

Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, is the leading international bank in Canada. With around 7,200 offices in 85 countries and territories and assets of US\$2,556 billion at 31 December 2011, the HSBC Group is one of the world's largest banking and financial services organizations.

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Dividend record and payable dates in 2012 for our preferred shares, subject to approval by our Board of Directors, are:

<i>Record Date</i>	<i>Payable Date</i>
15 March	31 March
15 June	30 June
14 September	30 September
14 December	31 December

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

Designation of Eligible Dividends

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

Shareholder Information

PRINCIPAL ADDRESSES:
Vancouver:

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Vancouver, British Columbia
Canada V6C 3E9
Tel: (604) 685-1000
Fax: (604) 641-3098

Toronto:

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Toronto, Ontario
Canada M5J 1S9
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Media Enquiries:

Vancouver (English) (604) 641-2973
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Toronto (French) (416) 868-8282

WEBSITE:

www.hsbc.ca

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

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

TRANSFER AGENT AND REGISTRAR:

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

SHAREHOLDER CONTACT:

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

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

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

Shareholder Relations:

Chris Young (604) 642-4389
Harry Krentz (604) 641-1013

Caution Concerning Forward-Looking Statements

This document contains forward-looking information, including statements regarding the business and anticipated actions of the bank. These statements can be identified by the fact that they do not pertain strictly to historical or current facts. Forward-looking statements often include words such as “anticipates,” “estimates,” “expects,” “projects,” “intends,” “plans,” “believes” and words and terms of similar substance in connection with discussions of future operating or financial performance. Examples of forward-looking statements in this document include, but are not limited, to statements made in “Message from the President and Chief Executive Officer” on page 3, “Economic Outlook for 2012” on page 11, “Employee future benefits” on page 27, and “Transition to IFRS” on page 28. By their very nature, these statements require us to make a number of assumptions and are subject to a number of inherent risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. We caution you to not place undue reliance on these statements as a number of risk factors could cause our actual results to differ materially from the expectations expressed in such forward-looking statements. These risk factors – many of which are beyond our control and the effects of which are difficult to predict – that could cause such differences include: capital management, credit, liquidity and funding, market, structural, and operational risks all of which are discussed in the Risk Management section of the 2011 MD&A on pages 32 to 54. Additional risk factors include the extra-territorial impact of recent legislative developments from the Dodd-Frank Wall Street Reform and Consumer Protection Act and the regulations issued thereunder, technological change, global capital market activity, changes in government monetary and economic policies, changes in prevailing interest rates, inflation levels and general economic conditions in geographic areas where the bank operates. Canada is an extremely competitive banking environment, and pressures on our net interest margin may arise from actions taken by individual banks or other financial institutions acting alone. Varying economic conditions may also affect equity and foreign exchange markets, which could also have an impact on our revenues. We caution you that the risk factors disclosed above are not exhaustive, and there could be other uncertainties and potential risk factors not considered here which may adversely affect our results and financial condition. Any forward-looking statements in this document speak only as of the date of this document. We do not undertake any obligation to, and expressly disclaim any obligation to, update or alter our forward-looking statements, whether as a result of new information, subsequent events or otherwise, except as required under applicable securities legislation.

Message from the President and Chief Executive Officer

In 2011, HSBC Bank Canada celebrated 30 years serving Canadians. When we first opened our doors as Hongkong Bank of Canada in 1981, those doors opened onto a single office in Vancouver. We are now the largest international bank in Canada with offices across the country.

As part of a group with operations in over 80 countries around the world, HSBC Bank Canada's deep understanding of the key issues, trends and challenges facing Canadian companies doing business abroad enables us to provide them unique support.

In 2011, to better serve our commercial clients, we continued the expansion of our Commercial Banking business in Central Canada, hiring more than 50 staff and launched an initiative to have Global Banking and Markets staff accompany our Commercial bankers on over 1,000 customer visits bringing the international expertise of Global Banking and Markets to our Canadian customers.

In May we celebrated with the inaugural winners of the HSBC International Business Awards – Canadian firms that have made a real difference in taking their products and services to the world. This program continues in 2012 and I am looking forward to meeting more exceptional examples of companies that are thriving by taking Canadian products abroad.

For the first time in 2011, HSBC was named the best domestic cash manager in Canada in the Euromoney Cash Management Survey – a true testament to our capabilities and the standard of customer service we provide.

HSBC became the fastest growing bank-owned mutual fund company in Canada, growing at a rate of over 17 per cent per year, the highest net mutual fund sales in our history.

We were also thrilled that HSBC Bank Canada was recognized as one of Canada's Top 10 Employers for Young People according to Mediacorp Canada for the second year in a row. This validates the considerable efforts we have made over recent years to create a workplace and culture that appeal to employees whatever their age or background. Our diverse workforce is a source of great pride and is a significant contributor to the high level of service provided to our customers by thousands of HSBC staff across the country each and every day.

I am pleased that the strong fundamentals underpinning HSBC Bank Canada's core businesses allowed us to continue to perform well in a year marked by an uncertain economy. We expect the economy to continue to show subdued growth in the face of a challenging external environment. However, we will focus on deepening our relationships with our customers ensuring access to our global and emerging market capabilities. These actions will enable us to continue to meet our customers' needs in the years ahead.



Lindsay Gordon
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
24 February 2012

Management's Discussion and Analysis

Five Year Financial Summary

<i>(in \$ millions, except where otherwise stated)</i>	IFRS 2011	IFRS 2010	GAAP 2009	GAAP 2008	GAAP 2007
Condensed statements of income					
Net interest income	1,556	1,608	1,479	1,644	1,718
Net fee income	644	638	545	454	454
Net trading income	150	153	329	402	256
Other operating income	147	187	223	104	183
Net operating income before loan impairment charges	2,497	2,586	2,576	2,604	2,611
Loan impairment charges and other credit risk provisions	(197)	(359)	(515)	(379)	(239)
Net operating income	2,300	2,227	2,061	2,225	2,372
Operating expenses	(1,348)	(1,357)	(1,323)	(1,353)	(1,383)
Operating profit	952	870	738	872	989
Share of profits in associates	4	5	–	–	–
Profit before income tax expense	956	875	738	872	989
Income tax expense	(252)	(257)	(207)	(253)	(347)
Profit for the year	704	618	531	619	642
Profit attributable to common shareholders	633	531	448	573	598
Profit attributable to preferred shareholders	61	61	57	20	18
Profit attributable to non-controlling interests	10	26	26	26	26
Basic earnings per common share (\$)	1.27	1.06	0.90	1.09	1.16
Financial highlights					
Total assets	79,995	78,017	71,695	73,952	68,194
Shareholders' equity	4,973	4,426	4,364	4,153	3,612
Risk-weighted assets	35,322	34,152	37,674	41,623	41,372
Loans and advances to customers (net of impairment allowances)	44,284	45,218	43,070	48,855	49,322
Customer accounts	46,614	45,492	50,207	51,962	48,878
Capital ratios (%)²					
Tier 1 ratio	13.4	13.3	12.1	10.1	8.8
Total capital ratio	16.0	16.0	14.9	12.5	11.3
Performance ratios (%)¹					
Return on average common equity	17.0	15.5	13.1	16.6	19.6
Post-tax return on average total assets	0.77	0.66	0.62	0.77	0.88
Post-tax return on average risk-weighted assets	1.8	1.5	1.1	1.4	1.5
Credit coverage ratios (%)					
Loan impairment charges as a percentage of total operating income	7.9	13.9	20.0	14.6	9.2
Loan impairment charges as a percentage of average gross customer advances and acceptances	0.4	0.7	1.5	1.2	1.0
Total impairment allowances outstanding as a percentage of impaired loans and acceptances	73.4	73.1	62.4	66.0	122.4
Efficiency and revenue mix ratios (%)¹					
Cost efficiency ratio	54.0	52.5	51.4	52.0	53.0
Adjusted cost efficiency ratio ³	51.8	49.1	–	–	–
Net interest margin	2.23	2.32	2.40	2.59	2.91
As a percentage of total operating income ¹					
Net interest income	62.3	62.2	57.4	63.1	65.8
Net fee income	25.8	24.7	21.2	17.4	17.4
Net trading income	6.0	5.9	12.8	15.4	9.8
Financial ratios (%)¹					
Ratio of customer advances to customer accounts	95.0	99.4	75.9	84.0	89.2
Average total shareholders' equity to average total assets	5.7	5.4	6.0	5.6	5.0
Assets under administration⁴					
Funds under management	26,383	31,501	28,174	21,287	26,213
Custodial accounts	967	1,303	10,721	9,221	10,914
	27,350	32,804	38,895	30,508	37,127

1 These are non-IFRS amounts or non-IFRS measures. Please refer to the discussion outlining the use of non-IFRS measures in this document on page 5.

2 Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI'). Risk-weighted assets and ratios at 31 December 2010 and prior years have not been restated for the adoption of IFRS as at 1 January 2011.

3 Adjusted cost efficiency ratio not calculated for years prior to 2010.

4 Funds under management include funds managed in the full-service brokerage business which was sold with effect 1 January 2012. This included \$10.6bn and \$15.7bn at 31 December 2011 and 2010 respectively.

HSBC Bank Canada's ('the bank', 'we', 'our') Management's Discussion and Analysis ('MD&A') is dated 24 February 2012, the date that our Consolidated Financial Statements and MD&A for the year ended 31 December 2011 were approved by our Board of Directors ('the Board').

Basis of preparation of financial information. The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards ('IFRS'). The financial information included in the MD&A is either at 31 December, or for the years then ended. The information is derived either directly from our Consolidated Financial Statements or from the information we have used to prepare them. Unless otherwise stated, all references to '\$' mean Canadian dollars. All tabular amounts are in millions of dollars except where otherwise stated. Prior to the adoption of IFRS, our financial statements were prepared in accordance with Canadian generally accepted accounting principles ('GAAP'). Prior period (2010) amounts have been restated on an IFRS basis and certain amounts have been reclassified to conform to the presentation adopted in the current period. Our adoption of IFRS is described in more detail in the 'Transition to IFRS' section of this MD&A and in note 34 of the accompanying Consolidated Financial Statements.

Certain financial information that we are required to disclose as part of the MD&A is included in the table on page 4, which also includes a number of IFRS and non-IFRS measures. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than IFRS may not have any standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers. The following outlines various measures which management regularly monitors, to more clearly indicate the derivation of the measure:

- *Return on average common equity* – Profit attributable to common shareholders divided by average common equity, which is calculated using month-end balances of common equity for the year.
- *Post-tax return on average assets* – Profit attributable to common shareholders divided by average assets, which is calculated using average daily balances for the year.
- *Post-tax return on average risk weighted assets* – Profit attributable to common shareholders divided by the average monthly balances of risk weighted assets for the year. Risk weighted assets are calculated using guidelines issued by OSFI in accordance with the Basel II capital adequacy framework.
- *Cost efficiency ratio* – Calculated as total operating expenses for the year divided by net operating income before loan impairment charges and other credit risk provisions for the year.
- *Adjusted cost efficiency ratio* – Cost efficiency ratio adjusted to exclude gains and losses from financial instruments designated at fair value from net operating income before loan impairment charges and other credit risk provisions and intra-group recoveries from HSBC Group entities from both net operating income before loan impairment charges and other credit risk provisions and total operating expenses. For purposes of this adjusted ratio, intra-group revenues and expenses, which are reported on a gross basis in "other operating income" and "general and administrative expenses" in our consolidated financial statements, are reflected on a net basis, consistent with our reporting to our parent.
- *Net interest income, net fee income and net trading income as a percentage of total operating income* – Net interest income, net fee income and net trading income for the year divided by net operating income before loan impairment charges and other credit risk provisions for the year.
- *Ratio of customer advances to customer accounts* – Loans and advances to customers divided by customer accounts, using year-end balances.
- *Average total shareholders' equity to average total assets* – Average shareholders' equity is calculated using month-end balances of total shareholders' equity for the year and average total assets are calculated using average daily balances for the year.

The sections on risk management included in this MD&A where indicated on pages 32 to 54 form an integral part of the Consolidated Financial Statements and should be read in conjunction with the Consolidated Financial Statements for the year ended 31 December 2011 and the related auditors' report.

Management's Discussion and Analysis (continued)

We make a number of references throughout this MD&A to 'notes' which means notes on the 2011 audited Consolidated Financial Statements, which are included with the MD&A in our Annual Report and Accounts.

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

Outstanding securities data. Note 27 of the Consolidated Financial Statements contains details of the number of preferred and common shares issued and outstanding at 31 December 2011. Note 28 contains details of the number of HSBC Canada Asset Trust Securities ('HSBC HaTSSM') outstanding at 31 December 2011. Subsequent to that date and up to the date of this MD&A, there have been no issues of any form of securities.

Overview

In Canada, HSBC is the leading full-service international bank and seventh largest bank overall with operations across the country and total assets of \$80bn at 31 December 2011.

Originally established in 1981, with our head office located in Vancouver, British Columbia, we have grown organically and through certain strategic acquisitions, to become an integrated financial services organization. We provide Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets and Consumer Finance services.

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

The HSBC Group

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

Through an international network linked by advanced technology, the HSBC Group provides a comprehensive range of financial services: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets and Global Private Banking.

Complete financial and operational information for HSBC Holdings and the HSBC Group can be obtained from its website, www.hsbc.com, including copies of HSBC Holdings 2011 Annual Review and its 2011 Annual Report and Accounts.

HSBC's values

The role of HSBC's values in daily operating practice has taken on increased significance in the context of the global financial crises, with the changes to the regulatory policies, investor confidence and society's view of the role of banks. We expect our executives and staff to act with courageous integrity in the execution of their duties.

HSBC's values are being:

- Dependable and doing the right thing
- Open to different ideas and cultures
- Connected with our customers, communities, regulators and each other.

We have strengthened our values-led culture by embedding HSBC's values through training, development and employee induction, and through the personal sponsorship of senior executives. These initiatives will continue in 2012 and beyond.

HSBC's objective is to deliver sustainable long-term value to its shareholders through consistent earnings and superior risk adjusted returns. We have a clear strategy to become the leading international bank, based on two elements which are aligned with the key trends shaping the global economy:

- **International connectivity** – we are strengthening our presence in those markets and businesses that are most relevant to global trade and capital flows; and
- **Economic development and wealth creation** – we are investing to capture wealth creation in selected markets and focusing on retail banking only in those markets where we can achieve profitable scale.

To deliver on our strategy we are taking action in three areas:

- **Capital deployment** – we are improving the way we deploy our capital as part of our efforts to achieve our targeted return on equity of 12% to 15% over the business cycle. We have introduced a strategic framework assessing each of our businesses on a set of five strategic evaluation criteria, namely international connectivity, economic development, profitability, cost efficiency and liquidity. The results of this review determine whether we invest in, turn around, continue with or exit the business.
- **Cost efficiency** – we have launched a transformation programme to achieve sustainable cost savings which is intended to facilitate self-funded growth in key markets and investment in new products, processes and technology, and to provide a buffer against regulatory and inflationary headwinds; and
- **Growth** – we continue to position ourselves for growth. We are increasing our relevance in fast growing markets and in wealth management and we are improving the collaboration between our international network of businesses, particularly between Commercial Banking and Global Banking and Markets.

The objectives and incentives of management are aligned to delivering the strategy.

Our Strategic Direction and Main Achievements for 2011

Products and services

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

In November 2010, our parent company announced that within the context of the customer group global business view of HSBC Group's performance, Retail Banking and Wealth Management would be managed as a single global business. Accordingly, the previous Personal Financial Services has been merged with Global Asset Management which was previously part of Global Banking and Markets.

Retail Banking and Wealth Management

The Retail Banking and Wealth Management business continued to focus on being the leading international premium bank in Canada, offering its premium customers global connectivity through innovative products, providing them access to emerging market exposure and deepening relationships with them through propositions and pricing.

Retail Banking and Wealth Management offers its products and services to customers based on their individual needs. *HSBC Premier* and *HSBC Advance* services are targeted at mass affluent and emerging affluent customers who value international connectivity and benefit from our global reach and scale. For customers who have simpler everyday banking needs, we offer a full range of banking products and services reflecting local requirements.

Customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (investment products, estate and financial planning services).

Management's Discussion and Analysis (continued)

- *HSBC Premier* provides preferential banking services and global recognition to our high net worth customers and their immediate families with a dedicated relationship manager, specialist wealth advice and tailored solutions. Customers can access emergency travel assistance, priority telephone banking and online 'global view' of their *HSBC Premier* accounts around the world with free money transfers between them.
- *HSBC Advance* provides a range of preferential products and services customized to meet local needs. With a dedicated telephone service, access to wealth advice and online tools to support financial planning, it gives customers an online 'global view' of their *HSBC Advance* accounts with money transfers between them.
- Wealth Solutions & Financial Planning: a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth through best-in-class investment products manufactured by in-house partners (Global Asset Management and Global Markets) and by selected third party providers.
- Customers can transact with the bank via a range of channels such as Internet banking, face to face and self-service terminals in addition to traditional branches, telephone call centres and ATMs.

Business developments and achievements for 2011 include:

- *HSBC Premier* – growing our *HSBC Premier* customer base to over 242,500, a net growth of over 37,100 customers. *HSBC Premier* offers seamless global banking with over 6,000 *HSBC Premier* branches and over 250 *HSBC Premier* Tier 1 centres worldwide in 46 countries. Our *HSBC Premier* Relationship managers and our developing multi channel provide a single point of contact to meet all our customers' financial needs.
- *HSBC Advance*, offering priority services to emerging mass affluent customers, provides seamless global banking in over 33 countries, with a customer base that has grown to over 67,500.
- *Wealth management* – ranking fifth amongst Canadian banks in mutual fund sales, with total net sales of \$1.3bn, significantly outselling relative to the size of our network compared to the Canadian banks and demonstrating the appeal to customers of bringing the world of investment opportunities to Canadians. HSBC has the fastest growing mutual fund business amongst Canadian banks – growing at 19.6% through 2011. HSBC is the only bank in Canada to offer *Premium* series pricing across the entire mutual fund range, an initiative designed to support growth in both fund sales and assets amongst affluent/high net worth *Premier* investors. We added emerging market debt exposure to *World Selection* via the launch of a new *HSBC Emerging Market Debt Fund*. With our *World Selection* family of funds, we now have the broadest emerging market fund range in Canada. *HSBC Indian Equity Fund* and *HSBC Chinese Equity Fund* continue to be the top selling funds of their kind in Canada for the year.
- *Product innovations* – continuing to bring innovative products to the Canadian market, launching four new reward programs in our *MasterCard*™ credit card business to strengthen alignment with our key client segments. In addition, exclusively for *HSBC Premier MasterCard*™ cardholders, we introduced the *HSBC Rewards for Miles* program (with Cathay Pacific and Singapore Airlines as partners) and the *HSBC Premier Alerts* service which allows cardholders to receive notification via email or SMS text message for transactions that are made online or internationally. HSBC recently launched a brand new web-based mobile banking application for 'Apple' devices, making it even easier for iPhone and iPad users to manage their every-day banking needs.
- *Business rationalization* – aligning with the five filters articulated at the HSBC Group's Investor day in May 2011, we decided to sell the full-service retail brokerage and related wealth management business. The business requires scale to achieve acceptable returns and we determined that the best course of action was to enter into a strategic relationship to serve our customers, focusing the proceeds on building our *HSBC Premier* wealth management professionals and proprietary wealth management offering via HSBC Global Asset Management. On 20 September 2011 the bank, together with certain of its wholly-owned subsidiaries, entered into an agreement to sell certain assets of the full-service retail brokerage and related wealth management business. The transaction closed effective 1 January 2012. Further details of this transaction are covered on page 14 of this report. Following the announcement of this sale, but prior to its closing, a number of investment advisors decided to leave and pursue opportunities elsewhere. This led to a reduction in funds under management during the fourth quarter.

Commercial Banking

We segment our Commercial Banking business into Corporate, to serve both Corporate and Mid-Market companies with more sophisticated financial needs and Business Banking, which serves the small and medium-sized enterprises sector. This enables the development of tailored customer propositions while adopting a broader view of the entire commercial banking sector, from sole proprietors to large corporations. It also allows us to provide continuous support to companies as they expand both domestically and internationally, and ensures a clear focus on the business banking segments that are typically the key to innovation and growth in market economies.

The Commercial Banking business continued to focus on its position as being the best bank for small business through our business direct strategy and as the leading international bank for business by strengthening our cross border capabilities, particularly through our investment to grow our presence in central Canada.

We place particular emphasis on international connectivity to meet our business customers' needs and aim to be recognized as the leading international bank in all our markets and the best bank for business in our target markets.

- Financing: we offer a broad range of financing, both domestic and cross border, including overdrafts, receivables finance, term loans and leasing.
- Payment and cash management: we are a leading provider of domestic and cross border payments and collections, liquidity management and account services worldwide, delivered through our e-platform, *HSBCnet*.
- International trade: we provide various international trade products and services, to both buyers and suppliers such as export finance, guarantees, documentary collections and forfaiting to improve efficiency and help mitigate risk throughout the supply chain.
- Treasury: Commercial Banking customers are volume users of our foreign exchange, derivatives and structured products.
- Capital markets and advisory: capital raising on debt and equity markets and advisory services are available as required.
- Commercial cards: card issuing helps customers enhance cash management, credit control and purchasing.
- Direct channels: these include online and direct banking offerings such as telephone banking, *HSBCnet* and *Business Internet Banking*.

Business developments and achievements for 2011 include:

- *Best Bank for Cash Management* – The 2011 Euromoney Cash Management survey, an annual survey of cash managers, treasurers and financial officers worldwide, named HSBC Bank Canada the Best Domestic Cash Manager for 2011.
- *Leading International Business* – We continued to strengthen our cross border capabilities and international connectivity through the HSBC Group's worldwide international banking centres. The number of successful Global Link customer referrals in and out of Canada grew 12% year on year. A new Commercial Bank card is due to be launched in Canada, facilitating greater customer segmentation and client experience, and will be aligned to Group's branding – further reinforcing our Leading International Business identity.
- *New Products and Campaigns launched in 2011* – Several products and campaigns were launched in 2011, prominent among them being our Trade campaign in line with the HSBC Commercial Banking Global Trade campaign which focussed on international business to position HSBC as the market leading global trade bank by 2014. A global Payments and Cash Management campaign generated over \$1bn in commercial deposits. Since its launch in 2002, *HSBCnet* has reached many milestones, and is a key driver of transaction volume and value that provides additional revenue opportunities to our Payments and Cash Management, Securities, and Trade and Supply Chain businesses.
- *Business without Borders* – The partnership with Rogers Media, The Globe and Mail and The Economist Intelligence Unit to launch an exclusive, first of its kind initiative, BUSINESS *without* BORDERS™, 'Helping businesses grow internationally', firmly reaffirmed our position as the leading international bank for business in Canada. This includes the HSBC International Business Awards program, which is designed to recognize, celebrate and promote businesses that are successfully investing, operating and growing internationally. The initiative resulted in signing up more than 6,000 members, easily surpassing the target of 5,000 by the end of 2011.

Management's Discussion and Analysis (continued)

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients and private investors worldwide. Managed as a global business, Global Banking and Markets operates a long-term relationship management approach to build a full understanding of clients' financial requirements. Sector-focused client service teams, comprising relationship managers and product specialists, develop financial solutions to meet individual client needs. With dedicated offices in over 65 countries and access to HSBC's worldwide presence and capabilities, this business serves subsidiaries and offices of our clients on a global basis.

The Global Banking and Markets business continued to focus on being the international bank of choice by building a client-driven franchise serving the global needs of our core clients, delivering global products to Canadian clients and Canadian products to global clients.

Global Banking and Markets is managed as two principal business lines, HSBC Global Markets and Global Banking. This structure allows us to focus on relationships and sectors that best fit the HSBC Group's footprint and facilitate seamless delivery of our products and services to clients.

- Global Markets operations consist of treasury and capital markets services. Products include foreign exchange, currency, interest rate, bond, credit, equity and other derivatives; government and non-government fixed income and money market instruments; precious metals and exchange-traded futures; equity services and distribution of capital markets instruments.
- Global Banking offers financing, advisory and transaction services. Products include:
 - Capital raising, advisory services, bilateral and syndicated lending, leveraged and acquisition finance, structured and project finance, lease finance and non-retail deposit taking;
 - International, regional and domestic payments and cash management services; and trade services for large corporate clients.

Business developments and achievements for 2011 include:

- *Global Markets* – focusing on enhanced connectivity with our clients, both internal and external – domestically and globally. This focus resulted in a significant increase in the number of clients with which HSBC dealt across all Global Markets products.
- *Global Banking* – leveraging the global network, building relationships with target clients in the resource, energy, infrastructure and financial sectors. Our joined up approach resulted in HSBC playing a leading role in a number of key transactions including a joint-book runner role on the largest equity transaction in Canada in 2011. We also continued to be active in cross border advisory activity and maintained a leading position in cross border debt financing for Canadian public sector and corporate clients. We will selectively look for opportunities to expand our platform in our primary markets and businesses in the coming year.

Consumer Finance

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

The primary focus of the Consumer Finance business continued to be the improvement of the sales force's productivity and managing risk and credit quality.

Business developments and achievements for 2011 include:

- *Consumer lending* – improved productivity on both real estate and unsecured loans, compared to 2010 results.
- *Retail* – signing a contract to fund 100% of new volume with one of our large merchants (previously at 85%) and continued efforts to improve overall profitability of the business.
- *Credit cards* – spend volume increased 13.5% in 2011 as a result of new account acquisitions and higher spend per card.
- *Reduced risk in business* – achieving significant reductions in delinquencies year over year, through our continued focus on collections and tighter collection policies and practices.

Economic Outlook For 2012

We expect the Canadian economy to show modest but continued improvement through 2012, with a moderate reduction in unemployment, increasing trade with emerging markets and a strong resource sector. Interest rates are expected to increase slowly in 2013, influenced by US rates.

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

Analysis of Financial Results For the Year Ended 31 December 2011

- Profit attributable to common shareholders was \$633m for 2011, an increase of 19.2% compared with \$531m for 2010.
- Return on average common equity was 17.0% for 2011 compared with 15.5% for 2010.
- The cost efficiency ratio was 54.0% for 2011 compared with 52.5% for 2010.
- Total assets were \$80.0bn at 31 December 2011, an increase of \$2.0bn, or 2.6%, from \$78.0bn at 31 December 2010.
- Total assets under administration were \$27.4bn at 31 December 2011, a decrease of \$5.4bn, or 16.5%, from \$32.8bn at 31 December 2010.

Overview

HSBC Bank Canada recorded profit for the year ended 31 December 2011 of \$704m, an increase of \$86m, or 13.9% compared to 2010. This increase in profits in 2011 was primarily due to lower loan impairment charges, partially offset by lower net interest income and a provision for the write-down of investment property. However, there was good growth in fee income in our core businesses.

HSBC Bank Canada delivered solid results in 2011 largely due to strong business fundamentals in our core businesses, despite reduced customer borrowing demands, and improving asset quality leading to lower loan impairment charges.

Net interest income

An analysis of net interest income for the year ended 31 December is as follows:

	2011			2010		
	Average balance \$m	Interest income \$m	Yield %	Average balance \$m	Interest income \$m	Yield %
Interest earning assets						
Loans and advances						
with customers	38,358	1,578	4.1%	40,392	1,600	4.0%
Loans and advances						
with banks	1,969	29	1.5%	1,530	16	1.0%
Financial instruments	26,840	411	1.5%	24,575	358	1.5%
HSBC Financial Corporation Limited.	2,572	348	13.5%	2,947	399	13.5%
Total interest earnings assets	69,739	2,366	3.4%	69,444	2,373	3.4%
Total interest costing liabilities	65,729	(810)	1.2%	66,130	(765)	1.1%
Net interest and Net interest margin		1,556	2.2%		1,608	2.3%

Management's Discussion and Analysis (continued)

Net interest income for the year was \$1,556m in 2011 compared with \$1,608m in 2010, a decrease of \$52m, or 3.2%. Although average interest earning assets increased marginally, commercial borrowings and consumer finance receivables have decreased as clients continue to de-leverage. The impact of the lower loan volumes is partially offset by the effect of increases in the Bank of Canada interest rates in the second half of 2010 which positively impacted the yield on the bank's prime rate-based assets compared to the prior year.

Net Fee Income

Fee income for the year ended 31 December is as follows:

	2011	2010
	\$m	\$m
Credit facilities.....	213	196
Funds under management.....	162	141
Account services.....	85	90
Brokerage commissions.....	63	74
Credit cards.....	51	46
Corporate finance.....	43	45
Insurance.....	22	40
Remittances.....	25	18
Trade finance import/export.....	11	11
Trustee fees.....	5	6
Other.....	54	60
Fee income.....	<u>734</u>	<u>727</u>
Less: fee expense.....	<u>(90)</u>	<u>(89)</u>
Net fee income.....	<u>644</u>	<u>638</u>

Net fee income increased by \$6m, 0.9% from \$638m in 2010 to \$644m in 2011. Strong fundamentals in our underlying core businesses resulted in increased fees earned for credit facilities, remittances and fund management which also benefited from increased average funds under management. This was partially offset by lower fees from the Global Investor Immigration Program due to a slowdown in the number of applications processed by the government as well as a reduction in brokerage commissions due to lower equity markets and the impact of the loss of investment advisors that left in advance of the sale of the full-service brokerage business. Fees from insurance declined due to non-recurring fees received in the previous year.

Net trading income of \$150m in 2011 decreased by \$3m, or 2.0% when compared with \$153m in 2010. Foreign exchange revenues showed a moderate increase as a result of increased customer volumes as well as the impact of volatile currency markets. However this was offset by a \$21m recovery in 2010 of previously recorded losses upon the disposal of substantially all of the bank's non-bank Canadian asset-backed commercial paper ('ABCP') portfolio.

Other operating income

Other operating income for the year ended 31 December is as follows:

	2011	2010
	\$m	\$m
Net gain/(loss) from financial instruments designated at fair value.....	16	(2)
Gains less losses from financial investments.....	43	8
Other operating income.....	88	181
Total other operating income.....	<u>147</u>	<u>187</u>

Net gain/(loss) from financial instruments designated at fair value Financial instruments designated at fair value resulted in a gain of \$16m compared with a loss of \$2m for 2010. The bank records certain subordinated debentures, deposits and liabilities at fair value. Credit spreads widened in 2011, particularly in the third quarter, resulting in a decrease in the fair value of these balances.

Gains less losses from financial investments were \$43m in 2011, an increase of \$35m when compared with \$8m in 2010. The increase in the year was a result of gains recognized on the disposal of the bank's available-for-sale ('AFS') preferred share portfolio, combined with higher gains from the sale of certain AFS government bonds and bank debt securities.

Other operating income was \$88m in 2011 compared with \$181m in 2010, a decrease of \$93m, or 51.4%. A \$59m charge was recorded in 2011 for a write down in the value of investment property. Following the Group's decision to emphasize cost containment and focus on certain core systems, there was a decrease of \$37m in revenues received in 2011 from affiliates in respect of software development services performed on their behalf.

Operating expenses and efficiency

Operating expenses for the year ended 31 December are as follows:

	2011	2010
	\$m	\$m
Employee compensation and benefits	796	750
General and administrative expenses	475	548
Depreciation of property, plant and equipment.....	37	40
Amortization and impairment of intangible assets	40	19
Total operating expenses	1,348	1,357
Cost efficiency ratio	54.0%	52.5%
Adjusted cost efficiency ratio.....	51.8%	49.1%

Total operating expenses were \$1,348m in 2011 compared with \$1,357m in 2010, a decrease of \$9m, or 0.7%. Employee compensation and benefits increased \$46m for the year, partially due to an increase in the post-retirement benefits expense as a result of enhancements to certain of the bank's defined contribution pension plans, combined with higher full-time salaries and restructuring costs associated with certain efficiency-driven initiatives. General and administrative expenses decreased by \$73m for the year largely due to a recovery from an HSBC affiliate of fees paid with respect to prior years as well as the impact of reduction in spend on Group systems noted above. Amortization and impairment of intangible assets increased \$21m for the year as a result of a write-off of certain internally-developed software costs in 2011. Also included were \$14m of charges relating to the sale of the full-service retail brokerage business.

The cost efficiency ratio increased marginally as a result of the lower income levels recorded for the year. The adjusted cost efficiency ratio of 51.8% is marginally up from 2010 due to the lower revenue levels for 2011.

Credit quality and provision for credit losses

Loan impairment charges and other credit risk provisions for the year were \$197m compared with \$359m in 2010, a decrease of \$162m, or 45.1%. The decrease in loan impairment charges in 2011 compared with 2010 was due to reduced levels of individually assessed impairment charges, and a lower collective impairment provision due to improved credit quality and lower loan volumes in the bank's commercial loan and consumer finance portfolios.

Further detailed discussion is contained in the 'Credit Risk' section of this report on pages 38 to 48.

Income taxes

The effective tax rate for the year was 26.4%, compared with 29.4% in 2010. The decrease was a result of the reduction in statutory tax rates and the recovery of fees from an HSBC affiliate during the second quarter of 2011 which were not taxable.

Management's Discussion and Analysis (continued)

Statement of financial position

Total assets at 31 December 2011 were \$80.0bn, an increase of \$2.0bn from 31 December 2010, primarily due to a \$3.0bn increase in financial investments and a \$0.8bn increase in derivatives partially offset by a \$1.3bn decrease in loans and advances to banks, and a \$0.9bn decrease in loans and advances to customers. Liquidity remained strong with \$28.5bn of cash and balances at the central bank, items in the course of collection from other banks, trading assets, loans and advances to banks and financial investments at 31 December 2011, compared with \$26.1bn at 31 December 2010. Loans and advances to customers at 31 December 2011 were \$44.3bn compared to \$45.2bn at 31 December 2010. The decline in loans and advances to customers is primarily due to a decrease in the balance of reverse repurchase agreements with customers. Excluding reverse repurchase agreements, loans and advances to customers increased marginally.

Improving asset quality resulted in a lower level of impaired loans and reduced specific and collective provisions. Gross impaired loans were \$678m, a decrease of \$120m compared with \$798m at 31 December 2010. Total impaired loans net of specific allowances for credit losses were \$470m at 31 December 2011, compared with \$571m at 31 December 2010. Total impaired loans includes \$59m (31 December 2010: \$117m) of consumer finance loans, for which impairment is assessed collectively. The collective allowance applicable to consumer finance loans was \$89m compared with \$148m at 31 December 2010. The total collective allowance was \$329m compared with \$400m at 31 December 2010.

Following campaigns with our commercial customers, total customer accounts of \$46.6bn at 31 December 2011 increased \$1.1bn from 31 December 2010.

Debt securities in issue decreased to \$13.3bn at 31 December 2011 from \$14.8bn at 31 December 2010 mainly as a result of a reduction on overall borrowing requirements.

The assets, liabilities, revenues and expenses relating to the full-service retail brokerage business are included in the Retail Banking and Wealth Management segment. Assets and liabilities relating to the business being sold were recorded as held for sale and are measured at the lower of the carrying amount and fair value less costs to sell. At 31 December 2011, non-current assets held for sale of \$3m representing goodwill and intangible assets have been included in other assets. Client accounts receivable and prepayments and accrued income of \$58m; and client trading accounts and accruals and deferred income of \$318m have been included in other assets and other liabilities respectively. There was no impact on the carrying amount on reclassifying these assets and liabilities as held for sale. In the fourth quarter, \$14m of charges were incurred relating to this transaction. A gain relating to the sale of approximately \$80m will be recorded in the first quarter of 2012.

Total assets under administration

A general decrease in market values as well as a reduction in funds under management following the announcement of the sale of the full-service brokerage business resulted in a decrease in funds under management to \$26.4bn at 31 December 2011 from \$31.5bn at 31 December 2010. Of these balances, \$10.6bn and \$15.4bn related to funds under management in the full-service brokerage business at 31 December 2011 and 2010 respectively. Including custody and administration balances, total assets under administration were \$27.4bn, compared with \$32.8bn at 31 December 2010.

Analysis of 2011 financial results by customer group

As noted above, following a reorganization of the certain customer groupings and the global business view of HSBC Group's performance, there were changes in reporting segments for certain businesses. Global Asset Management moved from Global Banking and Markets to the Retail Banking and Wealth Management business, effective for the current year. Prior year results have been restated to reflected the current reporting structure.

Retail Banking and Wealth Management

Selected Financial Information and Analysis. The following sets out financial information and other data for Retail Banking and Wealth Management:

	2011	2010
	\$m	\$m
Net interest income	399	391
Net fee income	255	252
Net trading income.....	20	26
Other operating income.....	9	8
Net operating income before loan impairment charges and other credit risk provisions	683	677
Loan impairment charges and other credit risk provisions	(20)	(27)
Net operating income	663	650
Total operating expenses	(589)	(587)
Profit before income tax expense.....	74	63

Overview

Profit before income tax expense for 2011 was \$74m compared with \$63m in 2010. Results for 2011 were impacted by a \$16m write-off of internally-developed software costs and \$14m of transaction costs related to sale of the full-service brokerage business, partially offset by a recovery of fees from an HSBC Group affiliate with respect to prior years of \$28m, while 2010 included a gain of \$7m arising from the recovery of previously recorded losses on non-bank asset backed commercial paper ('ABCP'). Excluding the impact of these items, the increase in year-to-date profit is mainly due to higher net interest income resulting from a re-pricing initiative, higher income from Wealth Management Business relating to funds under management due to stronger sales, higher loan fees, and lower loan impairment charges due to a release of collective impairment provisions resulting from improved credit quality.

Financial Performance

Net interest income was \$399m in 2011, an increase of \$8m, or 2.0%, compared to 2010. The increase was primarily due to the re-pricing of High Rate and Advance Savings Accounts, higher mortgage prepayment penalty fees and higher revenues related to customer balances in the securities business, partially offset by lower transaction volumes and higher funding costs.

Net fee income was \$255m in 2011, an increase of \$3m, or 1.2%, compared to 2010, primarily due to higher income from funds under management due to stronger sales, partially offset by lower brokerage commissions from the full-service brokerage business as well as lower trading volumes caused by lower equity markets, lower net revenues from Global Immigrant Investor Services program, lower trustee fees and lower service charges.

Net trading income was \$20m, a decrease of \$6m, or 23.1%, compared to 2010, primarily due to the \$7m recovery of previously recorded losses on ABCP that was recorded in 2010.

Loan impairment charges and other credit risk provisions were \$20m in 2011, a decrease of \$7m, or 25.9%, compared to 2010 primarily due to lower collective impairment provisions as a result of lower loan volumes and improved credit quality.

Total operating expenses were \$589m in 2011, an increase of \$2m, or 0.3%, compared to 2010. Excluding the Group fee recovery, software write-off and the costs relating to the sale of the full-service brokerage business, total operating expenses were little changed compared to 2010.

Management's Discussion and Analysis (continued)

Commercial Banking

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

	2011	2010
	\$m	\$m
Net interest income	727	773
Net fee income	268	251
Net trading income.....	24	32
Other operating (expense)/income.....	(55)	6
Net operating income before loan impairment charges and other credit risk provisions	964	1,062
Loan impairment charges and other credit risk provisions.....	(78)	(206)
Net operating income.....	886	856
Total operating expenses.....	(358)	(342)
Operating profit.....	528	514
Share of profit in associates	4	5
Profit before income tax expense.....	532	519

Overview

Profit before income tax expense was \$532m in 2011, an increase of \$13m over 2010. Results for 2011 were impacted by a \$59m write-down resulting from a write down in the value of investment property, partially offset by a recovery of fees from an HSBC Group affiliate with respect to prior years of \$18m, and a \$7m recovery on non-bank ABCP in 2010. Excluding the impact of these items, the increase in year-to-date profit is \$61m or 11.9% higher than 2010, mainly due to lower loan impairment charges resulting from lower loan volumes and improved credit quality, offset by lower interest revenues.

Financial performance

Net interest income was \$727m in 2011, a decrease of \$46m, or 6.0%, compared to 2010. The decrease was primarily due to lower lending volumes in the commercial real estate and mid-market sectors, together with lower margins on deposits. The increase in the deposit base over 2010 was offset by lower margins.

Net fee income was \$17m or 6.8% higher than 2010 primarily due to higher income from banker's acceptances, standby commitments and letters of guarantee, higher wire transfer fees following the implementation of a new price structure, partially offset by lower account service charges due to a decline in customer account activity.

Other operating income was a loss of \$55m, compared to income of \$6m in 2010. The loss in the current quarter and year was primarily due to the write-down in the value of investment property.

Loan impairment charges and other credit risk provisions were \$78m in 2011, a decrease of \$128m, compared to 2010 primarily due to reversal of collective provisions and lower individual impairment provisions as a result of lower loan volumes and improved credit quality.

Total operating expenses were \$358m in 2011, an increase of \$16m, or 4.7%, compared to 2010. Year-to-date expenses included a recovery of fees from an HSBC Group affiliate with respect to prior years. Excluding the fee recovery, expenses were higher by \$34m or 9.9% primarily due to investments in our business in central Canada, including personnel and marketing costs, as well as certain restructuring costs being incurred.

Global Banking and Markets

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

	2011	2010
	\$m	\$m
Net interest income	165	141
Net fee income	79	82
Net trading income.....	90	86
Gains less losses from financial investments	40	8
Other operating income.....	2	4
Net operating income before loan impairment charges and other credit risk provisions	376	321
Loan impairment charges and other credit risk provisions	1	7
Net operating income	377	328
Total operating expenses	(103)	(94)
Profit before income tax expense.....	274	234

Overview

Profit before income tax expense was \$274m compared with \$234m in 2010, an increase of \$40m, or 17.1%. The results for 2010 include a \$7m recovery of previously recorded losses on non-bank ABCP. When excluding the impact of ABCP profit before income tax expense increased \$47m, or 20.7% in 2011 compared to 2010, mainly as a result of higher net interest income and an increase in gains on sales of financial investments.

Financial performance

Net interest income increased by \$24m, or 17.0%, in 2011 to \$165m largely attributable to strategic interest rate positions taken as a result of balance sheet management activities.

Net fee income decreased marginally due to a lower average deal size for capital market revenues.

Net trading income increased largely due to the impact of increased customer volumes in foreign exchange products as well as trading in volatile foreign exchange markets. The positive impact from changes in the market value of our own debt stemmed from changes in credit spreads, partially offset by the negative impact from mark-to-market accounting gains and losses arising from economic hedges and hedge ineffectiveness. This was partially offset by the recovery in 2010 of previously recorded losses upon the disposal of the bank's ABCP portfolio.

Gains less losses from financial instruments increased due to gains on sale of the bank's AFS preferred share portfolio, and higher gains on sales of AFS government bonds and bank debt securities.

Loan impairment charges and other credit risk provisions A net recovery of \$1m was recorded in 2011 compared to \$7m in 2010 due to the release of collective impairment provision in our Global Banking business.

Operating expenses increased by \$9m to \$103m due to higher restructuring costs and allocated product and infrastructure support costs partially offset by a decrease in variable compensation costs.

Management's Discussion and Analysis (continued)

Consumer finance

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

	2011 \$m	2010 \$m
Net interest income	282	312
Net fee income	42	55
Gains less losses from financial investments	3	–
Other operating income	5	3
Net operating income before loan impairment charges and other credit risk provisions	332	370
Loan impairment charges and other credit risk provisions	(100)	(133)
Net operating income	232	237
Total operating expenses	(171)	(179)
Profit before income tax expense	61	58

Overview

Profit before income tax expense for 2011 was \$61m compared with \$58m for 2010. Included in the results for 2011 was \$5m recoveries of fees and previously recorded impairments of certain AFS financial investments while in 2010, \$15m in non-recurring insurance fees was received relating to previous years. Excluding these items the improvement in 2011 was \$13m or 30.3% compared to 2010. The year over year increase was primarily due to improved economic conditions, investments in credit collection processes and credit tightening actions taken in prior years. In addition operating expenses were lower, due to cost reduction initiatives undertaken during 2011, partially offset by lower net interest income as a result of lower average receivables.

Financial performance

Net interest income for 2011 was \$282m, a decrease of \$30m or 9.6% compared to the prior year. Average receivables declined by approximately \$0.3bn, or 12.0% year over year, primarily due to run-off in the non-core liquidating portfolios.

Net fee income for the year was \$42m, a decrease of \$13m, or 23.6% compared to 2010. Although there was higher credit card income resulting from higher transaction volumes in 2011, this was more than offset by the receipt in 2010 of certain non-recurring insurance revenues.

Gains from financial investments were \$3m for the 2011 arising from a gain in 2011 on partial settlement of AFS financial investments.

Other operating income for the year was \$5m, an increase of \$2m.

Loan impairment charges and other credit risk provisions were \$100m, or 24.8% better than 2010. The decrease was primarily due to lower receivables and improved delinquencies as a result of continued improvements in the credit quality of the portfolios as well as improved collection efforts.

Total operating expenses for the full year 2011 were \$171m and \$8m or 4.5% lower than 2010, mainly due to lower staffing costs and intercompany charges, partially offset by higher direct mail spend.

Other

Selected Financial Information and Analysis. The following sets out financial information for Other:

	2011 \$m	2010 \$m
Net interest expense	(17)	(9)
Net fee expense	–	(2)
Net trading income	16	9
Net income/(expense) from financial instruments designated at fair value	16	(2)
Other operating income	127	160
Net operating income before loan impairment charges and other credit risk provisions	142	156
Total operating expenses	(127)	(155)
Profit before income tax expense	15	1

Activities or transactions which do not relate directly to the four main business segments are reported in 'Other'. The main items reported in this segment include gains and losses from the impact of changes in credit spreads on financial instruments designated at fair value and revenues relating to inter group funds transfer as well as expenses and recoveries related to information technology activities performed on behalf of HSBC Group companies. The decrease in other operating income and expenses was as a result of a decrease in software development activities performed on behalf of Group affiliates. Profit before income tax expense was \$15m for 2011 compared to \$1m in 2010. The variance is primarily due to the impact of changes in credit spreads experienced during 2011 compared to the previous year.

Analysis of Financial Results for the Fourth Quarter 2011

The bank's results for the fourth quarter of 2011 are as follows:

	<i>Quarter ended</i>		
	31 December 2011 \$m	31 December 2010 \$m	30 September 2011 \$m
Interest income.....	585	621	579
Interest expense.....	(192)	(221)	(188)
Net interest income	393	400	391
Fee income	185	204	183
Fee expense	(28)	(22)	(21)
Net fee income	157	182	162
Trading income excluding net interest income	23	18	41
Net interest income on trading activities	8	6	5
Net trading income.....	31	24	46
Net gain/(loss) from financial instruments designated at fair value	-	(4)	22
Gains less losses from financial investments.....	3	-	20
Other operating income.....	(10)	51	33
Net operating income before loan impairment charges and other credit risk provisions.....	574	653	674
Loan impairment charges and other credit risk provisions.....	(54)	(115)	(63)
Net operating income	520	538	611
Employee compensation and benefits.....	(184)	(197)	(196)
General and administrative expenses.....	(125)	(158)	(129)
Depreciation of property, plant and equipment.....	(8)	(10)	(10)
Amortization of intangible assets.....	(18)	(5)	(4)
Total operating expenses.....	(335)	(370)	(339)
Operating profit	185	168	272
Share of profit in associates	-	1	2
Profit before income tax expense.....	185	169	274
Income tax expense.....	(50)	(51)	(73)
Profit for the period	135	118	201
Profit attributable to common shareholders	118	96	182
Profit attributable to preferred shareholders	15	15	16
Profit attributable to shareholders	133	111	198
Profit attributable to non-controlling interests	2	7	3
Average number of common shares outstanding (000's).....	498,668	498,668	498,668
Basic earnings per common share (\$).....	0.24	0.19	0.36

Management's Discussion and Analysis (continued)

Overview

HSBC Bank Canada recorded a profit of \$135m for the fourth quarter of 2011, an increase of \$17m, or 14.4% compared with \$118m for the fourth quarter of 2010 and a reduction of \$66m (32.8%) from \$201m for the third quarter of 2011. Profit attributable to common shareholders was \$118m for the fourth quarter of 2011, an increase of \$22m, or 22.9%, over the same period in 2010 and a reduction of \$64m (35.2%) from the third quarter of 2011. The increase compared to the same period in 2010 is primarily due to lower loan impairment charges, partially offset by lower net interest income and a write down in the value of investment property. Profit for the fourth quarter of 2011 was \$66m or 32.8% lower than the third quarter mainly due to the investment property write down, as well as lower gains on sale of financial investments and the impact in the third quarter of 2011 of changes in credit spreads on financial instruments designated at fair value.

Net interest income for the fourth quarter of 2011 was \$393m compared with \$400m for the fourth quarter of 2010, a decrease of \$7m, or 1.8% and marginally higher than the third quarter of 2011. The decrease is due to declines in commercial borrowings and consumer finance receivables as clients continue to de-leverage. The impact of the lower loan volumes is partially offset by the effect of increases in the Bank of Canada interest rates in the second half of 2010 which positively impacted the yield on the bank's prime rate-based assets compared to the prior year.

Fee income

	<i>Quarter ended</i>		
	31 December 2011	31 December 2010	30 September 2011
	\$m	\$m	\$m
Credit facilities.....	55	51	51
Funds under management.....	39	38	41
Account services.....	21	22	21
Brokerage commissions.....	11	21	13
Credit cards.....	13	13	13
Corporate finance.....	12	15	12
Insurance.....	6	16	6
Remittances.....	7	5	7
Trade finance import/export.....	3	3	3
Trustee fees.....	1	2	2
Other.....	17	18	14
Fee income.....	185	204	183
Less: fee expense.....	(28)	(22)	(21)
Net fee income.....	157	182	162

Net fee income for the fourth quarter of 2011 was \$157m compared with \$182m for the fourth quarter of 2010, a decrease of \$25m, or 13.7% and \$162m for the third quarter of 2011. The decrease in fee income in the fourth quarter was primarily due to lower brokerage commissions in our full-service retail brokerage arising from reduced funds under management, lower corporate finance fees arising from lower activity as well as a non-recurring receipt of credit insurance income in the fourth quarter of 2010, partially offset by higher fees from the Global Investor Immigration Program due to an increase in the number of applications processed by the government.

Net trading income for the fourth quarter of 2011 was \$31m compared with \$24m for the fourth quarter of 2010, an increase of \$7m, or 29.2% but decreased \$15m or 32.6% compared to the third quarter of 2011. The increase over 2010 is primarily due to an increase in foreign exchange trading revenue arising from increased customer volumes as well as the impact of volatile currency markets, partially offsetting losses arising from the impact of changes in market rates on certain hedge positions. Compared to the third quarter of 2011 revenues decreased \$12m due to an increase in mark-to-market accounting losses on derivatives partially offset by an increase in rates and credit trading revenues.

Net gain/(loss) from financial instruments designated at fair value The bank records certain debt securities and subordinated debentures at fair value. Although there were some changes in credit spreads in the fourth quarter of 2011, there were no net changes in the fair value of these balances, while a loss of \$4m was recorded in the same quarter in 2010 and a gain of \$22m in the third quarter of 2011.

Gains less losses from financial investments for the fourth quarter of 2011 were \$3m, compared with \$nil for the fourth quarter of 2010 and \$20m for the third quarter of 2011. The increase compared to the fourth quarter of 2010 is due to the sale of certain AFS securities including government bonds and bank debt securities in 2011 particularly in the third quarter of 2011.

Other operating income for the fourth quarter of 2011 was a loss of \$10m compared with income of \$51m for the fourth quarter of 2010, a decrease of \$61m and compared to \$33m for the third quarter of 2011, mainly as a write down in the value of investment property of \$42m in the fourth quarter of 2011.

Loan impairment charges and other credit risk provisions of \$54m were recorded in the fourth quarter of 2011 compared with \$115m for the fourth quarter of 2010, a decrease of \$61m, or 53.0% and \$63m for the third quarter of 2011. The decrease in loan impairment charges in 2011 compared with 2010 was due to reduced levels of individually assessed impairment charges, and a lower collective impairment provision due to improved credit quality and lower loan volumes in the bank's commercial loan and consumer finance portfolios.

Total operating expenses for the fourth quarter of 2011 were \$335m compared with \$370m for the fourth quarter of 2010, a decrease of \$35m, or 9.5% and marginally lower than the third quarter of 2011. Employee compensation and benefits decreased by \$13m in the quarter compared to same period in 2010 as well as the preceding quarter mainly as a result of the lower performance incentives. General and administrative expenses decreased by \$33m in the quarter mainly due to a reduction of inter-group expenses. Amortization and impairment of intangible assets increased by \$13m in the quarter mainly as a result of a write-off of certain internally developed software costs in the fourth quarter of 2011.

Income tax expense The effective tax rate in the fourth quarter of 2011 was 27.0% compared with 30.2% in the fourth quarter of 2010 mainly due to a reduction in statutory tax rates with little change from the third quarter of 2011.

Analysis of financial results for the fourth quarter 2011 by customer group

Retail Banking and Wealth Management

	<i>Quarter ended</i>		
	31 December 2011 \$m	31 December 2010 \$m	30 September 2011 \$m
Net interest income	98	96	100
Net fee income	57	68	62
Net trading income.....	4	3	6
Other operating income.....	3	2	2
Net operating income before loan impairment charges and other credit risk provisions.....	162	169	170
Loan impairment charges and other credit risk provisions	(7)	(6)	(7)
Net operating income.....	155	163	163
Total operating expenses.....	(162)	(154)	(144)
Profit/(loss) before income tax expense.....	(7)	9	19

The loss before income tax expense was \$7m for the fourth quarter of 2011, \$16m lower than the fourth quarter of 2010 and \$26m lower than the third quarter. The current quarter's results included a \$9m write-off of internally developed software costs and charges of \$14m related to the sale of the full-service retail brokerage business. Excluding the impact of these items, profit before income tax expense was \$16m for the quarter, \$7m higher than 2010. Compared to the third quarter of 2011, net fee income reduced by \$5m mainly as a reduced activity in the full-service brokerage business resulting from the departure of some investment advisors as well as lower fund management income due to reduction in market values of funds under management. Total operating expenses increased mainly as a result of the items noted above, partially offset by reductions in some inter-group expenses.

Management's Discussion and Analysis (continued)

Commercial Banking

	<i>Quarter ended</i>		
	31 December	31 December	30 September
	2011	2010	2011
	\$m	\$m	\$m
Net interest income	189	192	188
Net fee income	66	68	66
Net trading income.....	5	5	7
Other operating income/(expense).....	(40)	3	–
Net operating income before loan impairment charges and other credit risk provisions.....	220	268	261
Loan impairment charges and other credit risk provisions.....	(23)	(76)	(32)
Net operating income.....	197	192	229
Total operating expenses.....	(87)	(96)	(95)
Operating profit.....	110	96	134
Share of profit in associates	–	1	2
Profit before income tax expense.....	110	97	136

Profit before income tax expense was \$110m for the fourth quarter of 2011, \$13m higher than the fourth quarter of 2010 and \$26m lower than the third quarter of 2011. The current quarter's results included a \$42m write-down of the value of investment property. Excluding the impact of the write-down, profit before income tax expense was \$152m for the quarter, \$16m higher than the third quarter of 2011 and \$55m higher than 2010. This was mainly due to lower specific loan impairment charges together with a reduction in certain inter group charges.

Global Banking and Markets

	<i>Quarter ended</i>		
	31 December	31 December	30 September
	2011	2010	2011
	\$m	\$m	\$m
Net interest income	38	44	38
Net fee income	23	26	23
Net trading income.....	17	12	29
Gains less losses from financial investments.....	3	–	17
Other operating income.....	–	1	–
Net operating income before loan impairment charges and other credit risk provisions.....	81	83	107
Loan impairment recovery and other credit risk provisions.....	1	4	–
Net operating income.....	82	87	107
Total operating expenses.....	(15)	(27)	(32)
Profit before income tax expense.....	67	60	75

For the fourth quarter of 2011, profit before income tax expense was \$67m, an increase of \$7m, compared with the same period in 2010. The increase is mainly due to an increase in advisory fees, a decrease in mark-to-market accounting losses, gains from the disposal of certain AFS investments and a decrease in certain restructuring and variable compensation costs. This was offset by a decrease in capital market fees. Profit before income tax expense decreased by \$8m, compared with the third quarter of 2011 mainly due to an increase in mark-to-market accounting losses and a decrease in gains from the disposal of certain financial investments. This was offset by a decrease in certain restructuring and variable compensation costs.

Consumer Finance

	<i>Quarter ended</i>		
	31 December	31 December	30 September
	2011	2010	2011
	\$m	\$m	\$m
Net interest income	74	72	69
Net fee income	11	22	11
Gains less losses from financial investments	–	–	3
Other operating income	–	1	3
Net operating income before loan impairment charges and other credit risk provisions	85	95	86
Loan impairment charges and other credit risk provisions	(25)	(37)	(24)
Net operating income	60	58	62
Total operating expenses	(43)	(48)	(41)
Profit before income tax expense	17	10	21

Profit before income tax expense for Consumer Finance was \$17m for the fourth quarter of 2011 compared with \$10m for the same period in 2010. Net interest income and fees were \$9m lower for the fourth quarter of 2011 compared with the same period in 2010, mainly due to a receipt of \$10m in non-recurring insurance income in 2010 relating to previous periods. There was a reduction in loan impairment charges of \$12m resulting from improved economic conditions, investments in credit collection processes and credit tightening actions taken in prior years. There was a reduction in operating expenses of \$5m primarily due to cost reduction initiatives undertaken during 2011.

Other

	<i>Quarter ended</i>		
	31 December	31 December	30 September
	2011	2010	2011
	\$m	\$m	\$m
Net interest expense	(6)	(4)	(4)
Net fee income	–	(2)	–
Net trading income	5	4	4
Net (loss)/gain from financial instruments designated at fair value	–	(4)	22
Other operating income	27	44	28
Net operating income	26	38	50
Total operating expenses	(28)	(45)	(27)
Profit/(loss) before income tax expense	(2)	(7)	23

A loss before income tax expense of \$2m was recorded in the fourth quarter of 2011, compared with a loss of \$7m for the fourth quarter of 2010 and a profit of \$23m in the third quarter. There was little change in credit spreads over the fourth quarter while there was some narrowing of spreads in the fourth quarter of 2010, particularly in the midst of an economic recovery which was being experienced at that time. However economic uncertainty was experienced in the third quarter which resulted in wider spreads and an increase in income from instruments designated at fair value. Other operating income and the related total operating expenses reflected the reduction in revenues received from other group companies for software development.

Management's Discussion and Analysis (continued)

Quarterly Summary of Condensed Consolidated Statements of Income

The following table presents a summary of quarterly consolidated results prepared in accordance with IFRS for the last eight quarters.

	<i>Unaudited</i>							
	2011				2010			
	Quarter ended				Quarter ended			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Net interest income	393	391	390	382	400	404	410	394
Net fee income	157	162	162	163	182	152	158	146
Net trading income.....	31	46	36	37	24	32	61	36
Other operating income/(loss)	(7)	75	31	48	47	42	61	37
Net operating income before loan impairment charges and other credit risk provisions.....	574	674	619	630	653	630	690	613
Loan impairment charges and other credit risk provisions	(54)	(63)	(31)	(49)	(115)	(103)	(72)	(69)
Net operating income	520	611	588	581	538	527	618	544
Operating expenses	(335)	(339)	(315)	(359)	(370)	(331)	(336)	(320)
Operating profit.....	185	272	273	222	168	196	282	224
Share of profit in associates.....	–	2	1	1	1	4	–	–
Profit before income tax expense	185	274	274	223	169	200	282	224
Income tax expense....	(50)	(73)	(66)	(63)	(51)	(54)	(82)	(70)
Profit for the period....	135	201	208	160	118	146	200	154
Profit attributable to:								
Common shareholders	118	182	191	142	96	124	178	133
Preferred shareholders	15	16	15	15	15	16	15	15
Non-controlling interests	2	3	2	3	7	6	7	6
Basic earnings per common share (\$)...	0.24	0.36	0.38	0.28	0.19	0.25	0.36	0.27

Comments on trends over the past eight quarters

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

Following the credit and liquidity crisis in earlier periods, the results for 2010 and 2011 were impacted by increased and volatile credit spreads and relatively low interest margins. Customers de-leveraged their credit exposures resulting in reduced commercial loan demand, while the excess liquidity could only be invested in lower yielding government and other securities further reducing the interest margin.

Net fee income was broadly unchanged representing the stable underlying business of the bank's franchise especially for commercial banking. The fourth quarter of 2010 included a non-recurring receipt of insurance income and was a very strong quarter for capital market revenues. External market forces caused a considerable degree of volatility in interest and foreign exchange rates over the period as well as changing credit spreads, which resulted in significant variability in trading income and mark-to-market adjustments on derivatives. The variability of other operating income mainly results from the effect of changing credit spreads on liabilities designated at fair value as well as write-downs of investment property in the second and fourth quarters of 2011.

Although conditions continue to be uncertain, the lower level of credit losses in 2011 was due to a decrease in individual provisions reflecting improving economic conditions on the Commercial Banking business and lower delinquencies in the Consumer Finance business. The variability in quarterly charges mainly represents the impact of individual commercial banking provisions.

Operating expenses were mostly fairly stable over the past eight quarters. A reduction in the second quarter of 2011 was caused by the recovery of fees from an HSBC affiliate relating to previous years while an increase in the fourth quarter of 2010 was partially caused by increased performance based incentives as a result of higher capital markets revenues.

Critical Accounting Policies and Impact of Estimates and Judgements

The results of the bank are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its Consolidated Financial Statements. The significant accounting policies used in the preparation of the Consolidated Financial Statements are described in detail in note 2 on the Consolidated Financial Statements.

The accounting policies that are deemed critical to the bank's results and financial position, in terms of the materiality of the items to which the policy is applied, or which involve a high degree of judgement including the use of assumptions and estimates, are disclosed below.

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

Loan impairment charges and other credit risk provisions

The bank's accounting policy for losses arising from the impairment of customer loans and advances is described in note 2(f) on the Consolidated Financial Statements. Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the statement of financial position date.

Management is required to exercise judgement in making assumptions and estimates when calculating loan impairment allowances on both individually and collectively assessed loans and advances. The most significant judgement area is the calculation of collective impairment allowances.

The methods used to calculate collective impairment allowances on homogeneous groups of loans that are not considered individually significant are disclosed in note 2(f). They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

Management's Discussion and Analysis (continued)

The methods involve the use of statistically assessed historical information supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio. In certain circumstances, historical loss experience provides less relevant information about the inherent loss in a given portfolio at the statement of financial position date, for example, where there have been changes in economic, regulatory or behavioural conditions such that the most recent trends in the portfolio risk factors are not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account when calculating the appropriate levels of impairment allowances, by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other factors that can affect customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates, and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

The calculation of the collective impairment allowance to cover losses which have been incurred but not yet been identified on loans subject to individual assessment utilizes underlying credit metrics, including the probability of default, loss given default and exposure at default and for each customer are derived from the bank's internal rating systems as a basis for determining the collective impairment allowance. Management amends these metrics for some or all borrowers where they consider that the rating system metrics do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

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

Many of the factors have a high degree of interdependency and there is no one single factor to which the bank's loan impairment allowances as a whole are sensitive. It is possible that the outcomes in the next financial year could be different from the assumptions built into the models, resulting in a material adjustment to the carrying amount of loans and advances.

Valuation of financial instruments

The bank's accounting policy for valuation of financial instruments is described in note 2(d) on the Financial Statements. The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on a basis of valuation techniques that feature one or more significant market inputs that are unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

The main assumptions and estimates which management considers when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates. In selecting an appropriate discount rate for the instrument, management bases the determination of an appropriate discount rate for the instrument on its assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate the fair value in areas where the choice of valuation model is particularly subjective, for example, when used for valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there are little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there are some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the unobservable inputs are significant. Assumptions and methodologies used in our models are continually reviewed and revised to arrive at better estimates of fair value.

Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes within the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

The majority of our financial investments and AFS securities are either issued or guaranteed by Canadian federal and provincial governments.

Employee future benefits

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

Due to the long-term nature of the contribution and payment periods for defined benefit plans, changes in long-term rates could have a material impact on our reported financial results. After consultation with our actuaries, we make certain assumptions regarding the long-term rate of investment return on pension plan assets, the discount rate applied to accrued benefit obligations, the rates of future compensation increases and the trends in health care costs. The assumptions we use and an analysis of the sensitivity of those assumptions on our benefits expense and accrued benefit obligations are set out in note 4 on the consolidated financial statements. The most significant impact is a change in the discount rate applied to accrued benefit obligations. Under current accounting standards, the discount rate to be applied is a long-term bond rate rather than the estimated future performance of plan assets.

Funding requirements for the bank's defined benefit pension plans are based on formal actuarial valuations, which determine the cost of earnings benefits in a year, and any additional bank contributions that are required to eliminate past service deficits over time. As a result of legislative changes, with the exception of one small plan, the bank's plans are subject to formal annual actuarial valuations beginning in 2010. Funding requirements for the bank's defined benefit pension plans are based on these valuations, which determine the 'cost of earnings benefits' in a year, and any additional bank contributions that are required to eliminate past service deficits over time. During 2011, all but one of the bank's plans were subject to an actuarial valuation, which resulted in annual funding requirements of \$17m, a decrease of \$1m over the last valuation. This decrease was mainly due to higher than expected investment returns since the last valuation. Although contributions required for 2012 will not be known until the valuations are completed, given lower interest rates and asset returns in 2011 being less than expected, the bank is anticipating an increase in its defined benefit funding requirements lower than expected for in 2012.

Income taxes

In establishing the income tax provision and the amount of the net future income tax asset recorded in our consolidated financial statements, we estimate the rates at which our income will be taxed in a variety of jurisdictions in Canada as well as expectations regarding dates of reversal of temporary differences. If the actual amounts, timing, or rates differ from the estimates or our interpretations of the tax legislation differ from those of the federal and provincial tax authorities, adjustments may be necessary. Details of our income tax provision and net future income tax asset are set out in note 6 of the financial statements.

Management's Discussion and Analysis (continued)

Goodwill and intangible assets

We review goodwill and intangible assets, including internally generated computer software, for impairment at least annually, to ensure that the fair values are in excess of carrying values. In determining the fair value of goodwill and intangible assets, we use a variety of factors such as market comparisons, discount rates, price/earnings ratios and income estimates. The determination of values requires management judgement in the assumptions used as well as an appropriate method for determination of fair value. Any impairment in goodwill or intangible assets is charged to non-interest expense in the consolidated income statements. Although there were indicators of continuing market weakness during 2011, the carrying amount of our goodwill was not impacted by these weaknesses. In addition, the operating segments to which the goodwill relates continued to be profitable during the year and there was no indication that, at 31 December 2011, there was any impairment in the carrying value of goodwill.

Intangibles are reviewed on a regular basis and tested as to estimates of remaining useful life as well as effectiveness of intangible assets such as software development. As a result of a review of software under development, the Group concluded that certain applications under development would not be deployed and consequently were written down.

Accounting and Reporting Changes in 2011

Transition to International Financial Reporting Standards ('IFRS')

The Canadian Accounting Standards Board previously announced that for fiscal years commencing on or after 1 January 2011, all publicly accountable enterprises will be required to report financial results in accordance with IFRS. Accordingly, the Annual Financial Statements for 2011 with comparatives have been reported on an IFRS basis.

Upon transition to IFRS, we have, where possible, adopted the accounting policies used by entities reporting under IFRS within the HSBC Group. These policies are disclosed in note 2 on the consolidated financial statements. We have also changed our reporting format to be similar to other entities reporting under IFRS within the HSBC Group. Note 34 on the accompanying Consolidated Financial Statements contains an explanation of the significant presentational reclassifications and reconciliations between the new reporting format and the previous format under Canadian GAAP for the year ended 31 December 2010 as well as the opening balances as at 1 January 2010. The impact on our business activities, financial processes and information systems, and internal controls was not significant.

The transition to IFRS has not affected the bank's net cash flows or the underlying economics of the business, though the presentation of certain items in the statements of financial position and income statement are now changed. An explanation of how the transition to IFRS has affected our reported financial position, equity and financial performance has been provided in note 34 on the Consolidated Financial Statements. This includes a discussion of the transitional elections and exemptions under IFRS 1 and the following reconciliations as at the date of transition, 1 January 2010, and for the comparative period 31 December 2010:

- net income as previously reported under Canadian GAAP to profit for the period reported under IFRS;
- total comprehensive income as previously reported under Canadian GAAP to total comprehensive income for the period reported under IFRS;
- total shareholders' equity as previously reported under Canadian GAAP to total equity under IFRS;
- reconciliations from Canadian GAAP to IFRS, including a reconciliation to the new presentation format under IFRS of the income statements and statements of financial position.

The net impact of the adoption of IFRS on our opening shareholders' equity at the transition date of 1 January 2010 was a decrease of \$146m, primarily resulting from changes in accounting for securitized mortgages and employee defined benefit plans. In addition, non-controlling interests of \$430m, which was presented outside of shareholders' equity under Canadian GAAP has been reclassified as a component of total equity under IFRS. Total assets were \$7.4bn higher, primarily due to the recognition of securitized mortgages that were derecognized from the balance sheet under Canadian GAAP.

The restated profit for the year 2010 was \$618m on an IFRS basis, which is an increase of \$128m compared to the net income previously reported under Canadian GAAP of \$490m. The most significant differences between Canadian GAAP and IFRS affecting the profit for the restated period are related to the change in accounting for securitized mortgages and the associated swap transactions, which were marked-to-market under Canadian GAAP but are not required to be recognized under IFRS because the assets and risk are consolidated within our financial results, and foreign exchange translation gains and losses on available-for-sale financial assets, which were recorded in other comprehensive income under Canadian GAAP but are recorded in income under IFRS.

Other than the first time adoption of International Financial Reporting Standards noted above there were no other changes in accounting policies since 31 December 2010 which had a material impact on our results or financial position during 2011.

Off-Balance Sheet Arrangements

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

Guarantees and letters of credit

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

For credit risk management purposes, we consider guarantees and letters of credit to be part of our clients' credit facilities, which are subject to appropriate risk management procedures. Guarantees and letters of credit are considered to be part of our overall credit exposure, as set out in the analysis of our loan portfolio on page 42 of the MD&A.

Derivative financial instruments

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

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

We use derivatives to limit our exposure to interest rate risk on loans and deposits with differing maturity dates, or foreign currency assets and liabilities of differing amounts. Mismatches in currency or maturity dates could expose us to significant financial risks if there are adverse changes in interest rates or foreign exchange rates. The use of derivatives is subject to strict monitoring and internal control procedures as set out in our risk management discussion in the MD&A on pages 32 to 54.

Our accounting policies on recording the impact of derivatives are set out in note 2(k) of the Consolidated Financial Statements. Quantitative information on our derivative instruments is set out in note 11 on the Consolidated Financial Statements.

Management's Discussion and Analysis (continued)

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

Management's statement of responsibility for financial information contained in our Annual Report is set out on page 56.

Disclosure controls and procedures

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

As of 31 December 2011, management evaluated, under the supervision and with the participation of the CEO and the CFO, the effectiveness of our disclosure controls and procedures as defined by the Canadian securities regulatory authorities under National Instrument 52-109. Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures are effective as of 31 December 2011.

Internal control over financial reporting

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

Management has evaluated, under the supervision of and with the participation of the CEO and the CFO, the design and effectiveness of the internal control over financial reporting as required by the Canadian securities regulatory authorities under National Instrument 52-109. This evaluation was performed using the framework and criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as at 31 December 2011.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during the year ended 31 December 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Related Party Transactions

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

Further details can be found in note 32.

HSBC Group companies hold certain of our debentures and preferred and common shares. Reference should be made to notes 11 and 12.

There are also a number of routine transactions occurring during the course of the year, none of which are individually material to our results.

Dividends

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

	2011	2010	2009
Preferred Shares Class 1 (\$ per share)			
Series C	1.275	1.275	1.275
Series D	1.250	1.250	1.250
Series E	1.650	1.650	1.201
Preferred Shares Class 2 (\$ per share)			
Series B	0.310	0.310	0.310
HSBC HaTS™ (\$ per unit)			
Series 2010 ¹	–	77.80	77.80
Series 2015	51.50	51.50	51.50
Common Shares (\$ millions)			
HSBC Bank Canada	300	280	280

¹ Units were redeemed on 31 December 2010.

Credit Ratings

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

Our credit ratings influence our ability to secure cost-efficient wholesale funding. Our investment grade ratings were confirmed by DBRS in October 2011 and amended by S&P in November 2011, concurrent with changes to their global ratings methodology for banks, amended by S&P in November 2011. Our investment grade ratings remain among the highest assigned to Canadian banks.

Our ratings at 31 December 2011 were as follows:

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

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

Management's Discussion and Analysis (continued)

Risk Management

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

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

Overview

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

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

- Risk Governance and Oversight,
- Risk Appetite, and
- Risk-Based Capital Management.

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

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

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

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

Risk Governance and Oversight

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

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

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

Executive Management Committees

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

Risk Management Committee

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

- That risk identification, assessment and mitigation mechanisms are in place and effective;
- That the bank has a balanced risk-return profile; and
- That the bank’s capital is adequate to support risks.

The RMC mandate includes:

- Identifying and measuring emerging risks;
- Developing appropriate risk management policies and procedures to identify, assess and control material risks on an enterprise-wide basis, including business continuity planning;
- Providing direction regarding our overall risk philosophy and appetite, including the acceptability of new, modified or unusual risk and ensuring risk appetite is appropriately aligned with local, regional and global conditions;
- Ensuring business risk is balanced against economic return;
- Monitoring adherence to risk management policies and procedures; and
- Reporting policy or major practice changes, unusual situations, significant exceptions, and new strategy or products to our Executive Committee and, where appropriate, to the Audit Committee and, where required, the Board for review, ratification and/or approval.

Credit Risk Committee

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

Asset & Liability Committee (‘ALCO’)

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

Operational Risk & Internal Control Committee (‘ORIC’)

ORIC is a sub committee of the RMC. ORIC challenges risk limitation and control strategies proposed by the business through the review of business level operational risk management activity. ORIC is responsible for making specific recommendations to ensure that the bank maintains an effective operational risk program that meets both internal and regulatory standards and is independent from day-to-day operations.

Management's Discussion and Analysis (continued)

Risk Management Group

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

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

Internal Audit

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

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

Risk Appetite

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

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

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

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

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

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

Risk-Based Capital Management

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

- Pillar 1 relates to minimum regulatory capital requirements.
- Pillar 2 refers to the internal capital adequacy assessment process ('ICAAP'), which is subject to the Supervisory Review and Evaluation Process carried out by OSFI.
- Pillar 3 relates to market discipline by publishing capital and risk management practices.

Objectives, policies and procedures

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

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

The bank's capital management principles and related policies define the ICAAP by which management examines the bank's risk profile from both regulatory and economic capital viewpoints and ensures that the level of capital:

- Supports our risk profile and outstanding commitments;
- Exceeds our formal, minimum regulatory capital requirements by an agreed margin;
- Withstands a severe economic downturn stress scenario; and
- Remains consistent with our strategic and operational goals, and shareholder and rating agency expectations.

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

Capital managed and capital adequacy regulations and ratios

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

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

OSFI regulates capital adequacy for Canadian federally incorporated financial institutions including banks. OSFI's regulations are based on international standards set by the Bank for International Settlements ('BIS'). Although BIS sets minimum limits for financial institutions to maintain 4% and 8% Tier 1 and total capital ratios (as a percentage of risk-weighted assets), respectively, OSFI recommends Canadian banks maintain minimum Tier 1 and total capital ratios of 7% and 10%, respectively. The bank maintained ratios that satisfied these requirements in both 2011 and 2010.

Minimum regulatory capital requirements

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

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

Management's Discussion and Analysis (continued)

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

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

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

Regulatory capital and regulatory capital ratios

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

	IFRS 2011 \$m	IFRS 2010 \$m
Tier 1 capital		
Common shares.....	1,225	1,225
Retained earnings.....	2,363	2,274
Non-cumulative preferred shares.....	946	946
Non-controlling interests in trust and subsidiary ¹	230	230
Securitization-related deductions and other.....	(9)	(116)
Goodwill.....	(24)	(15)
Total Tier 1 capital.....	<u>4,731</u>	<u>4,544</u>
Tier 2 capital		
Subordinated debentures.....	752	739
Eligible general and excess allowances.....	163	205
Securitization-related deductions.....	(9)	(10)
Total Tier 2 capital.....	<u>906</u>	<u>934</u>
Total capital available for regulatory purposes.....	<u>5,637</u>	<u>5,478</u>
Actual regulatory capital ratios		
Tier 1 capital.....	13.4%	13.3%
Total capital.....	16.0%	16.0%
Actual assets-to-capital multiple.....	13.1x	13.3x
Minimum regulatory capital ratios required		
Tier 1 capital.....	7.0%	7.0%
Total capital.....	10.0%	10.0%

¹ Includes \$200m on HSBC HaTS™ (2010: \$200m)

The bank's core common equity is existing Tier 1 capital less non-controlling interest in subsidiaries, HSBC HaTS™ and preferred shares. At 31 December 2011 the bank's core common equity as a percentage of risk-weighted assets was 10.1% (2010: 9.5%).

Impact of IFRS on our capital adequacy requirements

The capital adequacy ratios shown in the above table for 2010 are on a Canadian GAAP basis as they were presented to the bank's regulator, OSFI.

The transition to IFRS did not have a material effect on the bank's regulatory capital. On a pro-forma IFRS basis, the bank's Tier 1 regulatory capital ratio at 31 December 2010 declined marginally to 13.0% from 13.3% on a Canadian GAAP basis and total regulatory capital ratio decreased to 15.75% from 16.0%. Although permitted to do so, we did not implement OSFI's relief provisions to phase in the impact of IFRS in the calculation of regulatory capital on a straight-line basis over eight quarters from 1 January 2011 to 31 December 2012, as the transition did not have a material impact on our regulatory capital.

OSFI has also provided transitional provisions for the asset-to-capital multiple ('ACM'), which allows for the exclusion of assets securitized and sold through Canada Mortgage and Housing Corporation sponsored programs prior to 1 April 2010 from the calculation of ACM. We took advantage of this relief provision. As at 31 December 2010, including the impact of the transitional provision, the ACM would have increased to 13.6 times on an IFRS basis times (14.8 excluding the impact of the transitional provision) from 13.3 times on a Canadian GAAP basis. As at 31 December 2011, the ACM was 13.1 times including the impact of the transitional provision and would have been 14.4 excluding the impact of the transitional provision.

Internal Capital Adequacy Assessment Process ('ICAAP')

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

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

The ICAAP program encompasses the following key risk management components:

- Risk Identification and Inventory;
- Risk Assessment and Measurement;
- Stress Testing;
- Capital Planning and Management; and
- Risk Monitoring and Reporting.

Risk Identification and Inventory

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

Risk Assessment and Measurement

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

Stress Testing

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

Management's Discussion and Analysis (continued)

Capital Planning and Management

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

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

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

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

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

Risk Monitoring and Reporting

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

Market Discipline

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

Credit risk

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

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

The bank's credit risk management objectives are to:

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

Credit Culture

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

The pillars of our credit culture are:

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

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

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

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

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

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

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

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

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

Management's Discussion and Analysis (continued)

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

Credit risk rating framework

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

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

Under the AIRB approach, the bank's credit risk rating framework incorporates Probability of Default ('PD') of an obligor and loss severity expressed in terms of Exposure at Default ('EAD') and Loss Given Default ('LGD'). These measures are used to calculate expected loss and minimum capital requirements. They are also used in conjunction with other inputs to inform rating assessments and other risk management decisions.

All estimates are subject to pre-implementation and post-implementation validation and/or monitoring, including a variety of tests designed to ensure the ongoing accuracy and validity of the data used.

For wholesale business (bank, sovereign and corporate), obligor PD is estimated using a 23-grade Customer Risk Rating scale, of which 21 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. Scores generated by models and/or scorecards for individual obligors are reviewed by credit approvers. The final approved customer risk ratings are mapped to a PD value range of which the 'mid-point' is used in the regulatory capital calculation.

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

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

HSBC Financial applies the simplified Standardized approach with the Basel II framework to calculate the risk weighting of credit exposures.

Stress testing and sensitivity analysis

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

In order to estimate both expected and unexpected losses under extreme, but plausible scenarios, we have established a framework for conducting stress testing around our credit portfolios. These scenarios are used to inform management about risks in the portfolio and implications for both capital requirements and income statement impacts. Stress testing also plays an important role in the ICAAP process.

Scenarios considered may be wide ranging, such as macroeconomic stresses or focused on particular industry or other portfolio issues. While there are a wide range of techniques that can be employed in such stress testing, our aim is to produce an estimate of potential outcomes and their likelihood of occurrence. Therefore a combination of quantitative and qualitative approaches is employed. There is naturally a significant degree of interpretation in these stress tests and therefore a range of outcomes is typically provided for management's review.

Maximum exposure to credit risk

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

The following table presents the maximum exposure to credit risk of balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements. For on-balance sheet financial assets, the exposure to credit risk equals their carrying amount. For financial guarantees, the maximum exposure to credit risk is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are not unconditionally cancellable, the maximum exposure to credit risk is the full amount of the committed facilities.

	2011 Maximum exposure \$m	2010 Maximum exposure \$m
On balance sheet		
Cash and balances at central bank	77	79
Items in the course of collection from other bank	104	84
Trading assets.....	4,578	3,942
Treasury and other eligible bills.....	245	557
Debt securities.....	2,034	1,712
Equity securities.....	29	26
Customer trading assets	304	553
Bankers acceptances	1,975	1,099
Less: securities not exposed to credit risk.....	(9)	(5)
Derivatives	2,203	1,363
Loans and advances held at amortized cost	48,814	51,010
Loans and advances to banks.....	4,530	5,792
Loans and advances to customers.....	44,284	45,218
Financial investments – available for sale	19,168	16,082
Treasury and other similar bills.....	1,716	2,898
Debt securities.....	17,452	13,234
Equity securities.....	–	17
Less: Securities not exposed to credit risk	–	(67)
Other assets		
Customers' liability under acceptances.....	4,059	4,372
Accrued income and other	429	412
Total On balance sheet.....	79,432	77,344
Off-balance sheet		
Financial guarantees.....	2,641	2,337
Loan commitments and other credit-related commitments	37,711	34,650
Credit and yield enhancement.....	–	15
	119,784	114,346

Management's Discussion and Analysis (continued)

Collateral and other credit enhancements

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

The principal collateral types are as follows:

- in the personal sector, mortgages over residential properties or charges over other personal assets being financed;
- in the commercial and industrial sector, charges over business assets such as land, buildings and equipment, inventory and receivables;
- in the commercial real estate sector, charges over the properties being financed; and
- in the financial sector, charges over financial instruments such as debt and equity securities in support of trading facilities.

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

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

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

The bank has policies in place to monitor the existence of undesirable concentration of the collateral supporting our credit exposures.

Loan portfolio diversity

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

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

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

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

	2011	2010
	\$m	\$m
Loans included in financial statements, net of impairment allowances.....	44,284	45,218
Less reverse repos and stock borrowing balances with customers.....	(1,050)	(2,674)
Impairment allowances.....	537	627
Customers' liability under acceptances.....	4,059	4,372
Trading acceptances.....	1,975	1,099
Guarantees and irrevocable letters of credit pledged as collateral security.....	2,641	2,337
Documentary credits and short-term trade related transaction.....	294	352
Total loans.....	52,740	51,331
Impaired loans and other impaired credit exposures ¹	(732)	(858)
Total performing loans.....	52,008	50,473

¹ Includes \$54m (2010 – \$60m) of impaired acceptances and letters of credit.

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

Performing loan portfolio

	2011		2010	
	\$m	%	\$m	%
Business and government loans ¹	25,092	48.3	23,298	46.2
Residential mortgages	18,951	36.4	18,807	37.3
Consumer finance loans	2,441	4.7	2,498	4.9
Other consumer loans	5,524	10.6	5,870	11.6
Total performing loans	52,008	100.0	50,473	100.0

¹ Includes \$454m (2010 – \$432m) of construction and other loans secured by mortgages over residential property.

Performing business and government loan portfolio by industry sector

	2011		2010	
	\$m	%	\$m	%
Real estate	5,530	22.0	6,110	26.2
Services	5,596	22.3	4,801	20.6
Trade	4,511	18.0	4,266	18.3
Manufacturing	3,023	12.1	2,812	12.1
Hotels and hospitality	758	3.0	924	4.0
Energy	2,893	11.5	2,166	9.3
Other	2,781	11.1	2,219	9.5
Total business and government	25,092	100.0	23,298	100.0

Performing loan portfolio by Geography

	2011		2010	
	\$m	%	\$m	%
British Columbia	21,852	42.0	21,805	43.2
Western Canada (excluding British Columbia)	10,302	19.8	9,669	19.2
Ontario	13,802	26.5	13,339	26.4
Quebec and Atlantic	6,052	11.7	5,660	11.2
Total performing loans	52,008	100.0	50,473	100.0

Large customer concentrations are borrowing groups where approved facilities exceed 10% of our regulatory capital base. At 31 December 2011, this amount was approximately \$564m (2010: \$548m).

The following table provides details of our large customer concentrations:

	2011	2010
Large customer concentration \$m	4,527	3,229
As a percentage of business and government loans	18.0%	13.9%
As a percentage of total performing loans	8.7%	6.4%

The increase in the large customer exposure is comprised mainly of increased exposures to Canadian provinces. Overall, three quarters of the large customer exposure is to Canadian sovereign customers and to Canadian Chartered banks. The remaining quarter is to low risk corporate clients.

Credit quality of financial assets

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

For core banking operations, the vast majority of the total loan portfolio is categorized as strong. Credit quality of the portfolio was historically stable until the latter part of 2007. Credit quality has deteriorated through the decline in this credit cycle. This decline continued since then but there are early signs of economic recovery. At 31 December 2011, \$673m, or 1.3%, of the loan portfolio was impaired, compared to \$741m, or 1.5% at 31 December 2010, with specific and general allowances providing 66.6% (2010: 64.6%) coverage of these loans. Overall credit quality remains satisfactory, reflecting our prudent lending standards. Provision levels overall remained stable compared to the prior year.

Management's Discussion and Analysis (continued)

The loan impairment charges and other credit risk provisions for the Consumer Finance business decreased by \$33m in 2011. The decline is primarily due to lower receivables and improved delinquencies as a result of continued efforts on improving the credit quality of the portfolios and improved economic conditions.

The total of impaired exposures include \$59m (2010: \$117m) of Consumer Finance loans, for which impairment is assessed collectively. The lower level of impaired credit exposures in 2011 was driven by a change in the charge-off policy for our Unsecured and Retail portfolios from 300 days to 180 days, to be consistent with other products and the improved economic conditions.

For the Retail Loan Portfolio, approximately 90% of the portfolio is secured by Residential Real Estate assets, through residential mortgage and Home Equity Line of Credit ('HELOC') advances. The current portfolio has an average loan to value of 52%, including HELOC outstandings, which has been stable over the past 12 months. New origination average loan to value is 64%, consistent over the last 12 months. Serious arrears in 2011 are below 2010 levels.

Eurozone exposures remain well controlled totaling \$746m at 31 December 2011, predominantly to France and Germany including \$257m of sovereign exposure. Within this amount, exposures to Greece, Italy, Ireland, Portugal and Spain are limited to \$1m in direct exposures to Ireland and \$13m in trade related and standby guarantees received from banks and \$21m in exposure relating to standby guarantees where our first recourse on these latter facilities is to our customers. In addition to the above, we also have exposures to Switzerland and the United Kingdom amounting to \$930m of which \$695m is sovereign exposure.

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

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

For core banking operations, the credit quality of financial assets is presented using EAD and will therefore not agree to the carrying values as disclosed within the consolidated statements of financial position. EAD represents the outstanding or drawn amount of a credit exposure, before deducting any specific provision or amounts written off as well as an undrawn portion, which represents estimated amounts not recognized in the statement of financial position that could be drawn at time of default by the credit party. The credit quality of financial assets in the Consumer Finance segment is presented at their carrying values included in the consolidated statements of financial position.

Credit quality of non-retail portfolio

	2011			2010		
	Drawn \$m	Undrawn \$m	Total \$m	Drawn \$m	Undrawn \$m	Total \$m
Strong	28,560	3,354	31,914	24,858	4,041	28,899
Medium	23,802	7,539	31,341	22,905	7,482	30,387
Sub-standard	911	96	1,007	1,072	114	1,186
Impaired	533	-	533	564	59	623
	53,806	10,989	64,795	49,399	11,696	61,095

Credit quality of retail portfolio (excluding Consumer Finance segment)

	2011			2010		
	Drawn \$m	Undrawn \$m	Total \$m	Drawn \$m	Undrawn \$m	Total \$m
Strong	10,324	604	10,928	10,473	607	11,080
Medium	13,046	4,189	17,235	12,926	4,291	17,217
Sub-standard	705	96	801	836	99	935
Impaired	165	0	165	217	–	217
	24,240	4,889	29,129	24,452	4,997	29,449

Included in residential mortgages of \$19.0bn (2010: \$18.8bn) are \$1.5bn (2010: \$1.8bn) of mortgages insured either under the National Housing Act or by a third party private insurer with an “AA” rating. In addition, as part of the bank’s securitization program, the bank has portfolio insured residential mortgages amounting to \$5.6bn (2010: \$7.2bn).

Credit quality of retail portfolio (Consumer Finance segment)

	2011 \$m	2010 \$m
Strong	605	677
Medium	1,598	1,394
Sub-standard	238	427
Impaired	59	117
	2,500	2,615

Renegotiated loans

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

The carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated was \$121m at 31 December 2011 (2010: \$89m). This is largely as a result of a decrease in re-negotiated residential mortgage loans and a decrease in number of renegotiated commercial loans.

Loans past due but not impaired

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

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

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

Loans and advances held at amortized cost	2011 \$m	2010 \$m
Up to 29 days	502	502
30-59 days	157	154
60-89 days	63	67
90-179 days	24	36
180 days and over	6	9
	752	768

Management's Discussion and Analysis (continued)

Impaired loans and allowance for credit losses

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

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

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

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

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

- known cash flow difficulties experienced by the borrower;
- past due contractual payments of either principal or interest;
- breach of loan covenants or conditions;
- the probability that the borrower will enter bankruptcy or other financial realization; and
- a significant downgrading in credit rating by an external credit rating agency.

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

The collectively assessed impairment allowance is our best estimate of incurred losses in the portfolio for those individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant. In determining an appropriate level of collectively assessed impairment, we apply the following methodologies:

Business and government – For these loans, the underlying credit metrics including PD, LGD and EAD, for each customer are derived from the bank's internal rating system as a basis for the collectively assessed impairment allowance. The Bank incorporates a quantitatively supported management judgement framework which includes both internal and external indicators, to establish an overall collective impairment allowance consistent with recent loss experience and uncertainties in the environment.

Residential mortgages – Historic average loss rates are used to determine the general provision for these portfolios. Management may consider other current information should they believe that these historic loss rates do not fully reflect incurred losses in these portfolios.

Consumer Finance and other consumer loans – Analysis of historical delinquency movements by product type is used as the basis for the collectively assessed impairment allowance for these loan portfolios. By tracking delinquency movement among pools of homogeneous loans, an estimate of incurred losses in each pool is determined. These estimates can be amended should management believe they do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

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

Impaired loan portfolio

	2011 \$m	2010 \$m
Business and government		
Real estate	256	265
Manufacturing	41	55
Trade	68	80
Services	95	91
Other	73	99
	533	590
Residential mortgages	103	116
Consumer finance loans	59	117
Other consumer loans	37	35
Total impaired loans, acceptances and letters of credit ¹	732	858
Specific allowances	208	227
Collective allowances	329	400
Total allowances for credit losses	537	627
Net impaired loans, acceptances and letters of credit	195	231
Allowance as percentage of total impaired loans, acceptances and letters of credit	73.4%	73.1%

¹ Includes \$54m (2010: \$60m) of impaired acceptances and letters of credit.

Movement in impairment allowances

	Customers		Total \$m
	Individually assessed \$m	Collectively assessed \$m	
At 1 January 2010	186	446	632
Movements 2010			
Amounts written off	(111)	(210)	(321)
Recoveries of loans and advances written off in previous years ...	(1)	8	7
Charge to income statement	211	148	359
Foreign exchange and other movements	(58)	8	(50)
At 31 December 2010	227	400	627
Movements 2011			
Amounts written off	(94)	(185)	(279)
Recoveries of loans and advances written off in previous years	-	7	7
Charge to income statement ¹	93	107	200
Foreign exchange and other movements	(18)	-	(18)
At 31 December 2011	208	329	537

Coverage by collectively assessed impairment¹

	2011 %	2010 %
As a percentage of total performing loans	0.63	0.79
As a percentage of risk-weighted assets ²	0.93	1.17

¹ In 2011, in addition to the charge in income above, 'Loan impairment charges and other credit risk provisions' as presented in the consolidated income statement includes a \$3m reversal of a previously recorded impairment loss relating to credit risk on an available-for-sale investment.

² Information does not form an integral part of the audited financial statements.

Management's Discussion and Analysis (continued)

Provisions for credit losses

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

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

	2011 \$m	2010 \$m
Individually assessed provisions.....	93	211
Collectively assessed provisions.....	107	148
Total provisions for credit loss ¹	<u>200</u>	<u>359</u>
Individually assessed provisions as a per cent of total loan portfolio.....	<u>0.18</u>	<u>0.41</u>

¹ In 2011, in addition to the charge to income above, 'Loan impairment charges and other credit risk provisions' as presented in the consolidated income statement includes a \$3m reversal of a previously recorded impairment loss relating to credit risk on an available-for-sale investment.

For core banking operations, the level of collectively assessed provisions has decreased marginally as a percentage of risk-weighted assets. The collectively assessed impairment will be maintained at a level consistent with the underlying risk of the loan book and management's view of economic and other conditions that impact incurred losses in the loan portfolio. Individual provisions decreased in 2011 reflecting improved credit quality and lower loan volumes in the bank's commercial loan portfolio. Overall improved credit quality and reduced outstandings resulted in a release of collective provisions in the commercial loan portfolio. Lower receivables and improved delinquencies as a result of continued efforts on improving the credit quality of the Consumer Finance portfolio resulted in a reduction in collective provision requirements in the consumer lending portfolio.

Impaired securities

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

Available-for-sale securities

In 2011, 'Loan impairment charges and other credit risk provisions' as presented in the consolidated income statement includes a \$3m reversal of a previously recorded impairment loss relating to credit risk on an available-for-sale investment.

Derivative portfolio

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

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

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

	2011 \$m	2010 \$m
Interest rate contracts.....	1,292	554
Foreign exchange contracts.....	2,014	1,612
Commodity contracts.....	35	-
Net credit equivalent amount.....	<u>3,341</u>	<u>2,166</u>

A more detailed analysis of our derivative portfolios is presented in note 11.

Liquidity and funding risk

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

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

The objective of our liquidity and funding management strategy is to ensure that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that access to the wholesale markets is coordinated and cost-effective.

Policies and procedures

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

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

Our liquidity and funding management process includes:

- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring statement of financial position liquidity ratios against internal measures;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within predetermined caps;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans.

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

Primary sources of funding

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

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

We also access professional markets in order to maintain a presence in local money markets and to optimize the funding of asset maturities not naturally matched by core deposit funding.

As part of our wholesale funding arrangements, we have a number of programs for fundraising activities, including asset securitizations and facilities with major Canadian institutional lenders and borrowers, so that undue reliance is not placed on any one source of funding.

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

Management's Discussion and Analysis (continued)

The following is an analysis, by remaining contractual maturities at the reporting date, of undiscounted cash flows payable under financial liabilities.

	On demand and due within 3 months \$m	Due between 3 and 12 months \$m	Due between 1 and 5 years \$m	Due after 5 years \$m	Total \$m
At 31 December 2011					
Deposits by banks	980	–	–	–	980
Customer accounts	36,520	5,795	4,498	–	46,813
Trading liabilities	2,996	–	–	–	2,996
Financial liabilities.....	45	96	142	1,510	1,793
Derivatives	700	–	–	–	700
Debt securities in issue.....	2,783	2,051	7,321	1,626	13,781
Subordinated liabilities ¹	3	8	242	86	339
Other financial liabilities.....	5,367	56	1,015	–	6,438
	49,394	8,006	13,218	3,222	73,840
Loan commitments.....	4,683	5,164	17,289	10,575	37,711
Financial guarantee contracts.....	620	1,224	132	–	1,976
	54,697	14,394	30,639	13,797	113,527

¹ Excludes interest payable exceeding 15 years.

Certain balances in the above table will not agree directly to the balances in the consolidated statements of financial position as the table incorporates cash flows for both principal and interest, on an undiscounted basis, except for derivatives and trading liabilities. Furthermore, loan commitments and financial guarantee contracts are not recognized on the statement of financial position. Trading liabilities and trading derivatives have been included in the 'On demand and due within 3 months' time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity. The undiscounted cash flows potentially payable under financial guarantee contracts are classified on the basis of the earliest date they can be drawn down.

Cash flows payable in respect of deposits are primarily contractually repayable on demand or on short notice. However, in practice, short-term deposit balances remain stable as cash inflows and outflows broadly match.

Advances to core funding

The bank emphasizes the importance of core current accounts and savings accounts as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits to restrict the bank's ability to increase loans and advances to customers without corresponding growth in current accounts and savings accounts. This measure is referred to as the 'advances to core funding' ratio.

The ratio describes loans and advances to customers as a percentage of the total of core customer current and savings accounts and term funding with a remaining term to maturity in excess of one year. Loans and advances to customers which are part of reverse repurchase arrangements, and where the bank receives securities which are deemed to be liquid, are excluded from the advances to core funding ratio, as are current accounts and savings accounts from customers deemed to be 'non-core'. The definition of a non-core deposit includes a consideration of the size of the customer's total deposit balances. The categorization of customer deposits into core and non-core takes into account the nature of the customer and the size and pricing of the deposit.

Advances to core funding ratio

	2011	2010
	%	%
Year-end	96	96
Maximum	96	108
Minimum	88	96
Average	90	102

The bank would meet any unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or collateralized lending markets.

The bank also uses measures other than the advances to core funding ratio to manage liquidity risk, including projected cash flow scenario analyzes.

Contractual obligations

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

A summary of our future contractual payments as at 31 December 2011 is as follows:

	Less than			Total
	1 year	1 to 5 years	After 5 years	Total
	\$m	\$m	\$m	\$m
Subordinated debentures ¹	–	–	726	726
Operating leases	57	183	89	329
Committed purchase obligations	118	130	34	282
Unsecured long-term funding ¹	936	982	1,121	3,039
Total contractual obligations	<u>1,111</u>	<u>1,295</u>	<u>1,970</u>	<u>4,376</u>

¹ Includes principal amounts only.

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

Market risk

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

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

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

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

Management's Discussion and Analysis (continued)

Policies and procedures

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

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

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

Value at Risk

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

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

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

The historical simulation models used incorporate the following features:

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

Statistically, we would expect to see losses in excess of VaR only 1% of the time over a one-year period. Although a valuable guide to risk, VaR should always be viewed in the context of its limitations:

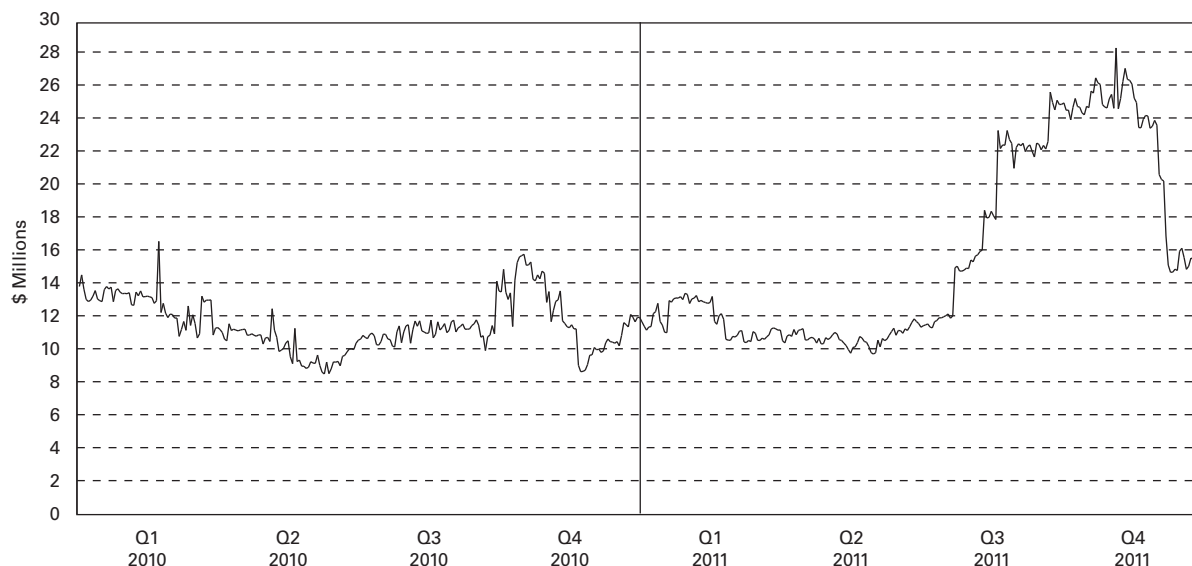
- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day, which may not fully reflect the market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

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

Summary Value at Risk information

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

	2011	2010
	\$m	\$m
End of Year.....	16	12
Average	16	12
Minimum.....	10	9
Maximum.....	29	17



The increase in VaR during Q3 2011 till Q4 2011 is due to high market volatility. Risk appetite is determined by the level of interest rate, foreign exchange, credit, and equity sensitivities. VaR levels remained within our approved limits throughout 2011.

Structural risk

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

Interest rate risk

Interest rate risk arises primarily out of differences in the term to maturity or repricing of our assets and liabilities both on and off-balance sheet. These interest rate risk exposures, or 'gaps', are monitored by ALCO against prescribed limits. The gap position measures assets and liabilities based on contractual repricing data as well as incorporating assumptions on customer behaviour on products with a degree of optionality as to prepayment, redemption or repricing (such as redeemable deposit products and mortgages with prepayment options). These assumptions, which are based on historical behavioural patterns, are periodically reviewed by ALCO.

We believe in a conservative approach in setting limits on these mismatched positions. Limits are established based on the impact on the present value of all net cash flows of an immediate and parallel upward shift in all relevant yield curves of 0.01%. We also have established limits on these mismatched positions in terms of Dollars at Risk and VaR. Net interest income is forecasted using various interest rate and statement of financial position growth scenarios to provide a comprehensive analysis of spread earnings at risk.

Management's Discussion and Analysis (continued)

We use a variety of cash and derivative instruments, principally interest rate swaps, to manage our interest rate risk. We use derivatives to modify the interest rate characteristics of related statement of financial position instruments and to hedge anticipated exposures when market conditions are considered beneficial.

In managing interest rate risk, we rely primarily upon our contractual interest rate sensitivity position adjusted for assumptions regarding customer behaviour. Adjustments made include assumptions relating to early repayment of consumer loans and residential mortgages and customer preferences for demand, notice and redeemable deposits. Based upon these adjustments made to our contractual positions, it is estimated that an immediate and sustained parallel increase in interest rates of 1% across all currencies and maturities would increase net interest income by \$61m (2010: \$61m) over the next twelve months assuming no additional hedging is undertaken.

Foreign exchange risk

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

Operational risk

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

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

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

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

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

Consolidated Financial Statements

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123	Note 34	Transition to IFRS

Statement of Management's Responsibility for Financial Information

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

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

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

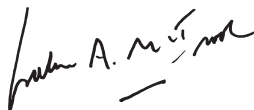
The bank's Board oversees management's responsibilities for financial reporting through the Audit Committee, which is composed of directors who are not officers or employees of the bank. The Audit Committee reviews the bank's interim and annual consolidated financial statements and MD&A and recommends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

As at 31 December 2011, we, the bank's Chief Executive Officer and Chief Financial Officer, have certified the effectiveness of our internal control over financial reporting as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings).

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



Lindsay Gordon
President and Chief Executive Officer



Graham A. McIsaac, FCA
Chief Financial Officer

Vancouver, Canada
24 February 2012

Independent Auditors' Report

To the Shareholders of HSBC Bank Canada

We have audited the accompanying consolidated financial statements of HSBC Bank Canada, which comprise the consolidated statements of financial position as at 31 December 2011, 31 December 2010 and 1 January 2010, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years ended 31 December 2011 and 31 December 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of HSBC Bank Canada as at 31 December 2011, 31 December 2010 and 1 January 2010, and its consolidated financial performance and its consolidated cash flows for the years ended 31 December 2011 and 31 December 2010 in accordance with International Financial Reporting Standards.



Chartered Accountants

Vancouver, Canada
24 February 2012

Consolidated income statement

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

	2011 \$m	2010 \$m
Interest income.....	2,366	2,373
Interest expense.....	(810)	(765)
Net interest income.....	1,556	1,608
Fee income.....	734	727
Fee expense.....	(90)	(89)
Net fee income.....	644	638
Trading income excluding net interest income.....	130	135
Net interest income on trading activities.....	20	18
Net trading income.....	150	153
Net income/(expense) from financial instruments designated at fair value.....	16	(2)
Gains less losses from financial investments.....	43	8
Other operating income.....	88	181
Net operating income before loan impairment charges and other credit risk provisions.....	2,497	2,586
Loan impairment charges and other credit risk provisions.....	(197)	(359)
Net operating income (note 3).....	2,300	2,227
Employee compensation and benefits (notes 4, 5).....	(796)	(750)
General and administrative expenses.....	(475)	(548)
Depreciation of property, plant and equipment.....	(37)	(40)
Amortization and impairment of intangible assets.....	(40)	(19)
Total operating expenses.....	(1,348)	(1,357)
Operating profit.....	952	870
Share of profit in associates.....	4	5
Profit before income tax expense.....	956	875
Income tax expense (note 6).....	(252)	(257)
Profit for the year.....	704	618
Profit attributable to common shareholders.....	633	531
Profit attributable to preferred shareholders.....	61	61
Profit attributable to shareholders.....	694	592
Profit attributable to non-controlling interests.....	10	26
Average number of common shares outstanding (000's).....	498,668	498,668
Basic earnings per common share.....	\$ 1.27	\$ 1.06

The accompanying notes on pages 63 to 139 and the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 form an integral part of these financial statements.

Consolidated statement of comprehensive income

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

	2011 \$m	2010 \$m
Profit for the year	704	618
Other comprehensive income		
Available-for-sale investments	29	22
– fair value gains	84	36
– fair value gains transferred to income statement on disposal	(43)	(8)
– income taxes	(12)	(6)
Cash flow hedges	213	(30)
– fair value gains	484	(45)
– fair value gains transferred to income statement	(193)	–
– income taxes	(78)	15
Actuarial losses on defined benefit plans	(39)	(42)
– before income taxes	(47)	(57)
– income taxes	8	15
Other comprehensive income/(loss) for the year, net of tax	203	(50)
Total comprehensive income for the year	907	568
Total comprehensive income for the year attributable to:		
– shareholders	897	542
– non-controlling interests	10	26
	907	568

The accompanying notes on pages 63 to 139 and the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 form an integral part of these financial statements.

Consolidated statement of financial position

(in millions of dollars)

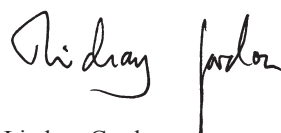
	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
ASSETS			
Cash and balances at central bank	77	79	189
Items in the course of collection from other banks	104	84	88
Trading assets (note 10)	4,587	3,947	4,042
Derivatives (note 11)	2,203	1,363	1,055
Loans and advances to banks	4,530	5,792	5,862
Loans and advances to customers	44,284	45,218	48,549
Financial investments (note 12)	19,168	16,149	13,033
Other assets (note 18)	559	610	575
Prepayments and accrued income	225	186	178
Customers' liability under acceptances	4,059	4,372	4,966
Property, plant and equipment (note 16)	123	123	144
Goodwill and intangible assets (note 19)	76	94	99
Total assets	79,995	78,017	78,780
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	1,377	967	2,496
Customer accounts	46,614	45,492	43,179
Items in the course of transmission to other banks	288	178	284
Trading liabilities (note 20)	2,996	2,764	2,812
Financial liabilities designated at fair value (note 22)	1,006	983	1,138
Derivatives (note 11)	1,746	1,161	823
Debt securities in issue (note 21)	13,327	14,816	16,235
Other liabilities (note 23)	2,187	1,440	980
Acceptances	4,059	4,372	4,966
Accruals and deferred income	566	597	573
Retirement benefit liabilities	300	267	214
Subordinated liabilities (note 24)	326	324	432
Total liabilities	74,792	73,361	74,132
Equity			
Preferred shares (note 27)	946	946	946
Common shares (note 27)	1,225	1,225	1,225
Other reserves	439	197	205
Retained earnings	2,363	2,058	1,842
Total shareholders' equity	4,973	4,426	4,218
Non-controlling interests (note 28)	230	230	430
Total equity	5,203	4,656	4,648
Total equity and liabilities	79,995	78,017	78,780

The accompanying notes on pages 63 to 139 and the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 form an integral part of these financial statements.

Approved on behalf of the Board of Directors:



Samuel Minzberg
Chairman, HSBC Bank Canada



Lindsay Gordon
President and Chief Executive Officer

Consolidated statement of cash flows

For the year ended 31 December (in millions of dollars)

	2011 \$m	2010 \$m
Cash flows from operating activities		
Profit before tax.....	956	875
Adjustments for:		
– non-cash items included in profit before tax (note 29).....	312	451
– change in operating assets (note 29).....	62	4,280
– change in operating liabilities (note 29).....	433	(1,079)
– tax paid.....	(247)	(101)
Net cash from operating activities	<u>1,516</u>	<u>4,426</u>
Cash flows from investing activities		
Purchase of financial investments.....	(20,373)	(4,885)
Proceeds from the sale and maturity of financial investments.....	17,383	1,791
Purchase of property, plant and equipment.....	(46)	(36)
Proceeds from sale of property, plant and equipment.....	8	13
Purchase of intangibles	(21)	(10)
Net cash used in investing activities	<u>(3,049)</u>	<u>(3,127)</u>
Cash flows from financing activities		
Subordinated liabilities repaid	–	(100)
Dividends paid to shareholders.....	(361)	(341)
Redemption of trust units.....	–	(200)
Distributions to non-controlling interests	(10)	(26)
Net cash used in financing activities.....	<u>(371)</u>	<u>(667)</u>
Net (decrease)/increase in cash and cash equivalents.....	(1,904)	632
Cash and cash equivalents at the beginning of the year.....	<u>6,603</u>	<u>5,971</u>
Cash and cash equivalents at the end of the year (note 29).....	<u>4,699</u>	<u>6,603</u>

The accompanying notes on pages 63 to 139 and the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 form an integral part of these financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2011 (in millions of dollars)

	Other reserves						Total share- holders' equity \$m	Non- controlling interests \$m	Total equity \$m
	Share capital ¹ \$m	Retained earnings \$m	Available- for-sale fair value reserve \$m	Cash flow hedging reserve \$m	Total other reserves \$m	Total sharehold- ers' equity \$m			
At 1 January	2,171	2,058	81	116	197	4,426	230	4,656	
Profit for the year	-	694	-	-	-	694	10	704	
Other comprehensive income/(loss), net of tax	-	(39)	29	213	242	203	-	203	
Available-for-sale investments	-	-	29	-	29	29	-	29	
Cash flow hedges	-	-	-	213	213	213	-	213	
Actuarial gains/(losses) on defined benefit plans	-	(39)	-	-	-	(39)	-	(39)	
Total comprehensive income for the year	-	655	29	213	242	897	10	907	
Dividends to shareholders (note 7)	-	(361)	-	-	-	(361)	-	(361)	
Distributions to unit holders	-	-	-	-	-	-	(10)	(10)	
Other movements	-	11	-	-	-	11	-	11	
At 31 December	2,171	2,363	110	329	439	4,973	230	5,203	

For the year ended 31 December 2010 (in millions of dollars)

	Other reserves						Total share- holders' equity \$m	Non- controlling interests \$m	Total equity \$m
	Share capital ¹ \$m	Retained earnings \$m	Available- for-sale fair value reserve \$m	Cash flow hedging reserve \$m	Total other reserves \$m	Total share- holders' equity \$m			
At 1 January	2,171	1,842	59	146	205	4,218	430	4,648	
Profit for the year	-	592	-	-	-	592	26	618	
Other comprehensive income/(loss), net of tax	-	(42)	22	(30)	(8)	(50)	-	(50)	
Available-for-sale investments	-	-	22	-	22	22	-	22	
Cash flow hedges	-	-	-	(30)	(30)	(30)	-	(30)	
Actuarial gains/(losses) on defined benefit plans	-	(42)	-	-	-	(42)	-	(42)	
Total comprehensive income/(loss) for the year	-	550	22	(30)	(8)	542	26	568	
Dividends to shareholders (note 7)	-	(341)	-	-	-	(341)	-	(341)	
Distributions to unit holders	-	-	-	-	-	-	(26)	(26)	
Other movements	-	7	-	-	-	7	(200)	(193)	
At 31 December	2,171	2,058	81	116	197	4,426	230	4,656	

1 Share capital is comprised of common shares \$1,225m and preference shares \$946m.

The accompanying notes on pages 63 to 139 and the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 form an integral part of these financial statements.

Notes on the Consolidated Financial Statements

31 December 2011 and 2010 *(all tabular amounts are in millions of dollars unless stated otherwise)*

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

1 Basis of preparation

a *Compliance with International Financial Reporting Standards*

From 1 January 2011, the bank has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ('IFRS') and accounting guidelines as issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI'), as required under Section 308(4) of the Bank Act.

IFRS comprise accounting standards as issued by the International Accounting Standards Board ('IASB') and its predecessor body as well as interpretations issued by the IFRS Interpretations Committee and its predecessor body.

These consolidated financial statements represent the first annual financial statements of the bank and its subsidiaries prepared in accordance with IFRS and accordingly IFRS 1, 'First-Time Adoption of International Financial Reporting Standards' ('IFRS 1'), has been applied.

In accordance with IFRS, the bank has:

- provided comparative financial information;
- retrospectively applied all IFRS, other than in respect of elections made under IFRS 1;
- applied all mandatory exceptions as applicable for first-time adopters of IFRS; and
- elected to align its reporting under IFRS with the reporting to its Parent for consolidation purposes, as permitted by IFRS 1.

The bank's consolidated financial statements were previously prepared in accordance with accounting principles generally accepted in Canada ('GAAP'). Canadian GAAP differs in some areas from IFRS. To comply with IFRS, management has amended certain accounting, measurement and consolidation methods previously applied in the Canadian GAAP financial statements. Note 34 contains reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS on equity, earnings and comprehensive income along with line-by-line reconciliations of the statement of financial position and income statement.

b *Presentation of information*

The bank's consolidated financial statements are presented in Canadian dollars which is its functional currency. The abbreviations '\$m' represents millions of dollars. All tabular amounts are in millions of dollars except where otherwise noted.

Disclosures required under IFRS 7 'Financial Instruments: Disclosures' ('IFRS 7') concerning the nature and extent of risks relating to financial instruments have been included in the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54.

Capital disclosures required and Loans and advances under IAS 1 'Presentation of financial statements' ('IAS1') have been included in the audited sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54.

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 bank's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances and the valuation of financial instruments as described within Management's Discussion and Analysis.

Notes on the Consolidated Financial Statements (continued)

1 Basis of preparation (continued)

d Consolidation

The consolidated financial statements of the bank comprise the financial statements of the bank and its subsidiaries as at 31 December 2011, 31 December 2010 and for the years then ended and as at 1 January 2010. Subsidiaries are consolidated from the date that the bank gains control. The acquisition method of accounting is used when subsidiaries are acquired by the bank. 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 recognized as an expense in the 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 identifiable assets acquired and 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. Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Entities that are controlled by the bank are consolidated until the date that control ceases.

In the context of Special Purpose Entities ('SPE'), the following circumstances may indicate a relationship which, in substance, the bank controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the bank according to its specific business needs so that the bank obtains the benefits from the SPE's operation;
- the bank has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the bank has delegated these decision-making powers;
- the bank has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; or
- the bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The bank performs a re-assessment of consolidation whenever there is a change in the substance of the relationship between the bank and an SPE.

All inter-company transactions are eliminated on consolidation.

The consolidated financial statements of the bank also include the attributable share of the results and reserves of associates.

In accordance with IFRS 1, the bank has chosen not to restate business combinations that took place prior to 1 January 2004, the date of transition to IFRS of its Parent, as described in note 34.

e Changes in accounting policy during 2011

The bank adopted the revised IFRS 3 'Business Combinations' ('IFRS 3') and amendments to IAS 27 'Consolidated and Separate Financial Statements'. The main changes under the standards are that:

- acquisition-related costs are recognized as an expense in the income statement in the period in which they are incurred;
- all consideration transferred, including contingent consideration, is recognized and measured at fair value at the acquisition date;
- equity interests held prior to control being obtained are re-measured to fair value at the date of obtaining control, and any gain or loss is recognized in the income statement;
- an option is available, on a transaction-by-transaction basis, to measure any non-controlling (previously referred to as minority) interests in the entity acquired either at fair value, or at the non-controlling interests' proportionate share of the net identifiable assets of the entity acquired; and
- changes in a parent's ownership interest in a subsidiary that do not result in a change of control are treated as transactions between equity holders and are reported in equity.

1 Basis of preparation (continued)

e *Changes in accounting policy during 2011 (continued)*

In terms of their application to the bank, the revised IFRS 3 and amendments to IAS 27 apply prospectively to acquisitions and transactions taking place on or after 1 January 2010, and have had no significant effect on the consolidated financial statements as there have been no acquisitions subsequent to 1 January 2010.

f *Future accounting developments*

At 31 December 2011, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for the bank's consolidated financial statements. The IASB is continuing to work on projects on insurance, revenue recognition and lease accounting, which together with the standards described below, represent widespread and significant changes to accounting requirements from 2013.

Standards applicable in 2013

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. IFRS 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 emphasizes legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on the investors' rights and obligations than on structure of the arrangement, 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.

Based on our initial assessment, we do not expect IFRS 10 and 11 to have a material impact on the bank's financial statements.

In May 2011, the IASB also 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 IFRS. 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.

Based on our initial assessment, we do not expect IFRS 13 to have a material impact on the bank's financial statements.

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 for the bank is the replacement of interest cost and expected return on plan assets by 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 bank is currently assessing the impact of IFRS 13 and it is not practical to quantify the effect as at the date of the publication of these financial statements.

Notes on the Consolidated Financial Statements (continued)

1 Basis of preparation (continued)

f Future accounting developments (continued)

In December 2011, the IASB issued amendments to IFRS 7 ‘Disclosures – Offsetting Financial Assets and Financial Liabilities’ which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related arrangements on an entity’s financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendments are required to be applied retrospectively.

Standards applicable in 2014

In December 2011, the IASB issued amendments to IAS 32 ‘Offsetting Financial Assets and Financial Liabilities’ which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 ‘Financial Instruments: Presentation’. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively.

The bank is currently assessing the impact of these clarifications but it is impracticable to quantify their effect as at the date of publication of these financial statements.

Standards applicable in 2015

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.

Following the IASB’s decision in December 2011 to defer the effective date, 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 but prior periods need not be restated.

The second and third phases in the IASB’s project to replace IAS 39 will address the impairment of financial assets measured at amortized cost and hedge accounting.

The IASB did not finalize the replacement of IAS 39 by its stated target of June 2011, and the IASB and the US Financial Accounting Standards Board have agreed to extend the timetable beyond this date to permit further work and consultation with stakeholders, including reopening IFRS 9 to address practice and other issues. The bank remains unable to provide a date by which it plans to apply IFRS 9 as OSFI does not presently allow early adoption. Therefore, it remains impracticable to quantify the impact of IFRS 9 as at the date of publication of these consolidated financial statements.

2 Summary of significant accounting policies

a Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (other than debt securities issued by the bank and derivatives managed in conjunction with such debt securities issued) are recognized in ‘Interest income’ and ‘Interest expense’ in the income statement using the effective interest rate method. The effective interest rate method is a way of calculating the amortized cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, we estimate 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 bank that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

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

2 Summary of significant accounting policies (continued)

b *Non-interest income*

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

- income earned on the execution of a significant act is recognized 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 an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognized 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 recognized as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in ‘Interest income’ (note 2(a)).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

Net income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on those financial instruments are also included in ‘Net income from financial instruments designated at fair value’, except for interest arising from debt securities issued, and derivatives managed in conjunction with debt securities, which is recognized in ‘Interest expense’.

Dividend income is recognized when the right to receive payment is established.

c *Segment reporting*

Operations are managed according to the main customer groups of the HSBC Group: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets and Consumer Finance. Measurement of segment assets, liabilities, income and expenses is based on the bank’s accounting policies. Segment income and expenses include transfers between segments and these transfers are conducted on arm’s length terms and conditions. Shared costs are included in segments on the basis of the actual recharges made.

d *Valuation of financial instruments*

All financial instruments are recognized initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the bank recognizes a trading gain or loss on inception of the financial instrument. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognized immediately in the income statement but is recognized over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the bank enters into an offsetting transaction.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models 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.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

d Valuation of financial instruments (continued)

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuation, including interest rate yield curves, prepayment and default rates, volatilities and exchange rates. If there are additional factors that are not incorporated within the valuation model but would be considered by market participants, further fair value adjustments may be applied. These fair value adjustments include adjustments for bid-offer spread, model uncertainty, credit risk and model limitation.

If the fair value of a financial asset measured at fair value becomes negative, the financial instrument is recorded as a financial liability until its fair value becomes positive, at which time the financial instrument is recorded as a financial asset.

The fair values of financial liabilities are measured using quoted market prices where available or using valuation techniques. These fair values include market participants' assessments of the appropriate credit spread to apply to the bank's liabilities. The amount of change during the period, and cumulatively, in the fair value of designated financial liabilities that is attributable to changes in their credit spread is determined as the amount of change in the fair value that is not attributable to changes in market conditions that give rise to market risk.

e Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the bank. Loans and advances are recognized when cash is advanced to borrowers. They are derecognized when either the borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest rate method, less impairment losses. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

The bank may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of the bank.

f Impairment of loans and advances

Losses for impairment are recognized when there is objective evidence that impairment of a loan or portfolio of loans has occurred as a result of a loss event and where the loss event has an impact on the estimated future cash flows of the loan or portfolio of loans. Impairment losses are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognized.

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 the volumes of defaults and losses are sufficient to enable a collective assessment methodology to be applied.

For all loans that are considered individually significant, the bank assesses on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the bank 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;

2 Summary of significant accounting policies (continued)

f Impairment of loans and advances (continued)

- the probability that the borrower will enter bankruptcy or other financial realization; and
- a significant downgrading in credit rating by an external credit rating agency.

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

- the bank's aggregate exposure to the customer;
- the viability of the customer's business model and its capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its 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 bank and the likelihood of other creditors continuing to support the company;
- 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 realizable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding; and
- when available, the secondary market price of 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 the timing and amount 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.

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.

For business and government loans, for which evidence of loss has been specifically identified on an individual basis, the underlying credit metrics, including probability of default, loss given default and exposure at default, for each customer is derived from the bank's internal rating systems as a basis for determining the collective allowance. Management amends these metrics for some or all borrowers where they consider that the rating system metrics do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

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

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

The loan impairment charges and other credit risk provisions is charged to income and comprises the amounts written off during the year, net of recoveries on amounts written off in prior years, and changes in provisions.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

f *Impairment of loans and advances (continued)*

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 realization of security. In circumstances where the net realizable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

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 recognized, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognized in the income statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realization are reported in 'Other assets' and at the lower of the carrying amount of the loan (net of any impairment allowance) and its net realizable value at the date of exchange. Any subsequent write-down of the acquired asset to its net realizable value is recognized in the income statement, in 'Other operating income'. Any subsequent increase in the net realizable value, to the extent this does not exceed the cumulative write-down, is also recognized in 'Other operating income', together with any realized gains or losses on disposal. Foreclosed assets that are expected to be held for longer than one year are recorded in accordance with the bank's accounting policy for such assets.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum numbers of payments required under the new arrangements have been received. These renegotiated loans are segregated from other parts of the loan portfolio for the purpose 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.

g *Trading assets and trading liabilities*

Treasury bills, debt securities, equity shares, acceptances, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired 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. These financial assets or financial liabilities are recognized on trade date, when the bank enters into contractual arrangements with counterparties to purchase or sell financial instruments, and are normally derecognized when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are re-measured, and gains and losses from changes therein are recognized in the income statement in 'Net trading income'.

h *Financial instruments designated at fair value*

Financial instruments, other than those held for trading, are classified in this category if they meet the necessary criteria and are so designated by management. The bank may designate financial instruments at fair value when the designation eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognizing gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by the bank are debt securities issued and subordinated debt. The interest payable on certain fixed rate long-term debt securities issued have been matched with the interest on 'receive fixed/pay variable' interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortized cost, because the related derivatives are measured at fair value with changes in the fair value recognized in the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognized in the income statement.

2 Summary of significant accounting policies (continued)

h *Financial instruments designated at fair value (continued)*

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognized when the bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognized when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the income statement. Subsequently, the fair values are re-measured, and gains and losses from changes therein are recognized in 'Net income from financial instruments designated at fair value'.

i *Financial investments*

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale. Financial investments are recognized on trade date, when the bank enters into contractual arrangements with counterparties to purchase securities, and are normally derecognized when either the securities are sold or the borrowers repay their obligations.

Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently re-measured at fair value, and changes therein are recognized in other comprehensive income in 'Available-for-sale investments – fair value gains/(losses)' until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognized in other comprehensive income are recognized in the income statement as 'Gains less losses from financial investments'.

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

At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognized 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 amortization) and the current fair value, less any previous impairment loss recognized in the income statement, is removed from other comprehensive income and recognized in the income statement.

Impairment losses for available-for-sale debt securities are recognized within 'Loan impairment charges and other credit risk provisions' in the income statement and impairment losses for available-for-sale equity securities are recognized within 'Gains less losses from financial investments' in the income statement.

Once an impairment loss has been recognized 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 recognized in the 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 fair value of the financial asset is recognized in other comprehensive income. If the fair value of the debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognized in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.
- for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognized directly in other comprehensive income. Impairment losses recognized on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are recognized in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

j *Sale and repurchase agreements (including stock lending and borrowing)*

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain in the statement of financial position and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell ('reverse repos') are not recognized in the statement of financial position and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price is treated as interest and recognized over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected in the statement of financial position. Cash collateral advanced or received is recorded as an asset or a liability, respectively.

Securities borrowed are not recognized on the statement of financial position.

k *Derivatives and hedge accounting*

Derivatives are recognized initially, and are subsequently re-measured, 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 and option pricing models.

Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

The method of recognizing fair value gains or 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 recognized in the income statement. When derivatives are designated as hedges, the bank classifies them as either: (i) hedges of the change in fair value of recognized assets or liabilities or firm commitments ('fair value hedges'); or (ii) hedges of the variability in highly probable future cash flows attributable to a recognized asset or liability, or a forecast transaction ('cash flow hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value or cash flow hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, the bank documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The bank 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 or cash flow 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 bank 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 amortized to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognized, in which case it is released to the income statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income within the 'Cash flow hedging reserve'. Any gain or loss in fair value relating to an ineffective portion is recognized immediately in the income statement. The accumulated gains and losses recognized in other comprehensive income are reclassified to the income statement in the periods in which the hedged item will affect profit or loss.

2 Summary of significant accounting policies (continued)

k *Derivatives and hedge accounting (continued)*

Cash flow hedge (continued)

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains separately in equity until the forecast transaction is eventually recognized in the income statement. When a forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately reclassified to the income statement.

Hedge effectiveness testing

To qualify for hedge accounting, the bank 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 the bank adopts for assessing 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 recognized in the income statement in 'Net trading income'.

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 recognized immediately in the income statement. These gains and losses are reported in 'Net trading income', except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives managed in conjunction with debt securities issued by the bank), in which case gains and losses are reported in 'Net income from financial instruments designated at fair value'. The interest on derivatives managed in conjunction with debt securities issued by the bank which are designated at fair value is recognized in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

l *Derecognition of financial assets and liabilities*

Financial assets are derecognized when the contractual right to receive cash flows from the assets has expired; or when the bank 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 bank has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

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

m *Offsetting financial assets and financial liabilities*

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

n *Associates*

The bank classifies investments in entities over which it has significant influence, but does not control, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

n Associates (continued)

Investments in associates are recognized using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the bank's share of net assets, less dividends or distributions received.

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

o Goodwill and intangible assets

- i) Goodwill arises on acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquiree exceeds the amounts of identifiable assets and liabilities acquired. If they do not exceed the amounts of the identifiable assets and liabilities of an acquired business, the difference is recognized immediately in the income statement.

Intangible assets are recognized separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the recoverable amount from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a cash-generating unit. If the recoverable amount is less than carrying value, an impairment loss is charged to the income statement. Goodwill is stated at cost less accumulated impairment losses.

At the date of disposal of a business, attributable goodwill is included in the bank's share of net assets in the calculation of the gain or loss on disposal.

- ii) The bank's intangible assets are comprised of internally generated computer software and purchased software with finite useful lives. The cost of internally generated software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

Intangible assets are subject to impairment review if there are events or circumstances that indicate the carrying amount may not be recoverable. Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognized during the current period is tested before the end of the current year. Intangible assets that have a finite useful life are stated at cost less amortization and accumulated impairment losses and are amortized over their estimated useful lives. Intangible assets with finite useful lives are amortized, generally on a straight-line basis, over their useful lives as follows:

- internally generated software between 3 and 5 years
- purchased software between 3 and 5 years

p Property, plant and equipment

Land and buildings are stated at historical cost or fair value at the Parent's date of transition to IFRS ('deemed cost'), less any impairment losses and depreciation calculated to write off the assets over their estimated useful lives as follows:

- land is not depreciated;
- buildings are depreciated over their estimated useful lives (between 20 and 40 years); and
- leasehold improvements are depreciated over the shorter of their lease term or over their estimated remaining useful lives.

2 Summary of significant accounting policies (continued)

p *Property, plant and equipment (continued)*

Equipment, fixtures and fittings (including equipment on operating leases where the bank is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their useful lives, which are generally between 3 and 5 years.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

Gains and losses on disposal are recorded in 'Other operating income' in the year of disposal.

Investment properties are included in the statement of financial position at fair value with changes therein recognized in the income statement in the period of change. Fair values are determined by independent professional valuers who apply recognized valuation techniques.

q *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 bank is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers', as appropriate. The finance income receivable is recognized in 'Net interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

All other leases are classified as operating leases. When acting as lessor, the bank includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognized to the extent that residual values are not fully recoverable and the carrying value of the assets is thereby impaired. When the bank is the lessee, leased assets are not recognized on the statement of financial position. 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.

r *Income tax*

Income tax comprises current tax and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized in other comprehensive income or directly in equity, in which case it is recognized 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 substantively enacted by the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the bank intends to settle on a net basis and the legal right to offset exists.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the statement of financial position and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilized.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realized or the liabilities settled based on tax rates and laws enacted, or substantively enacted, by the reporting date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting entity and relate to income taxes levied by the same taxation authority, and when the bank has a legal right to offset.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognized directly in other comprehensive income. Deferred tax relating to fair value re-measurement of available-for-sale investments and cash flow hedging instruments are charged or credited directly to other comprehensive income, and are subsequently recognized in the income statement when the deferred fair value gain or loss is recognized in the income statement.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

s Pension and other post-employment benefits

The bank operates a number of pension and other post-employment benefit plans. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post employment healthcare. The post-retirement plans include supplemental pension arrangements that provide pension benefits in excess of the benefits provided by the pension plans, and post-retirement, non-pension arrangements that provide certain benefits in retirement. The pension plans are funded by contributions from the bank or its employees, while the supplemental pension arrangements are not funded.

Payments to defined contribution plans are charged as an expense as they fall due.

The defined benefit pension costs and the present value of defined benefit obligations are calculated on the reporting date by the scheme's actuaries using the projected unit credit method. The net charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognized on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognized in other comprehensive income in the period in which they arise.

The defined benefit liability recognized in the statement of financial position represents the present value of defined benefit obligations adjusted for unrecognized past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognized past service costs plus the present value of available refunds and reductions in future contributions to the plan.

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

t 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 recognized as an expense on a straight-line basis over the vesting period, with a corresponding credit to retained earnings. 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 by 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. Market performance 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 recognized for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

Where an award has been modified, as a minimum the expense of the original award continues to be recognized 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 recognized 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 recognized immediately for the amount that would otherwise have been recognized for services over the vesting period.

2 Summary of significant accounting policies (continued)

t *Share-based payments (continued)*

HSBC Holdings is the grantor of its equity instruments for all share awards and share options across the group. The credit to 'Retained earnings' on expensing an award represents the effective capital contribution from HSBC Holdings. To the extent the bank will be, or has been, required to fund a share-based payment arrangement, this capital contribution is reduced and the fair value of shares expected to be released to employees is recorded within 'Other liabilities'.

u *Foreign currencies*

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 in effect at the statement of financial position date. Any resulting exchange differences are included in the income statement.

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 recognized in other comprehensive income if the gain or loss on the non-monetary item is recognized in other comprehensive income. Any exchange component of a gain or loss on a non-monetary item is recognized in the income statement if the gain or loss on the non-monetary item is recognized in the income statement.

v *Provisions*

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

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the bank; or are present obligations that have arisen from past events but are not recognized because it is not probable that settlement will require outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognized in the financial statements but are disclosed unless the probability of settlement is remote.

w *Financial guarantee contracts*

Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, the financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortization, and the best estimate of the expenditure required to settle the obligations.

x *Debt securities in issue and deposits by customers and banks*

Financial liabilities are recognized when the bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which are normally the proceeds received net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortized cost, using the effective interest rate method to amortize the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

Debt securities issued are debts for which transferable certificates have been issued. Debt securities in issue also include secured borrowings arising from securitization transactions.

y *Share capital and other equity instruments*

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets.

Notes on the Consolidated Financial Statements (continued)

2 Summary of significant accounting policies (continued)

z Cash and cash equivalents

For the purpose of the 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 bank, debt securities, loans and advances to banks, items in the course of collection from or in transmission to other banks and certificates of deposit.

3 Net operating income

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

	2011	2010
	\$m	\$m
Income		
Interest recognized on impaired financial assets.....	22	23
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities.....	231	215
Fees earned on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers.....	167	149
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value.....	794	738
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities.....	29	33
Fees payable on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers.....	12	10
Gains/(losses)		
Loss on disposal of property, plant and equipment, intangible assets and non-financial investments.....	(2)	(3)
Other.....	-	(4)
Loan impairment charge and other credit risk provision		
Net impairment charge on loans and advances.....	200	359
Reversal of impairment of available-for-sale debt securities.....	(3)	-

4 Employee compensation and benefits

a Total employee compensation

	2011 \$m	2010 \$m
Wages and salaries	635	622
Post-employee benefits	59	43
Other	102	85
	<u>796</u>	<u>750</u>

b Post-employment benefits

We sponsor a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to eligible employees. Non-pension plans comprise of healthcare and other post employment benefits and are not funded.

<i>Income statement charge</i>	2011 \$m	2010 \$m
Defined benefit plans		
Pension plans	14	15
Non-pension plans	10	9
Defined contribution pension plans	35	19
Post-employment benefits	<u>59</u>	<u>43</u>

c Post-employment benefit plans

Net liability

Net liability recognized on statement of financial position in respect of defined benefit plans

	2011 \$m	2010 \$m
Pension plans	(129)	(109)
Fair value of plan assets	388	385
Present value of defined benefit obligations	(513)	(480)
Effect of limit on plan	(4)	(14)
Non-pension plans	(172)	(158)
Present value of defined benefit obligations	(150)	(134)
Unrecognized past service cost	(22)	(24)
Net liability	<u>(301)</u>	<u>(267)</u>

	2011 \$m	2010 \$m
Fair value of plan assets	388	385
Present value of defined benefit obligations	(663)	(614)
Effect of limit on plan surpluses	(4)	(14)
Unrecognized past service cost	(22)	(24)
Net liability	<u>(301)</u>	<u>(267)</u>

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the bank's obligations under its defined plans are presented in the table below. The 2011 and 2010 assumptions will also form and have formed the basis for measuring periodic costs under the plans in 2012 and 2011 respectively.

	Pension plans		Non-pension plans	
	2011	2010	2011	2010
	%	%	%	%
Discount rate	4.75-5.25	5.50	4.75-5.25	5.50
Expected rate of return	6.5-7.0	6.5	n/a	n/a
Rate of increase for pensions	3.0-3.8	3.25	3.0-3.8	3.25
Rate of pay increase	3.0-3.8	3.25	3.0-3.8	3.25
Healthcare cost trend rates – Initial rate	n/a	n/a	8.0-6.5	6.90
Healthcare cost trend rates – Ultimate rate ¹	n/a	n/a	5.0-4.9	4.90

¹ The non-pension 'Healthcare cost trend rates – Ultimate rate' is applied from 2016 onwards for fiscal 2011 (applied from 2015 onwards for fiscal 2010).

The bank determines the discount rates to be applied to its obligations in consultation with the plans' local actuaries, on the basis of the current average yield of high quality Canadian corporate bonds, with maturities consistent with those of the defined benefit obligations. The expected rate of return on plan assets represents the best estimate of long-term future asset returns, which takes into account historical market returns plus additional factors such as the current rate of inflation and interest rates.

Mortality assumption

The mortality assumption for 2011 and 2010 was determined using the 1994 Uninsured Pensioner Mortality Table with generational mortality improvements projected using projection scale AA (sex distinct rates).

The average life expectancies from age 65 under this assumption are as follows:

	Average years from age 65
For a male currently aged 65	19
For a male currently aged 45	21
For a female currently aged 65	22
For a female currently aged 45	23

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The rate of inflation was not modelled as the potential effect was not material. The following table shows the effect of a ¼ percentage point change ('25bps') in the above and other key assumptions on post-employment defined benefit plans:

Pension plans

	2011	2010
	\$m	\$m
Discount rate		
Change in pension obligation at year end from a 25 bps increase	(20)	(19)
Change in pension obligation at year end from a 25 bps decrease	20	19
Change in following year pension cost from a 25 bps increase	(1)	(1)
Change in following year pension cost from a 25 bps decrease	1	1
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at year end from a 25 bps increase	9	8
Change in pension obligation at year end from a 25 bps decrease	(8)	(8)
Change in following year pension cost from a 25 bps increase	1	1
Change in following year pension cost from a 25 bps decrease	(1)	(1)
Rate of pay increase		
Change in pension obligation at year end from a 25 bps increase	9	8
Change in pension obligation at year end from a 25 bps decrease	(8)	(8)
Change in following year pension cost from a 25 bps increase	1	1
Change in following year pension cost from a 25 bps decrease	(1)	(1)
Investment return		
Change in following year pension cost from a 25 bps increase	(1)	(1)
Change in following year pension cost from a 25 bps decrease	1	1
Mortality		
Change in pension obligation from each year of longevity assumed	11	10

Non-pension plans

The effect of a 25bps increase in the discount rate to the 2010 defined benefit charge was not material.

	2011	2010
	\$m	\$m
Change in defined benefit obligation at year end from a 25 bps increase in the discount rate	(6)	(6)
Increase in defined benefit obligation from each additional year of longevity assumed	4	4

The actuarial assumptions of the healthcare cost trend rates have a significant effect on the amounts recognized. A one percentage point change in assumed healthcare cost trend rates would have the following effects on amounts recognized in 2011:

	1% increase	1% decrease
	\$m	\$m
Increase/(decrease) of the aggregate of the current service cost and interest cost	1	(1)
Increase/(decrease) of defined benefit obligation	12	(10)

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Expected rates of return

Pension plans

	2011		2010	
	Expected rates of return ¹ %	Value \$m	Expected rates of return ¹ %	Value \$m
Fair value of plan assets				
Equities	7.7	252	8.0	257
Bonds	3.5	132	4.1	126
Other	3.2	4	3.0	2
		388		385
Defined benefit obligation.....		(513)		(480)
Effect of limit on plan surpluses		(4)		(14)
Net liability		(129)		(109)

¹ The expected rates of return are weighted on the basis of the fair value of plan assets.

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Fair value of plan assets and present value of defined benefit obligations

	Pension plans		Non-pension plans	
	2011 \$m	2010 \$m	2011 \$m	2010 \$m
<i>Fair value of plan assets</i>				
At 1 January	385	343	–	–
Expected return on plans assets	26	25	–	–
Contributions by the bank				
Normal contributions	24	24	4	2
Special contributions	11	–	–	–
Contributions by employees	1	1	–	–
Experience gains/(losses)	(35)	17	–	–
Benefits paid	(24)	(25)	(4)	(2)
At 31 December	388	385	–	–
<i>Present value of defined benefit obligations</i>				
At 1 January	(480)	(408)	(135)	(110)
Current service cost	(14)	(13)	(4)	(4)
Interest cost	(26)	(26)	(8)	(7)
Contributions by employees	(1)	–	–	–
Actuarial (gains)/losses	(16)	(58)	(7)	(16)
Benefits paid	24	25	4	3
At 31 December	(513)	(480)	(150)	(134)
Funded	(513)	(480)	–	–
Unfunded	–	–	(150)	(134)
Effect of limit on plan surpluses	(4)	(14)	–	–
Unrecognized past service cost	–	–	(22)	(24)
Net liability	(129)	(109)	(172)	(158)

The actual return on plan assets for the year ended 31 December 2011 was a negative return of \$9m (2010: positive return of \$41m). Based on the most recent valuations of the plans, the bank expects to make \$21m of contributions to defined benefit pension plans during 2012.

Benefits expected to be paid

	2012 \$m	2013 \$m	2014 \$m	2015 \$m	2016 \$m	2017-2021 \$m
Pension plan	23	20	21	22	24	146
Non-pension plan	4	4	5	5	5	35

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Total expense recognized in the income statement in 'Employee compensation and benefits'

	Pension plans		Non-pension plans	
	2011 \$m	2010 \$m	2011 \$m	2010 \$m
Current service cost.....	14	13	4	4
Interest cost.....	26	26	8	7
Expected return on plan assets.....	(26)	(25)	–	–
Past service cost.....	–	–	(2)	(2)
Surplus distribution expense.....	–	1	–	–
Total (gain)/expense.....	14	15	10	9

Total net actuarial losses recognized in other comprehensive income since transition to IFRS are \$30m. The total effect of the limit on plan surpluses recognized within actuarial losses in other comprehensive income during 2011 was a loss of \$4m (2010: \$14m).

Actuarial valuations for the bank's pension plans and non-pension arrangements are prepared annually. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at 31 December 2011.

The expected cash flows from the plan were projected by reference to the Canada Retail Prices Index ('RPI') swap break-even curve at 31 December 2011. Salary increases were assumed to be 3% per annum above RPI and inflationary pension increases were assumed to be in line with RPI.

Summary

	Pension plans				
	IFRS 2011 \$m	IFRS 2010 \$m	GAAP 2009 \$m	GAAP 2008 \$m	GAAP 2007 \$m
Defined benefit obligation.....	(513)	(480)	(404)	(365)	(423)
Fair value of plan assets.....	388	385	341	314	378
Effect of limit on plan surpluses.....	(4)	(14)	–	–	–
Net deficit.....	(129)	(109)	(63)	(51)	(45)
Experience gains/(losses) on plan liabilities.....	3	2	(25)	(75)	(12)
Experience gains/(losses) on plan assets.....	(35)	17	18	81	20
Gains/(losses) from changes in actuarial assumptions.....	(20)	(59)	–	–	–
Total net actuarial gains/(losses).....	(52)	(40)	(7)	6	8

4 Employee compensation and benefits (continued)

c Post-employment benefit plans (continued)

Summary (continued)

	Non-pension plans				
	IFRS 2011 \$m	IFRS 2010 \$m	GAAP 2009 \$m	GAAP 2008 \$m	GAAP 2007 \$m
Defined benefit obligation.....	(150)	(134)	(108)	(105)	(121)
Net deficit.....	(150)	(134)	(108)	(105)	(121)
Experience gains/(losses) on plan assets	-	-	(5)	26	4
Gains/(losses) from changes in actuarial assumptions.....	(7)	(17)	4	(24)	(2)
Total net actuarial gains/(losses).....	(7)	(17)	(1)	2	2

5 Share-based payments

The HSBC Share Plan was adopted by the HSBC Group in 2005. Under this plan, share and share options of HSBC Holdings' shares may be made.

During 2011, \$24m was charged to the income statement in respect of equity-settled share-based payment transactions (2010: \$22m). This expense, which was computed from the fair values of the share-based payment transactions when contracted, arose under employee share awards made in accordance with the HSBC Group's reward structures.

Calculation of fair values

Fair values of share options/awards, measured at the date of grant of the option/award are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model by HSBC Holdings plc.

Restricted share awards

Restricted shares are awarded to other employees on the basis of their performance, potential and retention requirements, to aid recruitment 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 continuously employed by the bank for this period.

The bank has a liability in respect of restricted share awards of \$16m as at 31 December 2011 (2010: \$27m) to its parent, HSBC Holdings, for the funding as the vested portion as of unexercised grants. The liability is fair valued each reporting period with an adjustment to equity.

	2011 Number ('000)	2010 Number ('000)
Outstanding at 1 January.....	3,412	4,248
Awarded in the year	1,483	1,644
Released in the year	(2,122)	(2,133)
Lapsed and cancelled in the year	(217)	(373)
Transfers and other movements in the year	8	26
Outstanding at 31 December.....	2,564	3,412

The weighted average fair value of shares awarded by the HSBC Group for restricted share awards in 2011 was \$10.03 per share (2010: \$10.93 per share).

Notes on the Consolidated Financial Statements (continued)

5 Share-based payments (continued)

Savings-related share option plans

Savings-related share option plans invite eligible employees to enter into savings contracts to save up to \$425 as of 31 December 2011 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 the fifth anniversary of the commencement of three-year or five-year contracts, respectively. The exercise price is set at 20% (2010: 20%) discount to the market value immediately preceding the date of invitation.

	2011		2010	
	Number (‘000)	Weighted average \$	Number (‘000)	Weighted average \$
Outstanding at 1 January	4,281	6.03	4,861	5.72
Awarded in the year	534	8.04	652	8.60
Exercised in the year	(273)	8.32	(838)	5.81
Forfeited, cancelled and expired in the year	(661)	7.40	(369)	6.73
Transfers and other movements in the year	27	5.84	(25)	8.83
Outstanding at 31 December.....	3,908	5.91	4,281	6.03

The weighted average fair value of options awarded during the year was \$1.99 per option (2010: \$2.38 per option). The weighted average share price at the dates the share options were exercised was \$10.74 per share (2010: \$11.00 per share).

6 Tax expense

	2011 \$m	2010 \$m
Current taxation		
Federal.....	163	127
Provincial	96	85
	259	212
Deferred taxation		
Origination and reversal of temporary differences	(7)	45
Tax expense.....	252	257

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

	2011 %	2010 %
<i>Analysis of tax expense</i>		
Combined federal and provincial income tax rate	26.3	29.5
Adjustments resulting from:		
Adjustment for tax exempt income.....	(0.1)	(0.1)
Additional financial institution taxes	0.1	0.2
Other, net.....	0.1	(0.2)
Effective tax rate	26.4	29.4

In addition to the amount charged to the income statement, the aggregate amount of current and deferred taxation relating to items that are taken directly to equity was \$84m increase in equity (2010: \$24m increase in equity).

6 Tax expense (continued)

Deferred Taxation

Movement in deferred taxation during the year:

	2011 \$m	2010 \$m
At 1 January	133	166
Income statement credit/(charge).....	7	(45)
Other movements	(4)	4
Other comprehensive income:		
Cash flow hedges	–	8
Actuarial gains and losses.....	3	–
At 31 December	<u>139</u>	<u>133</u>

The amount of deferred taxation accounted for in the statement of financial position comprised the following deferred tax assets and liabilities:

	2011 \$m	2010 \$m
Deferred tax assets		
Retirement benefits	76	86
Loan impairment allowances	72	87
Unused tax credits.....	17	29
Assets leased to customers.....	(71)	(63)
Property, plant and equipment	–	2
Available-for-sale investments.....	–	(33)
Cash flow hedges	–	(18)
Share-based payments.....	6	4
Relief for tax losses carried forward.....	15	4
Other temporary differences	24	35
	<u>139</u>	<u>133</u>
Deferred tax liabilities		
Cash flow hedges	(1)	(1)
Net deferred tax asset.....	<u>138</u>	<u>132</u>

The amount of temporary differences for which no deferred tax asset is recognized in the statement of financial position is \$4m (2010: \$4m). This amount is in respect of capital losses where the recoverability of potential benefits is not considered likely. The entire amount \$4m (2010: \$4m) has no expiry date.

Deferred tax is not recognized in respect of the bank's investments in subsidiaries and branches where remittance is not contemplated, and for those associates where it has been determined that no additional tax will arise. The aggregate amount of temporary differences associated with investments where no deferred tax liability is recognized is \$217m (2010: \$208m).

On the evidence available, including management's updated analysis and projection of income, there will be sufficient taxable income generated by the bank to support the recognition of its net deferred tax asset.

Notes on the Consolidated Financial Statements (continued)

7 Dividends

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

	2011		2010	
	\$per share	\$m	\$per share	\$m
Common Shares		300		280
Preferred Shares Class 1				
Series C	1.275	9	1.275	9
Series D	1.250	9	1.250	9
Series E	1.650	16	1.650	16
Preferred Shares Class 2				
Series B	0.310	27	0.310	27
	2011		2010	
	\$per unit	\$m	\$per unit	\$m
HSBC HaTS™				
Series 2010	n/a	–	77.80	16
Series 2015	51.50	10	51.50	10

8 Segment analysis

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

A description of each customer group is as follows:

Retail Banking and Wealth Management

Retail Banking and Wealth Management provides services to individuals by offering a comprehensive range of financial products and services, which include retail banking, asset management, full-service and discount brokerage and trust and advisory services.

In November 2010, the Group announced that, with effect from March 2011, within the context of the customer group/global business view of HSBC Group's performance, Retail Banking and Wealth Management would be managed as a single global business. The business is the existing Personal Financial Services, with Global Asset Management moving from Global Banking and Markets to this new single business.

Commercial Banking

Commercial Banking meets the needs of Canadian commercial and corporate clients by offering commercial and corporate banking, asset management, merchant banking, treasury and trade finance.

Global Banking and Markets

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

8 Segment analysis (continued)

Consumer Finance

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

Other

Activities or transactions which do not relate directly to the business segments are reported in 'Other'. The main items reported under 'Other' include financial instruments classified as trading under the fair value option and revenue and expense recoveries related to information technology activities performed on behalf of HSBC Group companies.

The accounting policies of the segments are consistent with those followed in the preparation of the consolidated financial statements as disclosed in note 2.

	2011 \$m	2010 \$m
<i>Retail Banking and Wealth Management</i>		
Net interest income	399	391
Net fee income	255	252
Net trading income.....	20	26
Other operating income.....	9	8
Net operating income before loan impairment charges and other credit risk provisions	<u>683</u>	<u>677</u>
Loan impairment charges and other credit risk provisions	(20)	(27)
Net operating income	663	650
Total operating expenses	(589)	(587)
Profit before income tax expense	<u>74</u>	<u>63</u>
<i>Commercial Banking</i>		
Net interest income	727	773
Net fee income	268	251
Net trading income.....	24	32
Other operating (loss)/income.....	(55)	6
Net operating income before loan impairment charges and other credit risk provisions	<u>964</u>	<u>1,062</u>
Loan impairment charges and other credit risk provisions	(78)	(206)
Net operating income	886	856
Total operating expenses	(358)	(342)
Operating profit	528	514
Share of profit in associates	4	5
Profit before income tax expense	<u>532</u>	<u>519</u>

Notes on the Consolidated Financial Statements (continued)

8 Segment analysis (continued)

	2011 \$m	2010 \$m
<i>Global Banking and Markets</i>		
Net interest income	165	141
Net fee income	79	82
Net trading income.....	90	86
Gains less losses from financial investments.....	40	8
Other operating income.....	2	4
Net operating income before loan impairment charges and other credit risk provisions	<u>376</u>	<u>321</u>
Loan impairment charges and other credit risk provisions	1	7
Net operating income.....	<u>377</u>	<u>328</u>
Total operating expenses.....	<u>(103)</u>	<u>(94)</u>
Profit before income tax expense.....	<u>274</u>	<u>234</u>
<i>Consumer Finance</i>		
Net interest income	282	312
Net fee income	42	55
Gains less losses from financial investments.....	3	–
Other operating income.....	5	3
Net operating income before loan impairment and other credit risk provisions.....	<u>332</u>	<u>370</u>
Loan impairment charges and other credit risk provisions	(100)	(133)
Net operating income.....	<u>232</u>	<u>237</u>
Total operating expenses.....	<u>(171)</u>	<u>(179)</u>
Profit before income tax expense.....	<u>61</u>	<u>58</u>
<i>Other</i>		
Net interest expense	(17)	(9)
Net fee expense	–	(2)
Net trading income.....	16	9
Net income/(expense) from financial instruments designated at fair value.....	16	(2)
Other operating income.....	127	160
Net operating income before loan impairment charges and other credit risk provisions	<u>142</u>	<u>156</u>
Total operating expenses.....	<u>(127)</u>	<u>(155)</u>
Profit before income tax expense.....	<u>15</u>	<u>1</u>

8 Segment analysis (continued)

Other information about the profit/(loss) for the year

	Retail Banking and Wealth Management \$m	Commercial Banking \$m	Global Banking and Markets \$m	Consumer Finance \$m	Other \$m	Total \$m
Year ended						
31 December 2011						
Net operating income	663	886	377	232	142	2,300
External	746	809	371	232	142	2,300
Inter-segment	(83)	77	6	–	–	–
Year ended						
31 December 2010						
Net operating income	650	856	328	237	156	2,227
External	706	810	318	237	156	2,227
Inter-segment	(56)	46	10	–	–	–

Statement of financial position information

	Retail Banking and Wealth Management \$m	Commercial Banking \$m	Global Banking and Markets \$m	Consumer Finance \$m	Other \$m	Total \$m
At 31 December 2011						
Loans and advances to customers (net)	24,580	15,282	3,931	2,412	(1,921)	44,284
Customers' liability under acceptances....	–	3,298	761	–	–	4,059
Total assets	25,565	19,384	34,549	2,549	(2,052)	79,995
Customer accounts	25,210	18,935	2,505	1	(37)	46,614
Acceptances	–	3,298	761	–	–	4,059
Total liabilities.....	28,270	23,100	22,807	2,159	(1,544)	74,792
At 31 December 2010						
Loans and advances to customers (net)	24,839	14,741	3,790	2,468	(620)	45,218
Customers' liability under acceptances....	–	3,468	904	–	–	4,372
Total assets	25,792	18,908	31,392	2,618	(693)	78,017
Customer accounts	26,259	17,505	1,739	622	(633)	45,492
Acceptances	–	3,468	904	–	–	4,372
Total liabilities.....	37,235	21,689	12,399	2,257	(219)	73,361

Notes on the Consolidated Financial Statements (continued)

9 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis at either fair value or amortized cost. The summary of significant accounting policies in note 2 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognized. The following tables analyze the carrying amount of financial assets and liabilities by category as defined in IAS 39 and by statement of financial position heading:

		31 December 2011						Total \$m
		Held for trading \$m	Designated at fair value \$m	Available- for-sale securities \$m	Financial assets and liabilities at amortized cost \$m	Derivatives designated as fair value hedging instruments \$m	Derivatives designated as cash flow hedging instruments \$m	
Financial assets								
	Cash and balances at central bank.....	—	—	—	77	—	—	77
	Items in the course of collection from other banks..	—	—	—	104	—	—	104
	Trading assets.....	4,587	—	—	—	—	—	4,587
	Derivatives.....	1,617	—	—	—	2	584	2,203
	Loans and advances to banks.....	—	—	—	4,530	—	—	4,530
	Loans and advances to customers.....	—	—	—	44,284	—	—	44,284
	Financial investments.....	—	—	19,168	—	—	—	19,168
	Other assets.....	—	—	—	217	—	—	217
	Accrued income.....	—	—	—	212	—	—	212
	Customers' liability under acceptances.....	—	—	—	4,059	—	—	4,059
	Total financial assets.....	6,204	—	19,168	53,483	2	584	79,441
Financial liabilities								
	Deposits by banks.....	—	—	—	1,377	—	—	1,377
	Customer accounts.....	—	—	—	46,614	—	—	46,614
	Items in the course of transmission to other banks..	—	—	—	288	—	—	288
	Trading liabilities	2,996	—	—	—	—	—	2,996
	Financial liabilities designated at fair value.....	—	1,006	—	—	—	—	1,006
	Derivatives.....	1,513	—	—	—	127	106	1,746
	Debt securities in issue.....	—	—	—	13,327	—	—	13,327
	Other liabilities.....	—	—	—	1,982	—	—	1,982
	Acceptances.....	—	—	—	4,059	—	—	4,059
	Accruals.....	—	—	—	528	—	—	528
	Subordinated liabilities.....	—	—	—	326	—	—	326
	Total financial liabilities.....	4,509	1,006	—	68,501	127	106	74,249

9 Analysis of financial assets and liabilities by measurement basis (continued)

31 December 2010

	Held for trading	Designated at fair value	Available-for-sale securities	Financial assets and liabilities at amortized cost	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Financial assets							
Cash and balances at central bank	—	—	—	79	—	—	79
Items in the course of collection from other banks ..	—	—	—	84	—	—	84
Trading assets	3,947	—	—	—	—	—	3,947
Derivatives	1,090	—	—	—	14	259	1,363
Loans and advances to banks	—	—	—	5,792	—	—	5,792
Loans and advances to customers	—	—	—	45,218	—	—	45,218
Financial investments	—	—	16,149	—	—	—	16,149
Other assets	—	—	—	245	—	—	245
Accrued income	—	—	—	166	—	—	166
Customers' liability under acceptances	—	—	—	4,372	—	—	4,372
Total financial assets	5,037	—	16,149	55,956	14	259	77,415
Financial liabilities							
Deposits by banks	—	—	—	967	—	—	967
Customer accounts	—	—	—	45,492	—	—	45,492
Items in the course of transmission to other banks ..	—	—	—	178	—	—	178
Trading liabilities	2,764	—	—	—	—	—	2,764
Financial liabilities designated at fair value	—	983	—	—	—	—	983
Derivatives	1,099	—	—	—	8	54	1,161
Debt securities in issue	—	—	—	14,816	—	—	14,816
Other liabilities	—	—	—	1,311	—	—	1,311
Acceptances	—	—	—	4,372	—	—	4,372
Accruals	—	—	—	555	—	—	555
Subordinated liabilities	—	—	—	324	—	—	324
Total financial liabilities	3,863	983	—	68,015	8	54	72,923

Notes on the Consolidated Financial Statements (continued)

9 Analysis of financial assets and liabilities by measurement basis (continued)

	Held for trading	Designated at fair value	Available-for-sale securities	Financial assets and liabilities at amortized cost	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Financial assets							
Cash and balances at central bank	—	—	—	189	—	—	189
Items in the course of collection from other banks ..	—	—	—	88	—	—	88
Trading assets	4,042	—	—	—	—	—	4,042
Derivatives	771	—	—	—	7	277	1,055
Loans and advances to banks	—	—	—	5,862	—	—	5,862
Loans and advances to customers	—	—	—	48,549	—	—	48,549
Financial investments	—	—	13,033	—	—	—	13,033
Other assets	—	—	—	330	—	—	330
Accrued income	—	—	—	154	—	—	154
Customers' liability under acceptances	—	—	—	4,966	—	—	4,966
Total financial assets	4,813	—	13,033	60,138	7	277	78,268
Financial liabilities							
Deposits by banks	—	—	—	2,496	—	—	2,496
Customer accounts	—	—	—	43,179	—	—	43,179
Items in the course of transmission to other banks ..	—	—	—	284	—	—	284
Trading liabilities	2,812	—	—	—	—	—	2,812
Financial liabilities designated at fair value	797	1,138	—	—	—	—	1,138
Derivatives	—	—	—	—	3	23	823
Debt securities in issue	—	—	—	16,235	—	—	16,235
Other liabilities	—	—	—	853	—	—	853
Acceptances	—	—	—	4,966	—	—	4,966
Accruals	—	—	—	537	—	—	537
Subordinated liabilities	—	—	—	432	—	—	432
Total financial liabilities	3,609	1,138	—	68,982	3	23	73,755

10 Trading assets

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Trading assets:			
which may be repledged or resold by counterparties.....	704	532	148
not subject to repledge or resale by counterparties.....	3,883	3,415	3,894
	4,587	3,947	4,042

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Treasury and other eligible bills.....	245	557	333
Debt securities.....	2,034	1,712	1,935
Equity securities.....	29	26	28
Customer trading assets.....	304	553	871
Bankers acceptances.....	1,975	1,099	875
	4,587	3,947	4,042

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Debt Securities			
Term to maturity			
Less than 1 year.....	542	561	296
1-5 years.....	1,155	822	1,159
5-10 years.....	222	208	182
After 10 years.....	115	121	298
	2,034	1,712	1,935

Included within the above figures for the bank are debt securities issued by banks and other financial institutions of \$84m (31 December 2010: \$35m; 1 January 2010: \$165m) of which \$nil (31 December 2010: \$nil; 1 January 2010: \$111m) are guaranteed by various governments.

11 Derivatives

Fair values of derivatives by product contract type held

	2011					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
Foreign exchange.....	1,034	87	1,121	999	9	1,008
Interest rate.....	548	499	1,047	479	224	703
Commodity.....	35	–	35	35	–	35
Gross total fair values ...	1,617	586	2,203	1,513	233	1,746

	2010					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
Foreign exchange.....	936	–	936	986	–	986
Interest rate.....	154	273	427	113	62	175
Gross total fair values ...	1,090	273	1,363	1,099	62	1,161

Notes on the Consolidated Financial Statements (continued)

11 Derivatives (continued)

The following tables summarize the notional amounts by remaining term to maturity of the derivative portfolio.

	2011				2010			
	Trading		Hedging		Trading		Hedging	
	Less than 1 year	More than 1 to 5 years	Total trading	Less than 1 year	Between 1-5 years	Over 5 years	Total hedging	Total
Interest rate contracts								
Futures.....	42,521	8,136	50,657	3,359	-	-	3,359	54,016
Swaps.....	20,406	10,803	35,277	4,845	19,425	1,605	25,875	61,602
Forward rate agreements.....	1,000	-	1,000	-	-	-	-	1,000
Caps.....	400	164	564	-	-	-	-	564
	64,327	19,103	87,948	8,204	19,425	1,605	29,234	117,182
Foreign exchange contracts								
Spot contracts.....	1,025	-	1,025	-	-	-	-	1,025
Forward contracts.....	40,877	2,894	43,771	-	-	-	-	43,771
Currency swaps and options.....	6,274	4,970	12,578	-	1,389	-	1,389	13,967
	48,176	7,864	57,374	-	1,389	-	1,389	58,763
Other derivative contracts								
Commodity contracts.....	29	101	130	-	-	-	-	130
	112,532	27,068	145,452	8,204	20,814	1,605	30,623	176,075
Interest rate contracts								
Futures.....	18,214	1,458	19,672	-	-	-	-	19,672
Swaps.....	13,203	5,514	20,172	2,979	11,021	1,250	15,250	35,422
Forward rate agreements.....	50	-	50	-	-	-	-	50
Caps.....	-	400	400	-	-	-	-	400
	31,467	7,372	40,294	2,979	11,021	1,250	15,250	55,544
Foreign exchange contracts								
Spot contracts.....	858	-	858	-	-	-	-	858
Forward contracts.....	33,580	1,311	34,891	-	-	-	-	34,891
Currency futures.....	1	-	1	-	-	-	-	1
Currency swaps and options.....	3,157	3,627	8,564	-	-	-	-	8,564
	37,596	4,938	44,314	-	-	-	-	44,314
	69,063	12,310	84,608	2,979	11,021	1,250	15,250	99,858

11 Derivatives (continued)

Use of derivatives

The bank utilizes derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes and to manage and hedge the bank's own risks. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. The held for trading classification includes two types of derivatives: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not qualify for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

The bank'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 in accordance with the bank's approved risk management policies, with matching deals being used to achieve this where necessary. When entering into derivative transactions, the bank employs the same credit risk management procedures that are used for traditional lending to assess and approve potential credit exposures.

Trading derivatives

Most of the bank's derivative transactions relate to sales and 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. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held for trading 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. These include derivatives managed in conjunction with financial instruments designated at fair value.

Gains and losses from changes in the fair value of derivatives, including the contractual interest, that do not qualify for hedge accounting are reported in 'Net trading income', except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value', together with the gains and losses on the hedged items. Where the derivatives are managed with debt securities in issue, the contractual interest is shown in 'Interest expense' together with the interest payable on the issued debt.

Notes on the Consolidated Financial Statements (continued)

11 Derivatives (continued)

An analysis of the derivative portfolio and related credit exposure

	2011			2010		
	Notional amount ¹ \$m	Credit equivalent amount ² \$m	Risk-weighted balance ³ \$m	Notional amount ¹ \$m	Credit equivalent amount ² \$m	Risk-weighted balance ³ \$m
Interest rate contracts						
Future	54,016	–	–	19,672	–	–
Swaps	61,602	1,285	346	35,422	551	126
Forward rate agreements	1,000	–	–	50	–	–
Caps	564	7	1	400	3	1
	117,182	1,292	347	55,544	554	127
Foreign exchange contracts						
Spot contracts	1,025	12	1	858	9	1
Forward contracts	43,771	1,123	148	34,891	965	142
Currency futures	–	–	–	1	–	–
Currency swaps and options	13,967	879	247	8,564	638	255
	58,763	2,014	396	44,314	1,612	398
Other derivative contracts						
Commodity contracts	130	35	8	–	–	–
	176,075	3,341	751	99,858	2,166	525

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

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

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

Interest rate and currency futures are exchange-traded. All other contracts are over-the-counter. The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the reporting date; they do not represent amounts at risk.

Hedging instruments

The bank 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 bank to optimize the overall cost to the bank 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 bank'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 recognized 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 amortized to the income statement as a yield adjustment over the remainder of the hedging period.

11 Derivatives (continued)

Fair value of derivatives designated as fair value hedges

	2011		2010	
	Assets \$m	Liabilities \$m	Assets \$m	Liabilities \$m
Interest rate.....	2	127	14	8

Gains or losses arising from the change in fair value of fair value hedges

	2011 \$m	2010 \$m
Gains/(losses)		
– on hedging instruments.....	(185)	10
– on hedged items attributable to the hedged risk.....	179	(12)

The gains and losses on ineffective portions of fair value hedges are recognized immediately in 'Net trading income'.

Cash flow hedges

The bank's cash flow hedges consist principally of interest rate and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognized in other comprehensive income, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Fair value of derivatives designated as cash flow hedges

	2011		2010	
	Assets \$m	Liabilities \$m	Assets \$m	Liabilities \$m
Foreign exchange.....	87	9	–	–
Interest rate.....	497	97	259	54

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December is as follows:

	2011			
	3 months or less \$m	More than 3 months but less than 1 year \$m	More than 1 year but less than 5 years \$m	5 years or more \$m
Assets.....	19,190	15,454	12,201	1,157
Liabilities.....	(7,154)	(6,854)	(6,004)	(55)
Net cash inflow/(outflow) exposure.....	12,036	8,600	6,197	1,102

Notes on the Consolidated Financial Statements (continued)

11 Derivatives (continued)

	2010			
	3 months or less \$m	More than 3 months but less than 1 year \$m	More than 1 year but less than 5 years \$m	5 years or more \$m
Assets	11,066	10,536	8,912	1,200
Liabilities	(2,419)	(1,819)	(1,594)	–
Net cash inflow/(outflow) exposure	8,647	8,717	7,318	1,200

The gains and losses on ineffective portions of such derivatives are recognized immediately in 'Net trading income'. During 2011, a loss of \$1m (2010: loss of \$4m) was recognized due to hedge ineffectiveness.

The following tables summarize the fair values of the bank's derivative portfolio at 31 December segregated between derivatives that are in a favourable or receivable position and those in an unfavourable or payable position. Fair values of derivative instruments are determined using quoted market prices.

	2011						
	Trading			Hedging			Total
	Favourable position \$m	Unfavourable position \$m	Net position \$m	Favourable position \$m	Unfavourable position \$m	Net position \$m	Net position \$m
Interest rate contracts							
Swaps	547	(477)	70	499	(224)	275	345
Forward rate agreements	–	(3)	(3)	–	–	–	(3)
Caps	1	1	2	–	–	–	2
	548	(479)	69	499	(224)	275	344
Foreign exchange contracts							
Spot contracts ..	2	–	2	–	–	–	2
Forward contracts	568	(592)	(24)	–	–	–	(24)
Currency swaps and options	464	(407)	57	87	(9)	78	135
	1,034	(999)	35	87	(9)	78	113
Other derivative contracts							
Commodity contracts	35	(35)	–	–	–	–	–
	1,617	(1,513)	104	586	(233)	353	457

11 Derivatives (continued)

	2010						
	Trading			Hedging			Total
	Favourable position \$m	Unfavourable position \$m	Net position \$m	Favourable position \$m	Unfavourable position \$m	Net position \$m	Net position \$m
Interest rate contracts							
Swaps	154	(113)	41	273	(62)	211	252
Caps	–	–	–	–	–	–	–
	<u>154</u>	<u>(113)</u>	<u>41</u>	<u>273</u>	<u>(62)</u>	<u>211</u>	<u>252</u>
Foreign exchange contracts							
Spot contracts ..	1	(2)	(1)	–	–	–	(1)
Forward contracts	563	(652)	(89)	–	–	–	(89)
Currency swaps and options....	372	(332)	40	–	–	–	40
	<u>936</u>	<u>(986)</u>	<u>(50)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>(50)</u>
	<u>1,090</u>	<u>(1,099)</u>	<u>(9)</u>	<u>273</u>	<u>(62)</u>	<u>211</u>	<u>202</u>

12 Financial investments

Financial investments comprise the following:

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Financial investments			
Not subject to repledge or resale by counterparties	<u>19,168</u>	<u>16,149</u>	<u>13,033</u>
Available-for-sale			
Treasury bills and other eligible bills	<u>1,716</u>	2,898	2,655
Debt securities	<u>17,452</u>	13,234	10,359
Equity securities	<u>–</u>	17	19
	<u>19,168</u>	<u>16,149</u>	<u>13,033</u>

The term to maturity of debt securities included within financial investments are as follows:

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Debt Securities			
Term to maturity			
Less than 1 year	<u>2,735</u>	2,323	614
1-5 years	<u>14,191</u>	10,857	9,449
5-10 years	<u>526</u>	54	294
No specific maturity	<u>–</u>	–	2
	<u>17,452</u>	<u>13,234</u>	<u>10,359</u>

Notes on the Consolidated Financial Statements (continued)

12 Financial investments (continued)

Included within the above figures for the bank are debt securities issued by banks and other financial institutions of \$1,541m (31 December 2010: \$1,265m; 1 January 2010: \$917m) of which \$270m (31 December 2010: \$852m; 1 January 2010: \$917m) are guaranteed by various governments.

Included in the available-for-sale debt securities are debt securities issued by governments of \$15,590m (31 December 2010: \$11,863m; 1 January 2010: \$8,941m).

13 Assets held for sale

On 20 September 2011 the bank, together with certain of its wholly-owned subsidiaries, entered into an agreement to sell certain assets of the full-service retail brokerage and related wealth management business. The transaction closed on 1 January 2012.

On closing, the assets of the full-service business were transferred including accounts receivable, client accounts, certain contracts and goodwill. The assets, liabilities and profit relating to the business are included in the Retail Banking and Wealth Management segment.

Assets and liabilities relating to the disposal group sold were recorded as held for sale and measured at the lower of the carrying amount and fair value less costs to sell. Assets and liabilities are included within 'Other assets' and 'Other liabilities' respectively as follows:

	2011 \$m
Current assets	
Trading assets.....	36
Prepayments.....	5
Other assets.....	17
	<u>58</u>
Non-current assets	
Goodwill and intangible assets.....	3
Included in other assets.....	<u>61</u>
Current liabilities	
Trading liabilities.....	(310)
Accruals and deferred income.....	(5)
Other liabilities.....	(3)
Included in other liabilities.....	<u>(318)</u>
Net disposal group.....	<u>(257)</u>

In 2011, \$14m of charges were incurred relating to this transaction. A gain relating to the sale will be recorded in the first quarter of 2012. Trading liabilities represents customers' deposits in their broker trading accounts. On closing, cash representing these amounts was transferred to the purchaser.

14 Interest rate sensitivity

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

	2011									
	Floating rate \$m	Within 3 months \$m	3-12 months \$m	Effective interest rate %	1-5 years \$m	Effective interest rate %	Greater than 5 years \$m	Effective interest rate %	Non-interest sensitive \$m	Total \$m
Cash and balances at central bank.....	-	-	-	-	-	-	-	-	77	77
Items in the course of collection from other banks.....	-	-	-	-	-	-	-	-	104	104
Trading assets.....	2,612	1,943	32	1.1	-	-	-	-	2,203	4,587
Derivatives.....	-	-	-	0.9	-	-	-	-	769	2,203
Loans and advances to banks	-	3,683	78	-	-	-	-	-	-	4,530
Loans and advances to customers.....	28,920	4,540	3,178	3.8	7,253	7.0	311	8.4	82	44,284
Financial investments.....	-	3,762	2,501	1.4	12,491	1.9	414	3.2	-	19,168
Acceptances.....	-	-	-	-	-	-	-	-	4,059	4,059
Other assets.....	-	-	-	-	-	-	-	-	983	983
Total assets.....	31,532	13,928	5,789		19,744		725		8,277	79,995
Deposits by banks.....	-	509	1	0.8	-	-	-	-	867	1,377
Customer accounts.....	23,008	5,779	5,677	1.1	4,263	3.2	-	-	7,887	46,614
Items in the course of transmission to other banks.....	-	-	-	-	-	-	-	-	288	288
Trading liabilities.....	2,213	-	-	1.0	-	-	-	-	783	2,996
Financial liabilities designated at fair value ...	-	-	580	6.9	-	-	426	4.8	-	1,006
Derivatives.....	-	-	-	-	-	-	-	-	1,746	1,746
Debt securities in issue.....	109	4,878	1,772	1.7	5,571	3.2	997	3.6	3,053	13,327
Other liabilities.....	-	-	-	-	-	-	-	-	4,059	3,053
Acceptances.....	-	-	-	-	-	-	-	-	4,059	4,059
Subordinated liabilities	40	-	-	1.6	86	2.5	200	4.9	-	326
Shareholders' equity.....	-	-	-	-	600	5.7	-	-	4,373	4,973
Non controlling interest.....	-	-	-	-	200	5.1	-	-	30	230
Total liabilities and shareholders' equity.....	25,370	11,166	8,030		10,720		1,623		23,086	79,995
On-balance sheet gap.....	6,162	2,762	(2,241)	-	9,024	-	(898)	-	(14,809)	-
Off-balance sheet positions.....	-	(673)	(788)	-	353	-	1,109	-	-	-
Total interest rate gap.....	6,162	2,089	(3,029)		9,377		211		(14,809)	-

Notes on the Consolidated Financial Statements (continued)

14 Interest rate sensitivity (continued)

	2010							Non-interest sensitive \$m	Total \$m
	Floating rate \$m	Within 3 months \$m	3-12 months \$m	Effective interest rate %	1-5 years \$m	Effective interest rate %	Greater than 5 years \$m		
Cash and balances at central bank.....	—	—	—	—	—	—	—	79	79
Items in the course of collection from other banks.....	—	—	—	—	—	—	—	84	84
Trading assets.....	2,848	1,099	—	1.0	—	—	—	—	3,947
Derivatives.....	—	—	—	—	—	—	—	1,363	1,363
Loans and advances to banks	—	5,427	—	1.0	—	—	—	365	5,792
Loans and advances to customers.....	30,244	2,962	2,839	3.8	8,851	120	5.7	202	45,218
Financial investments.....	—	4,352	2,540	1.2	9,186	54	2.9	17	16,149
Acceptances.....	—	—	—	—	—	—	—	4,372	4,372
Other assets.....	275	—	—	2.1	—	—	—	738	1,013
Total assets.....	33,367	13,840	5,379	—	18,037	174	—	7,220	78,017
Deposits by banks.....	—	435	—	1.0	—	—	—	532	967
Customer accounts.....	21,450	5,087	6,460	1.1	5,597	—	3.5	6,898	45,492
Items in the course of transmission to other banks.....	—	—	—	—	—	—	—	178	178
Trading liabilities.....	2,385	—	—	1.0	—	—	—	379	2,764
Financial liabilities designated at fair value ...	—	—	—	—	568	415	4.8	—	983
Derivatives.....	—	—	—	—	—	—	—	1,161	1,161
Debt securities in issue.....	150	4,731	2,486	2.4	6,452	997	3.6	—	14,816
Acceptances.....	—	—	—	—	—	—	—	4,372	4,372
Other liabilities.....	—	—	—	—	—	—	—	2,304	2,304
Subordinated liabilities.....	40	—	—	1.6	84	200	4.9	—	324
Shareholders' equity.....	—	—	—	—	600	—	—	3,826	4,426
Non controlling interest.....	—	—	—	—	200	—	—	30	230
Total liabilities and shareholders' equity.....	24,025	10,253	8,946	—	13,501	1,612	—	19,680	78,017
On-balance sheet gap.....	9,342	3,587	(3,567)	—	4,536	(1,438)	—	(12,460)	—
Off-balance sheet positions...	—	(7,453)	565	—	5,338	1,550	—	—	—
Total interest rate gap.....	9,342	(3,866)	(3,002)	—	9,874	112	—	(12,460)	—

15 Transfers of financial assets not qualifying for derecognition

The bank enters into transactions in the normal course of business by which it transfers recognized financial assets directly to third parties or to SPEs.

Derecognition occurs when the bank transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks typically include credit, interest rate, prepayment and other price risks.

The following table analyzes the carrying amount of financial assets as at 31 December that did not qualify for derecognition during the year and their associated financial liabilities:

Financial assets and associated liabilities not qualifying for derecognition

Nature of transaction	2011		2010	
	Carrying amount of assets \$m	Carrying amount of associated liabilities \$m	Carrying amount of assets \$m	Carrying amount of associated liabilities \$m
Asset securitized	7,838	7,989	7,939	8,110
Mortgages sold with recourse	1,487	1,487	1,186	1,185
Repurchase agreements.....	515	516	299	301
Securities lending agreements.....	25	25	119	119
	9,865	10,017	9,543	9,715

16 Property, plant and equipment

	Freehold land and buildings \$m	Leasehold improvements \$m	Equipment, fixtures and fittings \$m	Total \$m
Cost or fair value				
At 1 January 2011	2	148	133	283
Additions at cost	1	27	18	46
Disposals	–	(31)	(18)	(49)
Other	–	–	(6)	(6)
At 31 December 2011	3	144	127	274
Accumulated depreciation and impairment				
At 1 January 2011	–	(79)	(81)	(160)
Depreciation charge for the year	–	(18)	(19)	(37)
Disposals	–	28	17	45
Other	(2)	(3)	6	1
At 31 December 2011	(2)	(72)	(77)	(151)
Net carrying amount at 31 December 2011	1	72	50	123

Notes on the Consolidated Financial Statements (continued)

16 Property, plant and equipment (continued)

	Freehold land and buildings \$m	Leasehold improve- ments \$m	Equipment, fixtures and fittings \$m	Total \$m
Cost or fair value				
At 1 January 2010	20	155	127	302
Additions at cost	–	13	23	36
Disposals	(19)	(20)	(17)	(56)
Other	1	–	–	1
At 31 December 2010	2	148	133	283
Accumulated depreciation and impairment				
At 1 January 2010	(3)	(78)	(77)	(158)
Depreciation charge for the year	–	(20)	(20)	(40)
Disposals	5	19	15	39
Other	(2)	–	1	(1)
At 31 December 2010	–	(79)	(81)	(160)
Net carrying amount at 31 December 2010	2	69	52	123

17 Investments in subsidiaries

HSBC Bank Canada wholly-owns the following principal subsidiaries:

Subsidiary	Place of incorporation	Shareholders' equity
HSBC South Point Investments (Barbados), LLP	St. Michael, Barbados	1,061
HSBC Financial Corporation Limited	Toronto, Ontario, Canada	368
HSBC Securities (Canada) Inc.	Toronto, Ontario, Canada	195
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia, Canada	132
HSBC Capital (Canada) Inc.	Vancouver, British Columbia, Canada	83
HSBC Trust Company (Canada)	Vancouver, British Columbia, Canada	66
Household Trust Company	Toronto, Ontario, Canada	30
HSBC Loan Corporation (Canada)	Vancouver, British Columbia, Canada	12
HSBC Global Asset Management (Canada) Limited	Vancouver, British Columbia, Canada	11

See also note 28(a) in respect of HSBC Canada Asset Trust.

18 Other assets

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Accounts receivable and other	137	230	264
Deferred tax	139	133	166
Current tax	15	7	20
Other non-financial assets	131	181	6
Assets held for sale (note 13)	61	–	–
Investments in associates	57	43	44
Due from clients, dealers and clearing corporations	11	6	66
Foreclosed assets	8	10	9
	559	610	575

19 Goodwill and intangible assets

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Goodwill	23	26	26
Internally generated computer software.....	53	68	73
	76	94	99

During 2011, no goodwill impairment was recognized (2010: \$nil). Impairment testing in respect of goodwill is performed annually. The review of goodwill impairment represents management's best estimates. These values are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term sustainable pattern of cash flows thereafter. While the acceptable range within which underlying assumptions can be applied is governed by the requirement for resulting forecasts to be compared with actual performance and verifiable economic data in future years, the cash flow forecasts necessarily and appropriately reflect management's view of future business prospects. The process of identifying and evaluating goodwill impairment is inherently uncertain because it requires significant management judgment in making a series of estimations, the results of which are highly sensitive to the assumptions used.

20 Trading liabilities

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Other debt securities in issue	175	98	56
Customer trading liabilities.....	1,516	1,402	1,606
Other liabilities – net short positions	1,305	1,264	1,150
	2,996	2,764	2,812

21 Debt securities in issue

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Bonds and medium term notes.....	10,168	12,535	11,862
Money market instruments	3,159	2,281	4,373
	13,327	14,816	16,235

Debt securities are carried at cost

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Term to maturity			
Less than 1 year	4,856	5,104	6,998
1-5 years.....	7,464	8,704	9,074
5-10 years.....	1,007	1,008	163
	13,327	14,816	16,235

Notes on the Consolidated Financial Statements (continued)

22 Financial liabilities designated at fair value

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Debt securities in issue and medium term notes	580	568	736
Subordinated debentures (note 24)	426	415	402
	1,006	983	1,138

The carrying amount at 31 December 2011 of financial liabilities designated at fair value was \$35m higher (31 December 2010: \$25m higher and 1 January 2010: \$19m higher) than the contractual amount at maturity. At 31 December 2011, the cumulative amount of change in fair value attributable to changes in credit risk was a gain of \$22m (31 December 2010: \$12m gain and 1 January 2010: \$19m gain).

23 Other liabilities

	31 December 2011 \$m	31 December 2010 \$m	1 January 2010 \$m
Mortgages sold with recourse	1,487	1,185	915
Accounts payable	178	151	(20)
Share based payment liability	16	27	28
Deferred tax	1	1	1
Current tax	187	76	56
Liabilities held for sale (note 13)	318	-	-
	2,187	1,440	980

24 Subordinated liabilities

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

	Year of Maturity \$m	Foreign Currency Amount \$m	Carrying amount	
			2011 \$m	2010 \$m
<i>Interest rate (%)</i>				
Issued to HSBC Group Companies				
4.822 ¹	2094	US\$85	86	84
Issued to third parties				
4.94 ²	2021		200	200
4.80 ³	2022		426	415
30 day bankers' acceptance rate plus 0.50%	2083		40	40
Total debentures			752	739
Less: designated at fair value (note 22)			(426)	(415)
Debentures at amortized cost			326	324

1 Effective 20 July 2010 and until it resets on 20 July 2015 the interest rate is fixed at 2.478% (previously 4.822%). These debentures are in a fair value hedging relationship which is adjusted for the fair value of the hedged risk.

2 The interest rate is fixed at 4.94% until March 2016 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1%.

3 Interest rate is fixed at 4.8% until 10 April 2017 and thereafter interest is payable at an annual rate equal to the 90 day bankers' acceptance rate plus 1%. These debentures are designated as held for trading under the fair value option.

25 Fair values of financial instruments

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined, or validated, by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with the bank's finance department, ('Finance'). Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilized. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the bank will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the reporting date; and
- the manner in which the data was sourced.

Models provide a logical framework for the capture and processing of necessary valuation inputs. For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and, (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

Determination of fair value

Fair values are determined according to the following hierarchy:

- (a) *Level 1 – quoted market price*: financial instruments with quoted prices for identical instruments in active markets.
- (b) *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.
- (c) *Level 3 – valuation technique with significant unobservable inputs*: financial instruments valued using models where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them, the derivation of fair value is more judgmental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's carrying amount and/ or inception profit ('day 1 gain and loss') is driven by unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used). Furthermore, in some cases the majority of the fair value derived from a valuation technique with significant unobservable inputs may be attributable to the observable inputs. Consequently, the effect of uncertainty in the determining unobservable inputs will generally be restricted to uncertainty about the overall fair value of the financial instrument being measured.

Notes on the Consolidated Financial Statements (continued)

25 Fair value of financial instruments (continued)

Determination of fair value (continued)

In certain circumstances, primarily where debt is hedged with interest rate derivatives or structured notes issued, the bank uses fair value to measure the carrying value of its own debt in issue. The bank records its own debt in issue at fair value, based on quoted prices in an active market for the specific instrument concerned, if available. When quoted market prices are unavailable, the own debt in issue is valued using valuation techniques, the inputs for which are either based upon quoted prices in an inactive market for the instrument, or are estimated by comparison with quoted prices in an active market for similar instruments. In both cases, the fair value includes the effect of applying the credit spread which is appropriate to the bank's liabilities. For all issued debt securities, discounted cash flow modelling is used to separate the change in fair value that may be attributed to the bank's credit spread movements from movements in other market factors such as benchmark interest rates or foreign exchange rates. Specifically, the change in fair value of issued debt securities attributable to the bank's own credit spread is computed as follows: for each security at each reporting date, an externally verifiable price is obtained or a price is derived using credit spreads for similar securities for the same issuer. Then, using discounted cash flow, each security is valued using a risk-free discount curve. The difference in the valuations is attributable to the bank's own credit spread. This methodology is applied consistently across all securities.

Structured notes issued and certain other hybrid instrument liabilities are included within trading liabilities and are measured at fair value. The credit spread applied to these instruments is derived from the spreads at which the bank issues structured notes. These market spreads are significantly smaller than credit spreads observed for plain vanilla debt or in the credit default swap markets.

Gains and losses arising from changes in the credit spread of liabilities issued by the bank reverse over the contractual life of the debt, provided that the debt is not repaid early. All net positions in non-derivative financial instruments, and all derivative portfolios, are valued at bid or offer prices as appropriate. Long positions are marked at bid prices; short positions are marked at offer prices.

The fair value of a portfolio of financial instruments quoted in an active market is calculated as the product of the number of units and its quoted price and no block discounts are made.

Transaction costs are not included in the fair value calculation, nor are the future costs of administering the over the counter derivative portfolio. These, along with trade origination costs such as brokerage fees and post-trade costs, are included either in 'fee expense' or in 'total operating expenses'.

A detailed description of the valuation techniques applied to instruments of particular interest follows:

– *Private equity*

The bank's private equity positions are generally classified as available-for-sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. The exercise of judgment is required because of uncertainties inherent in estimating fair value for private equity investments.

– *Debt securities, treasury and other eligible bills, and equities*

The fair value of these instruments is based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, when available. When unavailable, the fair value is determined by reference to quoted market prices for similar instruments, adjusted as appropriate for the specific circumstances of the instruments.

Illiquidity and a lack of transparency in the market for asset-backed securities has resulted in less observable data being available. While quoted market prices are generally used to determine the fair value of these securities, valuation models are used to substantiate the reliability of the limited market data available and to identify whether any adjustments to quoted market prices are required.

In the absence of quoted market prices, fair value is determined using valuation techniques based on the calculation of the present value of expected future cash flows of the assets. The inputs to these valuation techniques are derived from observable market data and, where relevant, assumptions in respect of unobservable inputs. In respect of asset-backed securities and mortgages, the assumptions may include prepayment speeds, default rates and loss severity based on collateral type, and performance as appropriate. The valuation output is benchmarked for consistency against observable data for securities of a similar nature.

25 Fair value of financial instruments (continued)

Determination of fair value (continued)

– Derivatives

Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modeling approaches used are standard across the industry. For more complex derivative products, there may be some differences in market practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures. Finally, some inputs are not observable, but can generally be estimated from historical data or other sources. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility spreads, in whole or in part, for less commonly traded option products, and correlations between market factors such as foreign exchange rates, interest rates and equity prices.

– Structured notes

The fair value of structured notes is derived from the fair value of the underlying debt security as described above, and the fair value of the embedded derivative is determined as described in the paragraph above on derivatives.

Bases of valuing financial assets and liabilities measured at fair value

The table below provides an analysis of the various bases described above which have been deployed for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements.

	Valuation techniques			Total \$m
	Level 1 quoted market price \$m	Level 2 using observable inputs \$m	Level 3 with significant unobservable inputs \$m	
At 31 December 2011				
Assets				
Trading assets.....	2,240	2,347	–	4,587
Derivatives	–	2,081	122	2,203
Financial investments: available-for-sale.....	17,039	2,110	19	19,168
Liabilities				
Trading liabilities	2,523	465	8	2,996
Financial liabilities at fair value.....	–	426	580	1,006
Derivatives	–	1,703	43	1,746
At 31 December 2010				
Assets				
Trading assets.....	2,206	1,741	–	3,947
Derivatives	–	1,285	78	1,363
Financial investments: available-for-sale.....	14,397	1,732	20	16,149
Liabilities				
Trading liabilities	2,507	212	45	2,764
Financial liabilities at fair value.....	–	415	568	983
Derivatives	–	1,161	–	1,161

Notes on the Consolidated Financial Statements (continued)

25 Fair value of financial instruments (continued)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

	Assets			Liabilities		
	Available- for-sale \$m	Held for Trading \$m	Derivatives \$m	Held for trading \$m	Designated at fair value \$m	Derivatives \$m
At 1 January 2011	20	–	78	45	568	–
Total gains or losses recognized in profit or loss	6	–	44	(1)	12	43
Purchases.....	–	–	–	13	–	–
Settlements.....	(7)	–	–	(8)	–	–
Transfer out.....	–	–	–	(43)	–	–
Transfer in.....	–	–	–	2	–	–
At 31 December 2011	19	–	122	8	580	43
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period....	3	–	44	–	12	43

	Assets			Liabilities		
	Available- for-sale \$m	Held for Trading \$m	Derivatives \$m	Held for trading \$m	Designated at fair value \$m	Derivatives \$m
At 1 January 2010	35	256	14	119	536	2
Total gains or losses recognized in profit or loss	(2)	21	64	(9)	32	(2)
Purchases.....	–	–	–	19	–	–
Sales.....	–	(277)	–	(60)	–	–
Settlements.....	(13)	–	–	–	–	–
Transfer out.....	–	–	–	(31)	–	–
Transfer in.....	–	–	–	7	–	–
At 31 December 2010	20	–	78	45	568	–
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period....	6	–	64	2	32	–

During 2011 and 2010, there were no significant transfers between Level 1 and 2.

For assets and liabilities classified as held for trading, realized and unrealized gains and losses are presented in the income statement under 'Trading income excluding net interest income'. The income statement line item 'Net income from financial instruments designated at fair value' captures fair value movements on all financial instruments designated at fair value and related derivatives.

25 Fair value of financial instruments (continued)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy (continued)

Realized gains and losses from available-for-sale securities are presented under 'Gains less losses from financial investments' in the income statement while unrealized gains and losses are presented in 'Fair value gains' taken to equity within 'Available-for-sale investments' in other comprehensive income.

Fair values of financial instruments not carried at fair value

Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure at follows:

i) Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by maturity and coupon rates. In general, contractual cash flows are discounted using the bank's estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics.

The fair value of a loan portfolio reflects both loan impairments at the reporting date and estimates of market participants' expectations of credit losses over the life of the loans. For impaired loans, fair value is estimated by discounting the future cash flows over the time period in which they are expected to be recovered.

ii) Deposits by banks and customer accounts

For the purposes of estimating fair value, deposits by banks and customer accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the reporting date.

iii) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the reporting date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realize immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the bank as a going concern.

For all classes of financial instruments, fair value represents the product of the value of a single instrument, multiplied by the number of instruments held.

The following table lists financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and balances at central bank
Items in the course of collection from other banks
Customers' liability under acceptances
Short-term receivables within 'Other assets'
Accrued income

Liabilities

Items in the course of transmission to other banks
Acceptances
Short-term payables within 'Other liabilities'
Accruals

Notes on the Consolidated Financial Statements (continued)

25 Fair value of financial instruments (continued)

Fair values of financial instruments which are not carried at fair value on the statement of financial position

	31 December 2011		31 December 2010	
	Carrying amount \$m	Fair value \$m	Carrying amount \$m	Fair value \$m
Assets				
Loans and advances to banks	4,530	4,530	5,792	5,792
Loans and advances to customers	44,284	44,534	45,218	45,605
Liabilities				
Deposits by banks	1,377	1,377	967	967
Customer accounts	46,614	46,995	45,492	46,016
Debt securities in issue	13,327	13,393	14,816	14,829
Subordinated liabilities	326	340	324	310

Further discussion of the bank's liquidity and funding management can be found in the audit sections of 'Risk Management' within the Management's Discussion and Analysis on pages 32 to 54 of the Annual Report.

26 Assets charged as security for liabilities and collateral accepted as security for assets

a *Assets charged as security for liabilities and contingent obligations*

In the ordinary course of business, we pledge assets recorded on our consolidated statement of financial position in relation to securitization activity, mortgages sold with recourse, securities lending and securities sold under repurchase agreements. These transactions are conducted under terms that are usual and customary to standard securitization, mortgages sold with recourse, securities lending and repurchase agreements. In addition, we also pledge assets to secure our obligations within payment and depository clearing systems.

Financial assets pledged to secure recognized liabilities and on the statement of financial position and obligations within payment and depository clearing systems:

	2011 \$m	2010 \$m
Cash	29	4
Residential mortgages	6,933	8,650
Debt securities	3,059	920
Equity securities	9	74
	10,030	9,648

The bank is required to pledge assets to secure its obligations in the Large Value Transfer System ("LVTS"), which processes electronically in real-time large value and time-critical payments in Canada. In the normal course of business, pledged assets are released upon settlement of the bank's obligations at the end of each business day. Only in very rare circumstances are we required to borrow from the Bank of Canada to cover any settlement obligations. Under those circumstances, the pledged assets would be used to secure the borrowing. No amounts were outstanding under this arrangement at 31 December 2011, or 2010. Consequently, the assets pledged with respect to the bank's LVTS obligations have not been included in the table above.

b *Collateral accepted as security for assets*

The fair value of financial assets accepted as collateral that the bank is permitted to sell or repledge in the absence of default is \$2,856m (2010: \$7,694m). The fair value of financial assets accepted as collateral that have been sold or repledged is \$164m (2010: \$980m). The bank is obliged to return equivalent assets.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

27 Share Capital

Authorized:

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

Common – 993,677,000 shares.

Issued and fully paid:

	2011		2010	
	Number of shares	Share capital \$m	Number of shares	Share capital \$m
Preferred shares Class 1				
Series C ¹	7,000,000	175	7,000,000	175
Series D ²	7,000,000	175	7,000,000	175
Series E ³	10,000,000	250	10,000,000	250
Preferred shares Class 2				
Series B ⁴	86,450,000	346	86,450,000	346
	110,450,000	946	110,450,000	946
Common Shares	498,668,000	1,225	498,668,000	1,225

1 The shares are non-voting, non-cumulative and redeemable. Each share yields 5.1%, payable quarterly, as and when declared. During 2011 and 2010, \$9m in dividends were declared and paid. The shares were not redeemable by the bank prior to 30 June 2010. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing 30 June 2010, at a declining premium up to 30 June 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption. We may also, at any time, but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

2 The shares are non-voting, non-cumulative and redeemable. Each share yields 5%, payable quarterly, as and when declared. During 2011 and 2010, \$9m in dividends were declared and paid. The shares were not redeemable by the bank prior to 31 December 2010. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing 31 December 2010 at a declining premium up to 31 December 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption. We may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

3 The shares are non-voting, non-cumulative and redeemable shares with a par value of \$25 each. Each share yields 6.6%, payable quarterly, as and when declared. During 2011 and 2010, \$16m in dividends were declared and paid. The shares are not redeemable by the bank prior to 30 June 2014. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing 30 June 2014 and on 30 June every five years thereafter at par. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption. We may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new Series of Class 1 Preferred Shares (Series F) on a share-for-share basis.

4 The shares are voting and non-cumulative. During 2011 and 2010, \$27m in dividends were declared and paid. Each share yields 7.75%, payable quarterly, as and when declared. Holders are entitled to one vote for each share held.

Dividend restrictions:

We have covenanted that if HSBC Canada Asset Trust ('the Trust') fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 28(a)).

Notes on the Consolidated Financial Statements (continued)

28 Non-controlling interest in trust and subsidiary

Non-controlling interest in trust and subsidiary comprises:

	2011	2010
	\$m	\$m
HSBC Canada Asset Trust	200	200
HSBC Mortgage Corporation (Canada).....	30	30
	230	230

a *HSBC Canada Asset Trust*

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

Unless we fail to declare dividends on our preferred shares, the Trust will make non-cumulative, semi-annual cash distributions to the holders of the HSBC HaTS™. We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 27).

	2011		2010	
	Units	\$m	Units	\$m
HaTS™ – Series 2015	200,000	200	200,000	200

Each Series 2015 unit was issued at \$1,000 per unit to provide an effective annual yield of 5.149% to 30 June 2015 and the six month bankers' acceptance rate plus 1.5% thereafter. The units are not redeemable by the holders. The Trust may redeem the units on 30 June 2010 and on any distribution date thereafter, subject to payment of a premium in certain circumstances and regulatory approval.

b *HSBC Mortgage Corporation (Canada)*

The bank holds \$30m, a 100% interest, of class B perpetual preferred shares issued by HSBC Mortgage Corporation (Canada) ("HMC"), a wholly-owned subsidiary. No dividends were paid or payable on these perpetual preferred shares for the years ended 31 December 2011 and 2010. Dividends may be declared at the discretion of the directors of HMC.

29 Notes on the statement of cash flows

<i>Non-cash items included in profit before tax</i>	2011	2010
	\$m	\$m
Depreciation and amortization	77	59
Share-based payment expense	24	21
Loan impairment charges and other credit risk provisions	197	359
Charge for defined benefit pension plans	14	12
	312	451
 <i>Change in operating assets</i>	 2011	 2010
	\$m	\$m
Change in prepayment and accrued income	(39)	(8)
Change in net trading securities and net derivatives	(1,000)	757
Change in loans and advances to customers	737	2,972
Change in other assets	364	559
	62	4,280
 <i>Change in operating liabilities</i>	 2011	 2010
	\$m	\$m
Change in accruals and deferred income	(31)	24
Change in deposits by banks	410	(1,529)
Change in customer accounts	1,122	2,313
Change in debt securities in issue	(1,489)	(1,419)
Change in financial liabilities designated at fair value	23	(155)
Change in other liabilities	398	(313)
	433	(1,079)
 <i>Cash and cash equivalents</i>	 2011	 2010
	\$m	\$m
Cash and balances at central bank	77	79
Items in the course of collection from/(to) other banks, net	(184)	(94)
Loans and advances to banks of one month or less	4,530	5,792
T-Bills and certificates of deposits – three months or less	276	826
	4,699	6,603
 <i>Interest</i>	 2011	 2010
	\$m	\$m
Interest paid	(834)	(775)
Interest received	2,321	2,360

Notes on the Consolidated Financial Statements (continued)

30 Contingent liabilities, contractual commitments and guarantees

	2011 \$m	2010 \$m
Guarantees and other contingent liabilities		
Guarantees and irrevocable letters of credit pledged as collateral security	2,641	2,337
	<u>2,641</u>	<u>2,337</u>
Commitments		
Documentary credits and short-term trade-related transactions	294	352
Undrawn formal standby facilities, credit lines and other commitments to lend ¹ ...	37,417	34,298
	<u>37,711</u>	<u>34,650</u>
Credit and yield enhancement.....	-	15

¹ Based on original contractual maturity.

The table above discloses the nominal principal amounts of commitments, guarantees and other contingent liabilities. They are mainly credit-related instruments which include both financial and non-financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of these nominal principal amounts is not representative of future liquidity requirements.

Litigation

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

Guarantees

The bank provides guarantees and similar undertakings on behalf of both third party customers and other entities within the bank. These guarantees are generally provided in the normal course of the bank's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which the bank could be required to make at 31 December, were as follows:

	2011 \$m	2010 \$m
Guarantees in favour of third parties		
Guarantee type		
Financial guarantee contracts ¹	1,976	1,840
Performance bonds ²	665	497
Total	<u>2,641</u>	<u>2,337</u>

¹ Financial guarantee contracts require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.

² Performance bonds, bid bonds, standby letters of credit and other transaction-related guarantees are undertakings by which the obligation on the bank and/or the bank to make payment depends on the outcome of a future event.

The amounts disclosed in the above table reflect the bank's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with the bank's overall credit risk management policies and procedures. Guarantees with terms of more than one year are subject to the bank's annual credit review process.

30 Contingent liabilities, contractual commitments and guarantees (continued)

Backstop liquidity facilities

Backstop liquidity facilities are provided to asset-backed commercial paper conduit programs ('programs') administered by the bank and third parties, as an alternate source of financing in the event that such programs are unable to access commercial paper markets, or in limited circumstances, when predetermined performance measures of the financial assets owned by these programs are not met. Generally, these facilities have a term for up to one year. The terms of the backstop liquidity facilities do not require us to advance money to these programs in the event of bankruptcy or to purchase non-performing or defaulted assets. None of the backstop liquidity facilities provided to programs administered by the bank have been drawn upon. No amounts were drawn on liquidity facilities provided to programs administered by third parties at 31 December 2011 or 2010. Undrawn commitments in respect of backstop liquidity facilities are included in the amounts above.

Credit enhancements

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

31 Lease commitments

Operating lease commitments

At 31 December 2011, the bank was obligated under a number of non-cancellable operating leases for land and buildings for which the future minimum lease payments extend over a number of years, with an option to renew after that period. Base rents are increased as according to the terms stated in the lease.

	Land and buildings	
	2011	2010
	\$m	\$m
Future minimum lease payments under non-cancellable operating leases expiring		
No later than one year	57	57
Later than one year and no later than five years	183	185
Later than five years	89	113
	329	355

In 2011, \$78m (2010: \$78m) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, all of which related to minimum lease payments.

Notes on the Consolidated Financial Statements (continued)

31 Lease commitments (continued)

Finance lease receivables

The bank leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of the lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2011			2010		
	Total future minimum payment \$m	Unearned finance income \$m	Present value \$m	Total future minimum payment \$m	Unearned finance income \$m	Present value \$m
Lease receivables:						
No later than one year	607	(72)	535	567	(68)	499
Later than one year and no later than five years	1,264	(100)	1,164	1,033	(93)	940
Later than five years	65	(3)	62	93	(6)	87
	1,936	(175)	1,761	1,693	(167)	1,526

At 31 December 2011, unguaranteed residual values of \$8m (2010: \$1m) had been accrued, and the accumulated allowance for uncollectible minimum lease payments is included in loan loss allowances.

During the year, no contingent rents were received (2010: \$nil) and recognized in the income statement.

32 Related party transactions

The ultimate parent company of the bank is HSBC Holdings, which is incorporated in England. The bank's related parties include the parent, fellow subsidiaries, and Key Management Personnel.

a Transactions with Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the bank and includes members of the Board of HSBC Bank Canada.

Compensation of Key Management Personnel

The following represents the compensation paid to the Key Management Personnel of the bank in exchange for services rendered to the bank.

	2011 \$m	2010 \$m
Short-term employee benefits	8	7
Post-employment benefits	1	1
Share-based payments	3	2
	12	10

32 Related party transactions (continued)

a Transactions with Key Management Personnel (continued)

Shareholdings and options of Key Management Personnel

	Balance at 31 December 2011	Balance at 31 December 2010
Number of share options held over HSBC Holdings ordinary shares under employee share plans	87,322	134,352
Number of HSBC Holdings ordinary shares held.....	496,310	1,006,199

Other transactions, arrangements and agreements involving Key Management Personnel

The disclosure of the year end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year. The transactions below were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

	2011		2010	
	Highest balance during the year \$m	Balance at 31 December \$m	Highest balance during the year \$m	Balance at 31 December \$m
Key Management Personnel ¹				
Loans	8.7	8.0	6.2	6.2
Credit cards	0.1	0.1	0.1	0.1

¹ Includes 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 member.

Notes on the Consolidated Financial Statements (continued)

32 Related party transactions (continued)

b Transactions between the bank and HSBC Holdings including fellow subsidiaries of HSBC Holdings

Transactions detailed below include amounts due to/from the bank and HSBC Holdings including fellow subsidiaries of HSBC Holdings. The disclosure of the year end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year. The transactions below were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

	2011		2010	
	Highest balance during the year \$m	Balance at the year end \$m	Highest balance during the year \$m	Balance at the year end \$m
Assets				
Derivatives	900	858	554	495
Loans and advances to banks	2,848	1,455	1,778	868
Loans and advances to customers	2,006	–	1,322	184
Financial investments	–	–	14	10
Other assets	66	54	109	58
Liabilities				
Deposits by banks	581	563	730	326
Customer accounts	2,087	578	487	301
Derivatives	1,060	829	629	616
Other liabilities	144	44	131	60
Subordinated liabilities	89	86	91	85
Income Statement				
Interest income			18	3
Interest expense			(2)	(1)
Fee income			17	32
Fee expense			(5)	(8)
Other operating income			132	168
General and administrative expenses			(113)	(167)

33 Events after the reporting period

There have been no material events after the reporting period which would require disclosure or adjustment to the 31 December 2011 financial statements.

These accounts were approved by the Board on 24 February 2012 and authorized for issue.

34 Transition to IFRS

As stated in note 1a, these are the bank's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in note 2 have been applied in preparing the financial statements for the year ended 31 December 2011, the comparative information presented in these financial statements for the year ended 31 December 2010 and in the preparation of an opening IFRS statement of financial position at 1 January 2010 (the bank's date of transition).

In preparing its opening IFRS statement of financial position, the bank has adjusted certain amounts and classifications previously reported in its financial statements prepared under Canadian GAAP. The transition has not affected the bank's net cash flows or the underlying economics of its business, though the recognition and classification of certain items in the statement of financial position and income statement are now changed. An explanation of how the transition to IFRS has affected the bank's financial position, financial performance and cash flows is set out below.

The bank has changed its reporting format to be similar to other entities reporting under IFRS within the HSBC Group. These changes are referenced as 'presentational re-classifications' in (c) and (d) below.

a *Transitional exemptions*

In preparing these consolidated financial statements, the bank has elected to take advantage of certain transitional provisions within IFRS 1 First-time Adoption of IFRS.

HSBC Holdings, our ultimate Parent, adopted IFRS in 2005. Accordingly for a number of years, we have reported our results on an IFRS basis for inclusion in the HSBC Group's consolidated financial results.

As we have become a first time adopter of IFRS later than our Parent, we have elected to measure our assets and liabilities at the carrying amounts that were included in our Parent's consolidated financial statements, based on our Parent's date of transition to IFRS, however excluding adjustments made by our Parent for its consolidation procedures and for the effects of the business combination in which our Parent acquired the bank.

Based on electing this optional exemption, the following exemptions under IFRS 1 were applied at the date of our Parent's date of transition to IFRS being 1 January 2004:

i) Business combinations

The HSBC Group has elected not to restate business combinations that took place prior to 1 January 2004, the transition date of its Parent.

On 30 November 2008 the bank acquired HSBC Financial Corporation Limited from an entity under common control. Under Canadian GAAP, the acquisition represented a transfer of equity interests between entities under common control and the acquisition was accounted for using the continuity of interest's method. Acquisitions from entities under common control are excluded from the scope of IFRS 3. Accordingly, the bank applied book value (carry-over basis) accounting under IFRS to account for this acquisition. As such, under IFRS the acquisition was accounted for on the same basis as Canadian GAAP.

ii) Fair value or revaluation as deemed cost

The HSBC Group has elected to measure individual items of property at fair value at the date of transition to IFRS and use that fair value as deemed cost at that date. The bank has included in its financial statements the fair value at 1 January 2004, the transition date of its Parent. The impact of this election at 1 January 2010 is an increase in property, plant and equipment of \$2m and a corresponding increase to shareholders' equity.

iii) Employee benefits

The HSBC Group has elected to apply the employee benefits exemption and has, therefore, recognized in equity at 1 January 2004 all cumulative actuarial gains and losses on retirement benefit plans (note 4).

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

b Reconciliations of net income, total comprehensive income and total equity under Canadian GAAP to IFRS

The bank previously prepared its primary financial statements under Canadian GAAP, which differs in certain significant respects from IFRS.

Reconciliation of net income as previously reported under Canadian GAAP to profit reported under IFRS for the year ended 31 December 2010

	Ref	31 December 2010 \$m
Net income under Canadian GAAP		490
Adjustments to net income:		
Derecognition of securitized financial assets	i	160
Employee defined benefit plans	ii	9
Treatment of foreign exchange on available-for-sale securities	iii	(12)
Hedge accounting	v	1
Tax	vi	(47)
Other	vii	(9)
Non-controlling interest ¹		26
Total adjustments to net income		128
Profit under IFRS		618

¹ Under Canadian GAAP, non-controlling interest distributions are an expense through the consolidated income statement; however under IFRS, non-controlling interest is a component of equity.

Reconciliation of total comprehensive income as previously reported under Canadian GAAP to total comprehensive income reported under IFRS for the year ended 31 December 2010

	Ref	31 December 2010 \$m
Total comprehensive income under Canadian GAAP		479
Difference in net income		128
Adjustments to other comprehensive income:		
Derecognition of securitized financial assets	i	(1)
Employee defined benefit plans	ii	(58)
Treatment of foreign exchange on available-for-sale securities	iii	12
Designation of debt securities held with other financial institutions	iv	(7)
Hedge accounting	v	(1)
Tax	vi	16
Other	vii	(1)
Total adjustments to other comprehensive income		(40)
Total comprehensive income under IFRS		567

34 Transition to IFRS (continued)

Reconciliation of total shareholders' equity as previously reported under Canadian GAAP to total equity under IFRS

		At 31 December 2010 Ref \$m	At 1 January 2010 \$m
Total shareholders' equity under Canadian GAAP		4,507	4,364
Adjustments to shareholders' equity:			
Derecognition of securitized financial assets	i	53	(106)
Employee defined benefit plans	ii	(231)	(183)
Treatment of foreign exchange on available-for-sale securities ¹	iii	–	–
Designation of debt securities held with other financial institutions	iv	6	13
Hedge accounting	v	–	–
Tax	vi	60	92
Other	vii	31	38
Total adjustments to shareholders' equity		(81)	(146)
Non-controlling interests ²		230	430
Total equity under IFRS		4,656	4,648

1 Reclassification entry between retained earnings and other comprehensive income.

2 Under Canadian GAAP, non-controlling interests is not presented as a component of total shareholders' equity; however, under IFRS non-controlling interests is presented as a component of total equity.

i) Derecognition of securitized financial assets (IAS 39 Financial instruments)

The bank securitizes National Housing Act – mortgage backed securities ('MBS') through programs sponsored by the CMHC. The programs involve a two step process through which insured mortgages are converted into MBS and thereafter sold.

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

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

Under Canadian GAAP the bank recognizes a servicing liability and related income in respect of retained interests. The liability represents future costs of fulfilling our servicing obligation relating to securitized and sold MBS. Under IFRS, the bank continues to recognize a full interest in the underlying securitized mortgages and therefore does not recognize the servicing liability and related income.

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

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

Reconciliation of total shareholders' equity as previously reported under Canadian GAAP to total equity under IFRS (continued)

i) Derecognition of securitized financial assets (IAS 39 Financial instruments) (continued)

The net effect of these securitization transactions on transition to IFRS is a decrease to Canadian GAAP shareholders' equity which represents the elimination of life-to-date securitization gains and losses subsequent to 1 January 2004 and servicing income realized under Canadian GAAP, less an adjustment for interest income and expense that would have otherwise been recognized under IFRS and the elimination of mark-to-market adjustments on the related derivatives. In addition, it includes the impact of the elimination of fair value revaluations adjustments on the recognized MBS classified as available-for-sale securities under Canadian GAAP, which are excluded from other comprehensive income ('OCI') under IFRS.

ii) Employee defined benefit plans (IAS 19 Employee benefits)

On transition from Canadian GAAP to IFRS on 1 January 2010 the bank has recognized a reduction in Canadian GAAP retained earnings due to differences in accounting treatment of defined benefit plans between Canadian GAAP and IFRS. The most significant portion of this reduction in shareholders' equity is due to a change in the way the bank has recognized actuarial gains and losses.

Under Canadian GAAP, the bank deferred the recognition of actuarial gains and losses to future years. Previously actuarial gains and losses outside a 10% corridor were recognized in the income statement over the effective average remaining service lives of employees using the 'corridor method'. The bank has aligned its accounting policy with that of its Parent and the 'corridor method' has not been used and the bank has chosen an accounting policy to recognize all actuarial gains and losses immediately in OCI. Therefore all previously net unrecognized actuarial gains at 1 January 2010 on transition to IFRS have been recognized through retained earnings via the statement of comprehensive income, which has the effect of aligning the bank's accounting policy to that of its Parent from 1 January 2004 to date. Profit under IFRS has increased as a result of reversing amortization of net actuarial losses and past vested service costs previously recorded under Canadian GAAP.

A number of additional differences between Canadian GAAP and IFRS exist relating to the accounting for defined benefit plans. The areas of difference which impacted the bank on transition included the calculation and treatment of the valuation allowance, the treatment of the transitional obligation recognized under Canadian GAAP, and the treatment of amendments to benefits and settlements. In addition, the bank utilized a 30 September measurement date under Canadian GAAP, however under IFRS the bank utilized a 31 December measurement date in accordance with IFRS.

iii) Treatment of foreign exchange on available-for-sale debt securities (IAS 39 Financial instruments)

The bank owns certain foreign currency denominated available-for-sale debt securities. Under Canadian GAAP, foreign exchange gains or losses on these debt securities are recognized in OCI, whereas under IFRS foreign exchange adjustments to these debt securities are recognized in the income statement. Due to the recognition of foreign exchange losses, profit under IFRS decreased relative to profit under Canadian GAAP. There is no impact on shareholders' equity as the adjustments to cumulative foreign exchange losses of \$111m at 31 December 2010 (1 January 2010: \$99m) result in an adjustment to retained earnings, offset by a corresponding adjustment to OCI. Profit under IFRS has decreased as a result of recording foreign exchange losses in profit that were previously reported in OCI under Canadian GAAP.

iv) Designation of debt securities held with other financial institutions (IAS 39 Financial instruments)

The bank classified certain debt securities held with other financial institutions as loans and receivables which are measured at amortized cost under Canadian GAAP. Under IFRS, the debt securities are designated as available-for-sale and measured at fair value, with changes in fair value recorded in OCI. The recognition of interest income has not changed, and accordingly for the year ended 31 December 2010, there was no difference in profit under IFRS and Canadian GAAP relating to this adjustment.

34 Transition to IFRS (continued)

Reconciliation of total shareholders' equity as previously reported under Canadian GAAP to total equity under IFRS (continued)

v) Hedge accounting (IAS 39 Financial instruments)

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

The net effect of these changes is to increase OCI with a corresponding decrease to retained earnings reflects the net additional hedging relationships established under IFRS and ineffectiveness adjustments. There is no impact on total shareholders' equity. The impact on profits for the periods presented relate to the recording of differences in measuring hedge ineffectiveness and the recording of the effective portion of fair value changes relating to net additional hedging relationship established under IFRS.

vi) Tax (IAS 12 Income taxes)

Deferred tax liabilities and assets are generally recognized in respect of all temporary differences except where expressly prohibited, subject to an assessment of the recoverability of deferred tax assets. Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. The tax adjustments to profit and OCI reflect the tax impact of the IFRS transitional adjustments.

vii) Other

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

c *Reconciliation of the bank's income statement*

i) Change in reporting format:

The bank has changed its reporting format to be consistent with other entities reporting under IFRS within the HSBC Group. In general, the revised reporting format consolidates line items that were previously presented as individual line items.

'Fee income' summarizes certain fee income items which were previously individually presented. 'Trading income excluding net interest revenue' includes 'Foreign exchange', 'Trading revenue' and 'Other mark-to-market non-interest revenue' which were presented as individual line items under Canadian GAAP. 'Net interest income on trading activities' was previously included within 'Net interest income'. For a more detailed description of the nature of the above line items refer to note 2b.

Certain expense line items which were formerly presented under 'Non-interest expenses' have been re-categorized and reclassified within 'Total operating expenses'. Certain fee expenses previously included under 'Non-interest expenses' have been reclassified to 'Fee expense'.

Distributions to unit holders of non-controlling interests

Under IFRS, non-controlling interests is presented as a component of total shareholders' equity; however, under Canadian GAAP non-controlling interests is presented outside of shareholders' equity. Therefore under IFRS, distributions to unit holders of non-controlling interests are distributed directly out of retained earnings and are not recognized in the consolidated income statement as under Canadian GAAP.

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

c Reconciliation of the bank's income statement (continued)

Consolidated income statement for the year ended 31 December 2010

Canadian GAAP numbers in Canadian GAAP format	\$m	Reclass	\$m	Canadian GAAP numbers in IFRS format
Interest income.....	2,147	(52)	2,095	Interest income
Interest expense.....	590	(35)	555	Interest expense
Net interest income	1,557	(17)	1,540	Net interest income
Deposit and payment service fees	111	(111)		
Credit fees	194	(194)		
Capital market fees	119	(119)		
Investment administration fees	143	(143)		
		709	709	Fee income
		71	71	Fee expense
			638	Net fee income
		(50)	(50)	Trading income excluding net interest income
		18	18	Net interest income on trading activities
			(32)	Net trading income
		(2)	(2)	Net income/(expense) from financial instruments designated at fair value
		8	8	Gains less losses from financial investments
Foreign exchange.....	48	(48)		
Trade finance.....	24	(24)		
Trading revenue	104	(104)		
Gain on available-for-sale and securities.....	14	(14)		
Securitization income.....	83	(83)		
Other	292	(28)	264	Other operating income
Other mark-to-market	(196)	196		
Non-interest revenue.....	936	(60)	876	
Total revenue	2,493	(77)	2,416	Net operating income before loan impairment charges and other credit risk provisions
		335	335	Loan impairment charges and other credit risk provisions
			2,081	Net operating income
Salaries and employee benefits	753	5	758	Employee compensation and benefits
Premises and equipment	175	(175)	548	General and administrative expenses
		40	40	Depreciation of property, plant and equipment
Other	504	(504)	16	Amortization of intangible assets
Non-interest expenses	1,432	(70)	1,362	Total operating expenses
Net operating income before provision for credit losses	1,061	(342)	719	Operating profit
Provision for credit losses.....	335	(335)	7	Share of profit in associates
Income before provision for taxes	726	-	726	Profit before income tax expense
Provision for income tax	210	-	210	Income tax expense
Non-controlling interest in income	26	(26)		
Net income	490	26	516	Profit for the year
			26	Distribution to non-controlling interests

34 Transition to IFRS (continued)

c Reconciliation of the bank's income statement (continued)

ii) Reconciliation of Canadian GAAP and IFRS

Adjustments to conform the bank's Canadian GAAP income statement to its accounting policies under IFRS are set out below:

Consolidated income statement for the year ended 31 December 2010

	Canadian GAAP	Derecog- nition of securitized financial assets	Employee defined benefit plans	Treatment of foreign exchange available- for-sale securities	Hedge account- ing	Tax ¹	Other	IFRS
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Interest income.....	2,095	244	–	–	–	–	34	2,373
Interest expense.....	(555)	(197)	–	–	(8)	–	(5)	(765)
Net interest income.....	1,540	47	–	–	(8)	–	29	1,608
Fee income.....	709	–	–	–	–	–	18	727
Fee expense.....	(71)	–	–	–	–	–	(18)	(89)
Net fee income.....	638	–	–	–	–	–	–	638
Trading income excluding net interest income.....	(50)	196	–	(12)	9	–	(8)	135
Net interest income on trading activities.....	18	–	–	–	–	–	–	18
Net trading income.....	(32)	196	–	(12)	9	–	(8)	153
Net income/(expense) from financial instruments designated at fair value...	(2)	–	–	–	–	–	–	(2)
Gains less losses from financial investments....	8	–	–	–	–	–	–	8
Other operating income...	264	(83)	–	–	–	–	–	181
Net operating income before loan impairment charges and other credit risk provisions.....	2,416	160	–	(12)	1	–	21	2,586
Loan impairment charges and other credit risk provisions.....	(335)	–	–	–	–	–	(24)	(359)
Net operating income....	2,081	160	–	(12)	1	–	(3)	2,227
Employee compensation and benefits.....	(758)	–	9	–	–	–	(1)	(750)
General and administrative expenses	(548)	–	–	–	–	–	–	(548)
Depreciation of property, plant and equipment.....	(40)	–	–	–	–	–	–	(40)
Amortization of intangibles	(16)	–	–	–	–	–	(3)	(19)
Total operating expenses	(1,362)	–	9	–	–	–	(4)	(1,357)
Operating profit.....	719	160	9	(12)	1	–	(7)	870
Share of profit in associates	7	–	–	–	–	–	(2)	5
Profit before tax expense	726	160	9	(12)	1	–	(9)	875
Tax expense.....	(210)	–	–	–	–	(47)	–	(257)
Profit for the year².....	516	160	9	(12)	1	(47)	(9)	618

1 The tax effect of all adjustments are presented in the tax column.

2 Under Canadian GAAP, non-controlling interest distributions are an expense through the consolidated income statement; however, under IFRS, non-controlling interest.

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position

i) Change in reporting format:

The new statement of financial position presentation groups assets and liabilities together according to their financial instrument classification under IAS39. For a more detailed description of the assets and liabilities presented within the various line items within the statement of financial position refer to note 2.

Significant presentational reclassifications of line items include:

Assets

- Under the revised format 'Trading assets' include financial assets classified as held for trading through the income statement that were previously presented as 'Deposits with regulated Financial Institutions', 'Securities: Trading', 'Loans' and 'Other assets'.
- 'Loans and advances to banks' and 'Loans and advances to customers' include securities purchased under reverse repurchase agreements which were previously presented under 'Securities purchased under reverse repurchase agreements'.
- 'Financial Investments' include financial assets classified as available-for-sale that were previously presented as 'Securities: Available-for-sale' and includes certain items previously presented in 'Deposits with regulated financial institutions'.

Liabilities

- 'Trading liabilities' under the revised format include financial liabilities classified as held for trading that were previously presented as 'Deposits', 'Securities sold short' and certain items presented in 'Interest bearing liabilities of subsidiaries, other than deposits' and certain items presented in 'Other liabilities'.
- 'Debt securities in issue' include debts for which transferable certificates have been issued that were previously presented as 'Deposits' and 'Interest bearing liabilities of subsidiaries, other than deposits'.
- 'Interest bearing liabilities of subsidiaries, other than deposits' under the previous format has been reclassified to 'Trading liabilities', 'Financial liabilities designated at fair value' or 'Debt securities in issue' as appropriate.
- 'Securities sold under repurchase agreements' under the previous format have been presented as 'Deposits by banks' where the counterparty is a financial institution and 'Customer accounts' where the counterparty is a not a financial institution.

The reclassifications described below were made due to presentational requirements under IFRS:

Non-controlling interests

- Under IFRS, non-controlling interests is presented as a component of total shareholders' equity; however, under Canadian GAAP non-controlling interests was presented outside of shareholder's equity.

Debt securities held with other financial institutions

- Certain debt securities held with other financial institutions were classified as loans and receivables and formerly presented as 'Deposits held with regulated financial institutions' under Canadian GAAP. Under IFRS, these securities are designated as available-for-sale and presented as 'Financial investments'.

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 1 January 2010

Canadian GAAP numbers in Canadian GAAP format	\$m	Reclass	\$m	Canadian GAAP numbers in IFRS format
ASSETS				ASSETS
Cash and non-interest deposits with Bank of Canada and other banks.....	652	(463)	189	Cash and balances at central bank
Deposits with regulated financial institutions.....	1,245	(1,245)		Items in the course of collection from other banks
		88	88	
Securities: Available-for-sale.....	12,682	(12,682)		
Securities: Held-for-trading.....	1,986	(1,986)		
Securities: Other.....	41	(41)		
		4,042	4,042	Trading assets
		1,100	1,100	Derivatives
Securities purchased under reverse repurchase agreements.....	8,496	(8,496)		
		5,862	5,862	Loans and advances to banks
Loans.....	38,104	2,213	40,317	Loans and advances to customers
		13,598	13,598	Financial investments
Customers' liability under acceptances..	4,966	(4,966)		
Derivatives.....	1,100	(1,100)		
Land, buildings and equipment.....	142	(142)		
Other assets.....	1,923	(1,440)	483	Other assets
		465	465	Prepayments and accrued income
		4,966	4,966	Customers' liability under acceptances
		142	142	Property, plant and equipment
		85	85	Goodwill and intangibles
Total assets.....	71,337	–	71,337	Total assets

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 1 January 2010 (continued)

Canadian GAAP numbers in Canadian GAAP format	\$m	Reclass	\$m	Canadian GAAP numbers in IFRS format
LIABILITIES AND EQUITY				
Deposits.....	50,207	2,648 (6,425)	2,648 43,782	Deposits by banks Customer accounts Items in course of transmission to other banks
		284	284	Trading liabilities
		2,812	2,812	Financial liabilities designated at fair value
		1,138	1,138	Derivatives
		897	897	Debt securities in issue
		7,870	7,870	Other liabilities
		1,019	1,019	Acceptances
Acceptances	4,966	–	4,966	Accruals and deferred income
		576	576	
Interest bearing liabilities of subsidiaries, other than deposits	3,324	(3,324)		
Derivatives	897	(897)		
Securities sold under repurchase agreements.....	2,517	(2,517)		
Securities sold short	1,148	(1,148)		
Other liabilities.....	2,650	(2,650)		
		119	119	Retirement benefit liabilities
		432	432	Subordinated liabilities
Non-controlling interest in trust and subsidiary	430	(430)		
Total liabilities	66,139	404	66,543	Total liabilities
Subordinated debentures	834	(834)		
Shareholders' equity:				Equity:
Preferred shares.....	946	–	946	Preferred shares
Common shares.....	1,225	–	1,225	Common shares
Contributed surplus.....	7	(7)		
Retained earnings.....	2,113	7	2,120	Retained earnings
Accumulated other comprehensive income	73	–	73	Other reserves
		430	430	Non-controlling interests
Total equity	4,364	430	4,794	Total equity
Total equity and liabilities	71,337	–	71,337	Total equity and liabilities

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 31 December 2010

Canadian GAAP numbers in Canadian GAAP format	\$m	Reclass	\$m	Canadian GAAP numbers in IFRS format
ASSETS				ASSETS
Cash and non-interest deposits with Bank of Canada and other banks.....	513	(434)	79	Cash and balances at central bank
Deposits with regulated financial institutions.....	2,173	(2,173)		
		84	84	Items in the course of collection from other banks
Securities: Available-for-sale.....	15,804	(15,804)		
Securities: Held-for-trading.....	2,254	(2,254)		
Securities: Other.....	40	(40)		
		3,947	3,974	Trading assets
		1,365	1,365	Derivatives
Securities purchased under reverse repurchase agreements.....	7,155	(7,155)		
		5,777	5,777	Loans and advances to banks
Loans.....	35,969	1,554	37,523	Loans and advances to customers
		17,137	17,137	Financial investments
Customers' liability under acceptances...	4,372	(4,372)		
Derivatives.....	1,364	(1,364)		
Land, buildings and equipment.....	123	(123)		
Other assets.....	1,729	(1,180)	549	Other assets
		458	458	Prepayments and accrued income
		4,372	4,372	Customers' liability under acceptances
		122	122	Property, plant and equipment
		83	83	Goodwill and intangibles
Total assets.....	71,496	-	71,496	Total assets

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 31 December 2010 (continued)

Canadian GAAP numbers in Canadian GAAP format	\$m	Reclass	\$m	Canadian GAAP numbers in IFRS format
LIABILITIES AND EQUITY				LIABILITIES AND EQUITY
Deposits.....	52,055	1,194 (5,304)	1,194 46,751	Deposits by banks Customer accounts Items in course of transmission to other banks
		178	178	Trading liabilities
		2,764	2,764	Financial liabilities designated at fair value
		983	983	Derivatives
		1,330	1,330	Debt securities in issue
		6,459	6,459	Other liabilities
Acceptances	4,372	1,677	1,677	Acceptances
		–	4,372	Accruals and deferred income
		599	599	
Interest bearing liabilities of subsidiaries, other than deposits	2,363	(2,363)		
Derivatives	1,329	(1,329)		
Securities sold under repurchase agreements.....	1,560	(1,560)		
Securities sold short	1,262	(1,262)		
Other liabilities.....	3,079	(3,079)		
		128	128	Retirement benefit liabilities
		324	324	Subordinated liabilities
Non-controlling interest in trust and subsidiary	230	(230)		
Total liabilities	66,250	509	66,759	Total liabilities
Subordinated debentures	739	(739)		
Shareholders' equity:				Equity:
Preferred shares.....	946	–	946	Preferred shares
Common shares.....	1,225	–	1,225	Common shares
Contributed surplus.....	12	(12)		
Retained earnings.....	2,262	12	2,274	Retained earnings
Accumulated other comprehensive income	62	–	62	Other reserves
		230	230	Non-controlling interests
Total equity	4,507	230	4,737	Total equity
Total equity and liabilities	71,496	–	71,496	Total equity and liabilities

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

ii) Reconciliation of Canadian GAAP and IFRS

Adjustments to conform the bank's Canadian GAAP statement of financial position to its accounting policies under IFRS are set out below:

Consolidated statement of financial position at 1 January 2010

	Canadian GAAP	Derecog- nition of securitized financial assets	Employee defined benefit plans	Treatment of foreign exchange available- for-sale securities	Designa- tion of debt securities held with other financial institutions	Hedge accounting	Tax ¹	Other	IFRS
ASSETS									
Cash and balances at central bank	189	-	-	-	-	-	-	-	189
Items in the course of collection from other banks	88	-	-	-	-	-	-	-	88
Trading assets	4,042	-	-	-	-	-	-	-	4,042
Derivatives	1,100	(44)	-	-	-	-	(1)	-	1,055
Loans and advances to banks	5,862	-	-	-	-	-	-	-	5,862
Loans and advances to customers	40,317	8,216	-	-	-	-	16	-	48,549
Financial investments	13,598	(579)	-	-	13	-	1	-	13,033
Other assets	483	(1)	-	-	-	-	92	1	575
Prepayments and accrued income	465	(197)	(88)	-	-	-	(2)	-	178
Customers' liability under acceptances	4,966	-	-	-	-	-	-	-	4,966
Property, plant and equipment	142	-	-	-	-	-	2	-	144
Goodwill and intangibles	85	-	-	-	-	-	14	-	99
Total assets	71,337	7,395	(88)	-	13	-	92	31	78,780

¹ The tax effect of all adjustments are presented in the tax column.

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

ii) Reconciliation of Canadian GAAP and IFRS (continued)

Consolidated statement of financial position at 1 January 2010 (continued)

	Canadian GAAP	Derecog- nition of securitized financial assets	Employee defined benefit plans	Treatment of foreign exchange available- for-sale securities	Designa- tion of debt securities held with other financial institutions	Hedge accounting	Tax ¹	Other	IFRS
LIABILITIES AND EQUITY									
Liabilities									
Deposits by banks	2,648	(152)	-	-	-	-	-	-	2,496
Customer accounts	43,782	(603)	-	-	-	-	-	-	43,179
Items in the course of transmission to other banks	284	-	-	-	-	-	-	-	284
Trading liabilities	2,812	-	-	-	-	-	-	-	2,812
Financial liabilities designated at fair value	1,138	-	-	-	-	-	-	-	1,138
Derivatives	897	(74)	-	-	-	-	-	-	823
Debt securities in issue	7,870	8,365	-	-	-	-	-	-	16,235
Other liabilities	1,019	(34)	-	-	-	-	-	(5)	980
Acceptances	4,966	-	-	-	-	-	-	-	4,966
Accruals and deferred income	576	(1)	-	-	-	-	-	(2)	573
Retirement benefit liabilities	119	-	95	-	-	-	-	-	214
Subordinated liabilities	432	-	-	-	-	-	-	-	432
Total liabilities	66,543	7,501	95	-	-	-	-	(7)	74,132
Equity									
Preferred shares	946	-	-	-	-	-	-	-	946
Common shares	1,225	-	-	-	-	-	-	-	1,225
Other reserves	73	1	-	99	13	66	(52)	5	205
Retained earnings	2,120	(107)	(183)	(99)	-	(66)	144	33	1,842
Total shareholders' equity	4,364	(106)	(183)	-	13	-	92	38	4,218
Non controlling interests	430	-	-	-	-	-	-	-	430
Total equity	4,794	(106)	(183)	-	13	-	92	38	4,648
Total equity and liabilities	71,337	7,395	(88)	-	13	-	92	31	78,780

1 The tax effect of all adjustments are presented in the tax column.

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 31 December 2010

	Canadian GAAP	Derecog- nition of securitized financial assets	Employee defined benefit plans	Treatment of foreign exchange available- for-sale securities	Designa- tion of debt securities held with other financial institutions	Hedge accounting	Tax ¹	Other	IFRS
ASSETS									
Cash and balances at central bank	79	-	-	-	-	-	-	-	79
Items in the course of collection from other banks	84	-	-	-	-	-	-	-	84
Trading assets	3,947	-	-	-	-	-	-	-	3,947
Derivatives	1,365	(2)	-	-	-	-	-	-	1,363
Loans and advances to banks	5,777	15	-	-	-	-	-	-	5,792
Loans and advances to customers	37,523	7,680	-	-	-	-	15	15	45,218
Financial investments	17,137	(995)	-	-	6	-	1	1	16,149
Other assets	549	-	(1)	-	-	60	2	2	610
Prepayments and accrued income	458	(180)	(91)	-	-	-	(1)	(1)	186
Customers' liability under acceptances	4,372	-	-	-	-	-	-	-	4,372
Property, plant and equipment	122	-	-	-	-	-	-	1	123
Goodwill and intangibles	83	-	-	-	-	-	11	11	94
Total assets	71,496	6,518	(92)	-	6	-	60	29	78,017

¹ The tax effect of all adjustments are presented in the tax column.

Notes on the Consolidated Financial Statements (continued)

34 Transition to IFRS (continued)

d Reconciliation of the bank's statements of financial position (continued)

Consolidated statement of financial position at 31 December 2010 (continued)

	Canadian GAAP	Derecog- nition of financial assets	Employee defined benefit plans	Treatment of foreign exchange available- for-sale securities	Designa- tion of debt securities held with other financial institutions	Hedge accounting	Tax ¹	Other	IFRS
LIABILITIES AND EQUITY									
Liabilities									
Deposits by banks	1,194	(227)	-	-	-	-	-	-	967
Customer accounts	46,751	(1,259)	-	-	-	-	-	-	45,492
Items in the course of transmission to other banks	178	-	-	-	-	-	-	-	178
Trading liabilities	2,764	-	-	-	-	-	-	-	2,764
Financial liabilities designated at fair value	983	-	-	-	-	-	-	-	983
Derivatives	1,330	(175)	-	-	-	-	6	6	1,161
Debt securities in issue	6,459	8,358	-	-	-	-	(1)	(1)	14,816
Other liabilities	1,677	(232)	-	-	-	-	(5)	(5)	1,440
Acceptances	4,372	-	-	-	-	-	-	-	4,372
Accruals and deferred income	599	-	-	-	-	-	(2)	(2)	597
Retirement benefit liabilities	128	-	139	-	-	-	-	-	267
Subordinated liabilities	324	-	-	-	-	-	-	-	324
Total liabilities	66,759	6,465	139	-	-	-	(2)	(2)	73,361
Equity									
Preferred shares	946	-	-	-	-	-	-	-	946
Common shares	1,225	-	-	-	-	-	-	-	1,225
Other reserves	62	-	-	111	6	65	(51)	4	197
Retained earnings	2,274	53	(231)	(111)	-	(65)	111	27	2,058
Total shareholders' equity	4,507	53	(231)	-	6	-	60	31	4,426
Non controlling interests	230	-	-	-	-	-	-	-	230
Total equity	4,737	53	(231)	-	6	-	60	31	4,656
Total equity and liabilities	71,496	6,518	(92)	-	6	-	60	29	78,017

¹ The tax effect of all adjustments are presented in the tax column.

34 Transition to IFRS (continued)

e *Impact of transition to IFRS on the Statement of Cash Flows*

Under Canadian GAAP, the bank defined cash and cash equivalents as cash and balances at central bank.

Under IFRS, the bank has aligned its policy with group and has defined cash and cash equivalents as cash and balances at central bank, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks and certificates of deposit. As a result, the bank has included additional “cash equivalents” which are defined as short term highly liquid investments, held for the purpose of meeting short-term cash commitments rather than investment, that are both convertible to known amounts of cash, and so near their maturity that they present an insignificant risk of changes in value. The inclusion of cash equivalents in the definition of reported cash flows had no significant effect on the net cash flows for the reported period.

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Channel Islands	31	China	185	Brazil	1,344	Egypt	86
Czech Republic	2	Cook Islands	1	British Virgin Islands	2	Iraq	11
France	409	Hong Kong Special Administrative Region	261	Canada	241	Israel	1
Germany	14	India	113	Cayman Islands	8	Jordan	4
Greece	21	Indonesia	144	Chile	8	Kenya	1
Ireland	7	Japan	10	Colombia	23	Kuwait	1
Isle of Man	3	Korea, Republic of	14	Costa Rica	33	Lebanon	5
Italy	2	Macau Special Administrative Region	7	El Salvador	84	Libya	1
Kazakhstan	10	Malaysia	65	Guatemala	1	Mauritius	12
Luxembourg	6	Maldives	1	Honduras	75	Nigeria	1
Malta	43	New Zealand	11	Mexico	1,071	Oman	5
Monaco	3	Pakistan	11	Nicaragua	1	Palestinian Autonomous Area	1
Netherlands	1	Philippines	21	Panama	69	Qatar	3
Poland	8	Singapore	22	Paraguay	7	Saudi Arabia	83
Russia	3	Sri Lanka	17	Peru	24	South Africa	5
Slovakia	2	Taiwan	52	United States of America	481	United Arab Emirates	20
Spain	4	Thailand	2	Uruguay	15		
Sweden	2	Vietnam	20	Venezuela	1		
Switzerland	17						
Turkey	333						
United Kingdom	1,276						

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¹ As at 27 February 2012

² As at 1 March 2012

³ Does not include sub-branches

Executive Committee¹

Lindsay Gordon
President and Chief Executive
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¹ As at 1 March 2012

Notes

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