recognised in other comprehensive income. The group's management of structural foreign currency exposures is discussed in the 'Market risk management' section in Note 26.

26 Risk management

All of the group's activities involve measurement, evaluation, acceptance and management of some degree of risk, or combination of risks. The most important types of risk categories that the group are exposed to are market risk (including interest rate, equity price, foreign exchange and credit spread risk), liquidity risk, operational risks in various forms, insurance risk, credit risk (including cross-border risk), reputational risk and sustainability (environmental and social) risks. This note presents information about the group's exposure to each of the material risks, the group's risk governance framework, objectives, policies and processes for measuring and managing risk, and the group's management of capital.

(i) Risk governance

The risk management framework established by the group seeks to foster the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

Primary responsibility for managing risk at the group's operating entity levels lies with the relevant Chief Executive Officer, as custodian of the relevant balance sheets. In turn, the Chief Risk Officer and the group's internal controls division ('IC') have functional responsibility for the primary financial risk types, namely: credit, market, operational and security / fraud risks. The IC co-ordinates the development of the risk appetite, economic capital and stress-testing frameworks, in consultation with the finance and the asset and liability management divisions.

(ii) Risk management framework

The group's risk management policies, encapsulated in the HSBC Group Standards Manual are cascaded in a hierarchy of policy manuals throughout the group and are designed to support the formulation of risk appetite, guide employees and establish procedures for monitoring and controlling risks, with timely and reliable reporting to senior management. Personal accountability reinforced by the group's governance structure and instilled by training, helps to foster throughout the group a disciplined and constructive culture of risk management and control.

(a) Market risk management

Market risk is the risk that changes in interest rates, credit spreads, foreign exchange rates or equity and commodity prices will affect the group's income or the value of its holdings of financial instruments. Market risk arises on financial instruments which are valued at current market prices (mark-to-market basis) and those valued at cost plus accrued interest (accruals basis). The main valuation sources are securities prices, foreign exchange rates, interest rate yield curves and volatilities.

Trading risks arise from customer-related business and positions are valued on a mark-to-market basis.

Equity price risk is subject to regular monitoring by the group but is not currently significant in relation to the overall results and financial position.

The group manages market risk through risk limits assigned by HSBC. Traded Markets Development and Risk ('TMR'), a division within HSBC, develops risk management policies and measurement techniques and reviews limit utilisation on a daily basis. HSBC global risk limits are approved by TMR. Limits are set by product and risk type, using a combination of risk measurement techniques, including position limits, sensitivity limits, as well as value at risk limits at a portfolio level.

The group's interest rate risks relate exclusively to structural interest rate exposures managed under the limits described above. Structural interest rate risk arises primarily on accrual book positions and from the differing repricing characteristics of commercial and retail banking assets and liabilities.

The group assesses the structural interest rate risks which arise in the businesses and transfers these risks to the group's balance sheet management team. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the appropriate underlying interest rate risk. The Asset and Liability Committee ('ALCO') regularly monitors all such behavioural assumptions and interest rate risk positions to ensure they comply with established interest rate risk limits. In the course of managing interest rate risk, quantitative techniques and simulation models are used where appropriate to identify the potential net interest income and market value effects of these interest rate positions under different scenarios. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on net interest income whilst balancing the effect on the current net operating income stream and unrealised mark-to-market positions.

(In US dollar thousands) 31 December 2011

The table in Note 24 discloses the mismatching of the dates on which interest rates on assets and interest rates on liabilities are next reset to market rate on a contractual basis, or, if earlier, the dates on which the instruments mature. Contractual terms may not be representative of the behaviour of assets and liabilities and the group therefore manages its interest rate risk on the behavioural characteristics of its assets and liabilities.

A principal part of the group's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The group aims to mitigate the effect of prospective interest rate movements, which could reduce future net interest income, while balancing the cost of such hedging activities on the current net operating income stream.

The models measure the effect on net interest income due to parallel and ramp movements of plus or minus 100 basis points in all yield curves. The sensitivities are illustrative only and are based on simplified assumptions as set out below. The figures represent the effect of the pro-forma movements in net interest income based on the projected yield curve scenarios and the group's current interest rate risk profile.

Change in 2012 projected net interest income arising from 100 basis points movement in yield curves *(unaudited)*	**At 31 December 2011 increase (decrease)**	At 31 December 2010 increase (decrease)
+100 basis points parallel	43,559	29,533
+100 basis points ramp	17,103	16,321
-100 basis points parallel	(28,209)	(20,029)
-100 basis points ramp	(14,420)	(13,683)

The scenarios are calculated by first establishing a base case projection for the following financial year using the current consolidated balance sheet. The base case assumes no change in volumes or margins across all currencies. The parallel scenario is calculated by impacting all interest margins by 100 basis points immediately while the ramp scenario simulates a margin impact of 25 basis points every 3 months. The prospective annual differences in net interest income, between the base case and the parallel and ramp cases respectively, are set out in the table above. The model is further simplified in the assumption that all currency yield curves rise and fall at the same time and does not incorporate any management response to changes in prospective interest rates. In particular, the model does not incorporate the proactive management of the interest rate risk profile undertaken by the group's ALCO and global markets division in order to minimise losses and optimise net income. In the falling interest rate scenarios for 2010, the low absolute interest rate levels in shorter maturities provide a natural 0% interest rate floor in the model.

The group's foreign exchange exposure comprises trading exposures and structural foreign currency translation exposure. Structural currency risk exists for the group in holding subsidiary company investments whose functional currencies are not the US dollar or Bermuda dollar.

(b) Liquidity risk management

The group manages its liquidity risk by:

- Modelling scenarios based on behavioural characteristics of individual classes of financial instruments;
- Monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- Monitoring of depositor concentration both in terms of the overall funding mix and to avoid undue reliance on large individual depositors; and
- Maintaining liquidity and funding contingency plans.

These actions ensure the group adheres to HSBC liquidity policies and maintains sufficient liquidity to meet day-to-day needs and local regulatory requirements.

Core deposits form a significant part of the group's overall funding. Considerable importance is attached to this core deposit base which, over the years, has been stable and predictable. Additional information regarding liquidity risk is found in Note 23.

(c) Operational risk management

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, systems failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues.

The group manages this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by internal control reviews as well as an independent programme of periodic reviews undertaken by internal audit, and by monitoring external operational risk events, which ensure that the group adheres to best practice and actively learns from the publicised operational failures within the financial services industry.

The group has adopted the HSBC operational risk management process with annual compliance certification. The HSBC standards explain how the group manages operational risk by identifying, assessing, monitoring, controlling and mitigating the risk, rectifying operational risk events, and implementing any additional procedures required for compliance with local regulatory requirements. The processes undertaken to manage operational risk are determined by reference to the scale and nature of each business operation. The HSBC standard covers the following:

- Operational risk management responsibility is assigned at a senior management level within the business operation;
- Information systems are used to record the identification and assessment of operational risks and generate appropriate, regular management reporting;
- Operational risks are identified by risk assessments covering operational risks facing each business and risks inherent in processes, activities and products. Risk assessment incorporates a regular review of risks identified to monitor significant changes;
- Operational risk loss data is collected and reported to senior management. This report covers aggregate operational risk losses and details of incidents above a materiality threshold; and
- Risk mitigation, including insurance, is considered where this is cost-effective.

HSBC has adopted the standardized approach to determine its operational risk capital requirement. It continues to enhance its Operational Risk Management Framework including the use of the risk and control assessment process that provides business areas and functions with a forward-looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels.

Local management is responsible for implementation of the HSBC standards on operational risk, throughout their operations and where deficiencies are evident, these are required to be rectified within a reasonable timeframe. During 2011, our top and emerging risk analysis included a number of risks which were of an operational nature including External Fraud, Compliance, Fiduciary, Information Security, Operations and Business Continuity Risk.

(d) Insurance risk management

Insurance risk is the risk of incurring financial loss through an insured event, such as fraud, error or omission, fire, theft and natural disaster. The frequency and severity of losses are affected by several factors. The most significant are the effectiveness of HSBC's operational risk management and the individual insurance policy deductible. HSBC manages its operational risk through a controls-based environment, as explained more fully in (c) 'Operational risk management' above. All HSBC companies are required to share in HSBC's insurance risk assumed by HSBC Insurance (Bermuda) Limited ('the Captive'), by retaining appropriate deductibles. The Captive was owned by the group for 2009 and effective 1 July 2010, it was disposed of to an HSBC affiliated entity (see Note 18).

The objective of the Captive is to enhance financial risk management in the HSBC Group through increased risk retention by transfer of insurance risk to the Captive where economically beneficial to do so. This provides the benefits of pricing stability, reduced counter-party risk, greater claims certainty, capture of insurance profits and improved insurance for the HSBC Group. The Captive retains a portion of the HSBC Group insurance risk and writes coverage for HSBC on a direct and indirect basis on a number of lines including, but not limited to, criminal, professional indemnity and directors' and officers' liability lines, personal accident, property and employers' liability.

The Board of Directors of the Captive is responsible for determining the Captive's underwriting strategy, and has appointed an underwriting committee to ensure the strategy is appropriately implemented and monitored. Specific responsibilities of the underwriting committee include:

- Risk selection;
- Acceptance of limits of liability / sums insured;
- Imposition of appropriate deductibles;
- Arms length premium pricing; and
- Claims investigation.

In addition to the work of the underwriting committee, insurance risk is also managed by performing an annual risk scenario analysis and stress test on the insurance risk underwritten by the Captive. Independent, qualified actuaries perform an annual actuarial valuation and assessment of insurance liabilities to ensure these accurately and adequately correspond to the projected future liquidity and cash flow requirements of the risks assumed.

(e) Credit risk management

Credit risk is the risk that a customer or counterparty of the group will be unable or unwilling to meet a commitment into which it has entered with a member of the group. It arises from lending, trade finance, treasury and other activities. The group has in place standards, policies and procedures for the control and monitoring of all such risks. Additional credit-related information is presented in Note 9 'Derivatives', Note 10 'Loans and advances to banks', Note 11 'Loans and advances to customers' and Note 12 'Financial investments'.

The group is responsible for the formulation of high-level credit policies based on HSBC policies. The group also reviews the application of HSBC's universal credit risk rating system. The group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. Cross-border risk is controlled through the imposition of country limits, which are determined by taking into account economic and political factors, and local business knowledge, with sub-limits by maturity and type of business. Transactions with counterparties in higher risk countries are considered on a case-by-case basis.

Within the overall framework of the HSBC policy, the group has an established risk management process encompassing credit approvals, the control of exposures (including those to borrowers in financial difficulty), credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis. The group's management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products. Special attention is paid to the management of problematic loans. Where deemed appropriate, specialist units are established to provide intensive management and control to maximise recoveries of assets, which show early signs of potential impairment.

(f) Capital management

(i) Regulatory capital

The group's lead regulator, Bermuda Monetary Authority (the "Authority"), sets and monitors capital requirements for the group as a whole under the Banks and Deposit Companies Act 1999. Individual banking operations of the group are directly supervised by their local regulators.

The group is required to comply with the provisions of the Basel II framework in respect of regulatory capital. Basel II is structured around three 'pillars': Pillar 1, 'minimum capital requirements', 'Pillar 2, 'supervisory assessment process' and Pillar 3, 'market discipline'. The "Revised Framework for Regulatory Capital Assessment" is the means by which Basel II is implemented in Bermuda.

The group's total banking regulatory capital is analysed into two tiers:

- Tier 1: Called up share capital, share premium, retained earnings, less goodwill and other intangible assets; and
- Tier 2: Collective impairment allowances.

Various limits are applied to elements of the capital base. Total Tier 2 capital is limited to 100% of the Tier 1 capital. There are also restrictions on the level of collective impairment allowances that may be included in Tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.

The group's policy is to maintain a strong capital base so as to maintain creditor and market confidence and to sustain future development of the business. The group and its individual regulated operations have complied with all external imposed capital requirements throughout the period. There have been no material changes in the group's management of capital during the year.

(In US dollar thousands) 31 December 2011

The group's consolidated regulatory capital position under Basel II at 31 December was as follows:

Composition of regulatory capital

	Notes	**2011**	2010
Tier 1 capital			
Called up share capital	*29*	30,027	30,027
Share premium		388,652	388,652
Retained earnings		1,273,135	1,425,277
Less goodwill and other intangibles assets		(29,866)	(220,386)
Total Tier 1 capital		1,661,948	1,623,570
Tier 2 capital			
Collective impairment allowances	*11*	6,340	6,192
Deductions: Investments in insurance subsidiary and associates		(1,182)	(1,743)
Deductions: Investments in capital of other banks		(420,275)	(4,093)
Total regulatory capital		1,246,831	1,623,926

The group has been granted approval by the Authority to adopt the standardised approach to credit and operational risk management. For credit risk, the standardised approach requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. It groups other counterparties into broad categories and applies standardised risk weightings to these categories. Basel II also introduces an additional capital requirement for operational risk. The capital required for operational risk is calculated by applying a percentage to each of the eight defined revenue categories. The group continued to be exempt from market risk reporting requirements under Basel II from the Authority.

The second Pillar of Basel II involves both the group and the Authority to assess and agree the appropriate capital necessary to mitigate the impact of risks not fully captured by the credit risk measures ('Pillar 1'). The annual Supervisory Assessment Process ('SAP'), undertaken by the Authority, aims to assess the group's risk profile and self assessment as documented in the Capital Assessment and Risk Profile ('CARP'). The completion of the SAP formed the basis for the final agreements on new statutory minimum capital requirements for the group going forward. The group has complied with all minimum capital requirements prescribed by the Authority in 2011 and 2010.

Pillar 3 of Basel II, implemented by the Authority in the second half of 2009, aims to encourage market discipline by the requirement of disclosures, quantitative and qualitative, to allow market participants to assess certain specified information on the scope of application of Basel II, capital, particular risk exposures, risk assessment processes, and hence the capital adequacy of the group. The most recent disclosure of the group, 'Capital and Risk Management Interim Pillar 3 Disclosures as at 30 June 2011', is published in the group's internet website in the 'About us' section.

(ii) Capital allocation

Although maximisation of return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the group to particular operations or activities, it is not the sole basis used for decision-making. Account is also taken of synergies, and the fit of the activity within the group's longer-term strategic objectives.

27 Litigation

In the ordinary course of business, the Company is routinely defendant in, or party to, a number of pending and threatened legal actions and proceedings. Management believes, based on information currently available to it, that the actions and proceedings and losses, if any, resulting from the final outcome thereof will not be material in the aggregate to the Company's financial position or results of operations.

Bernard L. Madoff Investment Securities LLC

In December 2008, Bernard L. Madoff ("Madoff") was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L. Madoff Investment Securities LLC ("Madoff Securities"), an SEC-registered broker-dealer and investment adviser. Since his appointment, the trustee has been recovering assets and processing claims of Madoff Securities' customers. Madoff subsequently pleaded guilty to various charges and is serving a 150 year prison sentence. He has acknowledged, in essence, that while purporting to invest his customers' money in securities and, upon request, return their profits and principal, he in fact never invested in securities and used other customers' money to fulfil requests for the return of profits and principal. The relevant US authorities are continuing their investigations into his fraud, and have brought charges against others including certain former employees and the former auditor of Madoff Securities.

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities. Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US$8.4 billion, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, we estimate that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US$4.0 billion.

Plaintiffs (including funds, fund investors, and the Madoff Securities trustee) have commenced Madoff-related proceedings against numerous defendants in a multitude of jurisdictions. Various HSBC companies have been named as defendants in suits in the US, Ireland, Luxembourg, and other jurisdictions. The suits (which included four US putative class actions) allege that the HSBC defendants knew or should have known of Madoff's fraud and breached various duties to the funds and fund investors.

In July 2010, the US District Court Judge overseeing a putative class action in the Southern District of Florida dismissed all claims against the HSBC defendants for lack of personal jurisdiction and on *forum non conveniens* grounds. In August 2011, the US Court of Appeals for the Eleventh Circuit affirmed the dismissal.

In November 2011, the US District Court Judge overseeing three related putative class actions in the Southern District of New York dismissed all claims against the HSBC defendants on *forum non conveniens* grounds. Plaintiffs in all three actions have filed notices of appeal to the US Court of Appeals for the Second Circuit.

In December 2010, the Madoff Securities trustee commenced suits against various HSBC companies in the US Bankruptcy Court and in the English High Court. The US action (which also names certain funds, investment managers, and other entities and individuals) sought US$9 billion in damages and additional recoveries from HSBC and the various co-defendants. It sought damages against HSBC for allegedly aiding and abetting Madoff's fraud and breach of fiduciary duty. In July 2011, after withdrawing the case from the Bankruptcy Court in order to decide certain threshold issues, the US District Court Judge dismissed the trustee's various common law claims on the grounds that the trustee lacks standing to assert them. In December 2011, the District Court issued an order that allowed the trustee to immediately appeal that ruling and the trustee has filed a notice of appeal.

The District Court returned the remaining claims to the US Bankruptcy Court for further proceedings. Those claims seek, pursuant to US bankruptcy law, recovery of unspecified amounts received by HSBC from funds invested with Madoff, including amounts that HSBC received when it redeemed units HSBC held in the various funds. HSBC acquired those fund units in connection with financing transactions HSBC had entered into with various clients. The trustee's US bankruptcy law claims also seek recovery of fees earned by HSBC for providing custodial, administration and similar services to the funds. In September 2011, certain non-HSBC defendants moved again to withdraw the case from the bankruptcy court. Those withdrawal motions are currently pending before the District Court.

The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the ground that the HSBC defendants actually or constructively knew of Madoff's fraud. HSBC has not yet been served.

Between October 2009 and July 2011, Fairfield Sentry Limited and Fairfield Sigma Limited ('Fairfield'), funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the British Virgin Islands ('BVI') and the US against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield actions seek restitution of amounts paid to the defendants in connection with share redemptions, on the ground that such payments were made by mistake, based on inflated values resulting from Madoff's fraud, and some actions also seek recovery of the share redemptions under BVI insolvency law. The actions in the United States are currently stayed in the Bankruptcy Court while plaintiffs pursue an appeal of a decision that reversed the Bankruptcy Court's denial of defendants' motions to remand or abstain and pending developments in related appellate litigation in the BVI.

(In US dollar thousands) 31 December 2011

There are many factors which may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings, including but not limited to the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities, or ranges of liabilities, that might arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

28 Related party transactions

Related parties of the group include subsidiaries, associates, post-employment benefit plans for group employees, key management personnel, close family members of key management personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by key management personnel or their close family members.

The group classifies the Directors of the Bank and the members of the Senior Management Committee as the key management personnel of the group.

Particulars of transactions, arrangements and agreements entered into by the group with its key management personnel, connected persons and companies controlled by them or the group are as follows:

	Loans and mortgages	Deposits
Balance at 1 January 2010	8,204	10,856
Advances and transfer in during the year	5,050	-
Repayments and transfers out during the year	(1,086)	-
Other movements	-	6,291
Balance at 31 December 2010	12,168	17,147
Advances and transfers in during the year	40,021	-
Repayments and transfers out during the year	(4,667)	-
Other movements	-	(7,054)
Balance at 31 December 2011	47,522	10,093

The above transactions were made in the ordinary course of business and substantially on the same terms, including interest rates and security, as for comparable transactions with other employees of the group which are at favourable rates. Normal banking risks are associated with these transactions.

Other compensation to key management personnel

	2011	2010
Short-term employee benefits	7,400	9,614
Post-employment benefits	285	836
Share-based payments	2,666	2,739
	10,351	13,189

Amounts included in balance sheet due from HSBC and affiliated companies

	2011	2010
Derivatives	8,134	7,064
Loans and advances to banks	2,021,031	771,141
Financial investments	697,372	341,459
Other assets	5,875	2,245

(In US dollar thousands) 31 December 2011

Amounts included in balance sheet due to HSBC and affiliated companies

	2011	2010
Deposits by banks	17,822	20,192
Derivatives	4,248	185
Other liabilities	624	231

Amounts in income statement received from HSBC and affiliated companies

	2011	2010
Interest income	11,442	998
Fee income	8,273	9,564
Gross written insurance premiums	-	48,846
Other operating income	509	4,392

Amounts in income statement paid to HSBC and affiliated companies

	2011	2010
Interest expense	28	177
Fee expense	1,752	2,500
Gross insurance claims and underwriting expenses incurred	-	43,481
General and administration expenses	19,326	37,315

There are no individually assessed loan impairment allowances in respect of outstanding balances in 2011 (2010: $NIL). No impairment charges were recognised during the year in respect of loans to related parties (2010: $NIL).

Segregated assets and liabilities

As part of the group's insurance holdings, the group owned HSBC Insurance (SAC) Limited ('SAC') which is a Bermuda incorporated company registered under the Segregated Accounts Companies Act 2000 and HSBC Insurance PCC Limited ('PCC') which is a Guernsey incorporated company registered under The Companies (Guernsey) Law, 2008. These two companies were disposed of during 2011 as part of the disposal of HSBC Insurance Holdings (Bermuda) Limited (Note 18). Both companies provide 'rent-a-captive' services including segregated cell arrangements. These programs cover professional indemnity, personal accident and travel, medical malpractice, property, casualty, workers compensation, marine and general liability risks. In 2011, there were NIL (2010: 59) segregated cell agreements in place and SAC agreed to write insurance for the participants and keep separate books of accounts for each program (the numbers of cell agreements are exact and not shown to the nearest thousand).

The assets and liabilities of the rent-a-captive program participants are legally segregated. Assets and liabilities amounting to $NIL (2010: $107,254) (unaudited) of the unrelated participants are segregated from the general assets and liabilities of the group; are not under the control of the group and therefore are not consolidated into the accompanying income statement, statement of comprehensive income, balance sheet, statement of cash flows and statement of changes in equity of the group.

29 Equity

(a) Called up share capital and share premium

The total number of authorised ordinary shares at 31 December 2011 was 140,000,000 (2010: 140,000,000) with a par value of $1 per share (2010: $1 per share). The total number of shares issued and fully paid at 31 December 2011 was 30,026,671 (2010: 30,026,671). These figures and amounts are exact (not rounded or shown to the nearest thousand). Share premium comprises additional paid in capital in excess of the par value. Share premium is not ordinarily available for distribution.

(b) Dividends

A final dividend of $113,000,000 ($3.76 per ordinary share), was declared by the Board of Directors on 17 February 2011 in respect of the 2010 financial year. An interim dividend of $79,040,000 ($2.63 per ordinary share), was declared by the Board of Directors on 21 July 2011 in respect of the 2011 financial year. In addition, the Board of Directors declared a dividend of $100,000,000 ($3.33 per ordinary share) on 17 November 2011 from the profits of the Bank arising from the period prior to 1 January 2007.

These figures and amounts are exact (not rounded or shown to the nearest thousand).

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