HSBC Bank Canada

Annual Report and Accounts 2013

HSBC

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Headlines

- Profit before income tax expense was $934m for the year ended 31 December 2013, a decrease of 9.2% compared with 2012.
- Profit attributable to common shareholders was $616m for the year ended 31 December 2013, a decrease of 9.8% compared with 2012.
- Return on average common equity was 14.5% for the year ended 31 December 2013 compared with 16.6% for 2012.
- The cost efficiency ratio was 49.5% for the year ended 31 December 2013 compared with 48.4% for 2012.
- Total assets were $84.3bn at 31 December 2013 compared with $80.7bn at 31 December 2012.
- Total assets under administration increased to $21.4bn at 31 December 2013 from $19.5bn at 31 December 2012.
- Common equity tier 1 capital ratio was 11.0%, the tier 1 ratio was 13.2% and the total capital ratio was 15.0% at 31 December 2013, determined using regulatory guidelines in accordance with the Basel II and Basel III capital adequacy frameworks adopted with effect from 1 January 2013.

Basis of Preparation of Financial Information

HSBC Bank Canada ('the bank', 'we', 'our') is an indirectly wholly-owned subsidiary of HSBC Holdings plc ('HSBC Holdings'). Throughout Management's Discussion and Analysis ('MD&A'), the HSBC Holdings Group is defined as the 'HSBC Group' or the 'Group'. The MD&A is dated 21 February 2014, the date that our consolidated financial statements and MD&A for the year ended 31 December 2013 were approved by our Board of Directors ('the Board').

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. The information in this MD&A is derived from our consolidated financial statements or from the information used to prepare them. The abbreviations '$m' and '$bn' represent millions and billions of Canadian dollars, respectively. All tabular amounts are in millions of dollars except where otherwise stated.

The references to 'notes' throughout this MD&A refer to notes on the consolidated financial statements for the year ended 31 December 2013.

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Message from the President and Chief Executive Officer

My first year leading HSBC Canada has been eventful, educational and highly fulfilling. As I have criss-crossed the country, I have come to learn and appreciate so much about Canada and the great people in our business. I was also privileged to meet many of our customers and see the wonderful ways we have supported them in fulfilling their hopes, dreams and ambitions. I am very proud that, together, we are working to support the local and national economy.

Canada is one of HSBC Group's priority growth markets. We are very well positioned for 2014 and have aspirations for organic growth right across our global business lines. And at a time when more and more Canadian individuals and businesses have their own global aspirations, we are the leading international bank operating in Canada with unmatched global connectivity.

In 2013, the team in Canada worked extremely hard and we have much to be proud of. We are moving forward under new structures, a more sustainable cost base and with a strategy that is aligned with the HSBC Group across all businesses and functions. None of this would have been possible without a strong team of dedicated and hardworking colleagues.

Over the past few years, we have restructured our Retail Banking and Wealth Management business to make it easier and more efficient for our customers to bank with us. This year, we launched an enhanced mobile and internet banking platform and improved our proposition for clients that are new to Canada. In 2013, customers deposited 12% more with us and, as shown by our improved customer recommendation index, more customers also said they would recommend HSBC to friends and family. In DALBAR's 2013 rankings of online brokerage firms, HSBC InvestDirect received the DALBAR Service Award for the second year in a row. We appreciate this support and plan to give customers more reasons to bank with us in 2014.

In Commercial Banking, we have refocused on those companies that we are best placed to help achieve their business goals – those with an international focus. We introduced specially trained International Relationship Managers, launched renminbi products and services, and mid-year, launched a $1 billion international growth loan program for small and medium-sized enterprises. Customer response has exceeded our expectations, so we have since added another $1 billion to the program. Deposits from commercial customers grew 8.4% and our revenues from global sources increased. Finally, HSBC has been consistently selected by Euromoney as the Best Domestic Cash Management Provider and HSBC Canada is now one of the recognized countries.

In 2013, our Global Banking and Markets team launched project and export financing in Canada and moved to a single platform to more efficiently help customers connect with opportunities. We supported the first Canadian renminbi-denominated bond issue for the Government of British Columbia, increasing their sources of financing and grew our business with subsidiaries of multinational businesses. Finally, we continued to improve the standing of our foreign exchange capability, moving up another spot in Euromoney's industry rankings. We look forward to further leveraging our differentiated expertise for our customers in 2014.

We have accomplished a tremendous amount in 2013, but our challenges included a sluggish Canadian economy. Over the next two years, we expect it to keep pace with US economic growth at best. With interest rates expected to stay low in 2014, we see business investment and exports having a larger impact on the Canadian economy while consumer spending and housing carry less of a burden. That said, the rebalancing toward business investment and exports has been choppy, and is not yet firmly entrenched.

Throughout our history we have been where the growth is, connecting customers to opportunities. We enable businesses to thrive and economies to prosper, helping people fulfil their hopes and dreams and realize their ambitions. This is our role and purpose.

As the leading international bank in Canada, we are looking ahead to 2014 and beyond with great optimism and excitement to best serve our retail, commercial and institutional clients.

Paulo Maia

Paulo Maia
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
21 February 2014

Management's Discussion and Analysis

Financial summary

(in $ millions, except where otherwise stated)	**2013**	2012	2011
Financial performance for the year ended 31 December ($m)			
Net operating income before loan impairment charges and other credit risk provisions	**2,161**	2,393	2,422
Profit before income tax expense	**934**	1,029	947
Profit	**687**	754	697
Profit attributable to common shareholders	**616**	683	626
Basic earnings per common share ($)	**1.24**	1.37	1.26
Financial position at 31 December ($m)			
Loans and advances to customers (net of impairment allowances)	**46,351**	45,572	44,357
Customer accounts	**51,844**	48,304	46,614
Total assets	**84,260**	80,714	80,068
Total liabilities	**79,175**	75,338	74,849
Shareholders' equity	**4,885**	5,146	4,989
Capital measures[1]			
Common equity tier 1 capital ratio (%)	**11.0**	n/a	n/a
Tier 1 ratio (%)	**13.2**	13.8	13.4
Total capital ratio (%)	**15.0**	16.0	16.0
Assets-to-capital multiple	**15.1**	13.1	13.1
Risk-weighted assets ($m)	**36,862**	36,668	35,322
Performance ratios (%)[2]			
Return on average common equity	**14.5**	16.6	17.0
Post-tax return on average total assets	**0.72**	0.83	0.77
Post-tax return on average risk-weighted assets[1]	**1.7**	1.9	1.8
Credit coverage ratios (%)[2]			
Loan impairment charges as a percentage of total operating income	**8.7**	8.8	8.1
Loan impairment charges as a percentage of average gross customer advances and acceptances	**0.4**	0.4	0.4
Total impairment allowances outstanding as a percentage of impaired loans and acceptances at year end	**64.2**	48.8	61.3
Efficiency and revenue mix ratios (%)[2]			
Cost efficiency ratio	**49.5**	48.4	52.9
Adjusted cost efficiency ratio	**49.4**	47.9	52.9
As a percentage of total operating income:			
– net interest income	**60.7**	61.6	64.2
– net fee income	**27.9**	25.1	26.6
– net trading income	**8.2**	7.5	6.2
Financial ratios (%)[2]			
Ratio of customer advances to customer accounts	**89.4**	94.3	95.2
Average total shareholders' equity to average total assets	**5.7**	6.1	5.7
Total assets under administration ($m)[2]			
Funds under management[3]	**20,167**	18,327	26,383
Custodial accounts	**1,209**	1,133	967
Total assets under administration	**21,376**	19,460	27,350

[1] *Effective 1 January 2013, the bank assesses capital adequacy against standards established in guidelines issued by OSFI in accordance with the Basel II and Basel III capital adequacy frameworks. Comparative 2012 information is presented using guidelines issued by OSFI in accordance with the Basel II capital adequacy framework and therefore is not comparable.*

[2] *Refer to the 'Use of non-IFRS financial measures' section of this document for a discussion of non-IFRS financial measures.*

[3] *Funds under management at 31 December 2011 include funds managed in the full service retail brokerage business which was sold on 1 January 2012 of $10.6bn.*

Use of non-IFRS financial measures

In measuring our performance, the financial measures that we use include those which have been derived from our reported results. However these are not presented within the Financial Statements and are not defined under IFRS. These are considered non-IFRS financial measures and are unlikely to be comparable to similar measures presented by other companies. The following non-IFRS financial measures are used throughout this document and their purposes and definitions are discussed below:

Performance ratios

Performance ratios are useful for management to evaluate profitability on equity, assets and risk-weighted assets.

Return on average common equity is calculated as annual profit attributable to common shareholders divided by average common equity (determined using month-end balances).

Post-tax return on average assets is calculated as annual profit attributable to common shareholders divided by average assets (determined using average daily balances).

Post-tax return on average risk-weighted assets is calculated as 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 and III capital adequacy frameworks (2012 and 2011: Risk weighted assets are calculated using the guidelines issued by OSFI in accordance with the Basel II capital adequacy framework).

Efficiency ratios

Efficiency ratios are measures of the bank's efficiency in managing its operating expense to generate revenue.

Cost efficiency ratio is calculated as annual total operating expenses as a percentage of annual net operating income before loan impairment charges and other credit risk provisions.

Adjusted cost efficiency ratio is calculated similar to the cost efficiency ratio; however, annual net operating income before loan impairment charges and other credit risk provisions excludes annual gains and losses from financial instruments designated at fair value, as the movement in value of the bank's own subordinated debt issues primarily driven by changes in market rates and are not under the control of management.

Revenue mix ratio

This measure demonstrates the contribution of each of the primary revenue streams to total income.

Net interest income, net fee income and net trading income as a percentage of total operating income is calculated as annual net interest income, annual net fee income and annual net trading income divided by annual net operating income before loan impairment charges and other credit risk provisions.

Financial ratios

These measures are indicators of the stability of the bank's balance sheet and the degree funds are deployed to fund assets.

Ratio of customer advances to customer accounts is calculated by dividing loans and advances to customers by customer accounts using year-end balances.

Average total shareholders' equity to average total assets is calculated by dividing average total shareholders' equity for the year (determined using month-end balances) with average total assets (determined using daily balances) for the year.

Assets under administration

These are assets administered by the bank on behalf of our customers. The bank does not recognize these assets on its consolidated statement of financial position because our customers are the beneficial owners. This indicator demonstrates the bank's ability to earn net fee income.

Who we are

HSBC is one of the largest banking and financial services organizations in the world with around 6,300 offices in 75 countries and territories and assets of US$2,671bn.

Throughout our history HSBC has been where the growth is, connecting customers to opportunities, enabling businesses to thrive and economies to prosper, helping people fulfil their hopes and dreams and realize their ambitions.

HSBC Bank Canada is the leading international bank in Canada with total assets of $84.3bn at 31 December 2013. Established in 1981 and headquartered in Vancouver, British Columbia, we have grown organically and through strategic acquisitions to become an integrated financial services organization with more than 150 offices across the country.

No international bank has our Canadian presence and no domestic bank has our international reach. Our business model is structured and focussed on helping companies and individuals do business internationally with a comprehensive range of financial service, trade and investment products.

We are a priority market for the HSBC Group, whose parent company HSBC Holdings is headquartered in London, UK. HSBC's international network spans 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 through four business lines: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, and Global Private Banking.

The bank's continuous disclosure materials, including interim and annual filings, are available on the bank's website and on the Canadian Securities Administrators' web site at www.sedar.com.

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 2013 Annual Review and its 2013 Annual Report and Accounts.

Our purpose and strategic priorities

Our purpose

Our purpose is to connect customers to opportunities, enabling businesses to thrive and economies to prosper, helping people to fulfil their hopes and realize their ambitions.

Our strategic priorities

Our strategic goal is to support the HSBC Group to be regarded as the world's leading and most respected international bank. We will achieve this by focusing on the needs of our customers and the societies we serve, and thereby deliver long-term sustainable value to all our various stakeholders.

We have set three interconnected priorities to help us deliver our strategy. They are:

– grow the business and dividends;

– implement Global Standards; and

– streamline processes and procedures.

Grow the business and dividends

Profit underpins long-term business sustainability and growing our profit is an integral part of our strategy. The conditions for creating value and generating profits are reflected in our business and our global lines of business.

Our business model is based on an international network connecting and serving the Canadian market.

Our three global lines of business, Commercial Banking, Global Banking and Markets, as well as Retail Banking and Wealth Management, are responsible for developing, implementing and managing their business propositions consistently across the HSBC Group, focusing on profitability and efficiency. They set their strategies within the parameters of the HSBC Group strategy, are responsible for issuing planning guidance regarding their businesses, are accountable for their profit and loss performance, and manage their headcount.

We launched a strategic plan focussed on growing HSBC's business in Canada, connecting our customers with opportunities, with investments committed in all of our global lines of business, Risk and Compliance functions.

Implement Global Standards

The HSBC Group has committed to develop Global Standards shaped by the highest or most effective standards available in any location where HSBC operates and to deploy them globally on a consistent basis. These Global Standards are being implemented throughout the HSBC Group. They affect all aspects of our business, including governance, and are embedded in the HSBC Values which employees are required to adhere to. They inform our response to employee and remuneration issues, and set the tone for our interactions with customers.

We see the implementation of Global Standards as a source of competitive advantage. Global Standards allow us to:

– strengthen our response to the ongoing threat of financial crime;

– make consistent – and therefore simplify – the ways by which we monitor and enforce high standards;

– strengthen policies and processes which govern how we do business and with whom; and

– ensure that we consistently apply our HSBC Values.

Embedding HSBC Values in every decision and every interaction with customers and with each other is a top priority for the HSBC Group and is shaping the way we do business in Canada.

The role of HSBC Values in daily operating practice is fundamental to our culture, and is particularly important in the light of developments in regulatory policy, investor confidence and society's expectations of banks. We expect our executives and employees to act with courageous integrity in the execution of their duties by being:

– dependable and doing the right thing;

– open to different ideas and cultures; and

– connected with our customers, communities, regulators and each other.

HSBC Values are integral to the selection, assessment, recognition and training of staff.

We are committed to the highest standards of corporate governance. We believe that a strong and transparent corporate governance framework is directly linked to the long-term success of the bank and the HSBC Group globally.

Streamline processes and procedures

This initiative is critical to the long-term sustainability of our business. Society's expectations of the financial services industry are evolving and becoming more demanding. At the same time markets are becoming increasingly competitive. In this environment, it is essential that we focus relentlessly on improving efficiency, ensuring that the bank as a part of the HSBC Group streamlines its processes and procedures and, as a consequence, reduce costs. In doing so, we must remain cognizant of our wider obligations to the community, including human rights, and the environment.

During 2013, the bank initiated a comprehensive program to reposition our portfolios in line with our risk appetite, and we made progress with programs to improve organizational efficiency, making the bank easier to manage and control. Our risk profile is underpinned by our core philosophy of maintaining a strong balance sheet and liquidity position, and capital strength.

We have simplified management structures and will continue to remove unnecessary complexity from our activities, and make processes and systems consistent in different markets. We will continue to refine our operational processes, develop our support functions and streamline our information technology.

Financial performance

Summary consolidated income statement

	2013 **$m**	2012 $m
Net interest income	**1,311**	1,475
Net fee income	**603**	601
Net trading income	**178**	180
Net expense from financial instruments designated at fair value	**(5)**	(27)
Gains less losses from financial investments	**58**	52
Other operating income	**16**	24
Gain on sale of full service brokerage business	**–**	88
Net operating income before loan impairment charges and other credit risk provisions	**2,161**	2,393
Loan impairment charges and other credit risk provisions	**(188)**	(211)
Net operating income	**1,973**	2,182
Total operating expenses (excluding restructuring charges)	**(1,070)**	(1,122)
Restructuring charges	**–**	(36)
Operating profit	**903**	1,024
Share of profit in associates	**31**	5
Profit before income tax expense	**934**	1,029
Income tax expense	**(247)**	(275)
Profit for the year	**687**	754

Overview

HSBC Bank Canada reported a profit before income tax expense for 2013 of $934m, a decrease of $95m, or 9%, compared with 2012.

Profit before income tax expense for the prior year included a gain on the sale of the full service brokerage business of $88m and a restructuring charge of $36m mostly relating to the wind-down of the bank's consumer finance business. Excluding the impact of these items, profit before income tax expense for the year decreased by $43m, or 4%, compared with the prior year primarily due to lower net interest income from the declining loan balances of the run-off consumer finance portfolio as well as a reduction in net interest spread. The decrease is partially offset by lower operating expenses as a result of our ongoing organizational effectiveness programs, which resulted in sustainable cost savings as well as an increase in value of the bank's investment in private equity funds. Also partially offsetting the decrease were lower loan impairment charges primarily from a reduction in collectively assessed provisions driven by declining loan balances of the run-off consumer finance portfolio, as well as tightening credit spreads on our own subordinated debentures designated at fair value.

Performance by income and expense item

Net interest income

	2013			2012		
	Average balance **$m**	*Interest income/ (expense)* **$m**	*Yield* **%**	*Average balance* $m	*Interest income/ (expense)* $m	*Yield* %
Interest-earning assets						
Loans and advances with banks	**3,271**	**31**	**1.0**	1,672	16	1.0
Loans and advances with customers	**48,260**	**1,738**	**3.6**	46,920	1,902	4.0
Financial instruments	**20,985**	**287**	**1.4**	21,180	297	1.4
Other interest-earning assets	**878**	**9**	**1.0**	579	21	3.7
Total interest earning assets	**73,394**	**2,065**	**2.8**	70,351	2,236	3.2
Total interest costing liabilities	**(63,749)**	**(754)**	**1.2**	(61,073)	(761)	1.3
Net interest and net interest spread		**1,311**	**1.6**		1,475	1.9

Net interest income for 2013 was $1,311m, a decrease of $164m, or 11%, compared with 2012. Net interest income decreased primarily due to the declining loan balances of the run-off consumer finance portfolio and the sale of the consumer private label credit card portfolio during the third quarter of 2013 as well as a reduction in net interest spread.

Net fee income

	2013 **$m**	2012 $m
Credit facilities	**254**	239
Funds under management	**135**	127
Account services	**83**	86
Credit cards	**62**	62
Immigrant Investor Program	**35**	37
Corporate finance	**34**	38
Remittances	**32**	31
Brokerage commissions	**14**	17
Insurance	**14**	20
Trade finance import/export	**10**	11
Trustee fees	**6**	5
Other	**15**	16
Fee income	**694**	689
Less: fee expense	**(91)**	(88)
Net fee income	**603**	601

Net fee income for 2013 was $603m, broadly unchanged compared with 2012.

Net trading income

	2013 **$m**	2012 $m
Trading activities	**129**	138
Net interest from trading activities	**43**	37
Hedge ineffectiveness	**6**	5
Net trading income	**178**	180

Net trading income for 2013 was $178m, marginally lower compared with 2012.

Other items of income

	2013 **$m**	2012 $m
Net expense from financial instruments designated at fair value	**(5)**	(27)
Gains less losses from financial investments	**58**	52
Other operating income	**16**	24
Gain on the sale of the full service retail brokerage business	**–**	88
Other items of income	**69**	137

Net expense from financial instruments designated at fair value for 2013 was a loss of $5m compared with a loss of $27m in 2012. The bank's financial instruments designated at fair value are fixed-rate long-term subordinated debt issued, the rate profile of which has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. We reported net expense from financial instruments in both the current and last year primarily as a result of adverse fair value movements driven by the tightening of credit spreads.

Gains less losses from financial investments for 2013 were $58m, an increase of $6m, or 12%, compared with 2012 as Balance Sheet Management recognized higher gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes based on the low interest rate environment.

Other operating income for 2013 was $16m, a decrease of $8m, or 33% compared with 2012. The decrease is primarily due to a reduction in fair value of an investment property sold during 2013.

Gain on the sale of the full service retail brokerage business. The sale of the full service retail brokerage business resulted in a gain of $88m, net of assets written off and directly related costs, and was reported in the results of 2012.

Loan impairment charges and other credit risk provisions

	2013 **$m**	2012 $m
Individually assessed allowances	**138**	103
Collectively assessed allowances	**69**	99
Loan impairment charges	**207**	202
Impairment of available-for-sale debt securities	**–**	1
Other credit risk provisions (reversal of provisions)	**(19)**	8
Loan impairment charges and other credit risk provisions	**188**	211

Loan impairment charges and other credit risk provisions for 2013 were $188m, a decrease of $23m, or 11%, compared with 2012. The decrease in loan impairment charges and other credit risk provisions is primarily as a result of a reduction in collectively assessed allowances driven by declining loan balances of the run-off consumer finance portfolio and lower provisions carried relating to off-balance sheet exposures due to an overall improved credit quality. The decrease in loan impairment charges and other credit provisions was partially offset by higher specific allowances for commercial customers in the energy, real estate and agriculture sectors.

Management's Discussion and Analysis (continued)

Operating expenses

	2013 **$m**	2012 $m
Employee compensation and benefits	**614**	659
General and administrative expenses	**408**	409
Depreciation of property, plant and equipment	**34**	35
Amortization and impairment of intangible assets	**14**	19
Total operating expenses (excluding restructuring charges)	**1,070**	1,122
Restructuring charges	**–**	36
Total operating expenses	**1,070**	1,158

Total operating expenses (excluding restructuring charges) for 2013 were $1,070m, a decrease of $52m, or 5%, compared with 2012. Total operating expenses decreased notably as a result of our on-going organizational effectiveness programs, which resulted in sustainable cost savings of $33m in 2013. Cumulative sustainable cost savings from 2011 to the end of 2013 are in excess of $130m. Right sizing operations of the bank's consumer finance business further contributed to the decrease in total operating expenses.

Restructuring charges of $36m were recognized in the first quarter of 2012 primarily relating to the wind-down of the bank's consumer finance business. These restructuring charges were not repeated in 2013.

Share of profit in associates

Share of profit in associates for 2013 was $31m, an increase of $26m compared with 2012. Share of profit in associates was higher due to an increase in value of the bank's investment in private equity funds.

Income tax expense

The effective tax rate was 26.7% for 2013, broadly unchanged compared with 26.9% for 2012.

Movement in financial position

Summary consolidated statement of financial position

	2013 **$m**	2012 $m	2011 $m
ASSETS			
Trading assets	**6,728**	5,272	4,587
Derivatives	**2,112**	1,810	2,203
Loans and advances to banks	**1,482**	1,480	4,530
Loans and advances to customers	**46,351**	45,572	44,357
Financial investments	**21,814**	20,411	19,168
Customer's liability under acceptances	**4,757**	4,737	4,059
Other assets	**1,016**	1,432	1,164
Total assets	**84,260**	80,714	80,068
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	**1,205**	2,173	1,329
Customer accounts	**51,844**	48,304	46,614
Trading liabilities	**4,396**	2,672	2,996
Derivatives	**1,746**	1,415	1,746
Debt securities in issue	**11,348**	11,980	13,327
Acceptances	**4,757**	4,737	4,059
Other liabilities	**3,879**	4,057	4,778
Total liabilities	**79,175**	75,338	74,849
Equity			
Share capital and other reserves	**1,959**	2,452	2,610
Retained earnings	**2,926**	2,694	2,379
Non-controlling interests	**200**	230	230
Total equity	**5,085**	5,376	5,219
Total equity and liabilities	**84,260**	80,714	80,068

Assets

Excluding reverse repurchase agreements, loans and advances balances were as follows:

	2013 **$m**	2012 $m	2011 $m
Loans and advances to banks	**1,149**	673	1,489
Loans and advances to customers	**40,523**	42,456	43,479
Reverse repurchase agreements	**6,161**	3,923	3,919

Total assets at 31 December 2013 were $84.3bn, an increase of $3.5bn from 31 December 2012, primarily due to increases of $2.2bn in reverse repurchase agreements, $1.5bn in trading assets, and $1.4bn in financial investments. The increase was partially offset by a $1.9bn decrease in loans and advances to customers excluding reverse repurchase agreements.

The growth in reverse repurchase agreements is primarily due to balance sheet management activities as well as customer facilitation. The growth in trading assets is primarily as a result of a higher holding of government and agency bonds from increased trading activity in the rates business as well as a higher pending settlement balances. The growth in financial investments is primarily due to the investment of excess liquidity within bonds and treasury bills. Loans and advances to customers decreased primarily as a result of the declining loan balances of the run-off consumer finance portfolio, the sale of the consumer private label credit card portfolio during the third quarter of 2013, as well as a decline in mortgage and overdraft accounts.

Management's Discussion and Analysis (continued)

Liabilities

Excluding repurchase agreements, deposits and customer accounts balances were as follows:

	2013 **$m**	2012 $m	2011 $m
Deposits by banks	**636**	1,156	1,222
Customer accounts	**50,926**	46,292	46,205
Repurchase agreements	**1,487**	3,029	516

Total liabilities at 31 December 2013 were $79.2bn, an increase of $3.8bn from 31 December 2012, primarily due to increases of $4.6bn in customer accounts excluding repurchase agreements and $1.7bn in trading liabilities. The increase was partially offset by decreases of $1.5bn in repurchase agreements, $0.6bn in debt securities in issue and $0.5bn in deposits by banks excluding repurchase agreements.

The increase in customer accounts is primarily due to growth in savings, deposits and current accounts. The increase in trading liabilities is primarily as a result of increased activity in the rates business. Repurchase agreements decreased primarily as a result of reduced customer facilitating activity and balance sheet management activities. Debt securities in issue decreased primarily as a result of the maturity of $2.6bn in secured funding and bearer deposit notes, partially offset by replacement wholesale term funding of $2.0bn. Deposits by banks excluding repurchase agreements decreased primarily due to a reduction in treasury money market term deposits.

Equity

Total equity at 31 December 2013 was $5.1bn, a decrease of $0.3bn from 31 December 2012, primarily due to the purchase and cancellation of $346m preferred share capital and $30m in non-controlling interests in accordance with the bank's capital plan. The decrease in equity was partially offset by profits generated in the year.

Global lines of business

We manage and report our operations around the following global lines of business: Commercial Banking; Global Banking and Markets, and, Retail Banking and Wealth Management.

As a result of the bank's previous decision to wind-down the consumer finance business in Canada and in order to more appropriately reflect the bank's active global lines of business, effective for 2013, results previously reported as the 'Consumer Finance' segment have been included under Retail Banking and Wealth Management, with exception of results relating to corporate credit cards, which are included under Commercial Banking. The results for the comparative period have been restated to reflect this change.

Commercial Banking

Commercial Banking offers a full range of commercial financial services and tailored solutions to more than 30 thousand customers ranging from small and medium-sized enterprises ('SMEs') to publicly quoted companies.

Products and services

We segment our Commercial Banking business into Corporate, to serve both large and mid-market companies with more sophisticated financial needs, and Business Banking, to serve SMEs, enabling differentiated coverage of our target customers. This allows us to provide continuous support to companies as they grow both domestically and internationally, and ensures a clear focus on internationally aspirant customers.

We place particular emphasis on international connectivity to meet the needs of our business customers. We aim to be recognized as the leading international trade and business bank by focusing on target segments, repositioning towards international business and enhancing collaboration across the Group. This will be underpinned by reducing complexity and operational risk and driving efficiency gains through adopting a global operating model.

– *Credit and Lending:* we offer a broad range of domestic and cross-border financing, including overdrafts, term loans, leasing, and syndicated, leveraged, acquisition and project finance.

- *International trade and receivables finance:* we provide the services and finance our clients need throughout the trade cycle including; letters of credit, collections, guarantees; receivables finance; supply chain solutions; and risk distribution. HSBC is supporting the development of renminbi as a trade currency, with renminbi capabilities for exporters, importers, and companies looking to invest in China.

- *Payments and Cash Management:* we are a leading provider of domestic and cross-border payments, collections, liquidity management and account services offering local, regional and global solutions delivered via e-enabled platforms designed to address the current and future needs of our clients.

- *Global Banking and Markets:* our Commercial Banking franchise represents a key client base for Global Banking and Markets products and services, including foreign exchange and interest rate products, together with capital raising on debt and equity markets.

Strategic direction

Commercial Banking aims to be the banking partner of choice for international businesses by building on our rich heritage, international capabilities and relationships to enable connectivity and support trade and capital flows around the world, thereby strengthening our leading position in international business and trade.

We have three growth priorities:

- grow coverage in target segments;

- drive revenue growth through our international network; and

- grow collaboration revenues.

Implementing Global Standards, enhancing risk management controls models and simplifying processes also remain top priorities for Commercial Banking.

Review of financial performance

	2013 $m	2012 $m
Net interest income	**675**	710
Net fee income	**317**	307
Net trading income	**28**	31
Other operating income/(expense)	**(31)**	(25)
Net operating income before loan impairment charges and other credit risk provisions	**989**	1,023
Loan impairment charges and other credit risk provisions	**(124)**	(79)
Net operating income	**865**	944
Total operating expenses	**(373)**	(377)
Operating profit	**492**	567
Share of profit in associates	**31**	5
Profit before income tax expense	**523**	572

Overview

Profit before income tax expense was $523m for 2013, a decrease of $49m, or 9%, compared with 2012. Profit before income tax decreased primarily due to higher specific loan impairment charges in the energy, real estate and agriculture sectors as well as lower net interest income from the narrowing of net interest spread in a competitive low interest rate environment. The decrease in profit before tax was partially offset by growth in the value of the bank's investment in private equity funds and higher net fee income as a result of growth in bankers' acceptances and related transaction volume.

Financial performance by income and expense item

Net interest income for 2013 was $675m, a decrease of $35m, or 5%, compared with 2012 primarily due to lower net interest spread in a competitive low interest rate environment.

Net fee income for 2013 was $317m, an increase of $10m, or 3%, compared with 2012 primarily as a result of growth in bankers' acceptances and related transaction volume.

Net trading income for 2013 was $28m, a decrease of $3m, or 10% compared with 2012 primarily due to lower trading volume related to foreign exchange products.

Other operating income for 2013 was a loss of $31m, compared with a loss of $25m in 2012. The higher loss in 2013 is primarily due to adjustments related to a decline in the fair value of an investment property sold in the fourth quarter of 2013.

Loan impairment charges and other credit risk provisions for 2013 were $124m, an increase of $45m, or 57%, compared with 2012 primarily due to higher specific provisions in the energy, real estate and agriculture sectors.

Total operating expenses for 2013 were $373m, marginally lower compared with 2012.

Share in profit in associates for 2013 was $31m, an increase of $26m compared with 2012 due to an increase in value of the bank's investment in private equity funds.

Global Banking and Markets

Global Banking and Markets is an emerging markets-led and financing-focused business providing tailored financial solutions to major government, corporate and institutional clients worldwide.

Products and services

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients 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 a presence in over 60 countries and territories and access to the HSBC Group's worldwide presence and capabilities, this business serves subsidiaries and offices of our clients on a global basis.

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

– *Markets* consists of sales and trading functions specializing in various products including foreign exchange; currency, interest rate, bond, credit, equity and other derivatives; government and non-government fixed income and money market instruments; and, precious metals and exchange-traded futures. Markets also includes Balance Sheet Management, which is responsible for the management of liquidity, funding and the structural interest rate positions of the bank.

– *Capital Financing* brings together our capital raising and risk management services into a single platform. This group provides clients with a single integrated financing business, focused across a client's capital structure and financing needs. Its expertise ranges from primary equity and debt capital markets; to specialized structured financing solutions such as asset-backed finance, leveraged and acquisition finance and project finance; to transformative merger and acquisition advisory and execution; to credit and lending activities.

– *Banking* is responsible for the overall management of relationships with major corporate, government and institutional clients across a broad range of geographies. This involves working closely with a variety of product specialists to deliver a comprehensive range of Markets, Capital Finance, Trade and Receivables Finance, and Payments and Cash Management services.

Strategic direction

Global Banking and Markets continues to pursue its well-established 'emerging markets-led and financing-focused' strategy, with the objective of being a leading international wholesale bank. This strategy has evolved to include a greater emphasis on connectivity between the global businesses, across the regions and within Global Banking and Markets, leveraging the HSBC Group's extensive distribution network.

We focus on four strategic initiatives:

– leveraging our distinctive geographical network which connects developed and faster-growing regions;

– connecting clients to global growth opportunities;

– continuing to be well positioned in products that will benefit from global trends; and

– enhancing collaboration with other global businesses to appropriately service the needs of our international client base.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for Global Banking and Markets.

Review of financial performance

	2013 **$m**	2012 $m
Net interest income	**159**	167
Net fee income	**83**	87
Net trading income	**103**	106
Gains less losses from financial investments	**54**	51
Other operating income	**1**	2
Gain on sale of the full service retail brokerage business	**–**	8
Net operating income	**400**	421
Total operating expenses	**(113)**	(112)
Profit before income tax expense	**287**	309

Overview

Profit before income tax expense was $287m for 2013, a decrease of $22m, or 7%, compared with 2012. Profit before income tax in 2012 included a gain of $8m on the sale of full services retail brokerage business.

Excluding the impact of the gain, profit before income tax expense decreased by $14m, or 5%, compared with 2012 primarily due to lower net interest income from reduced interest margin, lower trading income as a result of a decline in customer spreads on foreign exchange products, as well as lower net fee income from a decline in derivative sales and debt underwriting fees.

Financial performance by income and expense item

Net interest income for 2013 was $159m, a decrease of $8m, or 5%, compared with 2012 primarily due to lower interest margin.

Net fee income for 2013 was $83m, a decrease of $4m, or 5% compared with 2012 primarily due to lower derivative sales and debt underwriting fees.

Net trading income for 2013 was $103m, a decrease of $3m, or 3%, compared with 2012. Net trading income decreased primarily as a result of lower customer spreads related to foreign exchange products and lower trading income generated from rates products. In the first quarter of 2013, the bank implemented changes in the methodology in respect of credit and debit valuation adjustments on derivative contracts to reflect evolving market practices. The decrease in net trading income was partially offset as a result of the change in methodology as well as prior year losses caused by the narrowing of credit spreads on our own instruments.

Gains less losses from financial investments for 2013 was $54m, an increase of $3m, or 6%, compared with 2012 as Balance Sheet Management recognized higher gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes based on the low interest rate environment.

Total operating expenses for 2013 were $113m, broadly unchanged compared with 2012.

Retail Banking and Wealth Management

Retail Banking and Wealth Management provides banking and wealth management services for our personal customers to help them to manage their finances and protect and build their financial future.

Products and services

Retail Banking and Wealth Management serves over 900,000 personal customers. We take deposits and provide transactional banking services to enable customers to manage their day-to-day finances and save for the future. We selectively offer credit facilities to assist customers in their short or longer-term borrowing requirements, and we provide financial advisory and investment services to help them to manage their financial future.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

Typically, customer offerings include:

- *liability-driven services:* deposits and account services;
- *asset-driven services:* credit and lending, both secured and unsecured; and
- *fee-driven and other services:* financial advisory and asset management.

Management's Discussion and Analysis (continued)

Strategic direction
Retail Banking and Wealth Management provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale to do so cost effectively.

We focus on three strategic initiatives:

– building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our financial advisory and asset management businesses;

– leveraging global expertise to improve customer service and productivity, to provide a high standard of banking solutions and service to our customers efficiently; and

– simplifying and re-shaping the Retail Banking and Wealth Management portfolio of products and services, to focus our capital and resources where we have, or can build, the scale to do so cost effectively.

To support these initiatives, we have targeted growth through deepening customer relationships and enhancing distribution capabilities.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for Retail Banking and Wealth Management.

Review of financial performance

	2013 **$m**	2012 $m
Net interest income	**505**	629
Net fee income	**203**	207
Net trading income	**19**	12
Gains less losses from financial investments	**4**	1
Other operating income	**13**	16
Gain on sale of the full service retail brokerage business	**–**	80
Net operating income before loan impairment charges and other credit risk provisions	**744**	945
Loan impairment charges and other credit risk provisions	**(64)**	(132)
Net operating income	**680**	813
Total operating expenses (excluding restructuring charges)	**(549)**	(589)
Restructuring charges	**–**	(36)
Profit before income tax expense	**131**	188

Profit before income tax expense

	2013 **$m**	2012 $m
Ongoing Retail Banking and Wealth Management business	**52**	43
Gain on the sale of the full service retail brokerage business	**–**	80
Run-off consumer finance portfolio[1]	**79**	65
Profit before income tax expense	**131**	188

[1] *Refer to the beginning of this section for an explanation of the merger of Consumer Finance with Retail Banking and Wealth Management.*

Overview
Profit before income tax expense was $131m for 2013, a decrease of $57m, or 30%, compared with 2012. Profit before income tax expense relating to ongoing business (excluding the run-off consumer finance portfolio and gain on the sale of the full service retail brokerage business) was $52m for 2013, an increase of $9m, or 21%, compared with 2012. Profit before income tax expense relating to ongoing business increased primarily due to lower total operating expenses as a result of cost control and continued delivery of our organizational effectiveness programs as well as higher net trading income from mark to market gains on structured products and an increase in foreign exchange activity. The increase was partially offset by lower net interest income from a decline in loan balances and narrowing net interest spread in a competitive low interest rate environment.

Profit before income tax expense relating to the run-off consumer finance portfolio was $79m for 2013, an increase of $14m, or 22%, compared with 2012. Profit before income tax, relating to the run-off consumer finance portfolio in 2012, included restructuring charges of $32m in connection with the wind-down of the consumer finance business. Excluding the impact of the restructuring charges, profit before income tax expense relating to the run-off consumer finance portfolio decreased by $18m, or 19%, compared with 2012 primarily due to lower interest income from declining loan balances and the sale of the consumer private label credit card portfolio. The decrease in profit before income tax expense relating to the run-off consumer finance portfolio was partially offset by reductions in collective provisions and lower operating expenses from right sizing operations.

Financial performance by income and expense item

Net interest income relating to ongoing business for 2013 was $360m, a decrease of $22m, or 6%, compared with 2012 primarily due to a decline in loan balances and lower net interest spread in a competitive low interest rate environment.

Net fee income relating to ongoing business for 2013 was $197m, an increase of $3m, or 2%, compared with 2012 primarily due to growth in funds under management and related fees.

Net trading income relating to ongoing business for 2013 was $19m, an increase of $7m, or 58%, compared with 2012 primarily due to mark to market gains on structured products and an increase in foreign exchange activity.

Loan impairment charges and other credit risk provisions relating to ongoing business for 2013 were $33m, a decrease of $1m, or 3%, compared with 2012 primarily due lower collective provisions driven by a decline in loan balances.

Total operating expenses (excluding restructuring charges) relating to ongoing business for 2013 were $501m, a decrease of $19m, or 4%, compared with 2012 primarily as a result of cost control and continued delivery of our organizational effectiveness programs, which resulted in sustainable cost savings.

Other

'Other' contains the results of movements in fair value of own debt, income related to information technology services provided to HSBC Group companies on an arm's length basis with associated recoveries and other transactions which do not directly relate to our global lines of business.

Review of financial performance

	2013 **$m**	2012 $m
Net interest expense	**(28)**	(31)
Net trading income	**28**	31
Net expense from financial instruments designated at fair value	**(5)**	(27)
Other operating income	**33**	31
Net operating income	**28**	4
Total operating expenses	**(35)**	(44)
Loss before income tax expense	**(7)**	(40)

Fourth quarter 2013 financial performance

Summary consolidated income statement

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Net interest income	**316**	348	319
Net fee income	**151**	154	152
Net trading income	**34**	45	42
Net expense from financial instruments designated at fair value	**(2)**	(3)	–
Gains less losses from financial investments	**6**	4	2
Other operating income/(expense)	**19**	(26)	7
Gain on sale of full service retail brokerage business	**–**	4	–
Net operating income before loan impairment charges and other credit risk provisions	**524**	526	522
Loan impairment charges and other credit risk provisions	**(39)**	(33)	(9)
Net operating income	**485**	493	513
Total operating expenses	**(270)**	(277)	(271)
Operating profit	**215**	216	242
Share of profit in associates	**17**	2	9
Profit before income tax expense	**232**	218	251
Income tax expense	**(50)**	(64)	(65)
Profit for the quarter	**182**	154	186

Overview

HSBC Bank Canada reported a profit before income tax expense of $232m for the fourth quarter of 2013, an increase of $14m, or 6%, compared with the fourth quarter of 2012, and a decrease of $19m, or 8%, compared with the third quarter of 2013.

Profit before income tax expense in the fourth quarter of 2012 included a $42m write down in the value of investment property. Excluding the impact of the write down, profit before income tax expense decreased by $28m, or 11%, compared with the same quarter last year primarily due to lower net interest income from the declining run-off consumer finance portfolio. The decrease in profit before income tax expense compared with the prior quarter is primarily due to higher levels of specific provisions within Commercial Banking.

Performance by income and expense item

Net interest income

Net interest income for the fourth quarter of 2013 was $316m, a decrease of $32m, or 9%, compared with the fourth quarter of 2012 and broadly unchanged compared with the third quarter of 2013. Net interest income decreased compared with the same quarter last year primarily due to declining loan balances of the run-off consumer finance portfolio and the sale of the consumer private label credit card portfolio during the prior quarter as well as a reduction in net interest spread.

Net fee income

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Credit facilities	**64**	63	64
Funds under management	**32**	33	35
Account services	**20**	20	20
Credit cards	**16**	22	16
Corporate finance	**10**	12	8
Remittances	**8**	8	8
Immigrant Investor Program	**6**	8	8
Brokerage commissions	**3**	4	4
Insurance	**3**	4	3
Trade finance import/export	**3**	2	3
Trustee fees	**1**	1	1
Other	**7**	1	4
Fee income	**173**	178	174
Less: fee expense	**(22)**	(24)	(22)
Net fee income	**151**	154	152

Net fee income for the fourth quarter of 2013 was $151m, marginally lower compared with the fourth quarter of 2012 and broadly unchanged compared with the third quarter of 2013.

Net trading income

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Trading activities	**26**	36	27
Net interest from trading activities	**10**	11	11
Hedge ineffectiveness	**(2)**	(2)	4
Net trading income	**34**	45	42

Net trading income for the fourth quarter of 2013 was $34m, a decrease of $11m, or 24% compared with the fourth quarter of 2012, and a decrease of $8m, or 19%, compared with the third quarter of 2013. Net trading income decreased compared with the same quarter last year primarily as a result of lower activity in the rates business. Net trading income decreased compared with the prior quarter primarily due to trading losses driven by hedge ineffectiveness.

Management's Discussion and Analysis (continued)

Other items of income

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Net expense from financial instruments designated at fair value	**(2)**	(3)	–
Gains less losses from financial investments	**6**	4	2
Other operating income/(expense)	**19**	(26)	7
Gain on the sale of the full service retail brokerage business	**–**	4	–
Other items of income/(expense)	**23**	(21)	9

Net expense from financial instruments designated at fair value for the fourth quarter of 2013 was a loss of $2m, compared with a loss of $3m in the fourth quarter of 2012 and nil in the third quarter of 2013. The bank's financial instruments designated at fair value are fixed-rate long-term subordinated debt issued, the rate profile of which has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. We reported net expense from financial instruments in the current quarter and the same quarter last year primarily as a result of adverse fair value movements driven by the tightening of credit spreads.

Gains less losses from financial investments for the fourth quarter of 2013 were $6m, an increase of $2m and $4m respectively, compared with the fourth quarter of 2012 and the third quarter of 2013. Gains less losses from financial investments increased as Balance Sheet Management recognized higher gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes based on the low interest rate environment.

Other operating income for the fourth quarter of 2013 was $19m, an increase of $45m compared with the fourth quarter of 2012, and an increase of $12m compared with the third quarter of 2013. The increase is primarily due to a reduction in fair value of an investment property in comparative periods.

Gain on the sale of the full service retail brokerage business. In the fourth quarter of 2012, the bank satisfied certain conditions relating to the sale which allowed a further gain of $4m to be recognized. These gains were not repeated in 2013.

Loan impairment charges and other credit risk provisions

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Individually assessed allowances/(allowance releases)	**31**	23	(3)
Collectively assessed allowances	**16**	6	14
Loan impairment charges	**47**	29	11
Other credit risk provisions/(reversal of provisions)	**(8)**	4	(2)
Loan impairment charges and other credit risk provisions	**39**	33	9

Loan impairment charges and other credit risk provisions for the fourth quarter of 2013 were $39m, an increase of $6m and $30m respectively, compared with the fourth quarter of 2012 and the third quarter of 2013. The increase in loan impairment charges and other credit risk provisions compared with both the same quarter last year and the prior quarter is primarily due to higher specific allowances for commercial customers.

Operating expenses

	Quarter ended		
	31 December 2013 $m	31 December 2012 $m	30 September 2013 $m
Employee compensation and benefits	**146**	152	154
General and administrative expenses	**112**	109	105
Depreciation of property, plant and equipment	**9**	8	8
Amortization and impairment of intangible assets	**3**	8	4
Total operating expenses	**270**	277	271

Total operating expenses for the fourth quarter of 2013 were $270m, a decrease of $7m, or 3%, compared with the fourth quarter of 2012 and broadly unchanged compared with the third quarter of 2013. Total operating expenses decreased compared with the same quarter last year notably as a result of our on-going organizational effectiveness programs, which resulted in sustainable cost savings of $9m in the current quarter. Right sizing operations of the bank's consumer finance business further contributed to the decrease in total operating expenses.

Share of profit in associates

Share of profit in associates for the fourth quarter of 2013 was $17m, an increase of $15m and $8m respectively, compared with the fourth quarter of 2012 and the third quarter of 2013. Share of profit in associates was higher due to an increase in value of the bank's investment in private equity funds.

Income tax expense

The effective tax rate in the fourth quarter of 2013 was 21.8%, compared with 29.5% in the fourth quarter of 2012 and 26.5% in the third quarter of 2013. Income tax expense in the fourth quarter of 2013 included a reversal of an overprovision resulting in a lower effective tax rate.

Management's Discussion and Analysis (continued)

Summary quarterly performance

Summary consolidated income statement

	2013				2012[1]			
	Quarter ended				Quarter ended			
	Dec 31 $m	Sep 30 $m	Jun 30 $m	Mar 31 $m	Dec 31 $m	Sep 30 $m	Jun 30 $m	Mar 31 $m
Net interest income	316	319	340	336	348	357	372	398
Net fee income	151	152	154	146	154	157	147	143
Net trading income	34	42	45	57	45	48	47	40
Other operating income/(expense)	23	9	(8)	45	(25)	10	48	16
Gain on the sale of the full service retail brokerage business	–	–	–	–	4	–	–	84
Net operating income before loan impairment charges and other credit risk provisions	524	522	531	584	526	572	614	681
Loan impairment charges and other credit risk provisions	(39)	(9)	(84)	(56)	(33)	(71)	(59)	(48)
Net operating income	485	513	447	528	493	501	555	633
Operating expenses	(270)	(271)	(266)	(263)	(277)	(258)	(279)	(308)
Restructuring charges	–	–	–	–	–	–	–	(36)
Operating profit	215	242	181	265	216	243	276	289
Share of profit in associates	17	9	1	4	2	1	1	1
Profit before income tax expense	232	251	182	269	218	244	277	290
Income tax expense	(50)	(65)	(52)	(80)	(64)	(64)	(76)	(71)
Profit for the period	182	186	130	189	154	180	201	219
Profit attributable to:								
common shareholders	164	168	113	171	136	162	184	201
preferred shareholders	16	15	15	15	16	15	15	15
non-controlling interests	2	3	2	3	2	3	2	3
Basic earnings per common share ($)	0.33	0.34	0.23	0.34	0.27	0.33	0.37	0.40

[1] *Comparative information has been adjusted for the effect of the adoption of the revised IAS 19 Employee benefits. Refer to the 'Changes in accounting policy during 2013' section for further information.*

Comments on trends over the past eight quarters
Seasonal factors did not have a significant impact on our results.

Net interest income declined from 2012 primarily as a result of the run-off consumer finance portfolio. In addition contributing to the decrease was lower interest margins in a competitive low interest rate environment. The decline in net interest income has been partially offset by growth in deposit volumes which reduced our cost of funding.

Net fee income trended upwards from 2012 due to higher funds under management fees driven by customer investment through our wealth management business.

Net trading income trended upwards through 2012 and downwards through 2013 in line with market volatility.

Operating expenses continue to decrease from the first quarter of 2012 primarily due to cost reductions relating to the wind-down of the bank's consumer finance business and as a result of continued cost reduction initiatives.

Economic outlook for 2014

At best, keeping pace with US
In 2014, the Canadian economy will, at best, keep pace with the US expansion. As things stand, we expect Gross Domestic Product ('GDP') growth of 2.3% in both countries. There are three key areas that we focus on as helping provide lift, or less of a restraint, to the US, but which will act as potentially growth-limiting headwinds to Canada. Those areas are housing, employment, and fiscal policy.

In the US, the housing sector is starting to emerge from its post bubble malaise. Meanwhile, in Canada, the housing sector is poised to step back after having helped lift the economy out of recession, and acting as an economic pillar since.

Employment has been a key indicator of economic rebound in Canada, versus the lacklustre performance of the US economy in recent years. To wit, full-time employment in Canada is 3.4% above its pre-recession peak, but is still 4.1% below its pre-recession peak in the US. There is more scope for job creation in the US. Hence, we look for consumption spending in the US to trend modestly upward in the next two years, from an advance of 1.9% in 2013, toward an increase of 2.2% in 2015. In Canada, we expect consumption to advance at 2.2% in 2013, but to slow to a 1.9% increase in 2015.

Lastly, in the US fiscal drag is starting to decline, while Canadian fiscal authorities are entering a critical period with regard to returning to fiscal balance in the next couple of years. As a result, we expect less of a fiscal headwind in the US, and only a small addition to GDP growth in Canada from fiscal policy. We see 2014 as a key year with regard to the Federal Government's plan to return to fiscal surplus in fiscal year 2015/16. Strict expenditure controls will be necessary as we anticipate sluggish nominal GDP growth, and thus sluggish tax revenue growth.

Part and parcel of our outlook for a more moderate contribution from consumers to Canadian GDP growth is a further slowdown in the pace of expansion of household credit. This will help stabilize the household debt to personal disposable income ratio, which is a key step in the process of the rebalancing of the household sector. The household debt slowdown will affect home renovation activity and existing home sales, both of which are part of the residential investment component of GDP, other consumer spending relate to renovations, and auto sales. After nearly hitting a record high in 2012, unit auto sales are on pace to achieve new highs in 2013. A key factor behind the strength in auto sales is the attraction of very long term, low rate loans. The problem with these loans is that there is an elevated risk that borrowers could find themselves in a negative equity position if they choose to trade in their vehicle before the loan is paid off. This could lead to a snowballing effect in auto-related debt, at a time when interest rates are not as low as they are at present. We look for auto sales to slow in 2014, though only modestly given that rates remain low.

Amid consumer restraint other sectors of the economy are expected to step in to share the burden of GDP growth, specifically business investment and exports. We expect the rotation toward business investment and exports, with a more moderate contribution from consumer spending and housing, to feature prominently in 2014. That said, the rebalancing toward business investment and exports has been choppy, and is not yet firmly entrenched.

On exports, we look to US domestic demand, and commodity prices as the most important drivers. Calls for a weaker Canadian dollar to boost exports are misplaced. For exports to take on more of the burden of growth, we require a solid increase in real exports or an increase in the actual volume of goods and services that transverse the border. This is unlikely to be affected by the currency at least in the short-term. The key factor that will boost exports is increased demand for what Canada produces. This would be reflected by increased US domestic demand, suggesting our largest customer is buying, and higher commodity prices, suggesting that demand for commodities is on the upswing.

On business investment, we focus much attention on the business sector. Following a decade focused on improving its balance sheet health, Canada's corporate sector is in tip top financial condition, with debt burdens at 20-year lows, and measures of liquidity at historically elevated levels. As well, interest rates remain favourably low, providing the opportunity to lock in low long-term borrowing costs. Even so, headwinds to business investment have included global economic uncertainty, weak commodity prices, and weak corporate profits. Looking ahead, after increasing by a very moderate 2.1% in 2013, we expect the business investment to expand by 6.5% year over year in 2014 as headwinds abate.

With fiscal authorities focused on returning to surplus in the next two to three fiscal years, we expect little contribution to GDP growth from government expenditure. Though the Federal Government reported a budget deficit of $18.9bn in fiscal year 2012/13, $7bn lower than projected, returning to surplus in fiscal year 2015/16 still requires a substantial improvement in the fiscal position in 2014. The Federal Government currently projects the budget deficit narrowing from $14.0bn in fiscal 2013/14 to $2.7bn in fiscal year 2014/15. Achieving these goals will require strict expenditure controls given moderate nominal GDP and thus tax revenue growth, augmented by revenues from asset sales.

With regard to monetary policy, we expect the Bank of Canada to remain on hold until at least mid-2015. Under Bank of Canada Governor Poloz, there has been a renewed focus on inflation, which is expected to linger near 1% in the first half of 2014. This would leave inflation near the bottom of the Bank of Canada's target rate of 1% to 3%, and well below the 2% inflation target. Given lingering concerns about financial imbalances, and still very stimulative financial conditions, we think that the benefit from further monetary stimulus would be marginal at best, while potentially exacerbating risks to financial stability.

Critical accounting policies

The results of HSBC are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements. A summary of our significant accounting policies are provided in note 2.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

Our accounting policy for losses arising from the impairment of customer loans and advances is described in note 2(f). Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolios at the balance sheet 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 methods used to calculate collective impairment allowances on homogeneous groups of loans and advances 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.

The estimation methods include the use of statistical analyses of 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. Where changes in economic, regulatory or behavioural conditions result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models, risk factors are taken into account by adjusting the impairment allowances derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical 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 influences on 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.

Where loans are individually assessed for impairment, management judgement is required in determining whether there is objective evidence that a loss event has occurred, and if so, the measurement of the impairment allowance. In determining whether there is objective evidence that a loss event has occurred, judgement is exercised in evaluating all relevant information on indicators of impairment, which is not restricted to the consideration of whether payments are contractually past-due but includes broader consideration of factors indicating deterioration in the financial condition and outlook of borrowers affecting their ability to pay. A higher level of judgement is required for loans to borrowers showing signs of financial difficulty in market sectors experiencing economic stress, particularly where the likelihood of repayment is affected by the prospects for refinancing or the sale of a specified asset. For those loans where objective evidence of impairment exists, management determine the size of the allowance required based on a range of factors such as the realisable value of security, the likely dividend available on liquidation or bankruptcy, the viability of the customer's business model and the capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations.

Under certain specified conditions, we provide loan forbearance to borrowers experiencing financial difficulties by agreeing to modify the contractual payment terms of loans in order to improve the management of customer relationships, maximize collection opportunities and, if possible, avoid default or repossession. Where forbearance activities are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on loan impairment allowances.

The exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors. Many of the factors have a high degree of interdependency and there is no single factor to which our loan impairment allowances as a whole are sensitive.

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 loans and advances.

Valuation of financial instruments

Our accounting policy for determining the fair value of financial instruments is described in note 2(d). The best evidence of fair value is a quoted price for the instrument being measured in an actively traded market. In the event that the market for a financial instrument is not active, another 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 the basis of valuation techniques that include 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.

Valuation techniques used to calculate fair values are discussed in note 24. The main assumptions and estimates which management consider when applying a model with valuation techniques are:

– the likelihood and expected timing of future cash flows on the instrument. These cash flows are estimated based on the terms of the instrument, and 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;

– selecting an appropriate discount rate for the instrument. The determination of this rate is based on an 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 fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a 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 is 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 is 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 are based on some market observable inputs even when unobservable inputs are significant.

Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in 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.

Deferred tax assets
Our accounting policy for the recognition of deferred tax assets is described in note 2(r). The recognition of a deferred tax asset relies on an assessment of the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

Defined benefit obligations
Our accounting policy for the recognition of defined benefit obligations is described in note 2(s). As part of employee compensation, the bank provides certain employees with pension and other post-retirement benefits under defined benefit plans. In consultation with our actuaries, we make certain assumptions in measuring the bank's obligations under its defined benefit plans as presented in note 4.

It is possible that the outcomes within the next financial year could differ from the actuarial assumptions applied, and this could result in a material adjustment to other comprehensive income.

Changes in accounting policy during 2013

On 1 January 2013, the bank adopted the following new or amended IFRS including International Accounting Standards ('IAS') retrospectively, with the exception of IFRS 13 which was applied prospectively:

Amendments to IAS 1 'Items of Other Comprehensive Income' ('IAS 1')
As a result of the adoption of changes within IAS 1, items presented within the consolidated statement of comprehensive income are grouped into those that will and those that will not be subsequently reclassified to income.

Amendments to IAS 19 'Employee Benefits' ('IAS 19 revised')
IAS 19 revised replaces the interest cost on the plan liability and the expected return on plan assets with a finance cost comprising the net interest on the net defined benefit liability or asset. This finance cost is determined by applying to the net defined benefit liability or asset the same discount rate used to measure the defined benefit obligation. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement is presented in other comprehensive income. The effect of this change is to increase or decrease the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

In addition, unvested amounts related to past service events are no longer amortized and recognized in the income statement over the vesting period, but recognized in full on the date of the past service event as a charge or a credit to income. Refer to note 1(e) for further information related to the restatement of comparative information.

Amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' ('IFRS 7')
IFRS 7 requires disclosure of the effect or potential effects of netting arrangements on an entity's financial position. The amendment requires disclosure of recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement. Disclosures are provided in note 32.

IFRS 10 'Consolidated Financial Statements' ('IFRS 10')
Under IFRS 10, there is one approach for determining if an investor controls an investee for all entities, based on the concept of power, variability of returns and their linkage. This replaced the previous approach which emphasizes legal control or exposure to risks and rewards, depending on the nature of the entity. The bank controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

In accordance with the transitional provisions of IFRS 10, we reviewed the population of investments in entities as at 1 January 2013 to determine whether entities previously consolidated or unconsolidated in accordance with IAS 27 'Consolidated and Separate Financial Statements' and SIC 12 'Consolidation – Special Purpose Entities' changed their consolidation status as a result of applying IFRS 10. The result of this review was that the effect of applying the requirements of IFRS 10 did not have a material effect on these consolidated financial statements.

IFRS 12 'Disclosure of Interests in Other Entities ('IFRS 12')
IFRS 12 is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including for unconsolidated structured entities. New disclosures are provided in notes 16 and 27.

IFRS 13 'Fair Value Measurement' ('IFRS 13')
IFRS 13 establishes a single framework for measuring fair value and introduces new requirements for disclosure of fair value measurements. The adoption of IFRS 13 did not have a material impact on the bank's consolidated financial statements. Disclosures are provided in note 24.

Future accounting developments

In addition to the projects to complete financial instrument accounting, discussed below, the International Accounting and Standards Board ('IASB') is continuing to work on its project on revenue recognition and lease accounting which could represent significant changes to accounting requirements in the future.

Offsetting
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 and are required to be applied retrospectively. Based on our assessment performed to date, we do not expect the amendments to IAS 32 to have a material effect on the bank's consolidated financial statements.

Financial instruments
The IASB issued IFRS 9 'Financial Instruments' which introduced new requirements for the classification and measurement of financial assets in November 2009 and financial liabilities in October 2010, with a further proposed amendments in November 2012. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 classification and measurement requirements are to be applied retrospectively but prior periods need not be restated. Since the final requirements for classification and measurement are uncertain, it remains impracticable to quantify the effect of the existing IFRS 9 as at the date of the publication of these consolidated financial statements.

The second phase in the IASB's project to replace IAS 39 will address the impairment of financial assets.

In November 2013, the IASB completed the third phase of its project to replace IAS 39 and issued general hedge accounting requirements. The revised hedge accounting requirements are applied prospectively and the bank is currently in the process of assessing the impact on its consolidated financial statements. Macro hedging is not included in the IFRS 9 project and will be addressed separately.

In November 2013, the IASB issued amendments to IFRS 9 in respect of transition requirements and the effective date. As a result of these amendments, it is confirmed that all phases of IFRS 9 (except for changes to the presentation of gains and losses for certain liabilities measured at fair value) must be applied from the same effective date. The IASB plans to determine the effective date when the entire IFRS 9 project is closer to completion.

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 financial statements. 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 statement of financial position. These arrangements include: guarantees, letters of credit, and derivatives.

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 financial statements, as there are no actual advances of funds. Any payments actually made under these obligations are recorded as loans and advances 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 customers' 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 33 of the MD&A.

Derivatives

As part of our overall risk management strategy, we enter into a variety of derivatives to manage or reduce our risks in certain areas. Derivatives are also offered as part of our product suite to meet the needs of our customers.

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 include equity, energy, commodity and other foreign exchange and interest rate 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 section of the MD&A.

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

As a result of changing market practices in response to regulatory and accounting changes, as well as general market developments, the banks revised its methodology for estimating the credit valuation adjustment and debit valuation adjustment for derivatives from 1 January 2013. Refer to note 1(b)(iii) for further information relating to the revision. There have been no other changes in the basis of calculating the fair value of financial instruments from 31 December 2012, and there have been no significant changes in the fair value of financial instruments that arose from factors other than normal economic, industry and market conditions. For financial instruments, including derivatives, valued using significant non-observable market inputs (level 3), assumptions and methodologies used in our models are continually reviewed and revised to arrive at better estimates of fair value.

Disclosure controls and procedures and internal control over financial reporting

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 Chief Executive Officer ('CEO') and the Chief Financial Officer ('CFO'), to allow timely decisions regarding required disclosure.

As of 31 December 2013, 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 2013.

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 the consolidated 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 the consolidated financial statements in accordance with IFRS;
- that receipts and expenditures of the bank are being made only in accordance with authorizations of management; 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 consolidated 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 in 1992. Based on this evaluation, management has concluded that internal control over financial reporting was effective as at 31 December 2013.

The Committee of Sponsoring Organizations of the Treadway Commission recently released its updated Internal Control – Integrated Framework (2013 Framework). Management will apply the 2013 Framework to evaluate the effectiveness of the internal control over financial reporting in 2014.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during the year ended 31 December 2013 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 31.

In December 2013, the bank redeemed subordinated debentures and purchased and cancelled preferred shares held with HSBC Group companies. Refer to the capital section for further information. All our common shares are indirectly held with HSBC Holdings as a wholly-owned subsidiary.

Risk management

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

How we manage risk

All of our business activities involve the measurement, evaluation, acceptance and management of some degree of risk with the primary goal being to achieve the appropriate balance between the risk assumed and the reward. Our risk culture plays an important role in delivering our strategic objectives. It is reinforced by our HSBC Values and our Global Standards, and forms the basis on which the Board, the Audit and Risk Committee ('ARC'), a sub-committee of the Board, and the Risk Management Committee ('RMC') establish our risk appetite and the risk management framework. These are instrumental in aligning the behaviour of individuals with our attitude to assuming and managing risk.

We manage risk actively, employing five main elements that underpin our risk culture.

Running risk like a business

Running risk like a business means ensuring that the Risk function is dynamic and responsive to the needs of its stakeholders. This is aided by:

- ensuring systems (for example, in Risk and Finance) are compatible so a complete picture of our risks is obtained;
- streamlining data production and re-engineering processes to create time to spend on risk management; and
- understanding the detail behind our risks and costs.

Organization and structure

Robust risk governance and accountability are embedded throughout the bank, fostering a continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions.

Our risk governance framework ensures accountability for the effective management of risk by the bank. The framework is integrated with the HSBC Group risk governance framework adding additional layers of oversight.

Risk governance from a corporate perspective is structured so that it is positioned at the uppermost level of the bank. The Board, assisted by the ARC, is responsible for overseeing a strong risk culture that is conservative yet competitive. On advice of the RMC and the ARC, the Board provides the risk discipline and structure necessary to achieve business objectives that align with risk strategy. Regular and timely communication between the Board and executive management ensures that key risks are identified and key information is shared regularly.

Three lines of defense

The risk governance framework is based on a risk management and internal control structure referred to as the 'three lines of defence' to ensure we achieve our commercial aims while meeting regulatory and legal requirements. It is a key part of our operational risk management framework. Refer to operational risk within this section for further information.

People

All staff play a role in the management of risk. They are required to identify, assess and manage risk within the scope of their assigned responsibilities, and as such they form part of the three lines of defence. Our Global Standards set the tone and are central to our approach to balancing risk and reward. Personal accountability is reinforced by our HSBC Values.

A suite of mandatory training on a range of critical risk and compliance topics helps to embed and strengthen the risk culture within HSBC. This training, which is updated regularly, ensures a clear and consistent message is communicated to staff. It covers technical aspects of the various risks assumed in the course of business and how these risks should be managed effectively, and serves to reinforce our attitude to risk and the behaviours expected of staff as described in our Global Standards and risk policies. Staff is supported by a disclosure line which enables them to raise concerns confidentially.

Our risk culture is reinforced by our approach to remuneration. Individual awards are based on compliance with HSBC Values and the achievement of financial and non-financial objectives which are aligned to our strategy.

Risk management processes and procedures

Risk management within the bank is driven by the following four processes:

- risk identification;
- risk appetite;
- mapping our risk profile; and
- stress testing.

Risk identification

We identify and monitor risks continuously. This process and the results of our stress testing program, give rise to the classification of certain key risks as top or emerging. Changes in our assessment of top and emerging risks may result in adjustments to our risk appetite and, potentially, our business strategy.

Primary risk categories monitored include credit, liquidity and funding, market, operational and reputational risk. Operational risk encompasses a wide range of risks including compliance, legal, security and fraud, and fiduciary risk.

Risk appetite

The Risk Appetite Statement describes the types and levels of risk that we are prepared to accept in executing our strategy. The Statement is approved by the ARC on the advice of the RMC. It is a key component of our risk management framework and informs our annual operating plan.

Global lines of business are required to align their risk appetite statements with the bank's overall risk appetite statement.

Quantitative and qualitative metrics are assigned to key categories. Measurement against the metrics:

- guides underlying business activity, ensuring it is aligned to risk appetite statements;
- informs risk-adjusted remuneration;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identifies business decisions needed to mitigate risk.

Mapping our risk profile

Risks are assumed by our Global lines of business in accordance with their risk appetite and are managed at both the bank and the Global line of business level. All risks are recorded and monitored through our risk mapping process, which describes our risk profile by category.

Stress testing

Our stress testing and scenario analysis program is central to our risk management.

We conduct stress-testing scenarios which reflect our business strategy and resultant risk exposures. The results of the stress tests are used to assess the potential demand for regulatory capital under the various scenarios including but not limited to adverse macro-economic events, catastrophic events and a variety of projected operational risk events. We also participate, where appropriate, in scenario analyses requested by regulatory bodies.

The results of scenarios subject to stress testing in 2013 demonstrated that the bank would remain satisfactorily capitalized after taking account of assumed management actions.

Credit risk

Credit risk is the risk of financial loss if a customer or counterparty fails to an obligation under contract. It arises principally from direct lending, trade finance and the leasing business, but also from other products such as guarantees and credit derivatives and from holding assets in the form of debt securities.

Credit risk management

The bank's principal objectives of credit risk management are:

- to maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;
- to both partner with and challenge businesses in defining and implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and
- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

Credit risk is managed in accordance with the bank's credit policy, which is established in consultation with HSBC Group and approved by the ARC. Risk limits and credit authorities are delegated to senior credit management staff. 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 and ARC meet regularly to review portfolio credit quality, geographic, product and industry distributions, large customer concentrations, adequacy of loan impairment allowances and rating system performance. Policies relating to large customer limits and industry, product and geographic concentration are approved by the ARC, 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 ARC. The appetite for credit risk is expressed through portfolio level limits on specific segments, e.g. commercial real estate, as well as through Commercial and Personal Lending Guidelines that conform with HSBC Group guidelines. These are disseminated throughout our business along with various credit manuals. The ARC is advised of any material changes in guidelines through the quarterly monitoring process noted above.

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 to ensure all our policies, guidelines, practices, conditions and terms are followed.

We manage real estate lending within well-defined parameters, with an emphasis on relationship and project sponsorship for all new transactions. We are actively managing the exposure level and composition of this portfolio given its concentration in our credit portfolio.

Where we are dependent upon third-parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

Maximum exposure to credit risk

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.

Maximum exposure to credit risk (Audited)

	2013	2012
	$m	$m
On-balance sheet		
Balances at central bank	**100**	4
Items in the course of collection from other banks	**107**	90
Trading assets	**6,728**	5,250
Treasury and other eligible bills	**467**	308
Debt securities	**2,528**	2,092
Equity securities	**–**	20
Customer trading assets	**885**	262
Bankers acceptances	**2,848**	2,590
Less: securities not exposed to credit risk	**–**	(22)
Derivatives	**2,112**	1,810
Loans and advances held at amortized cost	**47,833**	47,052
Loans and advances to banks	**1,482**	1,480
Loans and advances to customers	**46,351**	45,572
Financial investments – available for sale	**21,805**	20,402
Treasury and other similar bills	**799**	2,308
Debt securities	**21,010**	18,103
Equity securities	**5**	–
Less: Securities not exposed to credit risk	**(9)**	(9)
Other assets		
Customers' liability under acceptances	**4,757**	4,737
Accrued income and other	**285**	290
Total on-balance sheet	**83,727**	79,635
Off-balance sheet		
Financial guarantees	**3,940**	3,083
Loan and other credit-related commitments	**35,128**	36,918
Total maximum exposure to credit risk	**122,795**	119,636

Loan portfolio diversity

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. Diversification of credit risk is a key concept by which we are guided.

In assessing and monitoring for credit risk concentration, we aggregate exposures by product type, industry and geographic area as presented in the tables below. Exposures are measured at exposure at default ('EAD'), which reflects drawn balances as well as an allowance for undrawn amounts of commitments and contingent exposures, and therefore would not agree to the financial statements.

Wholesale loan portfolio by geographic area (Audited)

	EAD **2013** **$m**	*EAD* 2012 $m
Sovereign		
Canada	**19,929**	17,795
United States of America	**851**	684
Other	**2,211**	1,712
	22,991	20,191
Banks		
Canada	**2,509**	2,875
United States of America	**1,440**	1,082
Other	**2,220**	2,145
	6,169	6,102
Corporate		
Canada		
British Columbia	**11,551**	11,725
Ontario	**11,800**	11,009
Alberta	**10,565**	10,556
Quebec	**5,693**	5,346
Saskatchewan and Manitoba	**1,047**	1,009
Atlantic provinces	**716**	719
United States of America	**812**	369
Other	**269**	199
	42,453	40,932
Total wholesale loan portfolio exposure	**71,613**	67,225

Wholesale loan portfolio by industry sector (Audited)

	EAD **2013** **$m**	*EAD* 2012 $m
Sovereign	**22,991**	20,191
Banks	**6,169**	6,102
Corporate		
Real estate	**7,718**	7,812
Energy	**7,362**	6,904
Manufacturing	**4,845**	4,540
Finance and insurance	**3,943**	3,032
Wholesale trade	**3,679**	3,667
Services	**2,728**	2,856
Transport and storage	**2,114**	1,989
Business services	**2,073**	1,969
Mining, logging and forestry	**1,911**	1,589
Construction services	**1,705**	1,567
Automotive	**1,251**	1,641
Retail trade	**1,149**	1,288
Hotels and accommodation	**805**	903
Agriculture	**769**	764
Sole proprietors	**378**	369
Government services	**23**	42
	42,453	40,932
Total wholesale loan portfolio exposure	**71,613**	67,225

Loan portfolio by product type (Audited)

	EAD **2013** **$m**	*EAD* 2012 $m
Wholesale loan portfolios		
Sovereign		
Drawn exposures	**22,696**	20,083
Undrawn commitments	**17**	29
Derivatives	**278**	79
	22,991	20,191
Banks		
Drawn exposures	**3,275**	3,591
Repurchase type transactions	**16**	37
Derivatives	**2,409**	2,127
Other off-balance sheet exposures	**469**	347
	6,169	6,102
Corporate		
Drawn exposures	**26,456**	26,330
Undrawn commitments	**11,636**	11,124
Repurchase type transactions	**133**	131
Derivatives	**1,278**	1,070
Other off-balance sheet exposures	**2,950**	2,277
	42,453	40,932
Total wholesale loan portfolio	**71,613**	67,225
Retail loan portfolios		
Residential mortgages	**17,347**	17,850
Home equity lines of credit	**4,916**	5,543
Personal unsecured revolving loan facilities	**1,060**	1,127
Other personal loan facilities	**2,600**	2,827
Other small to medium enterprises loan facilities	**624**	746
Run-off consumer loan portfolio	**1,867**	2,319
Total retail loan portfolio	**28,414**	30,412
Total loan portfolio exposure	**100,027**	97,637

Large customer concentrations

We monitor and manage credit risk from large customer concentrations, which we define as borrowing groups where approved facilities exceed 10% of our regulatory capital base, or $553m at 31 December 2013 (2012: $588m). At 31 December 2013, the aggregate approved facilities from large customers was $22,143m (2012: $16,474m), an average of $963m (2012: $867m) per customer. The increase in the average approved facilities from large customers comprised primarily of increased facilities to Canadian provinces and to Canadian chartered banks.

Collateral and other credit enhancements

Although collateral can be an important mitigant of credit risk, it is the bank's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, some facilities may be unsecured. However, for other lending a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilize the collateral as a source of repayment.

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.

Credit quality

The bank uses the classification as outlined in the table below to measure the quality of its loans and advances.

Credit quality classification

		Wholesale lending		**Retail lending**	
Quality classification	*External credit rating*	*Internal credit rating*	*12 month probability of default %*	*Internal credit rating*	*Expected loss %*
Strong	A– and above	CRR1 to CRR2	0–0.169	EL1 to EL2	0–0.999
Good	BBB+ to BBB–	CCR3	0.170–0.740	EL3	1.000–4.999
Satisfactory	BB+ to B+	CCR4 to CCR5	0.741–4.914	EL4 to EL5	5.000–19.999
Sub-standard	B to C	CRR6 to CRR8	4.915–99.999	EL6 to EL8	20.000–99.999
Impaired	Default	CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted

Credit quality of wholesale portfolio (Audited)

	2013			2012		
	EAD Drawn **$m**	*EAD Undrawn* **$m**	*EAD Total* **$m**	*EAD Drawn* $m	*EAD Undrawn* $m	*EAD Total* $m
Strong	**33,220**	**3,320**	**36,540**	29,726	2,656	32,382
Good	**16,049**	**6,014**	**22,063**	13,843	5,745	19,588
Satisfactory	**9,157**	**2,065**	**11,222**	11,110	2,615	13,725
Sub-standard	**1,180**	**224**	**1,404**	880	137	1,017
Impaired	**354**	**30**	**384**	513	–	513
	59,960	**11,653**	**71,613**	56,072	11,153	67,225

Credit quality of retail portfolio (Audited)

	2013			2012		
	EAD Drawn **$m**	*EAD Undrawn* **$m**	*EAD Total* **$m**	*EAD Drawn* $m	*EAD Undrawn* $m	*EAD Total* $m
Strong	**10,586**	**829**	**11,415**	10,721	810	11,531
Good	**10,148**	**3,904**	**14,052**	11,093	4,200	15,293
Satisfactory	**1,842**	**269**	**2,111**	2,226	304	2,530
Sub-standard	**631**	**86**	**717**	772	96	868
Impaired	**119**	**–**	**119**	190	–	190
	23,326	**5,088**	**28,414**	25,002	5,410	30,412

The overall credit quality at 31 December 2013 improved compared with 2012 as a result of a 3.3% movement from satisfactory to good and strong categorized loans and advances. The improvement was primarily driven by the wholesale portfolio as the result of refocussing the business on existing high quality relationships and a more selective risk appetite. In addition contributing to the improvement was our retail portfolio primarily as a result of the run-off consumer finance portfolio and the sale of the private label credit card portfolio in the third quarter of 2013.

Renegotiated loans

The carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated was $237m at 31 December 2013 (2012: $266m).

Loans past due but not impaired

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.

Days past due but not impaired loans and advances (Audited)

	2013 **$m**	2012 $m
Up to 29 days	**546**	626
30–59 days	**93**	146
60–89 days	**28**	72
90–179 days	**–**	35
Over 180 days	**8**	10
	675	889

Impaired loans and allowance for credit losses

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

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 financial assets (Audited)

	EAD **2013** **$m**	*EAD* 2012 $m
Impaired wholesale portfolio[1]		
Real estate	**121**	221
Energy	**53**	55
Construction services	**33**	31
Manufacturing	**27**	27
Wholesale trade	**22**	38
Agriculture	**19**	16
Automotive	**18**	21
Hotels and accommodation	**17**	15
Mining, logging and forestry	**15**	8
Business services	**13**	6
Sole proprietors	**13**	14
Transportation and storage	**13**	38
Services	**12**	15
Finance and insurance	**5**	–
Retail trade	**3**	8
Total impaired wholesale portfolio	**384**	513
Impaired retail portfolio		
Residential mortgages	**77**	117
Other retail loans	**18**	23
Run off consumer finance portfolio	**24**	50
Total impaired retail portfolio	**119**	190
Total impaired financial assets	**503**	703

[1] *Includes $19m (2012: $7m) of impaired acceptances, letters of credit and guarantees*

Impairment allowances (Audited)

	2013 $m	2012 $m
Gross loans and advances to customers		
Individually assessed impaired loans and advances[1] (A)	**445**	685
Collectively assessed loans and advances (B)	**46,269**	45,306
– impaired loans and advances[1]	**101**	166
– non-impaired loans and advances	**46,168**	45,140
Total gross loans and advances to customers (C)	**46,714**	45,991
Less: impairment allowances (c)	**363**	419
– individually assessed (a)	**157**	202
– collectively assessed (b)	**206**	217
Net loans and advances to customers	**46,351**	45,572
Individually assessed impaired loans and advances coverage		
– (a) as a percentage of (A)	**35.3%**	29.5%
Collectively assessed loans and advances coverage		
– (b) as a percentage of (B)	**0.4%**	0.5%
Total loans and advances coverage		
– (c) as a percentage of (C)	**0.8%**	0.9%

[1] *Includes restructured loans with a higher credit quality than 'impaired' and for which there is insufficient evidence to demonstrate: a significant reduction in the risk of non-payment of future cash flows, or the absence of other indicators of impairment.*

Movement in impairment allowances and provision for credit losses (Audited)

	2013			
	Customers individually assessed **$m**	*Customers collectively assessed* **$m**	*Provision for credit losses* **$m**	*Total* **$m**
Opening balance at the beginning of the year	**202**	**217**	**80**	**499**
Movement				
Loans and advances written off net of recoveries of previously written off amounts[1]	**(167)**	**(80)**	**–**	**(247)**
Charge/(release) to income statement	**138**	**69**	**(19)**	**188**
Reclassified as held for sale	**–**	**–**	**–**	**–**
Interest recognized on impaired loans and advances	**(16)**	**–**	**–**	**(16)**
Other movements	**–**	**–**	**–**	**–**
Closing balance at the end of the year	**157**	**206**	**61**	**424**

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	2012			
	Customers individually assessed $m	*Customers collectively assessed* $m	*Provision for credit losses* $m	*Total* $m
Opening balance at the beginning of the year	208	256	73	537
Movement				
Loans and advances written off net of recoveries of previously written off amounts[1]	(91)	(118)	–	(209)
Charge to income statement	103	99	8	210
Reclassified as held for sale	–	(22)	–	(22)
Interest recognized on impaired loans and advances	(18)	–	–	(18)
Other movements	–	2	(1)	1
Closing balance at the end of the year	202	217	80	499

[1] *Recovered $6m (2012: $4m) of loans and advances written off in prior periods.*

Derivative portfolio

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.

Credit equivalent amount of our derivative portfolio (Audited)

	2013 **$m**	2012 $m
Interest rate contracts	**1,076**	1,101
Foreign exchange contracts	**2,811**	2,080
Commodity contracts	**78**	94
Net credit equivalent amount	**3,965**	3,275

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

Area of special interest: exposures to core and peripheral eurozone countries

Our exposure to core and peripheral eurozone remains within the bank's overall risk appetite. Exposures to peripheral eurozone countries increased by $134m compared with the position at 31 December 2012, of which $67m is held with other HSBC Group affiliates.

Exposures to core and peripheral eurozone countries (Audited)

	2013			2012		
	Financial institutions[1]	*Sovereign*	*Total*	*Financial institutions*[1]	*Sovereign*	*Total*
	$m	**$m**	**$m**	$m	$m	$m
Core countries						
Germany	**326**	**205**	**531**	326	–	326
France	**215**	**258**	**473**	316	156	472
Total core countries	**541**	**463**	**1,004**	642	156	798
Peripheral countries						
Greece	**3**	**–**	**3**	–	–	–
Italy	**60**	**–**	**60**	12	–	12
Portugal	**6**	**–**	**6**	1	–	1
Spain	**86**	**–**	**86**	8	–	8
Total peripheral countries	**155**	**–**	**155**	21	–	21
Total	**696**	**463**	**1,159**	663	156	819

[1] *Exposures with financial institutions include exposures with other HSBC Group affiliates of $3m in Germany, $29m in France, $64m in Spain and $3m in Greece (31 December 2012: $3m in Germany, $8m in France and $7m in Spain).*

Liquidity and funding risk

Liquidity risk is the risk that the bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Liquidity and funding risk management

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.

The ARC is responsible for defining the bank's liquidity risk tolerances within the HSBC Group's liquidity risk framework, which mandates that each site manages its liquidity and funding on a self-sustaining basis. The ARC also reviews and approves the bank's liquidity and funding policy and is responsible for its oversight.

The bank's Asset and Liability Committee ('ALCO') is responsible for the development of policies and practices to manage liquidity and funding risk. Its mandate is established by HSBC Group policy, the ARC, and the bank's RMC.

ALCO is responsible for the oversight of liquidity and funding risk management, establishing liquidity risk parameters, and monitoring metrics against risk appetite, funding costs, and early warning indicators of a liquidity stress. ALCO is also responsible for ensuring the operational effectiveness of the bank's liquidity contingency plan.

The management of liquidity and funding is carried out by our Balance Sheet Management group in accordance with practices and limits approved by ALCO, the ARC and HSBC Group. Compliance with policies is monitored by ALCO.

The objective of our liquidity framework is to allow us to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations.

Our liquidity and funding risk management framework requires:

- liquidity to be managed on a stand-alone basis with no implicit reliance on the HSBC Group or central banks;
- compliance with the limit for the advances to core funding ratio; and
- maintaining cumulative positive cash flows in each time band within the specified time horizons in respect of idiosyncratic and market-wide stress scenarios, respectively.

Our liquidity and funding management processes include:

- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring the 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 regulation

In 2010, the Basel Committee on Banking Supervision ('BCBS') published a framework document prescribing two liquidity standards: the liquidity coverage ratio ('LCR') and the net stable funding ratio ('NSFR'), together referred to as the Basel liquidity standards. The LCR estimates the adequacy of liquidity over a 30 day stress period. The NSFR estimates the extent to which assets are funded by longer-term stable liabilities.

In January 2013, the BCBS released its final rules for LCR. In January 2014, the BCBS issued a consultation document on a revised framework for the NSFR.

In November 2013, OSFI issued a draft guideline Liquidity Adequacy Requirements. The guideline, expected to be finalized in 2014, incorporates the Basel liquidity standards, introduces a suite of additional liquidity monitoring tools, and formalizes OSFI's use of the Net Cumulative Cash Flow ('NCCF') supervisory tool. According to the draft guideline, LCR and NCCF will be in force as of 1 January 2015. NSFR is expected to follow the BCBS implementation timelines in 2018.

Advances to core funding ratio

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 or long-term debt funding with a residual maturity beyond one year. 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 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.

The distinction between core and non-core deposits generally means that the bank's measure of advances to core funding is more restrictive than that which could be inferred from the published financial statements.

Advances to core funding ratio (Unaudited)

	2013 **%**	2012 %
Year-end	**93**	96
Maximum	**100**	96
Minimum	**93**	90
Average	**96**	94

Stress testing

The bank runs a range of stressed cash flow scenarios as its primary liquidity risk measures, spanning various idiosyncratic and market-wide stress scenarios. Stressed cash flow scenarios are further supplemented by regular enterprise-wide stress testing and reverse stress testing. The results of all liquidity stress tests are reviewed and monitored by ALCO.

We would meet any unexpected cash outflows primarily from our cash, by selling or entering into repurchase agreements ('repos') with the securities assessed as liquid assets, and by maturing interbank loans and reverse repos. In general, customer advances are assumed to be renewed and as a result are not assumed to generate a stressed cash inflow or represent a liquidity resource.

Contingent liquidity risk is the risk associated with the need to provide additional funds to clients. We include estimates of contingent liquidity cash outflows within all stressed cash flow scenarios.

The stressed coverage ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons. Inflows included in the numerator of the stressed coverage ratio are those that are assumed to be generated from monetization of liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the stressed cash flow horizon and not already reflected as a monetization of a liquid asset.

Stressed one-month coverage ratios (Unaudited)

	2013	2012
	%	%
Year-end	**137**	136
Maximum	**137**	142
Minimum	**120**	125
Average	**130**	136

Stressed three-month coverage ratios (Unaudited)

	2013	2012
	%	%
Year-end	**118**	116
Maximum	**118**	122
Minimum	**110**	106
Average	**113**	114

Liquid Assets

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorized as liquid used for the purpose of calculating one and three month stressed coverage ratio.

Any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, as these assets are reflected as contractual cash inflows. All assets held within the liquid asset portfolio are unencumbered.

Estimated liquidity value (Unaudited)

	2013	2012
	\$m	\$m
Level 1[1]	**17,955**	15,955
Level 2[2]	**3,960**	3,280
	21,915	19,235

[1] *Includes debt securities of central governments, central banks, supranationals and multilateral development banks.*
[2] *Includes debt securities of local and regional governments, public sector entities and secured covered bonds.*

Net contractual cash flows

The following table quantifies the contractual cash flows from interbank and intra-Group loans and deposits, and reverse repo, repo (including intergroup transactions) and short positions. These contractual cash inflows and outflows are reflected gross in the numerator and denominator, respectively, of the one and three-month stressed coverage ratios and should be considered alongside the level of liquid assets.

Cash flows within three months (Unaudited)

	2013 **$m**	2012 $m
Interbank and intra-Group loans and deposits	**855**	(573)
Reverse repo, repo and outright short positions (including intra-Group)	**1,057**	(750)

Contingent liquidity risk arising from committed lending facilities

The bank provides commitments to various counterparts. In terms of liquidity risk, the most significant risk relates to committed lending facilities which, whilst undrawn, give rise to contingent liquidity risk, as these could be drawn during a period of liquidity stress. Commitments are given to customers and committed lending facilities are provided to conduits, established to enable clients to access a flexible market-based source of finance.

The table below shows the level of undrawn commitments outstanding to conduits and customers for the five largest single facilities and the largest market sector.

The bank's contractual undrawn exposures monitored under the contingent liquidity risk structure (Unaudited)

	2013 **$m**	2012 $m
Commitments to conduits		
Total lines	**1,035**	940
Largest individual lines	**765**	765
Commitments to customers		
Five largest	**1,553**	1,733
Largest market sector	**3,644**	4,434

Sources of funding

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, so that undue reliance is not placed on any one source of funding.

No reliance is placed on unsecured money market wholesale funding as a source of core funding. Only wholesale funding with a residual term to maturity of one year or greater is counted towards the core funding base. In addition, our stress testing assumptions require an equivalent amount of liquid assets to be held against wholesale funding maturing within the relevant stress testing horizon.

Cash flows payable by the bank under financial liabilities by remaining contractual maturities (Audited)

	On demand and due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*	*Total*
	$m	$m	$m	$m	$m
At 31 December 2013					
Deposits by banks	1,209	–	–	–	1,209
Customer accounts	40,906	8,087	3,062	–	52,055
Trading liabilities	4,396	–	–	–	4,396
Financial liabilities designated at fair value	5	14	59	429	507
Derivatives	23	8	134	29	194
Debt securities in issue	1,791	1,831	7,109	1,404	12,135
Subordinated liabilities[1]	3	8	27	256	294
Other financial liabilities	4,835	69	1,722	–	6,626
	53,168	10,017	12,113	2,118	77,416
Loan commitments	34,900	155	74	–	35,129
Financial guarantee contracts	410	478	640	–	1,528
	88,478	10,650	12,827	2,118	114,073

[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.

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.

Trading derivatives and trading liabilities 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.

Furthermore, loan commitments and financial guarantee contracts are not recognized on the statement of financial position. The undiscounted cash flows potentially payable under financial guarantee contracts are classified on the basis of the earliest date they can be drawn down.

Encumbered assets

In the normal course of business, the bank will pledge or otherwise encumber assets. The pledging of assets will occur to meet the bank's payments and settlement system obligations, as security in a repurchase transaction, to support secured debt instruments or as margining requirements. Limits are in place to control such pledging.

The bank actively monitors its pledging positions. Encumbered assets are not counted towards the bank's liquid assets used for internal stress testing scenarios. We further estimate the impact of credit rating downgrade triggers, and exclude the estimated impact from liquid assets within the bank's liquidity stress testing scenarios.

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 statement of financial position, such as those relating to operating leases.

Summary of future contractual payments (Audited)

	Less than 1 year $m	*1 to 5 years* $m	*After 5 years* $m	*Total* $m
At 31 December 2013				
Subordinated debentures[1]	–	–	639	639
Operating leases	50	143	71	264
Committed purchase obligations	219	345	1	565
Unsecured long-term funding[1]	1,041	4,753	1,355	7,149
Total contractual obligations	1,310	5,241	2,066	8,617

[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.

Market risk

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.

Market risk management

The objective of market risk management is to identify, measure and control market risk exposures in order to optimize return on risk and to remain within the bank's risk appetite.

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.

Market risk is managed through strategies in accordance with policies and risk limits set out by RMC 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 RMC 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, credit spread limits, and issuer limits.

Value at risk

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, credit spreads, 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 one percent 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.

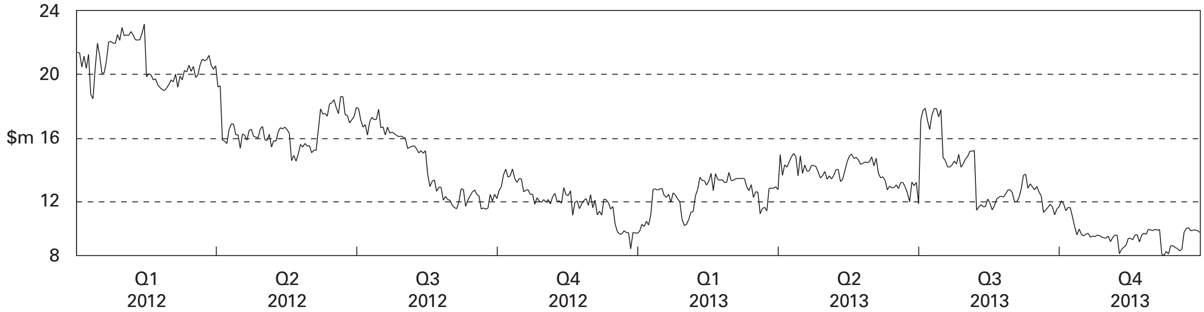
In 2010, the HSBC Group's policy regarding the VaR calculation was expanded to include Idiosyncratic Credit VaR ('ICVaR') from trading positions. ICVaR captures the residual market risk of a specific issuer that is not captured in the historical simulation credit VaR. Effective 1 January 2013, the bank has included ICVaR within the VaR information presented in the table and graph below.

VaR disclosed in the table and graph below is the bank's total VaR for both trading and non-trading books and remained within the bank's limits. The increase in VaR during July 2013, was due a temporary widening in credit spreads effecting credit VaR.

Summary VaR information (Unaudited)

	2013 **$m**	2012 $m
End of year	**10**	10
Average	**12**	16
Minimum	**8**	9
Maximum	**18**	23

Daily VaR (Unaudited)



Reputational risk

Reputational risk encompasses negative reaction not only to activities which may be illegal or against regulations, but also to activities that may be counter to societal standards, values and expectations. It can arise from a wide variety of causes including how we conduct our business and the way in which clients to whom we provide services conduct themselves.

Reputational risk is measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees. It is managed by every member of staff and is covered by a number of policies and guidelines.

Each of the lines of business is required to have a procedure to assess and address reputational risks potentially arising from proposed business transactions and client activity. Potential risks are directed to the RMC for review. Where necessary, the RMC reports reputational risks to the ARC quarterly.

Reputational risks are considered and assessed by the ARC, RMC and senior management during the formulation of policy and the establishment of our standards. These polices are communicated through manuals and statements of policy through internal communications and training. The policies set out our risk appetite and operational procedures in all areas of reputation risk, including money laundering deterrence, counterterrorist financing, environmental impact, anti-bribery and corruption measures and employee relations.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk is relevant to every aspect of our business, and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorized activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimizing operational risk lies with the bank's management and staff. Each business unit and functional head is required to maintain oversight over the operational risks and internal controls for the business and operational activities that they are responsible for.

Operational risk management framework

The Operational Risk function and the operational risk management framework ('ORMF') assist business management in discharging their responsibilities. The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control in our businesses and functions.

To implement the ORMF a 'three lines of defence' model is used for the management of risk, as described below:

– *First line of defence:* Every employee is responsible for the risks that are a part of their day-to-day jobs. The first line of defence ensures all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment.

– *Second line of defence:* Consists of Functions such as Risk, Finance and Human Resources who are responsible for providing assurance, challenge and oversight of the activities conducted by the first line.

– *Third line of defence:* Internal Audit provides independent assurance over the first and second lines of defence.

The ORMF has been codified in a high level standards manual supplemented with detailed policies, which describe our approach to identifying, assessing, monitoring and controlling operational risk and give guidance on mitigating action to be taken when weaknesses are identified.

Business and Functional management is responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational incident information. A centralized database is used to record the results of the operational risk management process. Significant improvement has been made in strengthening the first line of defence via enhancement of the Business Risk and Control Management ('BRCM') network. BRCMs act as risk and control subject matter experts for Businesses and Functions. They assist management in developing risk and control assessments and developing and executing key control monitoring to confirm the continued operation of key controls to management. They are responsible for reporting issues identified through risk and control monitoring and testing, reviewing adequacy of action plans and progress monitoring of remediation plans to closure.

An Operational Risk and Internal Control function, reporting to the Chief Risk Officer, provides end-to-end oversight, challenge and review of the ORMF. The function works closely with the Bank's Operational Risk and Internal Control Committee (an authorized subcommittee of the RMC), whose mission is to provide governance and strategic oversight of the bank's operational risk management framework. We actively manage operational risk to reduce exposure to events that could lead to negative impacts.

We continued to enhance our ORMF policies and procedures in 2013 and undertook various activities to further embed the use of the framework in the management of the business. Articulating our risk appetite for material operational risks helps business understand the level of risk our organization is willing to accept. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a more forward-looking manner and assists management in determining whether further action is required.

Compliance risk

Compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence. We have committed to adopt and enforce industry leading compliance standards and one of the ways to achieve this is to ensure that we put in place a robust compliance risk management infrastructure.

In 2013 we commenced the restructuring of our previous Compliance sub-function within Risk into two new sub-functions: Financial Crime Compliance and Regulatory Compliance. This restructuring is ongoing and will allow us to:

– manage different types of regulatory and financial crime compliance risk more effectively;

– focus our efforts appropriately in addressing issues highlighted by regulatory investigations and reviews, internal audits and risk assessments of our past business activities; and

– ensure we have in place clear, robust accountability and appropriate expertise and processes for all areas of compliance risk.

Financial Crime Compliance will focus on setting policy and managing risks in the following areas:

– anti-money laundering, counter terrorist financing and proliferation finance;

– sanctions; and

– anti-bribery and corruption.

Regulatory Compliance will focus on setting policy and managing risks in the following areas:

– conduct of business;

– market conduct; and

– general regulatory compliance management including stakeholder support.

Legal risk

Legal risk includes:

– contractual risk, which is the risk that the rights and/or obligations of the bank within a contractual relationship are defective;

– dispute risk, which is made up of the risks that the bank is subject to when it is involved in or managing a potential or actual dispute;

– legislative risk, which is the risk that the bank fails to adhere to the laws of the jurisdictions in which it operates; and

– non-contractual rights risk, which is the risk that the bank's assets are not properly owned or are infringed by others, or the bank infringes on another party's rights.

Our legal function assists management in controlling legal risk.

Security and fraud risk

Security and fraud risk includes: Fraud Risk, Information Security Risk, and Business Continuity.

The Fraud Risk function is responsible for ensuring that effective protection measures are in place against all forms of fraudulent activity, whether initiated internally or externally, and is available to support any part of the business. To achieve that and to attain the level of integration needed to face the threat, the management of all types of fraud (e.g. card fraud, non-card fraud and internal fraud, including investigations), is established within one management structure and is part of the overall Risk function. We have increased monitoring, root cause analysis and review of internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. Security and Fraud Risk is working closely with the businesses to continually assess fraud threats as they evolve and adapt our controls to mitigate these risks. We have developed a holistic and effective anti-fraud strategy comprising fraud prevention policies and practices, the implementation of strong internal controls, and investigations response team and liaison with law enforcement where appropriate.

Information Security Risk protects bank information assets against the risk of loss, operational discontinuity, misuse, unauthorized disclosure, inaccessibility and damage. It also protects against the ever-increasing potential for civil or legal liability that the bank could face as a result of information inaccuracy and loss, or the absence of due care in its protection. Information Security Risk covers all information processes, physical and electronic, regardless of whether they involve people and technology or relationships with trading partners, customers and third parties. Information Security Risk addresses information protection, confidentiality, availability and integrity throughout the life cycle of the information and its use within the bank. The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand.

The Business Continuity Management function is responsible for ensuring that our businesses and functions have the resilience to maintain continuity in the face of major disruptive events. Within this wider risk, Business Continuity Management pre-plans and considers strategies to minimize the adverse effects of major business disruption against a range of actual or emerging risks. The pre-planning concentrates on the protection of customer services, our staff, reputation, revenue generation and the integrity of data and documents. Each business and function has its own recovery plan, which is developed following the completion of a Business Impact Analysis. This determines how much time the business could sustain an outage before the level of losses becomes unacceptable, i.e. its criticality. These plans are reviewed and tested every year. The planning is undertaken against Group policy and standards and each business confirms in an annual compliance certificate that all have been met. Should there be exceptions, these are raised and their short-term resolution is overseen by Group and regional business continuity teams.

Fiduciary risk

Fiduciary risk is the risk of breaching fiduciary duties where we act in a fiduciary capacity. It is the risk associated with failing to offer services honestly and properly to clients in that capacity. We define a fiduciary duty as any duty where we hold, manage, oversee or have responsibilities for assets of a third party that involves a legal and/or regulatory duty to act with the highest standard of care and with utmost good faith. A fiduciary must make decisions and act in the best interests of the third parties and must place the wants and needs of the client first, above the needs of the organization.

Fiduciary risk is managed within the designated businesses via a policy framework and monitoring of key indicators. The bank's principal fiduciary businesses (designated businesses) are:

– HSBC Trust Company (Canada), where it is exposed to fiduciary risk via trustee's responsibilities, and

– HSBC Global Asset Management (Canada) Limited, which is exposed to fiduciary risks via its investment management activities on behalf of clients.

Factors that may affect future results

The risk management section in the MD&A describes the most significant risks to which the bank is exposed and if not managed appropriately could have a material impact on our future financial results. This section outlines additional factors which may affect future financial results.

General economic and market conditions

Factors such as the general health of capital and/or credit markets, including liquidity, level of activity, volatility and stability, could have a material impact on our business. As well, interest rates, foreign exchange rates, consumer saving and spending, housing prices, consumer borrowing and repayment, business investment, government spending and the rate of inflation affect the business and economic environment in which we operate.

In addition, the financial services industry is characterized by interrelations among financial services companies. As a result, defaults by other financial services companies could adversely affect our earnings. Given the interconnectedness of global financial markets and the importance of trade flows, deterioration of the still-unresolved European sovereign debt situation could affect the supply and cost of credit and constrain the pace of economic growth in Canada.

Fiscal, monetary and interest rate policies

Our earnings are affected by fiscal, monetary, interest rate and economic policies that are adopted by Canadian regulatory authorities in Canada. Such policies can have the effect of increasing or reducing competition and uncertainty in the markets. Such policies may also adversely affect our customers and counterparties, causing a greater risk of default by these customers and counterparties. As well, expectations in the bond and money markets about inflation and central bank monetary policy have an impact on the level of interest rates. Changes in market expectations and monetary policy are difficult to anticipate and predict. Fluctuations in interest rates that result from these changes can have an impact on our earnings. The current prolonged low interest rate policies have had a negative impact on results and a continuation of such policies would likely continue to pressure earnings.

Changes in laws, regulations and approach to supervision

Regulators in Canada are very active on a number of fronts, including consumer protection, capital markets activities, anti-money laundering, and the oversight and strengthening of risk management. Regulations are in place to protect our customers and the public interest. Considerable changes in laws and regulations that relate to the financial services industry have been proposed and enacted, including changes related to capital and liquidity requirements. Changes in laws and regulations, including their interpretation and application, and changes in approaches to supervision could adversely affect our earnings. For example, such changes could limit the products or services we can provide and the manner in which we provide them and, potentially, lower our ability to compete, while also increasing the costs of compliance.

As such, they could have a negative impact on earnings and return on equity. These changes could also affect the levels of capital and liquidity we choose to maintain.

In addition to the factors outlined here, our failure to comply with laws and regulations could result in sanctions and financial penalties that could adversely affect our strategic flexibility, reputation and earnings.

Level of competition

The level of competition among financial services companies is high. Furthermore, non-financial companies have increasingly been offering services traditionally provided by banks. Customer loyalty and retention can be influenced by a number of factors, including service levels, prices for products or services, our reputation and the actions of our competitors. Changes in these factors or any subsequent loss of market share could adversely affect our earnings.

Changes to our credit rating

Credit ratings are important to our ability to raise both capital and funding to support our business operations. Maintaining strong credit ratings allows us to access the capital markets at competitive pricing. Should our credit ratings experience a material downgrade, our costs of funding would likely increase significantly and our access to funding and capital through capital markets could be reduced.

Operational and infrastructure risks

We are exposed to many operational risks including: the risk of fraud by employees or others, unauthorized transactions by employees, and operational or human error. We face the risk of loss due to cyber-attack and also face the risk that computer or telecommunications systems could fail, despite our efforts to maintain these systems in good working order. Some of our services (such as online banking) or operations may face the risk of interruption or other security risks arising from the risks related to the use of the internet in these services or operations, which may impact our customers and infrastructure. Given the high volume of transactions we process on a daily basis, certain errors may be repeated or compounded before they are discovered and rectified. Shortcomings or failures of our internal processes, employees or systems, or those provided by third parties, including any of our financial, accounting or other data processing systems, could lead to financial loss and damage to our reputation. In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely affected by a disruption in the infrastructure that supports both our operations and the communities in which we do business, including but not limited to disruption caused by public health emergencies or terrorist acts.

Capital

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

Our objective in the management of capital is to maintain appropriate levels of capital to support our business strategy and meet our regulatory requirements.

Capital management

The bank manages its capital in accordance with the principles contained within its capital management policy and its annual capital plan, which includes the results of its Internal Capital Adequacy Assessment Process ('ICAAP'). The bank determines an optimal amount and composition of regulatory and working capital required to support planned business growth, taking into consideration economic capital and the costs of capital, accepted market practices and the volatility of capital and business levels in its annual operating plan.

The bank maintains a capital position commensurate with its overall risk profile and control environment as determined by the ICAAP. The ICAAP supports capital management and ensures that the bank carries sufficient capital to meet regulatory requirements and internal targets to cover current and future risks; and, survive periods of severe economic downturn (stressed scenarios). The key elements of the bank's ICAAP process include: a risk appetite framework; the identification and assessment of the risks the bank is exposed to; and, an assessment of capital adequacy against regulatory requirements as well as under stressed scenarios.

Management has established appropriate governance structures and internal control to ensure the ICAAP remains effective in supporting the bank's capital management objectives.

The bank remained within its required regulatory capital limits throughout 2013.

Adoption of Basel III capital and liquidity rules

Effective 1 January 2013, the bank assesses capital adequacy against standards established in guidelines issued by the Office of the Superintendent of Financial Institutions Canada ('OSFI') in accordance with the Basel II and Basel III capital adequacy frameworks. Comparative information is presented using guidelines issued by OSFI in accordance with the Basel II capital adequacy framework and therefore is not comparable.

The Basel III capital adequacy framework significantly revises the definitions of regulatory capital and introduces the requirement that all regulatory capital must be able to absorb losses in a failed financial institution. Capital instruments issued prior to adoption that do not meet the new requirements are being phased out as regulatory capital over a ten year period from 2013 to 2022.

The framework emphasizes common equity as the predominant component of tier 1 capital by adding a minimum common equity tier 1 ('CET1') capital ratio. In addition, for the purposes of calculating CET1 capital, certain other regulatory adjustments including those relating to goodwill, intangible assets, pension assets and deferred tax assets are being phased in over a five year period from 2014 to 2018. The Basel III rules also require institutions to hold capital buffers designed to avoid breaches of minimum regulatory requirements during periods of stress.

OSFI has announced that the leverage requirement it imposes on banks – the assets-to-capital multiple – will be replaced effective January 2015 with a leverage ratio that is consistent with the leverage requirement being implemented under the Basel III framework.

In guidance issued in December 2012, OSFI established "all-in" capital targets (including capital conservation buffer) that all institutions are expected to attain or exceed early in the transition period, as follows: CET1 capital ratio of 7.0% by the first quarter of 2013, and tier 1 capital ratio of 8.5% and total capital ratio of 10.5% by the first quarter of 2014.

Regulatory capital ratios

Actual regulatory capital ratios and capital limits (Unaudited)

	Basel III[1] **2013**	*Basel II* 2012
Actual regulatory capital ratios[2]		
Common equity tier 1 capital ratio	**11.0%**	n/a
Tier 1 capital ratio	**13.2%**	13.8%
Total capital ratio	**15.0%**	16.0%
Actual assets-to-capital multiple	**15.1x**	13.1x
Required regulatory capital limits		
Minimum Common equity tier 1 capital ratio	**7.0%**	n/a
Minimum Tier 1 capital ratio[3]	**8.5%**	7.0%
Minimum Total capital ratio	**10.5%**	10.0%

[1] *Presented under a Basel III 'all-in' basis which applies Basel III regulatory adjustments from 1 January 2013, however phases out of non-qualifying capital instruments over 10 years starting 1 January 2013.*

[2] *Presented under a Basel III on a 'transitional' basis which phases in Basel III regulatory adjustments over 4 years starting 1 January 2014 and phases out of non-qualifying capital instruments over 10 years starting 1 January 2013.*

[3] *Limits are effective from 1 January 2014.*

Regulatory capital

In December 2013, the bank purchased and cancelled certain of its preferred share capital and redeemed subordinated debentures as detailed in the table below in accordance with its capital plan.

Purchase and cancelled, as well as redeemed regulatory capital instruments (Unaudited)

Instrument description	*Line item previously presented*	2012 $m
Preferred shares Class 2 – Series B	Preferred shares	346
Preferred shares of HSBC Mortgage Corporation (Canada)	Non-controlling interests	30
Subordinated debentures	Subordinated liabilities	84

Regulatory capital and risk weighted assets (Unaudited)

	Basel III[1] **2013** **$m**	*Basel II* 2012 $m
Tier 1 capital	**4,857**	5,053
Common equity tier 1 capital	**4,057**	n/a
Gross common equity[2]	**4,285**	n/a
Regulatory adjustments	**(228)**	n/a
Additional tier 1 eligible capital[3]	**800**	n/a
Tier 2 capital[4]	**677**	823
Total capital available for regulatory purposes	**5,534**	5,876
Total risk-weighted assets	**36,862**	36,668

[1] *Presented under a Basel III 'all-in' basis which applies Basel III regulatory adjustments from 1 January 2013, however phases out of non-qualifying capital instruments over 10 years starting 1 January 2013.*

[2] *Includes common share capital, retained earnings and accumulated other comprehensive income.*

[3] *Includes directly issued capital instruments and instruments issued by subsidiaries subject to phase out.*

[4] *Includes directly issued capital instruments subject to phase out and collective allowances.*

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:

	2013	2012	2011
Common shares ($m)	**360**	330	300
Preferred shares ($ per share)			
Class 1, Series C	**1.275**	1.275	1.275
Class 1, Series D	**1.250**	1.250	1.250
Class 1, Series E	**1.650**	1.650	1.650
Class 2, Series B[1]	**0.310**	0.310	0.310
HSBC HaTS™ – Series 2015 ($ per unit)	**51.50**	51.50	51.50

[1] *Preferred shares – Class 2, Series B were redeemed on 27 December 2013.*

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 condition.

The bank’s Board of Directors oversees management’s responsibilities for financial reporting through the Audit and Risk Committee, which is composed of directors who are not officers or employees of the bank. The Audit and Risk Committee reviews the bank’s interim and annual consolidated financial statements and MD&A. The committee approves the interim statements and recommends the Annual statements for approval by the Board of Directors. Other key responsibilities of the Audit and Risk 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 2013, we, the bank’s Chief Executive Officer and Chief Financial Officer, have certified the effectiveness of our internal control over financial reporting as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer’s Annual and Interim Filings).

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

Paulo Maia

Paulo Maia
President and Chief Executive Officer

Jacques Fleurant
Chief Financial Officer

Vancouver, Canada
21 February 2014

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 2013 and 31 December 2012, the consolidated income statement and statements of comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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 2013 and 31 December 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

Vancouver, Canada
21 February 2014

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Consolidated income statement

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

	Notes	**2013** **$m**	2012 $m
Interest income		**2,065**	2,236
Interest expense		**(754)**	(761)
Net interest income		**1,311**	1,475
Fee income		**694**	689
Fee expense		**(91)**	(88)
Net fee income		**603**	601
Trading income excluding net interest income		**135**	143
Net interest income on trading activities		**43**	37
Net trading income		**178**	180
Net income/(expense) from financial instruments designated at fair value		**(5)**	(27)
Gains less losses from financial investments		**58**	52
Other operating income		**16**	24
Gain on sale of full service brokerage business		**–**	88
Net operating income before loan impairment charges and other credit risk provisions		**2,161**	2,393
Loan impairment charges and other credit risk provisions		**(188)**	(211)
Net operating income	3	**1,973**	2,182
Employee compensation and benefits	4, 5	**(614)**	(659)
General and administrative expenses		**(408)**	(409)
Depreciation of property, plant and equipment		**(34)**	(35)
Amortization and impairment of intangible assets		**(14)**	(19)
Restructuring charges		**–**	(36)
Total operating expenses		**(1,070)**	(1,158)
Operating profit		**903**	1,024
Share of profit in associates		**31**	5
Profit before income tax expense		**934**	1,029
Income tax expense	6	**(247)**	(275)
Profit for the year		**687**	754
Profit attributable to common shareholders		**616**	683
Profit attributable to preferred shareholders		**61**	61
Profit attributable to shareholders		**677**	744
Profit attributable to non-controlling interests		**10**	10
Average number of common shares outstanding (000’s)		**498,668**	498,668
Basic earnings per common share		**$ 1.24**	$ 1.37

The accompanying notes and the audited sections of ‘Risk Management’ and ‘Capital’ within Management’s Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

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

	Note	**2013** **$m**	2012 $m
Profit for the year		**687**	754
Other comprehensive income			
Available-for-sale investments[1]		**(86)**	(17)
– fair value gains/(loss)		**(57)**	20
– fair value gains transferred to income statement on disposal		**(58)**	(52)
– income taxes		**29**	15
Cash flow hedges[1]		**(61)**	(141)
– fair value gains		**71**	110
– fair value gains transferred to income statement		**(153)**	(307)
– income taxes		**21**	56
Remeasurement of defined benefit plans[2]	4	**16**	(34)
– before income taxes		**21**	(46)
– income taxes		**(5)**	12
Other comprehensive loss for the year, net of tax		**(131)**	(192)
Total comprehensive income for the year		**556**	562
Total comprehensive income for the year attributable to:			
– shareholders		**546**	552
– non-controlling interests		**10**	10
		556	562

[1] *Other comprehensive income/(loss) items that can be reclassified into income.*

[2] *Other comprehensive income/(loss) items that cannot be reclassified into income.*

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated statement of financial position

At 31 December *(in millions of dollars)*

	Notes	**2013** **$m**	2012 $m
ASSETS			
Cash and balances at central bank		**165**	56
Items in the course of collection from other banks		**107**	90
Trading assets	10	**6,728**	5,272
Derivatives	11	**2,112**	1,810
Loans and advances to banks		**1,482**	1,480
Loans and advances to customers		**46,351**	45,572
Financial investments	12	**21,814**	20,411
Other assets	17	**333**	910
Prepayments and accrued income		**206**	165
Customers' liability under acceptances		**4,757**	4,737
Property, plant and equipment	15	**137**	140
Goodwill and intangible assets	18	**68**	71
Total assets		**84,260**	80,714
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks		**1,205**	2,173
Customer accounts		**51,844**	48,304
Items in the course of transmission to other banks		**53**	71
Trading liabilities	19	**4,396**	2,672
Financial liabilities designated at fair value	21	**428**	436
Derivatives	11	**1,746**	1,415
Debt securities in issue	20	**11,348**	11,980
Other liabilities	22	**2,337**	2,389
Acceptances		**4,757**	4,737
Accruals and deferred income		**551**	528
Retirement benefit liabilities	4	**271**	309
Subordinated liabilities	23	**239**	324
Total liabilities		**79,175**	75,338
Equity			
Common shares	26	**1,225**	1,225
Preferred shares	26	**600**	946
Other reserves		**134**	281
Retained earnings		**2,926**	2,694
Total shareholders' equity		**4,885**	5,146
Non-controlling interests	27	**200**	230
Total equity		**5,085**	5,376
Total equity and liabilities		**84,260**	80,714

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Approved on behalf of the Board of Directors:

Sam Minzberg

Samuel Minzberg
Chairman, HSBC Bank Canada

Paulo Maia

Paulo Maia
President and Chief Executive Officer

Consolidated statement of cash flows

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

	Note	**2013** **$m**	2012 $m
Cash flows from operating activities			
Profit before tax		**934**	1,029
Adjustments for:			
– non-cash items included in profit before tax	28	**265**	203
– change in operating assets	28	**(584)**	(3,311)
– change in operating liabilities	28	**1,847**	1,150
– tax paid		**(215)**	(350)
Net cash from/(used in) operating activities		**2,247**	(1,279)
Cash flows from investing activities			
Purchase of financial investments		**(17,009)**	(15,682)
Proceeds from the sale and maturity of financial investments		**15,517**	14,423
Purchase of property, plant and equipment		**(37)**	(55)
Net cash flow from the sale of full service retail brokerage business		**–**	(116)
Net cash flow from the sale of held for sale assets		**371**	–
Purchase of intangibles		**(11)**	(14)
Net cash used in investing activities		**(1,169)**	(1,444)
Cash flows from financing activities			
Dividends paid to shareholders		**(421)**	(391)
Distributions to non-controlling interests		**(10)**	(10)
Purchase of preferred shares		**(419)**	–
Subordinated liabilities repaid		**(85)**	–
Net cash used in financing activities		**(935)**	(401)
Net increase/(decrease) in cash and cash equivalents		**143**	(3,124)
Cash and cash equivalents at the beginning of the year		**1,753**	4,877
Cash and cash equivalents at the end of the year	28	**1,896**	1,753

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

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

				Other reserves					
	Note	*Share capital*[1] **$m**	*Retained earnings* **$m**	*Available-for-sale fair value reserve* **$m**	*Cash flow hedging reserve* **$m**	*Total other reserves* **$m**	*Total shareholders' equity* **$m**	*Non-controlling interests* **$m**	*Total equity* **$m**
At 1 January 2013	1(e)	**2,171**	**2,694**	**121**	**160**	**281**	**5,146**	**230**	**5,376**
Profit for the period		**–**	**677**	**–**	**–**	**–**	**677**	**10**	**687**
Other comprehensive income/(loss), net of tax		**–**	**16**	**(86)**	**(61)**	**(147)**	**(131)**	**–**	**(131)**
Available-for-sale investments		**–**	**–**	**(86)**	**–**	**(86)**	**(86)**	**–**	**(86)**
Cash flow hedges		**–**	**–**	**–**	**(61)**	**(61)**	**(61)**	**–**	**(61)**
Remeasurement of defined liability/asset		**–**	**16**	**–**	**–**	**–**	**16**	**–**	**16**
Total comprehensive income for the period		**–**	**693**	**(86)**	**(61)**	**(147)**	**546**	**10**	**556**
Dividends paid on common shares		**–**	**(360)**	**–**	**–**	**–**	**(360)**	**–**	**(360)**
Dividends paid preferred shares		**–**	**(61)**	**–**	**–**	**–**	**(61)**	**–**	**(61)**
Distributions to unit holders		**–**	**–**	**–**	**–**	**–**	**–**	**(10)**	**(10)**
Purchase of preferred shares	26	**(346)**	**(43)**	**–**	**–**	**–**	**(389)**	**(30)**	**(419)**
Other movements		**–**	**3**	**–**	**–**	**–**	**3**	**–**	**3**
At 31 December 2013		**1,825**	**2,926**	**35**	**99**	**134**	**4,885**	**200**	**5,085**

				Other reserves					
		Share capital[1] $m	*Retained earnings* $m	*Available-for-sale fair value reserve* $m	*Cash flow hedging reserve* $m	*Total other reserves* $m	*Total shareholders' equity* $m	*Non-controlling interests* $m	*Total equity* $m
At 1 January 2012	1(e)	2,171	2,379	138	301	439	4,989	230	5,219
Profit for the period		–	744	–	–	–	744	10	754
Other comprehensive income (net of tax)		–	(34)	(17)	(141)	(158)	(192)	–	(192)
Available-for-sale investments		–	–	(17)	–	(17)	(17)	–	(17)
Cash flow hedges		–	–	–	(141)	(141)	(141)	–	(141)
Remeasurement of defined liability/asset		–	(34)	–	–	–	(34)	–	(34)
Total comprehensive income for the period		–	710	(17)	(141)	(158)	552	10	562
Dividends paid on common shares		–	(330)	–	–	–	(330)	–	(330)
Dividends paid on preferred shares		–	(61)	–	–	–	(61)	–	(61)
Distributions to unit holders		–	–	–	–	–	–	(10)	(10)
Other movements		–	(4)	–	–	–	(4)	–	(4)
At 31 December 2012		2,171	2,694	121	160	281	5,146	230	5,376

[1] *Share capital is comprised of common shares $1,225m and preference shares $600m (2012: $946m).*

The accompanying notes and the audited sections of 'Risk Management' and 'Capital' within Management's Discussion and Analysis form an integral part of these consolidated financial statements.

Notes on the Consolidated Financial Statements

31 December 2013 and 2012 *(all tabular amounts are in millions of dollars unless stated otherwise)*

1 Basis of preparation

a *Compliance with International Financial Reporting Standards*

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. 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.

b *Presentation of information*

i) The bank's consolidated financial statements are presented in Canadian dollars which is also its functional currency. The abbreviation "$m" represents millions of dollars. All tabular amounts are in millions of dollars except where otherwise noted. Certain prior period amounts have been reclassified to conform with the current period presentation.

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 and Capital' within Management's Discussion and Analysis.

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

ii) In 2013, the bank adopted a revised disclosure convention for the presentation of impaired loans and advances which affects the disclosure of the impaired loan portfolio. The revised disclosure convention introduces a more stringent approach to the assessment of whether renegotiated loans are presented as impaired. This reflects HSBC Group standards and developments in industry best practice disclosure.

Under the revised disclosure convention, renegotiated consumer finance loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment, are included as impaired loans and advances. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

Management believes that this revised approach better reflects the nature of risks and inherent credit quality in our loan portfolio as it applies stricter requirements for the performance of renegotiated loans before they may be presented as no longer impaired. The revised disclosure convention affects the disclosure presentation of impaired loans but does not affect the accounting policy for the recognition of impairment allowances as disclosed in Note 2(f) and accordingly there is no impact on the income statement.

iii) As a result of changing market practices in response to regulatory and accounting changes, as well as general market developments, the bank revised its methodology for estimating the credit valuation adjustment ('CVA') and debit valuation adjustment ('DVA') for derivatives from 1 January 2013. Previously, the probability of default ('PD') used in the CVA calculation was based on the bank's internal credit rating for the counterparty taking into account how credit ratings may deteriorate over the duration of the exposure based on historical rating transition matrices. The revised methodology maximizes the use of the PDs based on market-observable data, such as credit default swap ('CDS') spreads. Where CDS spreads are not available, PDs are estimated having regard to market practice, considering relevant data including both CDS indices and historical rating transition matrices. In addition, the bank aligned its methodology for estimating the debit valuation adjustment ('DVA') to be consistent with that applied for CVA. Historically, the bank considered that a zero spread was appropriate in respect of own credit risk and consequently did not adjust derivative liabilities for its own credit risk.

1 Basis of preparation *(continued)*

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 the Management's Discussion and Analysis.

d *Consolidation*

The consolidated financial statements of the bank comprise the financial statements of the bank and its subsidiaries as at 31 December 2013, 31 December 2012 and for the years then ended. 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.

1 Basis of preparation *(continued)*

e *Changes in accounting policy during 2013*

On 1 January 2013, the bank adopted the following new accounting standards and amendments to standards retrospectively, with exception of IFRS 13 which was applied prospectively:

Amendments to IAS 1 'Items of Other Comprehensive Income' ('IAS 1')

As a result of the adoption of changes within IAS 1, items presented within the consolidated statement of comprehensive income are grouped into those that will and those that will not be subsequently reclassified to income.

Amendments to IAS 19 'Employee Benefits' ('IAS 19 revised')

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

In addition, unvested amounts related to past service events are no longer amortized and recognized in the income statement over the vesting period, but recognized in full on the date of the past service event as a charge or a credit to income.

The estimated effect of the adoption of this standard is an increase in total operating expenses for fiscal 2013 of approximately $10m. In addition, as the standard is to be applied retrospectively, there is an increase in retained earnings on 1 January 2013 of $14m, net of income taxes, relating to past service gains recorded in previous years that were previously deferred and not yet recognized as a reduction of costs. The financial statements for 2012 have been restated through an adjustment to increase retained earnings at 1 January 2012 of $16m, net of taxes, an increase of costs for 2012 of $9m and an increase in other comprehensive income of $7m ($5m after tax).

The impact on retained earnings at 1 January is as follows:

	2013 **$m**	2012 $m
Retained earnings as previously reported	**2,680**	2,363
Change in accounting policy	**14**	16
Retained earnings as restated	**2,694**	2,379

Amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' ('IFRS 7')

IFRS 7 requires disclosure of the effect or potential effects of netting arrangements on an entity's financial position. The amendment requires disclosure of recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement. New disclosures relating to IFRS 7 are provided in note 32.

IFRS 10 'Consolidated Financial Statements' ('IFRS 10')

Under IFRS 10, there is one approach for determining if an investor controls an investee for all entities, based on the concept of power, variability of returns and their linkage. This replaced the previous approach which emphasizes legal control or exposure to risks and rewards, depending on the nature of the entity. The bank controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

In accordance with the transitional provisions of IFRS 10, we reviewed the population of investments in entities as at 1 January 2013 to determine whether entities previously consolidated or unconsolidated in accordance with IAS 27 'Consolidated and Separate Financial Statements' and SIC 12 'Consolidation – Special Purpose Entities' changed their consolidation status as a result of applying IFRS 10. The result of this review was that the effect of applying the requirements of IFRS 10 did not have a material effect on these consolidated financial statements.

1 Basis of preparation *(continued)*

e *Changes in accounting policy during 2013 (continued)*

IFRS 12 'Disclosure of Interests in Other Entities' ('IFRS 12')

IFRS 12 is a comprehensive standard covering disclosures on all forms of interests in other entities, including for unconsolidated structured entities. New disclosures are provided in notes 16 and 27.

IFRS 13 'Fair Value Measurement' ('IFRS 13')

IFRS 13 establishes a single framework for measuring fair value and introduces new requirements for disclosure of fair value measurements. The adoption of IFRS 13 did not have a material impact on the bank's consolidated financial statements. Disclosures are provided in note 24.

f *Future accounting developments*

Offsetting

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 and are required to be applied retrospectively. Based on our assessment performed to date, we do not expect the amendments to IAS 32 to have a material effect on the bank's consolidated financial statements.

Financial instruments

The IASB issued IFRS 9 'Financial Instruments' which introduced new requirements for the classification and measurement of financial assets in November 2009 and financial liabilities in October 2010, with a further proposed amendments in November 2012. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 classification and measurement requirements are to be applied retrospectively but prior periods need not be restated. Since the final requirements for classification and measurement are uncertain, it remains impracticable to quantify the effect of the existing IFRS 9 as at the date of the publication of these consolidated financial statements.

The second phase in the IASB's project to replace IAS 39 will address the impairment of financial assets.

In November 2013, the IASB completed the third phase of its project to replace IAS 39 and issued general hedge accounting requirements. The revised hedge accounting requirements are applied prospectively and the bank is currently in the process of assessing the impact on its consolidated financial statements. Macro hedging is not included in the IFRS 9 project and will be addressed separately.

In November 2013, the IASB issued amendments to IFRS 9 in respect of transition requirements and the effective date. As a result of these amendments, it is confirmed that all phases of IFRS 9 (except for changes to the presentation of gains and losses for certain liabilities measured at fair value) must be applied from the same effective date. The IASB plans to determine the effective date when the entire IFRS 9 project is closer to completion.

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 (except for debt securities issued by the bank and derivatives managed in conjunction with those debt securities) are recognized in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest 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.

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'.

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/(expense) from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income and expense in respect of financial assets and liabilities designated at fair value as well as derivatives managed in conjunction with the above. However, interest arising from debt securities issued, and derivatives managed in conjunction with those debt securities is recognized in 'Interest expense'.

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

c *Operating segments*

The bank's operations are managed according to the following global lines of business: Commercial Banking, Global Banking and Markets, as well as Retail Banking and Wealth Management. Measurement of segmental assets, liabilities, income and expenses is in accordance with the bank's accounting policies. Segmental 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.

2 Summary of significant accounting policies *(continued)*

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, being the difference between the transaction price and the fair value. 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 is not recognized immediately in the income statement. Instead, it is recognized over the life of the transaction on an appropriate basis, when the inputs become observable, 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 are measured in accordance with the bank's valuation methodologies, which are described in note 25.

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 a borrower. They are derecognized when either the borrower repays its 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 method, less any reduction from impairment or uncollectibility. 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 relating only to the hedged risk.

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

Individually assessed loans and advances

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

- the size of the loan;
- the number of loans in the portfolio; and
- the importance of the individual loan relationship, and how this is managed.

Loans that meet the above criteria will be individually assessed for impairment, except when volumes of defaults and losses are sufficient to justify treatment under a collective assessment methodology.

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

f *Impairment of loans and advances (continued)*

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;
- the probability that the borrower will enter bankruptcy or other financial realization;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant;
- there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful; and
- there is a significant downgrading in credit rating by an external credit rating agency.

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

- the bank's aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the 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.

The realizable value of security is determined based on the current market value when the impairment assessment is performed. The value is not adjusted for expected future changes in market prices; however, adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at the loan's 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.

2 Summary of significant accounting policies *(continued)*

f *Impairment of loans and advances (continued)*

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.

Collective allowances for business and government loans are estimated using the underlying credit metrics from the bank's internal rating system as a basis. Management adjusts the collective allowance where it is considered that the underlying credit metrics does not fully reflect recent portfolio and economic trends. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

Collective allowances for consumer loans, residential mortgages and credit cards are estimated through analysis of historical data including: losses, delinquency migration and write-off trends; and is supplemented by judgemental adjustments that employ an established framework referencing 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.

Provisions relating to off balance sheet credit instruments such as guarantees and credit commitments are included in other liabilities.

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.

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 recorded as assets held for sale and reported in 'Other assets' if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and their sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognized in the income statement, in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, 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.

f *Impairment of loans and advances (continued)*

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up to date loans for measurement purposes once a minimum number of payments required have been received.

A loan that is renegotiated is derecognized if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument.

g *Trading assets and trading liabilities*

Treasury bills, debt securities, equity securities, 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 and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognized on trade date, when the bank enters into contractual arrangements with counterparties to purchase or sell the 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, the 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.

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 securities 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’.

2 Summary of significant accounting policies *(continued)*

i *Financial investments (continued)*

Interest income is recognized on available-for-sale debt securities using the effective interest rate, 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 the fair value of the financial asset is recognized in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognized in the income statement, the impairment loss is reversed through the income statement. If there is no longer objective evidence that the debt security is impaired, the impairment loss is also reversed through the income statement;

– for an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognized 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.

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

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on 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 on 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 on 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. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

k *Derivatives and hedge accounting*

Derivatives

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 models 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 the 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 flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

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

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is 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.

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 recognized in other comprehensive income at that time remains in equity until the forecast transaction is eventually recognized in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognized 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'.

2 Summary of significant accounting policies *(continued)*

k *Derivatives and hedge accounting (continued)*

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'.

Derivatives that do not qualify for hedge accounting include non-qualifying hedges entered into as part of documented interest rate management strategies for which hedge accounting was not, or could not, be applied.

The size and direction of changes in fair value of non-qualifying hedges can be volatile from year to year, but do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the assets and liabilities to which the documented interest rate strategies relate. Non-qualifying hedges therefore operate as economic hedges of the related assets and liabilities.

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 is 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. New disclosures are provided in note 32.

n *Subsidiaries and associates*

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

The bank classifies investments in entities over which it has significant influence, but does not control, as associates. 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.

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.

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual agreement. Structured entities often have restricted activities and a narrow and well defined objective. Examples of structured entities include investment funds, securitization vehicles and asset backed financings. The bank would be considered to sponsor another entity if it has a key role in establishing that entity or in bringing together the relevant counterparties so that the transaction, which is the purpose of the entity, can occur. This may include instances where the bank initially sets up an entity for a structured transaction. The bank would not be considered a sponsor once our initial involvement in setting up the structured entity had ceased even if we were subsequently involved with an entity to the extent of providing arm's length services in the normal course of business.

o *Intangible assets*

The bank's intangible assets include both purchased and internally generated software. 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 changes in circumstances that indicate that the carrying amount may not be recoverable. 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.

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, is 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 valuators 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.

2 Summary of significant accounting policies *(continued)*

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

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 at the reporting date by the schemes’ actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses. Service cost comprises current service cost, past service cost, and gain or loss on settlement.

The past service cost which is charged immediately to the income statement, is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or curtailment (a significant reduction by the entity in the number of employees covered by a plan). A settlement is a transaction that eliminates all further legal and constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

Re-measurements of the net defined benefit liability, which comprise actuarial gains and losses, return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income.

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 reduced by the fair value of plan assets. Any net defined benefit surplus is limited to the present value of available refunds and reductions in future contributions to the plan.

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

t *Share-based payments*

HSBC Holdings is the grantor of its equity instruments awarded to employees of the bank. The bank is required to fund share-based payment arrangements awarded to its employees. 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. The vesting period is the period during which all the specified vesting conditions of the 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 of the award. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of the award at the date of grant, so that an award is treated as vesting irrespective of whether these conditions are satisfied, provided all other vesting 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. On a cumulative basis, no expense is recognized for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

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.

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 reporting 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 the 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, 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.

2 Summary of significant accounting policies *(continued)*

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 is normally the consideration 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 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.

y *Share capital*

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

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 the 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:

	2013 **$m**	2012 $m
Income		
Interest recognized on impaired financial assets	**16**	18
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	**340**	321
Fees earned on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers	**141**	131
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**724**	742
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	**58**	56
Fees payable on trust and other fiduciary activities where the bank holds or invests assets on behalf of its customers	**10**	8
Gains/(losses)		
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	**–**	88
Loan impairment charge and other credit risk provisions		
Net impairment charge on loans and advances	**207**	202
Other credit risk provisions/(reversal of provisions)	**(19)**	8
Impairment of available-for-sale debt securities	**–**	1

4 Employee compensation and benefits

a *Total employee compensation*

	2013 **$m**	2012 $m
Wages and salaries	**504**	525
Post-employee benefits	**62**	61
Other	**48**	73
	614	659

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.

Income statement charge	**2013** **$m**	2012 $m
Defined benefit plans		
Pension plans	**20**	19
Non-pension plans	**12**	–
Defined contribution pension plans	**30**	31
	62	50
Curtailment and settlement gains and other amounts related to restructuring included above	**–**	11
Post-employment benefits	**62**	61

c *Post-employment benefit plans*

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 2013 and 2012 assumptions will also form and have formed the basis for measuring periodic costs under the plans in 2014 and 2013 respectively.

	Pension plans		Non-pension plans	
	2013 **%**	2012 %	**2013** **%**	2012 %
Discount rate	**4.50–4.75**	4.0–4.5	**4.50–4.75**	4.0–4.5
Rate of pay increase	**3.4**	3.0–3.4	**3.4**	3.0–3.4
Healthcare cost trend rates – Initial rate	**n/a**	n/a	**7.2**	7.2–8.0
Healthcare cost trend rates – Ultimate rate[1]	**n/a**	n/a	**4.9**	4.9–5.0

[1] *The non-pension 'Healthcare cost trend rates – Ultimate rate' is applied from 2020.*

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. At 31 December 2013, the weighted average duration of the defined benefit obligation was 16.6 years.

Notes on the Consolidated Financial Statements (continued)

4 Employee compensation and benefits *(continued)*

c *Post-employment benefit plans (continued)*

Mortality assumption

Assumptions regarding future mortality have been based on published mortality tables. The life expectancies underlying the defined benefit obligation at the reporting dates are as follows:

	Average years from age 65	
	2013	2012
For a male currently aged 65	**22**	19
For a male currently aged 45	**23**	21
For a female currently aged 65	**24**	22
For a female currently aged 45	**25**	23

Actuarial assumption sensitivities

The following table shows the effect of a ¼ percentage point change ('25bps') in key assumptions on the present value of defined benefit obligation at 31 December:

Pension plans

	2013	2012
	$m	$m
Discount rate		
Change in defined benefit obligation at year end from a 25 bps increase	**(22)**	(23)
Change in defined benefit obligation at year end from a 25 bps decrease	**23**	23
Rate of pay increase		
Change in defined benefit obligation at year end from a 25 bps increase	**9**	10
Change in defined benefit obligation at year end from a 25 bps decrease	**(9)**	(9)
Non-pension plans		
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	**6**	6

Plan Assets

	2013	2012
	$m	$m
Fair value of plan assets		
Equities	**233**	260
Bonds	**245**	147
Other – principally bank balances and short term investments	**8**	3
	486	410

Substantially all the equities and bonds are Level 1 (note 25). Bank balances and short term investments are considered Level 2.

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	
	2013	2012	**2013**	2012
	$m	$m	**$m**	$m
Fair value of plan assets				
At 1 January	**410**	388	**–**	–
Interest on plan assets	**18**	19	**–**	–
Contributions by the bank	**45**	30	**4**	1
Contributions by employees	**1**	1	**–**	–
Experience gains	**38**	14	**–**	–
Benefits paid	**(25)**	(36)	**(4)**	3
Non-investment expenses	**(1)**	(1)	**–**	–
Distributed on settlements	**–**	(5)	**–**	(4)
At 31 December	**486**	410	**–**	–
Present value of defined benefit obligations				
At 1 January	**(566)**	(517)	**(152)**	(150)
Current service cost	**(13)**	(13)	**(5)**	(5)
Interest cost	**(24)**	(25)	**(7)**	(8)
Contributions by employees	**(1)**	(1)	**–**	–
Actuarial gains/(losses) arising from changes in:				
– Demographic assumptions	**(26)**	–	**(7)**	–
– Financial assumptions	**27**	(61)	**6**	(16)
– Experience adjustments	**(1)**	6	**4**	12
Benefits paid	**25**	36	**4**	4
Special contractual benefits	**–**	(2)	**–**	–
Liabilities extinguished on curtailments and settlements	**–**	11	**–**	11
At 31 December	**(579)**	(566)	**(157)**	(152)
Funded	**(523)**	(511)	**–**	–
Unfunded	**(56)**	(55)	**(157)**	(152)
Other – effect of limit on plan surpluses	**(21)**	(1)	**–**	–
Net liability	**(114)**	(157)	**(157)**	(152)

The actual return on plan assets for the year ended 31 December 2013 was a return of $56m (2012: $33m).

Actuarial valuations for the bank's pension plans are prepared annually and for non-pension arrangements triennially. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at 31 December 2012 and the most recent actuarial valuation of the non-pension arrangements was as at 1 July 2012. Based on the most recent valuations of the plans, the bank expects to make $32m of contributions to defined benefit pension plans during 2014.

The defined benefit pension plans expose the bank to risks, including: interest rate risk to the extent that the assets are not invested in bonds that match the plans' obligations, general market risk in respect of its equity investments, and longevity risk in respect of pensioners and beneficiaries living longer than assumed. These risks would be realized through higher pension costs and a higher defined benefit liability.

The bank takes steps to manage these risks through an asset liability management program, which includes reducing interest rate and market risk over time by increasing its asset allocation to bonds that more closely match the plan's obligations.

4 Employee compensation and benefits *(continued)*

c *Post-employment benefit plans (continued)*

Summary of remeasurement, net on defined benefit obligations

	Pension plans		Non-pension plans	
	2013	2012	**2013**	2012
	$m	$m	**$m**	$m
Experience gain on plan assets	**38**	14	**–**	–
Demographic assumptions	**(26)**	–	**(7)**	–
Financial assumptions	**27**	(61)	**6**	(16)
Gain on curtailments	**(1)**	6	**4**	12
Effect of increase in limit on plan surpluses	**(20)**	(1)	**–**	–
	18	(42)	**3**	(4)

5 Share-based payments

Share-based payments income statement charge

	2013	2012
	$m	$m
Restricted share awards	**8**	15
Savings-related share option plans	**1**	2
	9	17

During 2013, $9m was charged to the income statement in respect of share-based payment transactions (2012: $17m) mostly relating to restricted share awards. These awards are generally granted to employees early in the year following the year to which the award relates. The charge for these awards is recognized from the start of the period to which the service relates to the end of the vesting period. The vesting period is the period over which the employee satisfies certain service conditions in order to become entitled to the award. Due to the staggered vesting profile of certain deferred share awards, the employee becomes entitled to a portion of the award at the end of each year during the vesting period. The income statement charge reflects this vesting profile.

The purpose of restricted share awards is to support retention of key employees, and to reward employee performance and potential. Vesting of restricted share awards is generally subject to continued employment with a vesting period of three years and may be subject to performance conditions.

The weighted average fair value of shares awarded by the HSBC Group for restricted share awards in 2013 was $11.20 per share (2012: $9.60 per share). Fair value is measured at the prevailing market price at the date of the share award.

The bank carries a liability in respect of restricted share awards of $20m as at 31 December 2013 (2012: $26m) to its parent, HSBC Holdings, for the funding of awards that will vest in the future. The liability is measured at fair value with changes recorded within equity.

6 Tax expense

	2013 **$m**	2012 $m
Current taxation		
Federal	**136**	168
Provincial	**100**	93
	236	261
Deferred taxation		
Origination and reversal of temporary differences	**11**	14
Tax expense	**247**	275

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

Analysis of tax expense	**2013** **%**	2012 %
Combined federal and provincial income tax rate	**26.1**	25.8
Adjustments resulting from:		
Adjustment for tax exempt income	**–**	(1.0)
Substantively enacted tax rate changes	**(0.2)**	1.0
Additional financial institution taxes	**–**	0.2
Other, net	**0.8**	0.9
Effective tax rate	**26.7**	26.9

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 $47m decrease in equity (2012: $86m increase in equity).

Deferred taxation

Movement in deferred taxation during the year:

	2013 **$m**	2012 $m
At 1 January	**138**	139
Income statement charge	**(11)**	(16)
Other movements	**–**	1
Other comprehensive income:		
Actuarial gains and losses	**(7)**	14
At 31 December	**120**	138

6 Tax expense *(continued)*

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

	2013 **$m**	2012 $m
Deferred tax assets		
Retirement benefits	**72**	86
Loan impairment allowances	**33**	54
Unused tax credits	**–**	7
Assets leased to customers	**(71)**	(66)
Property, plant and equipment	**(1)**	(2)
Share-based payments	**5**	7
Relief for tax losses carried forward	**40**	27
Other temporary differences	**42**	25
	120	138
Deferred tax liabilities		
Cash flow hedges	**(1)**	(1)
Net deferred tax asset	**119**	137

The amount of temporary differences for which no deferred tax asset is recognized in the statement of financial position is $4m (2012: $4m). This amount is in respect of capital losses where the recoverability of potential benefits is not considered likely. The entire amount has no expiry date.

Deferred tax is not recognized in respect of the bank's investments in subsidiaries where remittance of retained earning 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 $481m (2012: $381m).

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.

7 Dividends

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

	2013		2012	
	$per share/ unit	**$m**	$per share/ unit	$m
Common Shares		**360**		330
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[1]	**0.310**	**27**	0.310	27
HSBC HaTS™				
Series 2015	**51.50**	**10**	51.50	10

[1] *Preferred shares – Class 2, Series B were redeemed on 27 December 2013.*

8 Segment analysis

We manage and report our operations according to the following global lines of business: Commercial Banking, Global Banking and Markets, as well as Retail Banking and Wealth Management. Various estimate and allocation methodologies are used in the preparation of the global lines of business financial information. We allocate expenses directly related to earning revenues to the global lines of business that earned the related revenue. Expenses not directly related to earning revenue, such as overhead expenses, are allocated to global lines of business using appropriate allocation formulas. Global lines of business net interest income reflects internal funding charges and credits on the global lines of business assets, liabilities and capital, at market rates, taking into account relevant terms. The offset of the net impact of these charges and credits is reflected in Global Banking and Markets.

As a result of the bank's previous decision to wind-down the consumer finance business in Canada and in order to more appropriately reflect the bank's active global lines of business, effective for 2013, results previously reported as the 'Consumer Finance' segment have been included under Retail Banking and Wealth Management, with exception of results relating to corporate credit cards, which are included under Commercial Banking. The results for the comparative period have been restated to reflect this change. Profit before income tax relating to Consumer Finance of $88m (2012: $73m) is included in Retail Banking and Wealth Management and $5m (2012: $4m) in Commercial Banking.

A description of each customer group is as follows:

Commercial Banking

Commercial Banking is segmented into Corporate, to serve both large and mid-market companies with more sophisticated financial needs, and Business Banking, to serve small and medium-sized enterprises ('SME's), enabling differentiated coverage of our target customers. Client offering includes Credit and Lending; International trade and receivables finance; Payments and Cash Management; and Global Banking and Markets.

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients 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 of relationship managers and product specialists develop financial solutions to meet individual client needs. Global Banking and Markets is managed as three principal business lines: Markets, Capital Financing and Banking.

Retail Banking and Wealth Management

Retail Banking and Wealth Management provides banking and wealth management services for our personal customers to help them to manage their finances and protect and build their financial future. Customer offerings include: liability-driven services (deposits and account services), asset-driven services (credit and lending), and fee-driven and other services (financial advisory and asset management).

Other

'Other' contains the results of movements in fair value of own debt, income related to information technology services provided to HSBC Group companies on an arm's length basis with associated recoveries and other transactions which do not directly relate to our global lines of business.

8 Segment analysis *(continued)*

	2013 **$m**	2012 $m
Commercial Banking		
Net interest income	**675**	710
Net fee income	**317**	307
Net trading income	**28**	31
Other operating loss	**(31)**	(25)
Net operating income before loan impairment charges and other credit risk provisions	**989**	1,023
Loan impairment charges and other credit risk provisions	**(124)**	(79)
Net operating income	**865**	944
Total operating expenses	**(373)**	(377)
Operating profit	**492**	567
Share of profit in associates	**31**	5
Profit before income tax expense	**523**	572
Global Banking and Markets		
Net interest income	**159**	167
Net fee income	**83**	87
Net trading income	**103**	106
Gains less losses from financial investments	**54**	51
Other operating income	**1**	2
Gain on sale of full service brokerage	**–**	8
Net operating income	**400**	421
Total operating expenses	**(113)**	(112)
Profit before income tax expense	**287**	309
Retail Banking and Wealth Management		
Net interest income	**505**	629
Net fee income	**203**	207
Net trading income	**19**	12
Gain less losses from financial investments	**4**	1
Other operating income	**13**	16
Gain on sale of full service brokerage	**–**	80
Net operating income before loan impairment charges and other credit risk provisions	**744**	945
Loan impairment charges and other credit risk provisions	**(64)**	(132)
Net operating income	**680**	813
Operating expenses excluding restructuring charges	**(549)**	(589)
Restructuring charges	**–**	(36)
Profit before income tax expense	**131**	188
Other		
Net interest expense	**(28)**	(31)
Net trading income	**28**	31
Net expense from financial instruments designated at fair value	**(5)**	(27)
Other operating income	**33**	31
Net operating income	**28**	4
Total operating expenses	**(35)**	(44)
Loss before income tax expense	**(7)**	(40)

8 Segment analysis *(continued)*

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

	Commercial Banking	*Global Banking and Markets*	*Retail Banking and Wealth Management*	*Other*	*Total*
	$m	**$m**	**$m**	**$m**	**$m**
Year ended 31 December 2013					
Net operating income	**865**	**400**	**680**	**28**	**1,973**
External	**845**	**315**	**785**	**28**	**1,973**
Inter-segment	**20**	**85**	**(105)**	**–**	**–**
Year ended 31 December 2012					
Net operating income	944	421	813	4	2,182
External	925	337	916	4	2,182
Inter-segment	19	84	(103)	–	–

Statement of financial position information

	Commercial Banking	*Global Banking and Markets*	*Retail Banking and Wealth Management*	*Other*	*Total*
	$m	**$m**	**$m**	**$m**	**$m**
At 31 December 2013					
Loans and advances to customers (net)	**15,881**	**7,030**	**23,440**	**–**	**46,351**
Customers’ liability under acceptances	**3,941**	**816**	**–**	**–**	**4,757**
Total assets	**29,282**	**28,107**	**26,471**	**400**	**84,260**
Customer accounts	**21,986**	**7,103**	**22,755**	**–**	**51,844**
Acceptances	**3,941**	**816**	**–**	**–**	**4,757**
Total liabilities	**26,436**	**26,921**	**25,418**	**400**	**79,175**
At 31 December 2012					
Loans and advances to customers (net)	16,422	3,953	25,197	–	45,572
Customers’ liability under acceptances	3,982	755	–	–	4,737
Total assets	27,639	27,612	25,049	414	80,714
Customer accounts	20,270	7,738	20,296	–	48,304
Acceptances	3,982	755	–	–	4,737
Total liabilities	24,731	26,567	23,639	401	75,338

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:

	2013						
	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	–	–	–	**165**	–	–	**165**
Items in the course of collection from other banks	–	–	–	**107**	–	–	**107**
Trading assets	**6,728**	–	–	–	–	–	**6,728**
Derivatives	**1,604**	–	–	–	**60**	**448**	**2,112**
Loans and advances to banks	–	–	–	**1,482**	–	–	**1,482**
Loans and advances to customers	–	–	–	**46,351**	–	–	**46,351**
Financial investments	–	–	**21,814**	–	–	–	**21,814**
Other assets	–	–	–	**103**	–	–	**103**
Accrued income	–	–	–	**182**	–	–	**182**
Customers' liability under acceptances	–	–	–	**4,757**	–	–	**4,757**
Total financial assets	**8,332**	–	**21,814**	**53,147**	**60**	**448**	**83,801**
Financial liabilities							
Deposits by banks	–	–	–	**1,205**	–	–	**1,205**
Customer accounts	–	–	–	**51,844**	–	–	**51,844**
Items in the course of transmission to other banks	–	–	–	**53**	–	–	**53**
Trading liabilities	**4,396**	–	–	–	–	–	**4,396**
Financial liabilities designated at fair value	–	**428**	–	–	–	–	**428**
Derivatives	**1,518**	–	–	–	**70**	**158**	**1,746**
Debt securities in issue	–	–	–	**11,348**	–	–	**11,348**
Other liabilities	–	–	–	**2,257**	–	–	**2,257**
Acceptances	–	–	–	**4,757**	–	–	**4,757**
Accruals	–	–	–	**551**	–	–	**551**
Subordinated liabilities	–	–	–	**239**	–	–	**239**
Total financial liabilities	**5,914**	**428**	–	**72,254**	**70**	**158**	**78,824**

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

	2012						
	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	*Total* $m
Financial assets							
Cash and balances at central bank	–	–	–	56	–	–	56
Items in the course of collection from other banks	–	–	–	90	–	–	90
Trading assets	5,272	–	–	–	–	–	5,272
Derivatives	1,346	–	–	–	8	456	1,810
Loans and advances to banks	–	–	–	1,480	–	–	1,480
Loans and advances to customers	–	–	–	45,572	–	–	45,572
Financial investments	–	–	20,411	–	–	–	20,411
Other assets	–	–	–	650	–	–	650
Accrued income	–	–	–	151	–	–	151
Customers’ liability under acceptances	–	–	–	4,737	–	–	4,737
Total financial assets	6,618	–	20,411	52,736	8	456	80,229
Financial liabilities							
Deposits by banks	–	–	–	2,173	–	–	2,173
Customer accounts	–	–	–	48,304	–	–	48,304
Items in the course of transmission to other banks	–	–	–	71	–	–	71
Trading liabilities	2,672	–	–	–	–	–	2,672
Financial liabilities designated at fair value	–	436	–	–	–	–	436
Derivatives	1,237	–	–	–	94	84	1,415
Debt securities in issue	–	–	–	11,980	–	–	11,980
Other liabilities	–	–	–	2,341	–	–	2,341
Acceptances	–	–	–	4,737	–	–	4,737
Accruals	–	–	–	528	–	–	528
Subordinated liabilities	–	–	–	324	–	–	324
Total financial liabilities	3,909	436	–	70,458	94	84	74,981

Notes on the Consolidated Financial Statements (continued)

10 Trading assets

	2013 **$m**	2012 $m
Trading assets:		
not subject to repledge or resale by counterparties	**6,294**	4,123
which may be repledged or resold by counterparties	**434**	1,149
	6,728	5,272
Canadian and Provincial Government bonds[1]	**2,086**	1,753
Debt securities	**442**	339
Total debt securities	**2,528**	2,092
Bankers' acceptances	**2,848**	2,590
Treasury and other eligible bills	**467**	308
Customer trading assets	**885**	262
Equity securities	**–**	20
	6,728	5,272

[1] *Including government guaranteed bonds*

Term to maturity of debt securities		
Less than 1 year	**216**	301
1–5 years	**1,422**	1,255
5–10 years	**651**	291
Over 10 years	**239**	245
	2,528	2,092

11 Derivatives

Fair values of derivatives by product contract type held

	2013					
	Assets			**Liabilities**		
	Trading **$m**	*Hedging* **$m**	*Total* **$m**	*Trading* **$m**	*Hedging* **$m**	*Total* **$m**
Foreign exchange	**1,077**	**288**	**1,365**	**1,030**	**93**	**1,123**
Interest rate	**492**	**220**	**712**	**453**	**135**	**588**
Commodity	**35**	**–**	**35**	**35**	**–**	**35**
Gross total fair values	**1,604**	**508**	**2,112**	**1,518**	**228**	**1,746**

	2012					
	Assets			Liabilities		
	Trading $m	*Hedging* $m	*Total* $m	*Trading* $m	*Hedging* $m	*Total* $m
Foreign exchange	756	182	938	693	10	703
Interest rate	530	282	812	484	168	652
Commodity	60	–	60	60	–	60
Gross total fair values	1,346	464	1,810	1,237	178	1,415

11 Derivatives *(continued)*

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

	2013								
	Trading				**Hedging**				**Total**
	Less than 1 year **$m**	*1 to 5 years* **$m**	*More than 5 years* **$m**	*Total trading* **$m**	*Less than 1 year* **$m**	*Between 1–5 years* **$m**	*Over 5 years* **$m**	*Total hedging* **$m**	**$m**
Interest rate contracts									
Futures	**1,580**	**–**	**–**	**1,580**	**–**	**–**	**–**	**–**	**1,580**
Swaps	**7,844**	**20,864**	**4,028**	**32,736**	**3,342**	**19,469**	**3,701**	**26,512**	**59,248**
Caps	**2**	**303**	**–**	**305**	**–**	**–**	**–**	**–**	**305**
Other interest rate contracts	**3,124**	**–**	**–**	**3,124**	**–**	**–**	**–**	**–**	**3,124**
	12,550	**21,167**	**4,028**	**37,745**	**3,342**	**19,469**	**3,701**	**26,512**	**64,257**
Foreign exchange contracts									
Spot contracts	**3,866**	**–**	**–**	**3,866**	**–**	**–**	**–**	**–**	**3,866**
Forward contracts	**56,352**	**2,904**	**471**	**59,727**	**–**	**–**	**–**	**–**	**59,727**
Currency swaps and options	**12,765**	**7,386**	**3,590**	**23,741**	**870**	**2,033**	**213**	**3,116**	**26,857**
	72,983	**10,290**	**4,061**	**87,334**	**870**	**2,033**	**213**	**3,116**	**90,450**
Other derivative contracts									
Commodity contracts	**437**	**130**	**–**	**567**	**–**	**–**	**–**	**–**	**567**
	85,970	**31,587**	**8,089**	**125,646**	**4,212**	**21,502**	**3,914**	**29,628**	**155,274**

	2012								
	Trading				Hedging				Total
	Less than 1 year $m	*1 to 5 years* $m	*More than 5 years* $m	*Total trading* $m	*Less than 1 year* $m	*Between 1–5 years* $m	*Over 5 years* $m	*Total hedging* $m	$m
Interest rate contracts									
Futures	2,542	–	–	2,542	–	–	–	–	2,542
Swaps	8,862	17,426	6,102	32,390	8,618	16,626	1,612	26,856	59,246
Caps	–	578	–	578	–	–	–	–	578
	11,404	18,004	6,102	35,510	8,618	16,626	1,612	26,856	62,366
Foreign exchange contracts									
Spot contracts	1,168	–	–	1,168	–	–	–	–	1,168
Forward contracts	41,209	2,618	–	43,827	–	–	–	–	43,827
Currency swaps and options	10,717	7,586	2,285	20,588	238	2,063	–	2,301	22,889
	53,094	10,204	2,285	65,583	238	2,063	–	2,301	67,884
Other derivative contracts									
Commodity contracts	368	193	–	561	–	–	–	–	561
	64,866	28,401	8,387	101,654	8,856	18,689	1,612	29,157	130,811

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.

An analysis of the derivative portfolio and related credit exposure

	2013			2012		
	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	**1,580**	**–**	**–**	2,542	–	–
Swaps	**59,248**	**1,070**	**337**	59,246	1,094	382
Caps	**305**	**6**	**–**	578	7	1
Other interest rate contracts	**3,124**	**–**	**1**	–	–	–
	64,257	**1,076**	**338**	62,366	1,101	383
Foreign exchange contracts						
Spot contracts	**3,866**	**–**	**–**	1,168	–	–
Forward contracts	**59,727**	**1,341**	**226**	43,827	888	126
Currency swaps and options	**26,857**	**1,470**	**447**	22,889	1,192	333
	90,450	**2,811**	**673**	67,884	2,080	459
Other derivative contracts						
Commodity contracts	**567**	**78**	**25**	561	94	23
	155,274	**3,965**	**1,036**	130,811	3,275	865

[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

	2013		2012	
	Assets	*Liabilities*	*Assets*	*Liabilities*
	$m	**$m**	$m	$m
Interest rate	**60**	**69**	8	94

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

	2013	2012
	$m	$m
Gains/(losses)		
– on hedging instruments	**81**	(16)
– on hedged items attributable to the hedged risk	**(80)**	17

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

	2013		2012	
	Assets	*Liabilities*	*Assets*	*Liabilities*
	$m	**$m**	$m	$m
Foreign exchange	**288**	**93**	182	10
Interest rate	**160**	**66**	274	74

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

	2013			
	3 months or less	*More than 3 months but less than 1 year*	*More than 1 year but less than 5 years*	*5 years or more*
	$m	**$m**	**$m**	**$m**
Assets	**12,480**	**11,827**	**11,207**	**376**
Liabilities	**(8,113)**	**(7,049)**	**(6,461)**	**(762)**
Net cash inflow/(outflow) exposure	**4,367**	**4,778**	**4,746**	**(386)**

11 Derivatives *(continued)*

	2012			
		More than 3 months but less than 1 year	*More than 1 year but less than 5 years*	
	3 months or less			*5 years or more*
	$m	$m	$m	$m
Assets	17,239	14,621	11,826	119
Liabilities	(7,622)	(6,048)	(4,364)	(387)
Net cash inflow/(outflow) exposure	9,617	8,573	7,462	(268)

The gains and losses on ineffective portions of such derivatives are recognized immediately in ‘Net trading income’. During 2013, a gain of $5m (2012: gain of $3m) 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 observable inputs (note 24).

	2013						
	Trading			**Hedging**			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net position*
	$m	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Interest rate contracts							
Swaps	**483**	**(436)**	**47**	**220**	**(135)**	**85**	**132**
Caps	**4**	**(4)**	**–**	**–**	**–**	**–**	**–**
Other interest rate contracts	**5**	**(13)**	**(8)**	**–**	**–**	**–**	**(8)**
	492	**(453)**	**39**	**220**	**(135)**	**85**	**124**
Foreign exchange contracts							
Spot contracts	**3**	**(6)**	**(3)**	**–**	**–**	**–**	**(3)**
Forward contracts	**602**	**(565)**	**37**	**–**	**–**	**–**	**37**
Currency swaps and options	**472**	**(459)**	**13**	**288**	**(93)**	**195**	**208**
	1,077	**(1,030)**	**47**	**288**	**(93)**	**195**	**242**
Other derivative contracts							
Commodity contracts	**35**	**(35)**	**–**	**–**	**–**	**–**	**–**
	1,604	**(1,518)**	**86**	**508**	**(228)**	**280**	**366**

11 Derivatives *(continued)*

	2012						
	Trading			Hedging			
	Favourable position $m	*Unfavourable position* $m	*Net position* $m	*Favourable position* $m	*Unfavourable position* $m	*Net position* $m	*Total net position* $m
Interest rate contracts							
Swaps	524	(477)	47	282	(169)	113	160
Caps	6	(6)	–	–	–	–	–
	530	(483)	47	282	(169)	113	160
Foreign exchange contracts							
Spot contracts	1	(1)	–	–	–	–	–
Forward contracts	345	(294)	51	–	–	–	51
Currency swaps and options	410	(399)	11	182	(10)	172	183
	756	(694)	62	182	(10)	172	234
Other derivative contracts							
Commodity contracts	60	(60)	–	–	–	–	–
	1,346	(1,237)	109	464	(179)	285	394

12 Financial investments

Financial investments comprise the following:

	2013 **$m**	2012 $m
Financial investments		
Not subject to repledge or resale by counterparties	**20,468**	19,661
Which may be repledged or resold by counterparties	**1,346**	750
	21,814	20,411
Available-for-sale		
Canadian and Provincial Government bonds[1]	**16,534**	13,429
Treasury bills and other eligible bills	**799**	2,308
International Government bonds[1]	**3,248**	2,999
Other debt securities issued by banks and other financial institutions	**1,224**	1,666
Other debt securities	**9**	9
	21,814	20,411

[1] *Includes government guaranteed bonds.*

The term to maturity of financial investments are as follows:

	2013 **$m**	2012 $m
Term to maturity		
Less than 1 year	**5,534**	4,760
1–5 years	**13,271**	14,388
5–10 years	**3,004**	1,263
No specific maturity	**5**	–
	21,814	20,411

13 Interest rate sensitivity

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

	2013									
	Floating rate	*Within 3 months*	*3–12 months*	*Average interest rate*	*1–5 years*	*Average interest rate*	*Greater than 5 years*	*Average interest rate*	*Non-interest sensitive*	*Total*
	$m	$m	$m	%	$m	%	$m	%	$m	$m
Cash and balances at central bank	–	–	–		–		–		165	165
Items in the course of collection from other banks	–	–	–		–		–		107	107
Trading assets	3,880	2,821	27	1.1	–		–		–	6,728
Derivatives	–	–	–		–		–		2,112	2,112
Loans and advances to banks	–	938	–	1.0	–		–		544	1,482
Loans and advances to customers	23,913	11,461	2,978	3.1	7,777	3.5	105	4.5	117	46,351
Financial investments	–	4,364	3,920	1.5	10,571	1.5	2,959	2.6	–	21,814
Acceptances	–	–	–		–		–		4,757	4,757
Other assets	–	–	–		–		–		744	744
Total assets	27,793	19,584	6,925		18,348		3,064		8,546	84,260
Deposits by banks	–	722	–	1.0	–		–		483	1,205
Customer accounts	26,040	5,640	8,167	1.0	2,969	2.6	–		9,028	51,844
Items in the course of transmission to other banks	–	–	–		–		–		53	53
Trading liabilities	4,269	–	–	1.0	–		–		127	4,396
Financial liabilities designated at fair value	–	–	–		428	4.8	–		–	428
Derivatives	–	–	–		–		–		1,746	1,746
Debt securities in issue	–	4,070	1,297	1.7	4,643	3.1	1,338	3.1	–	11,348
Acceptances	–	–	–		–		–		4,757	4,757
Subordinated liabilities	–	39	–	1.7	200	5.0	–		–	239
Other liabilities	–	–	–		–		–		3,159	3,159
Shareholders' equity	–	–	250	6.6	350	5.1	–		4,285	4,885
Non controlling interest	–	–	–		200	5.2	–		–	200
Total liabilities and shareholders' equity	30,309	10,471	9,714		8,790		1,338		23,638	84,260
On-balance sheet gap	(2,516)	9,113	(2,789)		9,558		1,726		(15,092)	–
Off-balance sheet positions	–	1,696	(1,088)		1,330		(1,938)		–	–
Total interest rate gap	(2,516)	10,809	(3,877)		10,888		(212)		(15,092)	–

Notes on the Consolidated Financial Statements (continued)

13 Interest rate sensitivity *(continued)*

	2012									
	Floating rate $m	*Within 3 months* $m	*3–12 months* $m	*Average interest rate* %	*1–5 years* $m	*Average interest rate* %	*Greater than 5 years* $m	*Average interest rate* %	*Non-interest sensitive* $m	*Total* $m
Cash and balances at central bank	–	–	–		–		–		56	56
Items in the course of collection from other banks	–	–	–		–		–		90	90
Trading assets	2,682	2,541	49	1.2	–		–		–	5,272
Derivatives	–	–	–		–		–		1,810	1,810
Loans and advances to banks	–	1,282	–	1.3	–		–		198	1,480
Loans and advances to customers	27,183	8,885	2,505	3.4	6,625	4.0	79	4.9	295	45,572
Financial investments	–	743	4,017	1.5	14,388	1.6	1,263	2.3	–	20,411
Acceptances	–	–	–		–		–		4,737	4,737
Other assets	–	–	–		–		–		1,286	1,286
Total assets	29,865	13,451	6,571		21,013		1,342		8,472	80,714
Deposits by banks	–	1,556	1	0.9	–		–		616	2,173
Customer accounts	23,501	5,982	6,541	1.0	4,045	2.7	–	2.1	8,235	48,304
Items in the course of transmission to other banks	–	–	–		–		–		71	71
Trading liabilities	2,546	–	–	1.0	–		–		126	2,672
Financial liabilities designated at fair value	–	–	–		436	4.8	–		–	436
Derivatives	–	–	–		–		–		1,415	1,415
Debt securities in issue	–	2,931	2,836	2.3	6,120	3.0	93	4.1	–	11,980
Acceptances	–	–	–		–		–		4,737	4,737
Subordinated liabilities	–	40	–	1.6	284	3.9	–		–	324
Other liabilities	–	–	–		–		–		3,226	3,226
Shareholders' equity	–	22	65		600	5.6	–		4,459	5,146
Non controlling interest	–	–	–		200	5.2	–		30	230
Total liabilities and shareholders' equity	26,047	10,531	9,443		11,685		93		22,915	80,714
On-balance sheet gap	3,818	2,920	(2,872)		9,328		1,249		(14,443)	–
Off-balance sheet positions	–	(2,907)	944		3,160		(1,197)		–	–
Total interest rate gap	3,818	13	(1,928)		12,488		52		(14,443)	–

14 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 transferred not qualifying for derecognition are as follows:

	2013				2012	
	Fair value of assets **$m**	*Fair value of associated liabilities* **$m**	*Carrying amount of assets* **$m**	*Carrying amount of associated liabilities* **$m**	*Carrying amount of assets* $m	*Carrying amount of associated liabilities* $m
Nature of transaction						
Assets securitized..	**4,242**	**4,282**	**4,163**	**4,230**	6,412	6,525
Mortgages sold with recourse...	**1,887**	**1,887**	**1,881**	**1,881**	1,995	1,995
Repurchase agreements	**1,487**	**1,487**	**1,487**	**1,487**	3,025	3,025
	7,616	**7,656**	**7,531**	**7,598**	11,432	11,545

In addition to assets securitized as noted above, the bank has also created $1,084m (2012: $1,093m) of securitized assets which remain on the bank's balance sheet and have not been transferred.

15 Property, plant and equipment

	Freehold land and buildings **$m**	*Leasehold improvements* **$m**	*Equipment, fixtures and fittings* **$m**	*Total* **$m**
Cost				
At 1 January 2013	**3**	**153**	**100**	**256**
Additions at cost	**–**	**18**	**14**	**32**
Disposals and write-offs	**–**	**(8)**	**(17)**	**(25)**
At 31 December 2013	**3**	**163**	**97**	**263**
Accumulated depreciation and impairment				
At 1 January 2013	**(2)**	**(62)**	**(52)**	**(116)**
Depreciation charge for the year	**–**	**(16)**	**(18)**	**(34)**
Disposals and write-offs	**–**	**7**	**17**	**24**
At 31 December 2013	**(2)**	**(71)**	**(53)**	**(126)**
Net carrying amount at 31 December 2013	**1**	**92**	**44**	**137**

Notes on the Consolidated Financial Statements (continued)

15 Property, plant and equipment *(continued)*

	Freehold land and buildings $m	*Leasehold improvements* $m	*Equipment, fixtures and fittings* $m	*Total* $m
Cost				
At 1 January 2012	3	144	127	274
Additions at cost	–	39	18	57
Disposals and write-offs	–	(30)	(45)	(75)
At 31 December 2012	3	153	100	256
Accumulated depreciation and impairment				
At 1 January 2012	(2)	(72)	(77)	(151)
Depreciation charge for the year	–	(18)	(20)	(38)
Disposals and write-offs	–	28	45	73
At 31 December 2012	(2)	(62)	(52)	(116)
Net carrying amount at 31 December 2012	1	91	48	140

16 Investments in subsidiaries

At 31 December 2013, HSBC Bank Canada wholly-owned the following principal subsidiaries:

Subsidiary	*Place of incorporation*	*Shareholders' equity*
HSBC South Point Investments (Barbados) LLP	St. Michael, Barbados	1,148
HSBC Financial Corporation Limited[1]	Toronto, Ontario, Canada	513
HSBC Securities (Canada) Inc.	Toronto, Ontario, Canada	196
HSBC Capital (Canada) Inc.	Vancouver, British Columbia, Canada	119
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia, Canada	111
HSBC Trust Company (Canada)[1]	Vancouver, British Columbia, Canada	68
HSBC Global Asset Management (Canada) Limited	Vancouver, British Columbia, Canada	17
HSBC Loan Corporation (Canada)	Vancouver, British Columbia, Canada	12
Household Trust Company[1]	Toronto, Ontario, Canada	8

[1] *Effective 1 January 2014, HSBC Financial Corporation Ltd and its subsidiaries were reorganized and amalgamated with the bank including Household Trust Company which was amalgamated with HSBC Trust Company Canada. As part of this reorganization a new subsidiary HSBC Finance Mortgages Inc. was incorporated in Toronto, Ontario, Canada with Shareholder's Equity of $425m. The reorganization will have no financial impact on the bank's consolidated financial position.*

The bank sponsored and organized Performance Trust ('PT'), a multi-seller asset-backed commercial paper conduit, designed to provide collateralized asset-backed financing primarily to its corporate and institutional clients in Canada. The asset-backed commercial paper structure involves PT purchasing financial instruments issued by client-sponsored special purpose entities for cash or PT providing asset-backed financing directly to its clients. PT funds the eligible assets through a Funding Agreement between PT and Regency Trust Inc. ('Regency'), a multi-seller asset-backed commercial paper conduit sponsored by and consolidated into another HSBC group entity.

The bank is the financial services agent for PT for a market-based fee. As the agent, we are responsible for arranging transactions between clients and PT. The bank provides liquidity facilities of $1,035m to Regency to backstop the liquidity risk of the commercial paper issued by Regency to fund their clients including PT.

See also note 27(a) in respect of HSBC Canada Asset Trust.

17 Other assets

	2013 **$m**	2012 $m
Deferred tax	**120**	138
Accounts receivable and other	**75**	116
Investments in associates	**67**	77
Current tax	**34**	18
Due from clients, dealers and clearing corporations	**29**	24
Other non-financial assets	**8**	110
Assets held for sale	**–**	427
	333	910

At 31 December 2012 a portfolio of private label credit cards loans were held for sale. These were sold during the course of the year, with no significant impact on net profit.

18 Goodwill and intangible assets

	2013 **$m**	2012 $m
Goodwill	**23**	23
Internally generated computer software	**45**	48
	68	71

No goodwill impairment was recognized in 2013 or 2012.

19 Trading liabilities

	2013 **$m**	2012 $m
Other liabilities – net short positions	**3,617**	1,644
Customer trading liabilities	**442**	916
Trading liabilities due to other banks	**300**	55
Other debt securities in issue	**37**	57
	4,396	2,672

20 Debt securities in issue

	2013 **$m**	2012 $m
Bonds and medium term notes	**10,299**	10,559
Money market instruments	**1,049**	1,421
	11,348	11,980
Debt securities are recorded at cost		
Term to maturity		
Less than 1 year	**3,365**	4,136
1–5 years	**6,659**	7,735
Over 5 years	**1,324**	109
	11,348	11,980

Notes on the Consolidated Financial Statements (continued)

21 Financial liabilities designated at fair value

	2013 **$m**	2012 $m
Subordinated debentures (note 23)	**428**	436

The carrying amount at 31 December 2013 of financial liabilities designated at fair value was $28m higher (2012: $36m higher) than the contractual amount at maturity. At 31 December 2013, the cumulative amount of change in fair value attributable to changes in credit risk was a gain of $2m (2012: $7m gain).

22 Other liabilities

	2013 **$m**	2012 $m
Mortgages sold with recourse	**1,882**	1,995
Accounts payable	**273**	189
Provisions and other non-financial liabilities	**153**	162
Share based payment liability	**20**	26
Current tax	**9**	17
	2,337	2,389

23 Subordinated liabilities

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

		Foreign Currency	Carrying amount	
Interest rate (%)	*Year of maturity*	*Amount* $m	**2013** **$m**	2012 $m
Issued to HSBC Group Companies				
4.822[1]	2094	US$85	**–**	85
Issued to third parties				
4.94[2]	2021		**200**	200
4.80[3]	2022		**428**	436
30 day bankers' acceptance rate plus 0.50%	2083		**39**	39
Total debentures			**667**	760
Less: designated at fair value (note 21)			**(428)**	(436)
Debentures at amortized cost			**239**	324

[1] *The interest rate is fixed at 2.478%. These debentures are in a fair value hedging relationship which is adjusted for the fair value of the hedged risk. The debenture was redeemed at its fair value of US$85m for cash on 9 December 2013.*

[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 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.*

24 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 value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

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.

24 Fair values of financial instruments *(continued)*

Determination of fair value (continued)

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations. A range of valuation techniques is employed, dependent upon the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analysis, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to consideration of credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. Projection utilizes market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products are dependent upon more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may impact the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates. For interest rate derivatives with collateralized counterparties and in significant currencies, HSBC uses a discounting curve that reflects the overnight interest rate ('OIS discounting').

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.

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.

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'.

Determination of fair value (continued)

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.

  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.

- *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.

  As a result of changing market practices in response to regulatory and accounting changes, as well as general market developments, the bank revised its methodology for estimating the credit valuation adjustment ('CVA') and debit valuation adjustment ('DVA') for derivatives from 1 January 2013. This change is discussed in note 1 (iii) Basis of presentation.

  Derivative products valued using valuation techniques with significant unobservable inputs comprise certain long-dated foreign exchange options.

- *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.

  Trading liabilities valued using a valuation technique with significant unobservable inputs comprised equity-linked structured notes, which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities, correlations between equity prices and interest rates and between interest rates and foreign exchange rates.

24 Fair values of financial instruments *(continued)*

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			
	Level 1 Quoted market price	*Level 2 using observable inputs*	*Level 3 with significant unobservable inputs*	*Total*
	$m	**$m**	**$m**	**$m**
At 31 December 2013				
Assets				
Trading assets	**2,754**	**3,974**	**–**	**6,728**
Derivatives	**–**	**2,078**	**34**	**2,112**
Financial investments: available-for-sale	**19,143**	**2,671**	**–**	**21,814**
Liabilities				
Trading liabilities	**3,470**	**917**	**9**	**4,396**
Financial liabilities at fair value	**–**	**428**	**–**	**428**
Derivatives	**–**	**1,712**	**34**	**1,746**
At 31 December 2012				
Assets				
Trading assets	2,292	2,980	–	5,272
Derivatives	–	1,805	5	1,810
Financial investments: available-for-sale	17,705	2,697	9	20,411
Liabilities				
Trading liabilities	2,119	504	49	2,672
Financial liabilities at fair value	–	436	–	436
Derivatives	–	1,408	7	1,415

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

	Assets		**Liabilities**		
	Available-for-sale	*Derivatives*	*Held for trading*	*Designated at fair value*	*Derivatives*
	$m	**$m**	**$m**	**$m**	**$m**
At 1 January 2013	**9**	**5**	**49**	**–**	**7**
Total gains or losses recognized in profit or loss	**1**	**34**	**1**	**–**	**32**
Issues	**–**	**–**	**15**	**–**	**–**
Settlements	**(10)**	**–**	**(1)**	**–**	**–**
Transfer out	**–**	**(5)**	**(55)**	**–**	**(5)**
At 31 December 2013	**–**	**34**	**9**	**–**	**34**
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	**–**	**34**	**–**	**–**	**34**

24 Fair values of financial instruments *(continued)*

Bases of valuing financial assets and liabilities measured at fair value (continued)

	Assets		Liabilities		
	Available-for-sale	*Derivatives*	*Held for trading*	*Designated at fair value*	*Derivatives*
	$m	$m	$m	$m	$m
At 1 January 2012	19	122	8	580	43
Total gains or losses recognized in profit or loss	1	(117)	(1)	(9)	(36)
Issues	–	–	43	–	–
Settlements	(11)	–	–	(571)	–
Transfer out	–	–	(1)	–	–
At 31 December 2012	9	5	49	–	7
Total gains or losses recognized in profit or loss relating to those assets and liabilities held at the end of the reporting period	–	5	1	–	7

During 2013 and 2012, 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’. Fair value changes on long-term debt designated at fair value and related derivatives are presented in the income statement under ‘Changes in fair value of long-term debt issued and related derivatives’. The income statement line item ‘Net income from financial instruments designated at fair value’ captures fair value movements on all other financial instruments designated at fair value and related derivatives.

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 approximates its book value.

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.

24 Fair values of financial instruments *(continued)*

Fair values of financial instruments not carried at fair value (continued)

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

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

	2013					2012	
	Carrying amount **$m**	*Fair value* **$m**	*Level 1 Quoted market price* **$m**	*Level 2 using observable inputs* **$m**	*Level 3 with significant unobservable inputs* **$m**	*Carrying amount* $m	*Fair value* $m
Assets							
Loans and advances to banks	**1,482**	**1,482**	–	1,482	–	1,480	1,480
Loans and advances to customers	**46,351**	**46,420**	–	5,828	40,592	45,572	45,782
Liabilities							
Deposits by banks ...	**1,205**	**1,205**	–	1,205	–	2,173	2,173
Customer accounts ..	**51,844**	**51,919**	–	37,089	14,830	48,304	48,428
Debt securities in issue..................	**11,348**	**11,498**	–	11,498	–	11,980	12,203
Subordinated liabilities...........	**239**	**236**	–	236	–	324	299

25 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 on the statement of financial position and obligations within payment and depository clearing systems:

	2013 $m	2012 $m
Cash	**263**	35
Residential mortgages	**4,418**	5,725
Debt securities	**3,246**	5,835
	7,927	11,595

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 2013 or 2012. 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 $6,727m (2012: $4,328m). The fair value of financial assets accepted as collateral that have been sold or repledged is $2,651m (2012: $2,651m). 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.

26 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:

	2013		2012	
	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
	24,000,000	**600**	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 2013 and 2012, $9m in dividends were declared and paid. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash 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 2013 and 2012, $9m in dividends were declared and paid.*

Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash 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 2013 and 2012, $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 were voting and non-cumulative. During 2013 and 2012, $27m in dividends were declared and paid. Each share yielded 7.75%, payable quarterly, as and when declared. Holders were entitled to one vote for each share held. These shares were purchased for cash at the fair value of $389m on 27 December 2013 and cancelled. The premium on cancellation of $43m was charged to retained earnings.*

Dividend restrictions:

We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 27(a)).

27 Non-controlling interest in trust and subsidiary

Non-controlling interest in trust and subsidiary comprises:

	2013 **$m**	2012 $m
HSBC Canada Asset Trust	**200**	200
HSBC Mortgage Corporation (Canada)	**–**	30
	200	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 26).

	2013		2012	
	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 HSBC Group held $30m, a 100% interest, of class B perpetual preferred shares issued by HSBC Mortgage Corporation (Canada) ('HMC'), a wholly-owned subsidiary. Dividends were declared at the discretion of the directors of HMC. No dividends were paid or payable on these perpetual preferred shares for the years ended 31 December 2013 and 2012. These shares were purchased for cash and cancelled on 4 December 2013.

28 Notes on the statement of cash flows

Non-cash items included in profit before tax	**2013** **$m**	2012 $m
Depreciation and amortization	**48**	54
Share-based payment expense	**9**	17
Loan impairment charges and other credit risk provisions	**188**	211
Charge for defined benefit pension plans	**20**	9
Gain on sale of full service retail brokerage business	**–**	(88)
	265	203

Change in operating assets		
Change in prepayment and accrued income	**(41)**	55
Change in net trading securities and net derivatives	**235**	(891)
Change in loans and advances to customers	**(967)**	(1,426)
Change in other assets	**189**	(1,049)
	(584)	(3,311)

Change in operating liabilities		
Change in accruals and deferred income	**23**	(33)
Change in deposits by banks	**(968)**	844
Change in customer accounts	**3,540**	1,690
Change in debt securities in issue	**(632)**	(1,348)
Change in financial liabilities designated at fair value	**(8)**	(571)
Change in other liabilities	**(108)**	568
	1,847	1,150

Cash and cash equivalents		
Cash and balances at central bank	**165**	56
Items in the course of collection from other banks, net	**54**	19
Loans and advances to banks of one month or less	**1,482**	1,480
T-Bills and certificates of deposits – three months or less	**195**	198
	1,896	1,753

Interest		
Interest paid	**(714)**	(801)
Interest received	**2,033**	2,301

29 Contingent liabilities, contractual commitments and guarantees

	2013 **$m**	2012 $m
Guarantees and other contingent liabilities		
Guarantees and irrevocable letters of credit pledged as collateral security	**3,940**	3,083
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend[1]	**34,588**	36,291
Documentary credits and short-term trade-related transactions	**540**	627
	35,128	36,918

[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.

US regulatory and law enforcement investigations

In December 2012, HSBC Holdings plc ('HSBC Holdings'), the bank's ultimate parent company, HSBC Bank USA, N.A. ('HBUS'), and HSBC North America Holdings ('HNAH') entered into agreements to achieve a resolution with US and UK government agencies regarding past inadequate compliance with anti-money laundering ('AML'), Bank Secrecy Act (BSA) and sanctions laws. Among other agreements, HSBC Holdings and HBUS entered into a five-year Deferred Prosecution Agreement (the 'US DPA') with the US Department of Justice ('DOJ'), HSBC Holdings entered into a two-year Deferred Prosecution Agreement with the New York County District Attorney ('DANY'), and HSBC Holdings consented to a cease and desist order with the Federal Reserve Board ('FRB'). HSBC Holdings also entered into an Undertaking with the UK Financial Services Authority (now a Financial Conduct Authority ('FCA') Direction) to comply with certain forward-looking obligations with respect to anti-money laundering and sanctions requirements over a five-year term.

In addition, HBUS entered into a monetary penalty consent order with the US Department of the Treasury's Financial Crimes Enforcement Network ('FinCEN') and a separate monetary penalty order with the Office of the Comptroller of the Currency ('OCC'). HBUS also entered into a separate consent order with the OCC requiring it to correct the circumstances and conditions as noted in the OCC's then most recent report of examination, imposing certain restrictions on HBUS directly or indirectly acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, unless it receives prior approval from the OCC. HBUS entered into a separate consent order with the OCC requiring it to adopt an enterprise wide compliance program.

Under these agreements, HSBC Holdings and HBUS will continue to cooperate fully with US and UK regulatory and law enforcement authorities and take further action to strengthen its compliance policies and procedures. Under its agreements with DOJ, the FCA, and the FRB, an independent corporate compliance monitor will evaluate the HSBC Group's progress in implementing its obligations under the relevant agreements. Michael Cherkasky has been selected as the independent monitor, and, on 1 July, 2013, the United States District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of the same.

29 Contingent liabilities, contractual commitments and guarantees *(continued)*

US regulatory and law enforcement investigations (continued)

If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DOJ's charges against those entities will be dismissed at the end of the five-year period of that agreement. Similarly, if HSBC Holdings fulfils all of the requirements imposed by the DANY DPA, DANY's charges against it will be dismissed at the end of the two-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA, and DANY may prosecute HSBC Holdings in relation to the matters which are subject of the DANY DPA if HSBC Holdings violates the terms of the DANY DPA.

Under these agreements, HSBC Holdings has certain obligations to ensure that entities in the HSBC Group, including the bank and its subsidiaries, comply with certain requirements. Steps continue to be taken to implement ongoing obligations under the US DPA, FCA direction, and other settlement agreements.

The settlement with U.S. and U.K. authorities does not preclude private litigation relating to, among other things, the HSBC Group's compliance with applicable AML/BSA and sanctions laws or other regulatory or law enforcement actions for AML/BSA or sanctions matters not covered by the various agreements.

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:

	2013	2012
Guarantees in favour of third parties	**$m**	$m
Guarantee type		
Financial guarantee contracts[1]	**1,663**	1,305
Performance bonds[2]	**2,277**	1,778
Total	**3,940**	3,083

[1] *Financial guarantees 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.

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.

30 Lease commitments

Operating lease commitments

At 31 December 2013, 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	
	2013	2012
	$m	$m
Future minimum lease payments under non-cancellable operating leases expiring		
No later than one year	**50**	53
Later than one year and no later than five years	**143**	153
Later than five years	**71**	72
	264	278

In 2013, $52m (2012: $50m) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, all of which related to minimum lease payments.

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.

	2013			2012		
	Total future minimum payment	*Unearned finance income*	*Present value*	*Total future minimum payment*	*Unearned finance income*	*Present value*
	$m	**$m**	**$m**	$m	$m	$m
Lease receivables:						
No later than one year	**709**	**(58)**	**651**	674	(63)	611
Later than one year and no later than five years	**1,383**	**(97)**	**1,286**	1,317	(98)	1,219
Later than five years	**71**	**(3)**	**68**	56	(2)	54
	2,163	**(158)**	**2,005**	2,047	(163)	1,884

At 31 December 2013, unguaranteed residual values of $11m (2012: $11m) 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 (2012: $nil) and recognized in the income statement.

31 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.

	2013 **$m**	2012 $m
Short-term employee benefits	**8**	7
Post-employment benefits	**1**	1
Other long-term benefits	**–**	1
Termination benefits	**–**	1
Share-based payments	**2**	3
	11	13

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.

	2013		2012	
	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	**5.7**	**2.8**	11.2	9.0
Credit cards	**0.2**	**0.1**	0.2	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.*

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.

	2013		2012	
	Highest balance during the year	*Balance at 31 December*	*Highest balance during the year*	*Balance at 31 December*
	$m	**$m**	$m	$m
Assets				
Trading assets	**549**	**425**	1,046	47
Derivatives	**1,032**	**1,011**	853	642
Loans and advances to banks	**833**	**299**	977	299
Loans and advances to customers	**225**	**–**	130	–
Other assets	**45**	**36**	161	45
Liabilities				
Deposits by banks	**990**	**257**	781	278
Customer accounts	**3,928**	**716**	1,502	1,502
Derivatives	**884**	**740**	900	618
Trading liabilities	**524**	**118**	735	62
Other liabilities	**112**	**23**	121	13
Subordinated liabilities	**90**	**–**	88	85

	2013	2012
	$m	$m
Income Statement		
Interest income	**62**	80
Interest expense	**(42)**	(20)
Fee income	**13**	23
Fee expense	**(5)**	(4)
Other operating income	**50**	48
General and administrative expenses	**(106)**	(103)

32 Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is 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 ('the offset criteria').

Derivatives and reverse repurchase/repurchase agreements included in the amounts not set off in the statement of financial position column relate to transactions where:

– the counterparty has an offsetting exposure with HSBC and a master netting or similar arrangement is in place with a right of set off only in the event of default, insolvency or bankruptcy, or the offset criteria are otherwise not satisfied; and

– cash and non-cash collateral received/pledged in respect of the transactions described above.

The bank offsets certain loans and advances to customers and customer accounts when the offset criteria are met and the amounts presented above represent this subset of the total amounts recognized in the balance sheet. Of this subset, the loans and advances to customers and customer accounts included in amounts not set off in the balance sheet column primarily relate to transactions where the counterparty has an offsetting exposure with HSBC and an agreement is in place with the right of offset but the offset criteria are otherwise not satisfied.

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements are as follows:

				Amounts not set off in the statement of financial position		
	Gross amounts of recognized financial assets **$m**	*Gross amounts set off in the statement of financial position* **$m**	*Amounts presented in the statement of financial position* **$m**	*Financial instruments*[1] **$m**	*Cash collateral received* **$m**	*Net amount* **$m**
At 31 December 2013						
Derivatives[2] (note 11).....	**2,112**	**–**	**2,112**	**1,282**	**13**	**817**
Reverse repurchase, securities borrowing and similar agreements:						
– Loan and advances to banks at amortized cost.......	**596**	**(263)**	**333**	**333**	**–**	**–**
– Loan and advances to customers at amortized cost.......	**6,151**	**(323)**	**5,828**	**5,828**	**–**	**–**
Loans and advances excluding reverse repos						
– to customers at amortized cost.......	**1,699**	**(1,124)**	**575**	**–**	**–**	**575**
	10,558	**(1,710)**	**8,848**	**7,443**	**13**	**1,392**

32 Offsetting of financial assets and financial liabilities *(continued)*

				Amounts not set off in the statement of financial position		
	Gross amounts of recognized financial assets	*Gross amounts set off in the statement of financial position*	*Amounts presented in the statement of financial position*	*Financial instruments*[1]	*Cash collateral received*	*Net amount*
	$m	$m	$m	$m	$m	$m
At 31 December 2012						
Derivatives[2] (note 11).....	1,810	–	1,810	1,102	60	648
Reverse repurchase, securities borrowing and similar agreement classified as:						
– Loan and advances to banks at amortized cost.......	1,065	(258)	807	807	–	–
– Loan and advances to customers at amortized cost.......	3,348	(233)	3,115	3,115	–	–
Loans and advances excluding reverse repos						
– to customers at amortized cost.......	1,339	(941)	398	–	–	398
	7,562	(1,432)	6,130	5,024	60	1,046

[1] *Including non-cash collateral.*

[2] *Includes amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

32 Offsetting of financial assets and financial liabilities *(continued)*

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements are as follows:

				Amounts not set off in the statement of financial position		
	Gross amounts of recognized financial liabilities	*Gross amounts set off in the statement of financial position*	*Amounts presented in the statement of financial position*	*Financial instruments*[1]	*Cash collateral pledged*	*Net amount*
	$m	**$m**	**$m**	**$m**	**$m**	**$m**
At 31 December 2013						
Derivatives[2] (note 11).....	**1,746**	**–**	**1,746**	**1,282**	**93**	**371**
Repurchase, securities lending and similar agreements						
– Deposits by banks at amortized cost ..	**832**	**(263)**	**569**	**569**	**–**	**–**
– Customer accounts at amortized cost ..	**1,241**	**(323)**	**918**	**918**	**–**	**–**
Customer accounts excluding repos at amortized cost	**2,006**	**(1,124)**	**882**	**–**	**–**	**882**
	5,825	**(1,710)**	**4,115**	**2,769**	**93**	**1,253**
At 31 December 2012						
Derivatives[2] (note 11).....	1,415	–	1,415	1,102	35	278
Repurchase, securities lending and similar agreements						
– Deposits by banks at amortized cost ..	1,275	(258)	1,017	1,017	–	–
– Customer accounts at amortized cost ..	2,245	(233)	2,012	2,012	–	–
Customer accounts excluding repos at amortized cost	1,846	(941)	905	–	–	905
	6,781	(1,432)	5,349	4,131	35	1,183

[1] *Including non-cash collateral.*

[2] *Includes amounts that are both subject to and not subject to enforceable master netting agreements and similar agreements.*

33 Events after the reporting period

Except as noted above, there have been no other material events after the reporting period which would require disclosure or adjustment to the 31 December 2013 consolidated financial statements.

These accounts were approved by the Board of Directors on 21 February 2014 and authorized for issue.

HSBC Group International Network*

Services are provided by over 6,300 offices in 75 countries and territories:

Europe	*Offices*
Armenia	10
Austria	1
Belgium	2
Channel Islands	27
Czech Republic	2
France	406
Germany	14
Greece	17
Ireland	4
Isle of Man	2
Italy	3
Kazakhstan	6
Luxembourg	8
Malta	38
Monaco	3
Netherlands	1
Poland	5
Russia	3
Spain	3
Sweden	2
Switzerland	15
Turkey	317
United Kingdom	1,155

Asia-Pacific	*Offices*
Australia	37
Bangladesh	14
Brunei Darussalam	11
China	243
Cook Islands	1
Hong Kong Special Administrative Region	254
India	83
Indonesia	144
Japan	4
Korea, Republic of	13
Macau Special Administrative Region	7
Malaysia	75
Maldives	1
New Zealand	10
Philippines	17
Singapore	19
Sri Lanka	18
Taiwan	53
Thailand	1
Vietnam	19

Americas	*Offices*
Argentina	161
Bahamas	3
Bermuda	10
Brazil	1,353
British Virgin Islands	2
Canada	161
Cayman Islands	6
Chile	3
Colombia	22
Mexico	992
Peru	1
United States of America	257
Uruguay	10

Middle East and Africa	*Offices*
Algeria	3
Angola	1
Bahrain	5
Egypt	75
Israel	1
Jordan	4
Kenya	1
Kuwait	1
Lebanon	5
Libya	1
Mauritius	12
Nigeria	1
Oman	84
Pakistan	11
Palestinian Autonomous Area	1
Qatar	3
Saudi Arabia	102
South Africa	4
United Arab Emirates	16

Associated companies are included in the network of offices.

HSBC Bank Canada Subsidiaries*

HSBC Global Asset Management (Canada) Limited
1 (888) 390-3333
www.hsbc.ca

HSBC Investment Funds (Canada) Inc.
1 (800) 830-8888
www.hsbc.ca/funds

HSBC Private Wealth Services (Canada) Inc.
1 (888) 390-3333
www.hsbc.ca

HSBC Securities (Canada) Inc.
1 (800) 760-1180
www.hsbc.ca

HSBC Trust Company (Canada)
1 (888) 887-3388
www.hsbc.ca/trust

For more information, or to find the HSBC Bank Canada branch nearest you, call 1 (888) 310-4722 or visit our website at www.hsbc.ca

* *As of March 2014*

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Vancouver

Jacques Fleurant
Chief Financial Officer
Vancouver

Jason Henderson
Executive Vice President and Managing Director, Head of Global Banking and Markets
Toronto

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Vancouver

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Sandra Stuart
Chief Operating Officer
HSBC Bank Canada

Helen Wong
Deputy Chairman, President and Chief Executive Officer
HSBC Bank (China) Company Limited

* *As of March 2014*

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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)

SHAREHOLDER CONTACT:

For change of address, shareholders are requested to contact their brokers.

For general information please write to the bank's transfer agent, Computershare Investor Services Inc., at their mailing address or by e-mail to service@computershare.com.

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

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TRANSFER AGENT AND REGISTRAR:

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Shareholder Service Department
9th Floor, 100 University Avenue
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Tel: 1 (800) 564-6253

DIVIDEND DATES:

Dividend record and payable dates for the bank's preferred shares, subject to approval by the Board, are:

Record Date	*Payable Date*
14 March	31 March
13 June	30 June
15 September	30 September
15 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.

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