

HSBC HOLDINGS PLC
Form 6-K
March 02, 2010

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a — 16 or 15d — 16 of

the Securities Exchange Act of 1934

For the month of March

HSBC Holdings plc

42nd Floor, 8 Canada Square, London E14 5HQ, England

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F).

Form 20-F Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934).

Yes..... No

(If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-).

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**UNITED STATES SECURITIES AND
EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

(Mark One)

- x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

OR

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-7436

HSBC USA Inc.

(Exact name of registrant as specified in its charter)

Maryland

(State of incorporation)

452 Fifth Avenue, New York

(Address of principal executive offices)

13-2764867

(I.R.S. Employer Identification No.)

10018

(Zip Code)

(212) 525-5000

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Floating Rate Notes due August 13, 2010	New York Stock Exchange
Floating Rate Notes due June 17, 2011	New York Stock Exchange
3.125% Guaranteed Notes due December 16, 2011	New York Stock Exchange
Floating Rate Guaranteed Notes due December 19, 2011	New York Stock Exchange
Depository Shares (each representing a one-fourth share of Adjustable Rate Cumulative Preferred Stock, Series D)	New York Stock Exchange
\$2.8575 Cumulative Preferred Stock	New York Stock Exchange
Floating Rate Non-Cumulative Preferred Stock, Series F	New York Stock Exchange
Depository Shares (each representing a one-fortieth share of Floating Rate Non-Cumulative Preferred Stock, Series G)	New York Stock Exchange
Depository Shares (each representing a one-fortieth share of	

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Floating Rate Non-Cumulative Preferred Stock, Series H)

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of February 26, 2010, there were 712 shares of the registrant's common stock outstanding, all of which are owned by HSBC North America Inc.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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HSBC USA Inc. (HSBC USA) and, together with its subsidiaries, HUSI), incorporated under the laws of the State of Maryland in 1973 as Republic New York Corporation, traces its origin to 1850 and The Marine Trust Company in Buffalo, New York, which later became Marine Midland Bank. In 1980, The Hongkong and Shanghai Banking Corporation Limited (now HSBC Holdings plc, hereinafter referred to as HSBC) acquired 51 percent of the common stock of Marine Midland Banks, Inc., the holding company for Marine Midland Bank, and the remaining 49% in 1987. In December 1999, HSBC acquired Republic New York Corporation through a merger with RNYC Merger Corporation, a wholly owned subsidiary of HSBC, with Republic New York Corporation surviving the merger and merged Marine Midland Banks, Inc., then known as HSBC USA Inc., with and into Republic New York Corporation. In January 2000, Republic New York Corporation changed its name to HSBC USA Inc.

HSBC North America Operations

HSBC North America Holdings Inc. (HSBC North America) was the holding company for HSBC 's operations in the United States and Canada at December 31, 2009. The principal subsidiaries of HSBC North America at December 31, 2009 were HSBC USA, HSBC Markets (USA) Inc., a holding company for certain global banking and markets subsidiaries, HSBC Finance Corporation (HSBC Finance), a holding company for consumer finance businesses, HSBC Bank Canada, a Federal bank chartered under the laws of Canada (HBCA), and HSBC Technology & Services (USA) Inc. (HTSU), a provider of information technology and centralized operational and support services including human resources, corporate affairs and other services shared among the subsidiaries of HSBC North America which beginning in 2010, will also include tax, finance, compliance and legal. In late January 2010, HBCA was sold to an affiliate and is no longer a subsidiary of HSBC North America. Under the oversight of HSBC North America, HUSI works with its affiliates to maximize opportunities and efficiencies in HSBC 's operations in the United States. These affiliates do so by providing each other with, among other things, alternative sources of liquidity to fund operations and expertise in specialized corporate functions and services. This has been demonstrated by purchases and sales of receivables between HSBC Bank USA, National Association (HSBC Bank USA) and HSBC Finance and a pooling of resources within HTSU to provide shared, allocated support functions to all HSBC North America subsidiaries. In addition, clients of HSBC Bank USA, HSBC USA 's principal U.S. banking subsidiary, and other affiliates are investors in debt and preferred securities issued by HSBC USA and/or HSBC Bank USA, providing significant sources of liquidity and capital to both entities. HSBC Securities (USA) Inc., a Delaware corporation, a registered broker dealer and a subsidiary of HSBC Markets (USA) Inc., leads or participates as underwriter of all HUSI domestic issuances of term corporate and, historically, HSBC Finance term corporate and asset-backed securities. While neither HSBC USA nor HSBC Bank USA has received advantaged pricing, the underwriting fees and commissions payable to HSBC Securities (USA) Inc. benefit HSBC as a whole.

HSBC USA Inc. General

HSBC Bank USA, HSBC USA 's principal U.S. banking subsidiary, is a national banking association with banking branch offices and/or representative offices in California, Connecticut, Delaware, Florida, Illinois, Maryland, Massachusetts, New Jersey, New York, Oregon, Pennsylvania, Texas, Virginia, Washington and the District of Columbia. In addition to its domestic offices, HSBC Bank USA maintains foreign branch offices, subsidiaries and/or representative offices in the Caribbean, Europe, Asia, Latin America and Canada. In this Form 10-K, HSBC USA and

its subsidiaries are referred to as we, us or our. Through HSBC Bank USA, we offer our customers a full range of commercial and consumer banking products and related financial services. Our customers include individuals, including high net worth individuals, small businesses, corporations, institutions and governments.

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HSBC Bank USA also engages in mortgage banking, and is an international dealer in derivative instruments denominated in U.S. dollars and other currencies, focusing on structuring of transactions to meet clients' needs, as well as for proprietary purposes. HSBC Bank USA's main office is in McLean, Virginia, and its principal executive offices are located at 452 Fifth Avenue, New York, New York. Its domestic operations are located primarily in New York State.

In 2005, HSBC USA incorporated a nationally chartered limited purpose bank subsidiary, HSBC Trust Company (Delaware), National Association (HTCD). HTCD's charter includes the following primary activities:

Custodian of investment securities for other HSBC affiliates;

Personal trust services; and

Originator of refund anticipation loans and checks in support of taxpayer financial services business lines.

The operations of HTCD had an immaterial impact on HSBC USA's consolidated balance sheets and results of operations for the years ended December 31, 2009 and 2008.

In 2006, HSBC USA formed HSBC National Bank USA (HBMD), a national banking association established to support HSBC USA's retail branch expansion strategy. HBMD was merged with and into HSBC Bank USA in December 2008, at which time HSBC Bank USA relocated its main office to McLean, Virginia. The operations of HBMD had an immaterial impact on HSBC USA's consolidated balance sheet and results of operations for the years ended December 31, 2008 and 2007.

Income Before Income Tax Expense – Significant Trends Income before income tax expense, and various trends and activity affecting operations, are summarized in the following table.

Year Ended December 31,	2009	2008	2007
	(in millions)		
Income (Loss) before income tax from prior year	\$ (2,608)	\$ 137	\$ 1,566
Increase (decrease) in income before income tax expense attributable to:			
Balance sheet management activities ⁽¹⁾	676	127	(70)
Trading related activities ⁽²⁾	2,905	(2,387)	(606)
Credit card fees ⁽³⁾	477	62	237
Loans held for sale ⁽⁴⁾	263	(9)	(512)
Residential mortgage banking related revenue ⁽⁵⁾	183	(85)	(22)
Gain (loss) on own debt designated at fair value and related derivatives ⁽⁶⁾	(1,164)	670	-
Gain (loss) on instruments designated at fair value and related derivatives, excluding own debt ⁽⁶⁾	625	(384)	-
Provision for credit losses ⁽⁷⁾	(1,601)	(1,021)	(699)
Goodwill impairment loss ⁽⁸⁾	-	(54)	-
All other activity ⁽⁹⁾	18	336	243
	2,382	(2,745)	(1,429)

Income (Loss) before income tax for current year	\$	(226)	\$	(2,608)	\$	137
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- (1) Balance sheet management activities are comprised primarily of net interest income and, to a lesser extent, gains on sales of investments, resulting from management of interest rate risk associated with the repricing characteristics of balance sheet assets and liabilities. For additional discussion regarding Global Banking and Markets net interest income, trading revenues, and the Global Banking and Markets business segment see the caption **Business Segments** in the Management's Discussion and Analysis of Financial Condition and Results of Operations (**MD&A**) section of this Form 10-K.
- (2) For additional discussion regarding trading revenue (loss), see the caption **Results of Operations** in the MD&A section of this Form 10-K.
- (3) For additional discussion regarding credit card fees, see the caption **Results of Operations** in the MD&A section of this Form 10-K.
- (4) For additional discussion regarding loans, see the caption **Balance Sheet Review** in the MD&A section of this Form 10-K.

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HSBC USA Inc.

- (5) For additional discussion regarding residential mortgage banking revenue, see the caption Results of Operations in the MD&A section of this Form 10-K.
- (6) For additional discussion regarding fair value option and fair value measurement, see Note 17 Fair Value Option, in the accompanying consolidated financial statements.
- (7) For additional discussion regarding provision for credit losses, see the caption Results of Operation in the MD&A section of this Form 10-K.
- (8) For additional discussion regarding goodwill impairment, see Note 12, Goodwill, in the accompanying consolidated financial statements.
- (9) Represents other core banking activities.

Funding

We fund our operations using a combination of consumer and commercial deposits, issuing short-term and long-term debt, borrowing under secured financing facilities, issuing preferred equity, selling liquid assets and, as necessary, receiving capital contributions from our immediate parent, HSBC North America Inc. (HNAI). Our continued success is primarily dependent upon our ability to attract and retain deposits. Emphasis is placed on maintaining stability in core deposit balances. Numerous factors, both internal and external, may impact our access to, and the costs associated with, both retail and wholesale sources of funding. These factors may include our debt ratings, overall economic conditions, overall capital markets volatility, the counterparty credit limits of investors to the HSBC Group and the effectiveness of our management of the credit risks inherent in our business and customer base.

In 2009, our primary sources of funds were deposits, issuances of commercial paper and term debt, certain secured financings and receipt of capital contributions from our parent, HNAI. As a result of the systemic reduction in available liquidity in the market, we took steps to reduce our reliance on debt capital markets and increase deposits. While we raised \$3.6 billion of new term funding at various points during 2009, after adjusting for paydowns associated with the \$6.1 billion of debt acquired in connection with the credit card purchases from our affiliate in 2009, we retired long-term debt of \$9.5 billion in 2009. In the latter part of 2008, we grew deposits in anticipation of asset purchases from our affiliates, and December 31, 2008 balances also benefited from customers moving funds to larger, well-capitalized institutions. As a result, both core and overall deposit balances increased in 2008, in both absolute terms and in proportion to total liabilities. In 2009, we managed our overall balance sheet downward and, as a result, deposits decreased slightly to \$118.3 billion at December 31, 2009 from \$119.0 billion at December 31, 2008. In 2009, we received capital contributions from HNAI totaling \$2.2 billion which we used to support ongoing operations and to maintain capital at levels we believe are prudent in the current market conditions, including \$1.1 billion to provide capital support for the receivables purchased from HSBC Finance in January 2009.

A detailed description of our sources and availability of funding are set forth in the Liquidity and Capital Resources and Off Balance Sheet Arrangements sections of the MD&A.

We use the cash generated by these financing activities to service our debt obligations, to originate and purchase new loans, to purchase investment securities and to pay dividends to our preferred shareholders and, as available and appropriate, to our parent.

Our long-term debt, preferred stock and commercial paper have been assigned investment grade ratings by all nationally recognized statistical rating organizations. For a detailed listing of the ratings that have been assigned to HSBC USA at December 31, 2009, see the Liquidity and Capital Resources section of the MD&A.

Employees and Customers

At December 31, 2009, we had approximately 12,000 employees. Effective as of January 1, 2010, we had approximately 11,000 employees as a result of the transfer of certain staff function employees to HTSU which provides shared, allocated support services to all HSBC North America subsidiaries, including HUSI.

At December 31, 2009, we had over 4 million customers, some of which are customers of more than one of our businesses. Customers in the state of New York accounted for 31 percent of our outstanding loans.

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HSBC USA Inc.

Operations

We have five reportable segments: Personal Financial Services (PFS), Consumer Finance (CF), Commercial Banking (CMB), Global Banking and Markets and Private Banking (PB). Our segments are managed separately and are based upon customer groupings as well as products and services offered. Adjustments made at the corporate level for fair value option accounting related to certain debt issued and, in prior years, an equity investment in HSBC Private Bank (Suisse) S.A. are included under the Other caption within our segment disclosure.

Corporate goals and individual goals of executives are currently calculated in accordance with International Financial Reporting Standards (IFRSs) under which HSBC prepares its consolidated financial statements. As a result, operating results are monitored and reviewed, trends are evaluated and decisions about allocating resources, such as employees, are made almost exclusively on an IFRS basis (a non-U.S. GAAP financial measure). Accordingly, in accordance with applicable accounting standards, our segment reporting is on an IFRS basis. However, we continue to monitor capital adequacy, establish dividend policy and report to regulatory agencies on a U.S. GAAP basis. For additional financial information relating to our businesses and operating segments and a summary of the significant differences between U.S. GAAP and IFRSs as they impact our results, see Note 24, Business Segments, in the accompanying consolidated financial statements.

Personal Financial Services Segment Through its 479 branches, on-line and phone services, PFS provides a broad range of financial products and services directed towards the expansion of our core retail banking business, including revolving term loans, MasterCard¹ and Visa² credit card loans, deposits, branch services and financial planning products and services such as mutual funds, investments and insurance. Our lead proposition is HSBC Premier, a premium relationship banking service designed for the internationally minded mass affluent consumer. Premier enables customers to access all their local and international accounts from a single on-line view and provides free international funds transfers between these accounts. The Premier service is delivered by a personal Premier relationship manager, supported by a 24-hour priority telephone and internet service. Through our on-line banking business, we offer higher-yield savings, payment accounts and CDs. PFS also provides residential mortgage lending through our branch network. In 2008, we decided to discontinue residential mortgage loan originations through wholesale origination channels. Servicing is performed on a contractual basis for residential mortgage loans owned by HSBC Bank USA and by third parties.

Consumer Finance Segment The CF segment includes point of sale and other lending activities primarily to meet the financial needs of individuals. Specifically, operating activity within the CF segment relates to nonconforming residential mortgage loans, other consumer loans and private label credit card receivables purchased from HSBC Finance. As described herein, in January 2009 we purchased portfolios of credit card receivables originated under HSBC Finance's General Motors MasterCard program and Union Plus MasterCard and Visa credit card program, as well as certain auto finance receivables, from HSBC Finance. We will also purchase additional receivable originations generated under existing and future General Motors and Union Plus accounts. The CF segment also includes activities within these portfolios.

Commercial Banking Segment In support of HSBC's strategy to be the leader in international banking in target markets, CMB serves the growing number of U.S. companies that are increasingly in need of international banking and financial products and services. CMB offers comprehensive domestic and international services and banking, insurance and investment products to companies, government entities and non-profit organizations, with a particular emphasis on geographical collaboration to meet the banking needs of its international business customers. CMB provide loan and deposit products, payments and cash management services, merchant services, trade and supply

chain, corporate finance, global markets and risk advisory to small businesses and middle-market corporations, including specialized products such as real estate financing. CMB also offers various credit and trade

¹ MasterCard is a registered trademark of MasterCard International Incorporated (d/b/a MasterCard Worldwide).

² Visa is a registered trademark of Visa USA, Inc.

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HSBC USA Inc.

related products such as standby facilities, performance guarantees and acceptances. These products and services are offered through multiple delivery systems, including our branch banking network.

Global Banking and Markets Segment Global Banking and Markets is an emerging markets-led and financing-focused business that provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business, Global Banking and Markets clients are served by teams that bring together relationship managers and product specialists to develop financial solutions that meet individual client needs. To ensure that a comprehensive understanding of each client's financial requirements is developed, the Global Banking and Markets teams take a long-term relationship management approach.

Within client-focused business lines, Global Banking and Markets offers a full range of capabilities:

Investment banking and financing solutions for corporate and institutional clients, including corporate banking, investment banking, trade services, payments and cash management, and leveraged acquisition finance;

One of the largest markets businesses of its kind, with 24-hour coverage and knowledge of local markets and providing services in credit and rates, foreign exchange, money markets and securities services; and

Global asset management solutions for institutions, financial intermediaries and private investors worldwide.

Private Banking Segment PB provides private banking and trustee services to high net worth individuals and families with local and international needs. Accessing the most suitable products from the marketplace, PB works with its clients to offer both traditional and innovative ways to manage and preserve wealth while optimizing returns. PB offers a wide range of wealth management and specialist advisory services, including banking, liquidity management, investment services, custody services, tailored lending, wealth planning, trust and fiduciary services, insurance, family wealth and philanthropy advisory services. PB also works to ensure that its clients have access to other products and services, capabilities, resources and expertise available throughout HSBC, such as credit cards, investment banking and commercial real estate and middle market lending, to deliver services and solutions for all aspects of their wealth management needs.

Regulation and Competition

Regulation The statutory and regulatory framework governing our operations and that of our significant subsidiaries is described below. Congress has established this framework, applicable to bank holding companies, for the purpose of protecting depositors, the federal deposit insurance fund, consumers and the banking system as a whole. Applicable statutes, regulations or resulting policies could restrict our ability to diversify into other areas of financial services, acquire depository institutions or pay dividends on our capital stock. Banking rules and supervisors may also require us to provide financial support to one or more of our subsidiary banks, maintain capital balances in excess of those desired by management, and pay higher deposit insurance premiums as a result of a general deterioration in the financial condition of federally-insured depository institutions.

The U.S. Federal government and banking regulators continued their efforts to stabilize the U.S. economy in 2009. On June 17, 2009, the Administration unveiled its proposal for a sweeping overhaul of the financial regulatory system. The Financial Regulatory Reform proposals are comprehensive and include the creation of an inter-agency Financial Services Oversight Council to, among other things, identify emerging risks and advise the Board of Governors of the Federal Reserve System (the Federal Reserve Board) regarding institutions whose failure could pose a threat to financial stability; expand the Federal Reserve Board's powers to regulate these systemically-important institutions and

impose more stringent capital and risk management requirements; create a Consumer Financial Protection Agency (the CFPA) as a single primary Federal consumer protection supervisor, which will regulate credit, savings, payment and other consumer financial products and services and providers of those products and services; and impose comprehensive regulation of over-the-counter (OTC) derivatives markets, including credit default swaps, and prudent supervision of OTC derivatives dealers. In December 2009, the U.S. House of Representatives passed The Wall Street Reform and Consumer Protection Act, which addresses many

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of the Administration's proposed reforms. Similar legislation is under consideration by the U.S. Senate Committee on Banking, Housing, and Urban Affairs. On January 14, 2010, the Administration announced its intention to propose a Financial Crisis Responsibility Fee to be assessed against financial institutions with more than \$50 billion in consolidated assets for at least 10 years. On January 21, 2010, the Administration announced a proposal that would prohibit banks and financial institutions that own banks from owning, investing in or sponsoring a hedge fund or private equity fund and engaging in proprietary trading operations for their own account. The proposal would also place broader limits on growth in market share of liabilities at the largest financial institutions, which would supplement existing limits on market share of deposits. It is likely that some portion of the financial regulatory reform proposals will be adopted and enacted. The reforms may have a significant impact on the operations of financial institutions in the U.S., including us and our affiliates. However, it is not possible to assess the impact of financial regulatory reform until final legislation has been enacted and related regulations have been adopted.

Bank Holding Company Supervision As a bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956, as amended (BHC Act), and to inspection, examination and supervision by its primary regulator, the Federal Reserve Board. We are also subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the Securities and Exchange Commission (the SEC).

We have registered as a financial holding company pursuant to the BHC Act and, accordingly, may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. Financial in nature activities include securities underwriting, dealing and market making, sponsoring mutual funds and investment companies, insurance underwriting and agency, merchant banking, and activities that the Federal Reserve Board, in consultation with the Secretary of the U.S. Treasury, determines from time to time to be financial in nature or incidental to such financial activity.

Complementary activities are activities that the Federal Reserve determines upon application to be complementary to a financial activity and do not pose a safety and soundness risk.

Because we are a financial holding company, if any of our subsidiary banks receives a rating under the Community Reinvestment Act of 1977, as amended (CRA), of less than satisfactory, we will be prohibited, until the rating is raised to satisfactory or better, from engaging in new activities or acquiring companies other than bank holding companies, banks, or savings associations, except that we could engage in new activities, or acquire companies engaged in activities that are closely related to banking under the BHC Act. In addition, should the Federal Reserve determine that any of our subsidiary banks are not well capitalized or well managed, we would be required to enter into an agreement with the Federal Reserve Board to comply with all applicable capital and management requirements (which may contain additional limitations or conditions). Until corrected, we would not be able to engage in any new activity or acquire companies engaged in activities that are not closely related to banking under the BHC Act without prior Federal Reserve Board approval. If we fail to correct any such condition within a prescribed period, the Federal Reserve Board could order us to divest our banking subsidiaries or, in the alternative, to cease engaging in activities other than those closely related to banking under the BHC Act. As of December 31, 2009, no known deficiencies exist, and we are not subject to limitations or penalties relative to its status as a financial holding company.

We are generally prohibited under the BHC Act from acquiring, directly or indirectly, ownership or control of more than 5 percent of any class of voting shares of, or substantially all the assets of, or exercising control over, any U.S. bank, bank holding company or many other types of depository institutions and/or their holding companies without the prior approval of the Federal Reserve and potentially other U.S. banking regulatory agencies.

The Gramm-Leach-Bliley Act of 1999 (GLB Act) and the regulations issued thereunder contain a number of other provisions that affect our operations and those of our subsidiary banks. One such provision contained detailed requirements relating to the financial privacy of consumers. In addition, the so-called push-out provisions of the GLB Act removed the blanket exemption from registration for securities activities conducted in banks (including HSBC Bank USA) under the Exchange Act of 1934, as amended. New rules have been published to implement these changes and, when effective, will allow banks to continue to avoid registration as a broker or dealer only if

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they conduct securities activities that fall within a set of defined exceptions. A narrowed dealer definition took effect in September 2003, and a narrowed broker definition takes effect for each bank on the first day of its fiscal year following September 30, 2008. Pursuant to the new regulations, certain securities activities currently conducted by HSBC Bank USA were restructured or transferred to one or more U.S.-registered broker-dealer affiliates effective January 1, 2009.

Our consumer lending businesses operate in a highly regulated environment. These businesses are subject to laws relating to consumer protection including, without limitation, fair lending, use of credit reports, privacy matters, and disclosure of credit terms and correction of billing errors. Local, state and national regulatory agencies continue efforts to address perceived problems within the mortgage lending and credit card industries through broad or targeted legislative or regulatory initiatives aimed at lenders' operations in consumer lending markets. There continues to be a significant amount of legislative activity, nationally, locally and at the state level, aimed at curbing certain lending practices.

On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the CARD Act) was signed into law with likely significant impact on the credit card industry. The CARD Act, which through Federal Reserve Board rulemaking becomes effective in three stages (i.e., August 2009, February 2010 and August 2010), primarily amends the Truth in Lending Act by adding a number of new substantive and disclosure requirements building upon the Regulation AA and Regulation Z requirements adopted by the Federal Reserve Board in January 2009 (the January 2009 rules). The February 2010 rulemaking implemented the majority of the CARD Act provisions which, among other things, restrict application of interest rate increases on new and existing balances, prescribe the manner in which payments in excess of the minimum payment may be allocated to amounts due and when penalty rates may be charged on past due balances, and require customers to opt-in to over limit fee assessments. Because many of the requirements of the January 2009 Regulation AA and Regulation Z rules are included in the February 2010 CARD Act rule, the Federal Reserve Board has issued notices withdrawing the January 2009 rules. The Federal Reserve is expected in the near term to promulgate rules that will interpret and implement the provisions of the CARD Act which take effect in August 2010. The August 2010 CARD Act rules will address the reasonableness and proportionality of penalty fees and charges and require that accounts subjected to prior interest rate increases be periodically re-evaluated for interest rate decreases. The CARD Act also requires other government agencies to conduct studies on interchange, debt cancellation agreements and credit insurance products and present reports to Congress on these topics. We are compliant with the provisions of the CARD Act that took effect in August 2009 and February 2010 and continue to make changes to processes and systems in order to comply with the remaining provisions of the CARD Act by the applicable August 2010 effective date. The CARD Act has required us to make changes to our business practices, and will likely require us and our competitors to manage risk differently than has historically been the case. Pricing, underwriting and product changes in response to the new legislation have either been implemented or are under analysis. We currently believe the implementation of these new rules will not have a material adverse impact to us as any impact would be limited to only a portion of the existing affected loan portfolio as the purchase price on future sales volume paid to HSBC Finance would be adjusted to fully reflect the new requirements.

Due to the turmoil in the mortgage lending markets, there has also been a significant amount of federal and state legislative and regulatory focus on this industry. Several regulators, legislators and other government bodies have promoted particular views of appropriate or model loan modification programs, suitable loan products and foreclosure and loss mitigation practices. We have developed a modification program that employs procedures that we believe are most responsive to our customers needs and continue to enhance and refine these practices as other programs are announced, and we evaluate the results of our customer assistance efforts.

Supervision of Bank Subsidiaries Our subsidiary national banks, HSBC Bank USA and HTCD, are subject to regulation and examination primarily by the Office of the Comptroller of the Currency (OCC), secondarily by the FDIC, and by the Federal Reserve. HSBC Bank USA and HTCD are subject to banking laws and regulations that place various restrictions on and requirements regarding their operations and administration, including the establishment and maintenance of branch offices, capital and reserve requirements, deposits and borrowings, investment and lending activities, payment of dividends and numerous other matters.

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Federal law limits the extent to which HSBC Bank USA and HTCD may pay dividends to HSBC USA. The amount these banks may pay, without specific OCC approval, is limited to the lesser of the amounts calculated under a recent earnings test and an undivided profits test. Under the recent earnings test, a dividend may not be paid if the total of all dividends declared by a bank in any calendar year is in excess of the current year's net income combined with the retained net income of the two preceding years, unless the national bank obtains the approval of the OCC. Under the undivided profits test, a dividend may not be paid in excess of a bank's undivided profits. In addition, the OCC, the Federal Reserve Board, and the FDIC have authority to prohibit or to limit the payment of dividends by the banking organizations they supervise, including HSBC USA and HSBC Bank USA, if they would consider payment of such dividend to constitute an unsafe or unsound practice in light of the financial condition of the banking organization. HSBC Bank USA is also required to maintain reserves in the form of vault cash and deposits with the Federal Reserve Bank.

The Federal Reserve Act limits the extent to which HSBC Bank USA and HTCD may transfer funds or other items of value to HSBC USA or other affiliates in so-called covered transactions. Covered transactions include loans and other extensions of credit, investments and asset purchases, as well as certain other transactions involving the transfer of value from a subsidiary bank to an affiliate or for the benefit of an affiliate. Unless an exemption applies, or unless a specific waiver is granted by the Federal Reserve Board, covered transactions by a bank with a single affiliate are limited to 10 percent of the bank's capital and surplus and all covered transactions with affiliates in the aggregate, are limited to 20 percent of the bank's capital and surplus. Loans and extensions of credit to affiliates by a bank generally are required to be secured in specified amounts with specific types of collateral. All of a bank's transactions with its non-bank affiliates are also generally required to be on arm's length terms.

Federal Reserve Board policy states that a bank holding company such as HSBC USA, is expected to act as a source of financial and managerial strength to each of its subsidiary banks and, under appropriate circumstances, to commit resources to support each such subsidiary bank.

Regulatory Capital Requirements As a bank holding company, we are subject to regulatory capital requirements and guidelines imposed by the Federal Reserve Board, which are substantially similar to those imposed by the OCC and the FDIC on banks such as HSBC Bank USA and HTCD. A bank or bank holding company's failure to meet minimum capital requirements can result in certain mandatory actions and possibly additional discretionary actions by its regulators. Under current capital guidelines, a bank or a holding company's assets and certain specified off-balance sheet commitments and obligations are assigned to various risk categories. A bank or holding company's capital, in turn, is classified into one of three tiers. Tier 1 capital includes common equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock at the holding company level, and minority interests in equity accounts of consolidated subsidiaries, less goodwill and certain other deductions. Tier 2 capital includes, among other things, perpetual preferred stock not qualified as Tier 1 capital, subordinated debt, and allowances for loan and lease losses, subject to certain limitations. Tier 3 capital includes qualifying unsecured subordinated debt. At least one-half of a bank's total capital must qualify as Tier 1 capital. To be categorized as well capitalized, a banking institution must have the minimum ratios reflected in the table included in Note 25, Retained Earnings and Regulatory Capital Requirements of the consolidated financial statements and must not be subject to a directive, order or written agreement to meet and maintain specific capital levels. The federal bank regulatory agencies may, however, set higher capital requirements for an individual bank or when a bank's particular circumstances warrant. The Federal Reserve Board may also set higher capital requirements for holding companies whose circumstances warrant it. As part of the regulatory approvals with respect to the credit card and auto receivable portfolio purchases completed in January 2009 and described in the 2009 Events section of the MD&A, HSBC USA and its ultimate parent, HSBC, committed that HSBC Bank USA will maintain specified Tier 1 risk-based capital, total capital and Tier 1 leverage ratios for one year following the date of transfer, and that HSBC Bank USA will hold sufficient capital with respect to the purchased

receivables that are or become low-quality assets, as defined by the Federal Reserve Act. See Note 25, Retained Earnings and Regulatory Capital Requirements in the consolidated financial statements for further discussion.

In December 2007, U.S. regulators published a final rule regarding Risk-Based Capital Standards: Advanced Capital Adequacy Framework - Basel II. This final rule represents the U.S. adoption of the Basel II International

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Capital Accord (Basel II). The final rule became effective April 1, 2008, and requires large bank holding companies, including HSBC North America, to adopt its provisions subject to regulatory approval no later than April 1, 2011. HSBC North America has established comprehensive Basel II implementation project teams comprised of finance and risk management specialists representing all risk disciplines. We anticipate that the implementation of Basel II may impact our product offerings, funding of products and regulatory capital. However, any impact will be based on our prevailing risk profile. Basel II also requires that HSBC North America precede its adoption of the Basel II provisions by initiating a parallel run period for at least four quarters which was initiated in January 2010 by HSBC North America. As a result, we will support the parallel run period by supplying data relating to risk to HSBC North America.

HSBC North America and HSBC USA continue to support the HSBC implementation of the Basel II framework, as adopted by the U.K. Financial Services Authority (FSA). We supply data regarding credit risk, operational risk and market risk to support HSBC's regulatory capital and risk weighted asset calculations. Revised FSA capital adequacy rules for HSBC became effective January 1, 2008.

In addition, U.S. bank regulatory agencies have maintained the leverage regulatory capital requirements that generally require United States banks and bank holding companies to maintain a minimum amount of capital in relation to their balance sheet assets (measured on a non-risk-weighted basis).

Our capital resources are summarized under Liquidity and Capital Resources in MD&A. Capital amounts and ratios for HSBC USA and HSBC Bank USA are summarized in Note 25, Retained Earnings and Regulatory Capital Requirements of the consolidated financial statements. From time to time, bank regulators propose amendments to or issue interpretations of risk-based capital guidelines. Such proposals or interpretations could, upon implementation, affect reported capital ratios and net risk weighted assets.

FDIC Programs HSBC Bank USA and HTCD are subject to risk-based assessments from the FDIC, which insures deposits generally to a maximum of \$100,000 per depositor for domestic deposits. In October 2008, the FDIC raised the maximum amount of insured deposits to \$250,000 per depositor and, on May 20, 2009, extended the increased limit until December 31, 2013. On January 1, 2014, the limit will return to \$100,000 for all deposit accounts, except for certain retirement accounts which remain insured up to \$250,000 per depositor. Depository institutions subject to assessment are categorized based on supervisory ratings, financial ratios and, in the case of larger institutions, long-term debt issuer ratings, with those in the highest rated categories paying lower assessments. While the assessments are generally payable quarterly, the FDIC also has the authority to impose special assessments to prevent the deposit insurance fund from declining to an unacceptable level. Pursuant to this authority, the FDIC imposed a 5 basis point special assessment on June 30, 2009. In September 2009, the FDIC increased annual assessment rates by three basis points beginning in 2011. In November 2009, the FDIC amended its regulations to require depository institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012 on or before December 30, 2009.

The Deposit Insurance Funds Act of 1996 authorized the Financing Corporation (FICO), a Federal agency established to collect funds from FDIC-insured institutions, to pay interest on FICO bonds. The FICO assessment rate is adjusted quarterly. HSBC Bank USA and HTCD are subject to a quarterly FICO premium.

On October 14, 2008, the FDIC announced the TLGP, under which the FDIC guaranteed (i) newly-issued senior unsecured debt issued by eligible, participating institutions, and (ii) certain non-interest bearing transaction accounts. The Debt Guarantee Program applies to senior unsecured debt issued by eligible entities on or after October 14, 2008 and on or before October 31, 2009. The FDIC guarantee continues on qualifying debt until the earlier of maturity or

June 30, 2012. Eligible entities that participated in the debt guarantee component of the TLGP are assessed fees ranging from 50 to 100 basis points on the amount of FDIC-guaranteed debt issued on or after October 14, 2008 (excluding unsecured borrowings with maturities of 30 days or less issued after December 5, 2008), depending on the maturity of the FDIC-guaranteed debt. This fee is increased by 10 basis points for certain holding companies and participating affiliates of insured depository institutions that are not themselves insured depository institutions. We were not subject to the increased fee. In December 2008, we issued an aggregate of

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\$2.7 billion of guaranteed senior notes pursuant to the Debt Guarantee Program, all of which will mature in December 2011.

The Transaction Account Guarantee Program covers 100 percent of a bank's non-interest bearing transaction deposit accounts and, on August 26, 2009, the FDIC announced that the Transaction Account Guarantee Program would be extended to June 30, 2010. In connection with the extension, the fee payable to the FDIC under the Transaction Account Guarantee Program will be increased from 10 basis points on any deposit amounts exceeding the \$250,000 deposit insurance limit to 15, 20 or 25 basis points depending on the risk category assigned to the institution under the FDIC's risk-based premium system. In November 2009, HSBC Bank USA and its affiliated banks advised the FDIC of their election to opt out of the six-month extension of the Transaction Account Guarantee Program and, accordingly, our participation ended as of December 31, 2009.

Bank Secrecy Act/Anti-Money Laundering The USA Patriot Act (the Patriot Act), effective October 26, 2001, imposed significant record keeping and customer identity requirements, expanded the government's powers to freeze or confiscate assets and increased the available penalties that may be assessed against financial institutions for violation of the requirements of the Patriot Act intended to detect and deter money laundering. The Patriot Act required the U.S. Treasury Secretary to develop and adopt final regulations with regard to the anti-money laundering compliance obligations of financial institutions (a term which includes insured U.S. depository institutions, U.S. branches and agencies of foreign banks, U.S. broker-dealers and numerous other entities). The U.S. Treasury Secretary delegated certain authority to a bureau of the U.S. Treasury Department known as the Financial Crimes Enforcement Network (FinCEN).

Many of the anti-money laundering compliance requirements of the Patriot Act, as implemented by FinCEN, are generally consistent with the anti-money laundering compliance obligations that applied to HSBC Bank USA under the Bank Secrecy Act and applicable Federal Reserve Board regulations before the Patriot Act was adopted. These include requirements to adopt and implement an anti-money laundering program, report suspicious transactions and implement due diligence procedures for certain correspondent and private banking accounts. Certain other specific requirements under the Patriot Act involve compliance obligations. The Patriot Act has improved communication between law enforcement agencies and financial institutions. The Patriot Act and other recent events have also resulted in heightened scrutiny of the Bank Secrecy Act and anti-money laundering compliance programs by bank regulators.

Competition Following the enactment of the GLB Act, HSBC USA elected to be treated as a financial holding company. The GLB Act also eliminated many of the regulatory restrictions on providing financial services. The GLB Act allows for financial institutions and other providers of financial products to enter into combinations that permit a single organization to offer a complete line of financial products and services. Therefore, we face intense competition in all of the markets we serve, competing with both other financial institutions and non-banking institutions such as insurance companies, major retailers, brokerage firms and investment companies. The financial services industry has experienced consolidation in recent years as financial institutions involved in a broad range of products and services have merged, been acquired or dispersed. This trend is expected to continue and has resulted in, among other things, greater concentrations of deposits and other resources. It is likely that competition will become more intense as our businesses compete with other financial institutions that have or may acquire access to greater liquidity or that may have a stronger presence in certain geographies.

Corporate Governance and Controls

We maintain a website at www.us.hsbc.com on which we make available, as soon as reasonably practicable after filing with or furnishing to the SEC, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to these reports. Our website also contains our Corporate Governance Standards and committee charters for the Audit and Fiduciary Committees of our Board of Directors. We have a Statement of Business Principles and Code of Ethics that expresses the principles upon which we operate our businesses. Integrity is the foundation of all our business endeavors and is the result of continued dedication and commitment to the highest ethical standards in our relationships with each other, with other organizations and

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individuals who are our customers. You can find our Statement of Business Principles and Code of Ethics on our corporate website. We also have a Code of Ethics for Senior Financial Officers that applies to our finance and accounting professionals that supplements the Statement of Business Principles. That Code of Ethics is incorporated by reference in Exhibit 14 to this Form 10-K. You can request printed copies of this information at no charge. Requests should be made to HSBC USA Inc., 26525 North Riverwoods Boulevard, Mettawa, Illinois 60045, Attention: Corporate Secretary.

Certifications In addition to certifications from our Chief Executive Officer and Chief Financial Officer pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 (attached to this report on Form 10-K as Exhibits 31 and 32), we also file a written affirmation of an authorized officer with the New York Stock Exchange (the NYSE) certifying that such officer is not aware of any violation by HSBC USA of the applicable NYSE corporate governance listing standards in effect as of March 2, 2009.

Cautionary Statement on Forward-Looking Statements

Certain matters discussed throughout this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, we may make or approve certain statements in future filings with the SEC, in press releases, or oral or written presentations by representatives of HSBC USA that are not statements of historical fact and may also constitute forward-looking statements. Words such as may , will , should , would , could , appears , believe , intends , expects , estimates , targeted , plans , anticipates , goal are intended to identify forward-looking statements but should not be considered as the only means through which these statements may be made. These matters or statements will relate to our future financial condition, economic forecast, results of operations, plans, objectives, performance or business developments and will involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from that which was expressed or implied by such forward-looking statements. Forward-looking statements are based on our current views and assumptions and speak only as of the date they are made. We undertake no obligation to update any forward-looking statement to reflect subsequent circumstances or events.

Item 1A. Risk Factors

The following discussion provides a description of some of the important risk factors that could affect our actual results and could cause our results to vary materially from those expressed in public statements or documents. However, other factors besides those discussed below or elsewhere in other of our reports filed or furnished with the SEC, could affect our business or results. The reader should not consider any description of such factors to be a complete set of all potential risks that we may face.

The unprecedented current market and economic conditions may continue to affect our business, results of operations and financial condition. Our business and earnings are affected by general business, economic and market conditions in the United States and abroad. Given our concentration of business activities in the United States, we are particularly exposed to the continued turmoil in the economy, housing downturns, high unemployment, tighter credit conditions and reduced economic growth that have occurred over the past two years and appear likely to continue in 2010. General business, economic and market conditions that could continue to affect us include:

short-term and long-term interest rates;

a continuing recessionary economy;

unemployment levels;

inflation;

monetary supply;

availability of liquidity;

fluctuations in both debt and equity capital markets in which we fund our operations;

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market value of residential and commercial real estate throughout the United States;

tighter consumer credit conditions;

higher bankruptcy filings; and

new laws, regulations or regulatory initiatives.

During 2009, economic conditions in the U.S. continued to be challenged by continued declines in the housing market, rising unemployment, tight credit conditions and reduced economic growth. The problems in the housing markets in the United States in the last three years have been exacerbated by the significantly higher unemployment rates. Unemployment rates have been rising in most markets. If unemployment rates continue to increase, additional losses are likely to be significant in all types of our consumer loans, including credit cards. Additionally, with a continued loss in consumer confidence and high unemployment rates, we expect consumer loan originations, including credit card and private label credit card originations, to continue to decrease.

The dramatic decline in property values experienced throughout much of the United States continued through 2009, although housing prices experienced some stabilization in the second half of 2009. While we believe that the slowdown in the housing markets has started to stabilize, there is continuing concern that foreclosures may increase in 2010, which could result in further deterioration of property values and can be expected to result in increased delinquency and losses in our real estate portfolio. In addition, certain changes to the conditions described above could diminish demand for our products and services, or increase the cost to provide such products or services.

The overall deterioration in the economy in 2009 and the continued weak outlook for certain segments of the economy, such as commercial real estate and certain industrial sectors, have led to customer credit downgrades and higher levels of criticized loans across all commercial business lines. There is considerable uncertainty regarding the future recovery rate of the economy in general, particularly in these sectors, the pace of which will impact future trends in criticized asset levels. While we continue to actively manage our commercial portfolios, considerable uncertainty remains regarding the timing and pace of economic recovery in these segments and the associated impact on the commercial portfolios.

In a poor economic environment, such as is currently being experienced in the United States, more of our customers and counterparties are likely to, and have in fact, become delinquent or have defaulted on their loans or other obligations. This has resulted in higher levels of provisions for credit losses in our consumer portfolios as well as our commercial portfolio, which adversely affected our earnings. In the event economic conditions continue to be depressed and unemployment rates increase or do not decline, there would be a significant negative impact on delinquencies, charge-offs and losses in all loan portfolios.

The transition to Basel II in 2011 will continue to put significant pressure on earnings and capital. Subject to regulatory approval, HSBC North America will be required to adopt Basel II provisions no later than April 1, 2011. While HSBC USA will not report Basel II regulatory capital ratios on a standalone basis, HSBC Bank USA will report under the new rules. Whether any increase in capital will be required prior to the Basel II adoption date will depend on our prevailing risk profile. If current market conditions deteriorate further, the capital requirements of Basel II could grow prior to implementation in 2011, increasing HSBC Bank USA's capital requirements. The new rules could drive changes in our funding mix, reducing our return on capital and resulting in lower net income and/or continued shrinking of the balance sheet. HSBC has demonstrated its support of HUSI through significant capital contributions. Our parent contributed \$4 million, \$3.6 billion and \$2.2 billion in 2007, 2008 and 2009, respectively.

Capital infusions from HSBC were crucial to our operations in 2008 and the first half of 2009, and could be crucial to our operations in the future if economic conditions worsen. HSBC has provided capital support in the past and has indicated its commitment and capacity to fund the needs of the business in the future. In the absence of HSBC support, our credit ratings would be downgraded and our cost of funding our operations would rise substantially, negatively impacting net interest income and net income or loss.

Newly-implemented Federal and state laws and regulations may significantly impact our operations. We operate in a highly regulated environment. Changes in federal, state and local laws and regulations affecting banking, consumer credit, bankruptcy, privacy, consumer protection or other matters could materially impact our

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performance. For example, anti-money laundering requirements under the Patriot Act are frequently revisited by the U.S. Congress and Executive Agencies and continue to be a key regulator focus. There has also been an increased focus on compliance with economic sanctions following the publication in September 2008 of Economic Enforcement Guidelines by the Office of Foreign Assets Control which were promulgated as a final rule in November 2009. Ensuring compliance with increasing regulatory requirements and initiatives could affect operational costs and negatively impact our overall results.

Similarly, attempts by local, state and national regulatory agencies to address perceived problems with the mortgage lending and credit card industries more recently to address problems in the financial services industry generally through broad or targeted legislative or regulatory initiatives aimed at lenders' operations in consumer lending markets, could affect us in substantial and unpredictable ways, including limiting the types of consumer loan products we can offer, how those loan products may be originated, and the fees and charges that may be applied to accounts, which, ultimately, could negatively impact our results. There is also significant focus on loss mitigation and foreclosure activity for residential real estate loans. Although we believe our loan modification programs are most appropriate and responsive to our customers' needs, we cannot anticipate the response by national agencies and certain legislators or if changes to our operations and practices will be required as a result.

Specifically and of utmost relevance to our ongoing credit card operations and business, the Credit Card Accountability Responsibility and Disclosure Act of 2009 was signed into law with likely significant impact on the credit card industry. The CARD Act, which through Federal Reserve Board rulemaking becomes effective in three stages (i.e., August 2009, February 2010 and August 2010), primarily amends the Truth in Lending Act by adding a number of new substantive and disclosure requirements building upon the Regulation AA and Regulation Z requirements adopted by the Federal Reserve Board in January 2009 (the January 2009 rules). The February 2010 rulemaking implemented the majority of the CARD Act provisions which, among other things, restrict application of interest rate increases on new and existing balances prescribe the manner in which payments in excess of the minimum payment may be allocated to amounts due and when penalty rates may be charged on past due balances, and require customers to opt-in to over limit fee assessments. Because many of the requirements of the January 2009 Regulation AA and Regulation Z rules are included in the February 2010 CARD Act rule, the Federal Reserve Board has issued notices withdrawing the January 2009 rules. The Federal Reserve is expected in the near term to promulgate rules that will interpret and implement the provisions of the CARD Act which take effect in August 2010. The August 2010 CARD Act rules will address the reasonableness and proportionality of penalty fees and charges and require that accounts subjected to prior interest rate increases be periodically re-evaluated for interest rate decreases. The CARD Act also requires other government agencies to conduct studies on interchange, debt cancellation agreements and credit insurance products and present reports to Congress on these topics. We are compliant with the provisions of the CARD Act that took effect in August 2009 and February 2010 and continue to make changes to processes and systems in order to comply with the remaining provisions of the CARD Act by the applicable August 2010 effective date. The CARD Act has required us to make changes to our business practices, and will likely require us and our competitors to manage risk differently than has historically been the case. Pricing, underwriting and product changes in response to the new legislation have either been implemented or are under analysis. We currently believe the implementation of these new rules will not have a material adverse impact to us as any impact would be limited to only a portion of the existing affected loan portfolio as the purchase price on future sales volume paid to HSBC Finance would be adjusted to fully reflect the new requirements.

In 2009, the Federal government and bank regulatory agencies continued their efforts to stabilize the U.S. economy and reform the financial services industry. See Regulation under the caption Regulatory and Competition in Item 1. Business of this Form 10-K. It is likely that some portion of the financial regulatory reform proposals will be adopted and enacted. The reforms may have a significant impact on the operations of financial institutions in the U.S.,

including us and our affiliates. However, it is not possible to assess the impact of financial regulatory reform until final legislation has been enacted and related regulations have been adopted.

Operational risks, such as systems disruptions or failures, breaches of security, human error, changes in operational practices or inadequate controls may adversely impact our business and reputation. Operational risk is inherent in virtually all of our activities. While we have established and maintain an overall risk framework

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that is designed to balance strong corporate oversight with well-defined independent risk management, we continue to be subject to some degree of operational risk. Our businesses are dependent on our ability to process a large number of complex transactions. If any of our financial, accounting, or other data processing and other recordkeeping systems and management controls fail or have other significant shortcomings, we could be materially adversely affected. HSBC North America will continue the implementation of several high priority systems improvements and enhancements and the centralization of corporate functions in 2010, each of which may present increased or additional operational risk that may not be known until their implementation is complete.

We may also be subject to disruptions of our operating systems infrastructure arising from events that are wholly or partially beyond our control, which may include:

computer viruses or electrical or telecommunications outages;

natural disasters, such as hurricanes and earthquakes;

events arising from local or regional politics, including terrorist acts;

unforeseen problems encountered while implementing major new computer systems; or

global pandemics, which could have a significant effect on our business operations as well as on HSBC affiliates world-wide.

Such disruptions may give rise to losses in service to customers, an inability to collect our receivables in affected areas and other loss or liability to us.

We are similarly dependent on our employees. We could be materially adversely affected if an employee causes a significant operational break-down or failure, either as a result of human error or where an individual purposefully sabotages or fraudulently manipulates our operations or systems. Third parties with which we do business could also be sources of operational risk to us, including risks relating to break-downs or failures of such parties' own systems or employees. Any of these occurrences could result in diminished ability by us to operate one or more of our businesses, potential liability to clients, reputational damage and regulatory intervention, all of which could materially adversely affect us.

In a company as large and complex as ours, lapses or deficiencies in internal control over financial reporting are likely to occur from time to time.

In recent years, instances of identity theft and fraudulent attempts to obtain personal and financial information from individuals and from companies that maintain such information pertaining to their customers have become more prevalent. Use of the internet for these purposes has also increased. Such acts can have the following possible impacts:

threaten the assets of our customers;

negatively impact customer credit ratings;

impact customers' ability to repay loan balances;

increase costs for us to respond to such threats and to enhance our processes and systems to ensure maximum security of data; or

damage our reputation from public knowledge of intrusion into our systems and databases.

In addition, there is the risk that our controls and procedures as well as business continuity and data security systems could prove to be inadequate. Any such failure could affect our operations and could materially adversely affect our results of operations by requiring us to expend significant resources to correct the defect, as well as by exposing us to litigation or losses not covered by insurance.

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Changes to operational practices from time to time could materially positively or negatively impact our performance and results. Such changes may include:

- raising the minimum payment or fees to be charged on credit card accounts;
- determinations to acquire or sell credit card receivables, residential mortgage loans and other loans;
- changes to our customer account management and risk management/collection policies and practices;
- increasing investment in technology, business infrastructure and specialized personnel; or
- outsourcing of various operations.

Increasingly intense competition in the financial services industry may have a material adverse impact on our future results. We operate in a highly competitive environment. Competitive conditions are expected to continue to intensify as continued merger activity in the financial services industry produces larger, better-capitalized and more geographically diverse companies. New products, customers and channels of distribution are constantly emerging. Such competition may impact the terms, rates, costs and/or profits historically included in the financial products we offer and purchase. The traditional segregation of commercial and investment banks has all but eroded. There is no assurance that the significant and increasing competition within the financial services industry will not materially adversely affect our future results.

Lawsuits and regulatory investigations and proceedings may continue and increase in the current economic and anticipated regulatory environment. HSBC USA or one of our subsidiaries is or may be named as a defendant in various legal actions, including class actions and other litigation or disputes with third parties, as well as investigations or proceedings brought by regulatory agencies. We saw an increase in litigation in 2009 resulting from the deterioration of customers' financial condition, the mortgage market downturn and general economic conditions. Although we believe the number of new cases should stabilize or even decrease in 2010, there is no certainty that this will occur, especially in the event of increased unemployment rates or a resurgent recession. With the increased regulatory environment, particularly in the financial services industry, there may be additional regulatory investigations and reviews conducted by banking and other regulators and enforcement agencies. These or other future actions brought against us may result in judgments, settlements, fines, penalties or other results, including additional compliance requirements, adverse to us which could materially adversely affect our business, financial condition or results of operations, or cause serious reputational harm.

Unanticipated risks may impact our results. We seek to monitor and manage our risk exposure through a variety of separate but complementary financial, credit, market, operational, compliance and legal reporting systems, including models and programs that predict loan delinquency and loss. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques and prepare contingency plans in anticipation of developments, those techniques and plans and the judgments that accompany their application are complex and cannot anticipate every economic and financial outcome or the specifics and timing of such outcomes. Accordingly, our ability to successfully identify and manage all significant risks we face is an important factor that can significantly impact our results.

Our inability to meet funding requirements could impact operations. Adequate liquidity is critical to our ability to operate our businesses. Restrictions on our liquidity could have a negative effect on our financial results and our operations. In first half of 2009, financial markets remained extremely volatile. While the on-going financial market disruptions continued to impact credit spreads and liquidity during 2009, we have seen some improvements in

liquidity beginning in the second quarter and continuing through the second half of 2009. Additionally, credit spreads have continued to narrow due to increased market confidence stemming largely from the various government actions taken to restore faith in the capital markets. During 2008 and continuing through 2009, as we witnessed the systemic reduction in available liquidity in the market, we took steps to reduce our

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reliance on debt capital markets and to increase deposits. Despite the apparent improvements in liquidity and our liquidity position, potential conditions remain that would negatively affect our liquidity, including:

- an inability to attract or retain deposits;
- diminished access to capital markets;
- unforeseen cash or capital requirements;
- an inability to sell assets; and
- an inability to obtain expected funding from HSBC subsidiaries and clients.

HSBC has provided capital support in the past and has indicated its commitment and capacity to fund the needs of the business (under most foreseeable circumstances) in the future.

Our credit ratings are an important part of maintaining our liquidity. Any downgrade in credit ratings could potentially increase borrowing costs, impact the ability to issue commercial paper and, depending on the severity of the downgrade, substantially limit access to capital markets, require cash payments or collateral posting, and permit termination of certain significant contracts. In January 2009, Fitch, Inc. affirmed our debt ratings, however our outlook was changed from stable to negative. In March 2009, Moody's Investors Services (Moody's) downgraded the long-term debt ratings of both HUSI and HSBC Bank USA by one level to A1 and Aa3, respectively and reaffirmed the short-term ratings for each entity at Prime-1. Moody's also changed their outlook for both entities from stable to negative. In April 2009, DBRS re-affirmed the long and short-term debt ratings of HUSI and HSBC Bank USA at AA and R-1, respectively, with a negative outlook. In August 2009, Standard and Poor's re-affirmed the long-term and short-term debt ratings of both HUSI and HSBC Bank USA at AA-/A-1+ (HUSI) and AA/A-1+ (HSBC Bank USA). Our capital levels remain well above levels established by current banking regulations as well capitalized and, at December 31, 2009, our Tier 1 capital ratio had increased to 9.62 percent from 7.60 percent at December 31, 2008.

Significant reductions in pension assets may require additional financial contributions from us Effective January 1, 2005, our previously separate qualified defined benefit pension plan was combined with that of HSBC Finance's into a single HSBC North America qualified defined benefit plan. We are responsible for providing approximately 60 percent of the financial support required by the plan. In 2008 and 2009, the plan had allocated assets between three primary strategies: domestic equities, international equities and fixed income. At December 31, 2009, plan assets were lower than projected liabilities resulting in an under-funded status. During this period, domestic and international equity indices increased between 20 and 30 percent while interest rates decreased. After expenses, the combination of positive equity and fixed income returns along with a \$241 million contribution to the plan by HSBC North America in 2009 resulted in an overall increase in plan assets of eight percent in 2009. This increase, when combined with an increase in the projected benefit obligation continued to result in an under-funded status. At December 31, 2009, the projected benefit obligation exceeded the fair value of the plan assets by approximately \$970 million and the accumulated benefit obligation exceeded the fair value of plan assets by approximately \$775 million. As these obligations relates to the HSBC North America pension plan, only a portion of these deficits should be considered our responsibility. We and other HSBC North American affiliates with employees participating in this plan will be required to make up this shortfall over a number of years as specified under the Pension Protection Act. This can be accomplished through additional direct contributions, changes to the plan, appreciation in plan assets and/or increases in interest rates resulting in lower liability valuations. See Note 22, Pension and Other Postretirement Benefits in the accompanying consolidated financial statements for further information concerning the HSBC North

America defined benefit plan.

Management projections, estimates and judgments based on historical performance may not be indicative of our future performance. Our management is required to use certain estimates in preparing our financial statements, including accounting estimates to determine loan loss reserves, reserves related to litigation, deferred tax assets and the fair market value of certain assets and liabilities, including goodwill and intangibles, among other items. Loan loss reserve estimates and certain asset and liability valuations are judgmental and are influenced by factors outside our control. To the extent historical averages of the progression of loans into stages of delinquency

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and the amount of loss realized upon charge-off are not predictive of future losses and management is unable to accurately evaluate the portfolio risk factors not fully reflected in the historical model, unexpected additional losses could result. Similarly, to the extent assumptions employed in measuring fair value of assets and liabilities not supported by market prices or other observable parameters do not sufficiently capture their inherent risk, unexpected additional losses could result.

Another example in which management judgment is significant is in the evaluation of the recognition of deferred tax assets and in the determination of whether there is a need for a related valuation allowance. We are required to establish a valuation allowance for deferred tax assets and record a charge to income or shareholders' equity if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we estimate future taxable income based on management approved business plans, future capital requirements and ongoing tax planning strategies, including capital support from HSBC as a necessary part of such plans and strategies. This process involves significant management judgment about assumptions that are subject to change from period to period. The recognition of deferred tax assets requires management to make significant judgments about future earnings, the periods in which items will impact taxable income, and the application of inherently complex tax laws. Included in our forecasts are assumptions regarding our estimate of future expected credit losses. The use of different estimates can result in changes in the amounts of deferred tax items recognized, which can result in equity and earnings volatility because such changes are reported in current period earnings. See Note 18, *Income Taxes* in the accompanying consolidated financial statements for additional discussion of our deferred taxes/assets.

Changes in accounting standards are beyond our control and may have a material impact on how we report our financial results and condition. Our accounting policies and methods are fundamental to how we record and report our financial condition and the results of operations. From time to time, the Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), the SEC and our bank regulators, including the Office of Comptroller of the Currency and the Federal Reserve, change the financial accounting and reporting standards, or the interpretation thereof, and guidance that govern the preparation and disclosure of external financial statements. These changes are beyond our control, can be hard to predict and could materially impact how we report and disclose our financial results and condition, including our segment results. We could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements in material amounts. We may, in certain instances, change a business practice in order to comply with new or revised standards.

Key employees may be difficult to retain due to contraction of the business and limits on promotional activities. Our employees are our most important resource and, in many areas of the financial services industry, competition for qualified personnel is intense. If we were unable to continue to attract and retain qualified key employees to support the various functions of our businesses, our performance, including our competitive position, could be materially adversely affected. The significant losses we have recognized, reductions in variable compensation and the expectation of continued weakness in the general economy could raise concerns about key employees' future compensation and promotional opportunities. With the potential for an improved economic outlook, there will be increased risk to retain top performers and critical skill employees. If key personnel were to leave us and equally knowledgeable or skilled personnel are unavailable in HSBC or could not be retained in the market to fill these roles, our ability to manage through the difficult economy may be hindered or impaired.

Our reputation has a direct impact on our financial results and ongoing operations. Our ability to attract and retain customers and conduct business transactions with our counterparties could be adversely affected to the extent our reputation, or the reputation of affiliates operating under the HSBC brand, is damaged. Our failure to address, or to appear to fail to address, various issues that could give rise to reputational risk could cause harm to us and our

business prospects. Reputational issues include, but are not limited to:

appropriately addressing potential conflicts of interest;

legal and regulatory requirements;

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ethical issues;

anti-money laundering and economic sanctions programs;

privacy issues;

fraud issues;

data security issues;

recordkeeping;

sales and trading practices;

the proper identification of the legal, reputational, credit, liquidity and market risks inherent in products offered; and

general company performance.

The failure to address these issues appropriately could make our customers unwilling to do business with us or give rise to increased regulatory action, which could adversely affect our results of operations.

The inability to integrate business and portfolio acquisitions successfully could undermine the realization of the anticipated benefits of the acquisition and have a material adverse impact on our results of operation. We have in the past, and may again in the future, seek to grow our business by acquiring other businesses or loan portfolios. There can be no assurance that acquisitions will have the anticipated positive results, including results relating to:

the total cost of integration;

the time required to complete the integration;

the amount of longer-term cost savings; or

the overall performance of the combined entity.

Integration of an acquired business can be complex and costly, and may sometimes include combining relevant accounting, data processing and other record keeping systems and management controls, as well as managing relevant relationships with clients, suppliers and other business partners, as well as with employees.

There is no assurance that any businesses or portfolios acquired in the future will be successfully integrated and will result in all of the positive benefits anticipated. If we are not able to successfully integrate acquisitions, there is the risk that its results of operations could be materially and adversely affected.

Item 1B. Unresolved Staff Comments.

We have no unresolved written comments from the Securities and Exchange Commission Staff that have been outstanding for more than 180 days at December 31, 2009.

Item 2. Properties.

The principal executive offices of HSBC USA and HSBC Bank USA are located at 452 Fifth Avenue, New York, New York 10018, which is currently owned by HSBC Bank USA. In October 2009, HSBC Bank USA agreed to a sale-leaseback transaction that is expected to close in the second quarter of 2010, pursuant to which HSBC Bank USA agreed to the sell the headquarters building at 452 Fifth Avenue and to lease the entire building for one year and eleven floors of the building for a total of 10 years. The main office of HSBC Bank USA is located at 1800 Tysons Blvd., Suite 50, McLean, Virginia 22102. HSBC Bank USA has 374 branches in New York, 33 branches in California, 20 branches in Florida, 22 branches in New Jersey, 11 branches in Connecticut, five branches in Virginia, six branches in Maryland and the District of Columbia, four branches in Washington, two branches in

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Pennsylvania and one branch in each of Delaware, Illinois, and Oregon. Approximately 26 percent of these offices are located in buildings owned by HSBC Bank USA and the remaining are located in leased premises. In addition, there are offices and locations for other activities occupied under various types of ownership and leaseholds in New York and other states, none of which are materially important to our operations. HSBC Bank USA also owns properties in Montevideo, Uruguay and Punta del Este, Uruguay.

Item 3. Legal Proceedings.

General We are parties to various legal proceedings, including actions that are or purport to be class actions, resulting from ordinary business activities relating to our current and/or former operations. Due to uncertainties in litigation and other factors, we cannot be certain that we will ultimately prevail in each instance. We believe that our defenses to these actions have merit and any adverse decision should not materially affect our consolidated financial condition. However, losses may be material to our results of operations for any particular future period depending on our income level for that period.

Credit Card Litigation Since June 2005, HSBC Bank USA, HSBC Finance Corporation, HSBC North America and HSBC, as well as other banks and Visa Inc. and MasterCard Incorporated, were named as defendants in four class actions filed in Connecticut and the Eastern District of New York: *Photos Etc. Corp. et al. v. Visa U.S.A., Inc., et al.* (D. Conn. No. 3:05-CV-01007 (WWE)); *National Association of Convenience Stores, et al. v. Visa U.S.A., Inc., et al.* (E.D.N.Y. No. 05-CV 4520 (JG)); *Jethro Holdings, Inc., et al. v. Visa U.S.A., Inc. et al.* (E.D.N.Y. No. 05-CV-4521 (JG)); and *American Booksellers Asps v. Visa U.S.A., Inc. et al.* (E.D.N.Y. No. 05-CV-5391 (JG)). Numerous other complaints containing similar allegations (in which no HSBC entity is named) were filed across the country against Visa Inc., MasterCard Incorporated and other banks. These actions principally allege that the imposition of a no-surcharge rule by the associations and/or the establishment of the interchange fee charged for credit card transactions causes the merchant discount fee paid by retailers to be set at supracompetitive levels in violation of the Federal antitrust laws. These suits have been consolidated and transferred to the Eastern District of New York. The consolidated case is: *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, MDL 1720, E.D.N.Y. A consolidated, amended complaint was filed by the plaintiffs on April 24, 2006 and a second consolidated amended complaint was filed on January 29, 2009. The parties are engaged in discovery and motion practice. At this time, we are unable to quantify the potential impact from this action, if any.

Governmental and Regulatory Matters HSBC USA and certain of its affiliates and current and former employees are or may be subject to formal and informal investigations, as well as subpoenas and/or requests for information, from various governmental and self-regulatory agencies relating to our business activities. In all such cases, HSBC USA and its affiliates cooperate fully and engage in efforts to resolve these matters.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II**Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Not applicable.

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Year Ended December 31	2009	2008	2007	2006	2005
(dollars are in millions)					
Statement of Income (Loss) Data:					
Net interest income	\$ 5,134	\$ 4,326	\$ 3,398	\$ 3,081	\$ 3,063
Provision for credit losses	4,144	2,543	1,522	823	674
Total other revenues (losses)	2,714	(787)	1,847	2,563	1,911
Total operating expenses	3,930	3,604	3,586	3,255	2,758
Income (loss) before income tax benefit (expense)	(226)	(2,608)	137	1,566	1,542
Income tax benefit (expense)	84	919	1	(530)	(566)
Net income (loss)	\$ (142)	\$ (1,689)	\$ 138	\$ 1,036	\$ 976
Balance Sheet Data as of December 31:					
Loans:					
Commercial loans	\$ 30,304	\$ 37,429	\$ 36,835	\$ 29,380	\$ 27,650
Consumer loans	49,185	43,684	53,721	56,134	58,127
Total loans	79,489	81,113	90,556	85,514	85,777
Loans held for sale	2,908	4,431	5,270	4,723	4,565
Total assets	171,079	185,569	187,965	164,817	151,584
Total tangible assets	168,406	182,889	185,225	162,054	148,845
Total deposits	118,337	119,038	116,170	102,146	90,292
Long-term debt	18,008	22,089	28,268	29,252	29,595
Preferred stock	1,565	1,565	1,565	1,690	1,316
Common shareholder's equity	13,612	11,152	9,672	10,571	10,278
Total shareholders' equity	15,177	12,717	11,237	12,261	11,594
Tangible common shareholder's equity	11,110	9,258	7,297	8,034	7,562
Selected Financial Ratios:					
Total shareholders' equity to total assets	8.87%	6.85%	5.98%	7.44%	7.65%
Tangible common shareholder's equity to total tangible assets	6.60	5.06	3.94	4.96	5.08
Total capital to risk weighted assets	14.19	12.04	11.29	12.58	12.53
Tier 1 capital to risk weighted assets	9.61	7.60	7.12	8.58	8.25
Rate of return on average :					
Total assets	(.08)	(.92)	.08	.64	.66
Total common shareholder's equity	(1.68)	(17.58)	.37	9.03	8.78
Net interest margin	3.36	2.92	2.36	2.26	2.49
Loans to deposits ratio ⁽¹⁾	94.36	120.89	147.25	155.33	199.40

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Efficiency ratio	50.08	101.83	68.34	57.66	55.44
Commercial allowance as a percent of loans ⁽²⁾	3.10	1.53	.81	.73	.64
Commercial net charge-off ratio ⁽²⁾	.88	.42	.39	.35	.02
Consumer allowance as a percent of loans ⁽²⁾	5.94	4.18	2.07	1.22	1.15
Consumer two-months-and-over contractual delinquency	5.97	4.57	2.56	1.33	1.05
Consumer net charge-off ratio ⁽²⁾	5.35	2.83	1.65	1.19	1.01

(1) Represents period end loans, net of allowance for loan losses, as a percentage of domestic deposits equal to or greater than \$100,000.

(2) Excludes loans held for sale.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**Executive Overview**

Organization and Basis of Reporting HSBC USA Inc. (HSBC USA) and, together with its subsidiaries, HUSI), is an indirect wholly owned subsidiary of HSBC North America Holdings Inc. (HSBC North America) which is an indirect wholly owned subsidiary of HSBC Holdings plc (HSBC). HUSI may also be referred to in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) as we , us or our .

Through our subsidiaries, we offer a comprehensive range of personal and commercial banking products and related financial services. HSBC Bank USA, National Association (HSBC Bank USA), our principal U.S. banking subsidiary, is a national banking association with banking branch offices and/or representative offices in 12 states and the District of Columbia. In addition to our domestic offices, we maintain foreign branch offices, subsidiaries and/or representative offices in the Caribbean, Europe, Asia, Latin America and Canada. Our customers include individuals, including high net worth individuals, small businesses, corporations, institutions and governments. We also engage in mortgage banking and serve as an international dealer in derivative instruments denominated in U.S. dollars and other currencies, focusing on structuring of transactions to meet clients' needs as well as for proprietary purposes.

Current Environment During 2009, challenging economic conditions in the U.S. continued, marked by continued declines in the housing markets, rising unemployment, tight credit conditions and reduced economic growth. A prolonged period of low Federal funds rates has also put pressure on spreads earned on our deposit base. Although the economic recession continued to deepen into the first half of 2009, signs of stabilization and improvement began to appear in the second half of the year. While the on-going financial market disruptions continued to impact credit and liquidity during the year, marketplace improvements beginning in the second quarter and continuing through the end of the year strengthened liquidity and narrowed credit spreads due to increased market confidence stemming largely from various government actions taken to restore faith in the capital markets and stimulate consumer spending. The improving capital markets and a recovery in the stock market have enabled many businesses to issue debt and raise new capital, which is bolstering consumer and business sentiment. While the easing pace of job losses in the second half of 2009 is helping the housing markets, the first-time homebuyer tax credit as well as low interest rates resulting from government actions have been the main factors driving up home sales and shrinking home inventories, which has resulted in some signs of home price stabilization in the latter half of 2009, particularly in the middle and lower price sectors.

U.S. unemployment rates, which have been a major factor in the deterioration of credit quality in the U.S., increased to 10.0 percent in December 2009, an increase of 260 basis points since December 2008. Unemployment rates in 16 states are greater than the U.S. national average and unemployment rates in 10 states are at or above 11 percent while in New York, where approximately 31 percent of our loan portfolio is concentrated, unemployment remained lower than the national average at nine percent. In addition, a significant number of U.S. residents are no longer looking for work and are not included in the reported percentages. Personal bankruptcy filings in the U.S. have also increased throughout the year. This has continued to have an impact on our provision for credit losses in our loan portfolio and in loan portfolios across the industry. Concerns about the future of the U.S. economy, including the timing and extent of any recovery from the current economic downturn, consumer confidence, volatility in energy prices, adverse developments in the credit markets and mixed corporate earnings continue to negatively impact the stability of both the U.S. economy and the capital markets. These adverse conditions also continued to impact the carrying value of several asset classes, although the dollar magnitude of the impact on these assets slowed considerably in 2009.

Improvement in unemployment rates and a sustained recovery of the housing market, including stabilization in home prices, continue to remain critical components for a broader U.S. economic recovery. Further weakening in these components as well as in consumer confidence may result in additional deterioration in consumer payment patterns and increased delinquencies and charge-off rates in loan portfolios across the industry, including our own.

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Although consumer confidence has improved since early 2009, it remains low on a historical basis. Weak consumer fundamentals including declines in wage income, lower customer spending, declines in wealth and a difficult job market are depressing confidence. Additionally, there is uncertainty as to the impact to the economy and consumer confidence when the actions taken by the government to restore faith in the capital markets and stimulate consumer spending end. As a result, the above conditions, together with weakness in the overall economy and recent and proposed regulatory changes, will likely to continue to impact our results in 2010, the degree of which is largely dependent upon the nature and timing of an economic recovery and any further regulatory changes.

The U.S. Federal government and banking regulators continued their efforts to stabilize the U.S. economy and reform the financial markets in 2009. On June 17, 2009, the Administration unveiled its proposal for sweeping overhaul of the financial regulatory system. The Financial Regulatory Reform proposals are comprehensive and include the creation of an inter-agency Financial Services Oversight Council to, among other things, identify emerging risks and advise the Federal Reserve Board regarding institutions whose failure could pose a threat to financial stability; expand the Federal Reserve Board's powers to regulate these systemically-important institutions and impose more stringent capital and risk management requirements; create a Consumer Financial Protection Agency (the CFPA) as a single primary Federal consumer protection supervisor that will regulate credit, savings, payment and other consumer financial products and services and providers of those products and services; and impose comprehensive regulation of OTC derivatives markets, including credit default swaps, and prudent supervision of OTC derivatives dealers. In December 2009, the House of Representatives passed The Wall Street Reform and Consumer Protection Act, which addresses many of the Administration's proposed reforms. Similar legislation is under consideration by the U.S. Senate Committee on Banking, Housing and Urban Affairs. On January 14, 2010, the Administration announced its intention to propose a Financial Crisis Responsibility Fee to be assessed against financial institutions with more than \$50 billion in consolidated assets for at least 10 years. Other proposals have also been announced in 2010. It is likely that some portion of the financial regulatory reform proposals will be adopted and enacted. The reforms may have a significant impact on the operations of financial institutions in the U.S., including us and our affiliates. However, it is not possible to assess the impact of financial regulatory reform until final legislation has been enacted and the related regulations have been adopted.

U.S. Treasury sponsored programs in the mortgage lending environment have been introduced, which are focused on reducing the number of foreclosures and potentially making it easier for some customers to refinance loans. One such program intends to help certain at-risk homeowners avoid foreclosure by reducing monthly mortgage payments. This program provides certain incentives to lenders to modify all eligible loans that fall under the guidelines of the program. Another program focuses on homeowners who have a proven payment history on an existing mortgage owned by Fannie Mae or Freddie Mac and provides assistance to eligible homeowners to refinance their mortgage loans to take advantage of current lower mortgage rates or to refinance adjustable rate mortgages into more stable fixed rate mortgages. We have implemented such programs for mortgage loans we service for government sponsored enterprises. We continue to evaluate our consumer relief programs and account management practices to ensure our programs benefit both our customers in accordance with their financial needs and our stakeholders as the economy recovers. As a result, to date we have elected not to participate in the U.S. Treasury sponsored programs for our loan portfolios and continue to focus on expanding and improving our current programs.

2009 Events

The adverse conditions described above have continued to impact the carrying value of several asset classes, including asset-backed securities held for both trading purposes and as available-for-sale, subprime residential mortgage loans held for sale and credit derivative products including derivative products with monoline insurance companies during 2009, although the dollar magnitude of the impact on these assets has slowed

considerably as compared to 2008 and, for leveraged acquisition finance loans held for sale, have actually begun to reverse. Despite this positive trend, however, we remain cautious as volatility with respect to certain capital markets activities remains elevated and we expect these conditions, together with continued weakness in the overall economy, to continue to impact our results into 2010.

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A summary of the significant valuation adjustments associated with these market conditions that contributed to the decrease in revenues in 2009, 2008 and 2007 is presented in the following table:

Year Ended December 31,	2009	2008	2007
	(in millions)		
Losses (Gains)			
Insurance monoline structured credit products	\$ 152	\$ 1,020	\$ 287
Other structured credit products	219	1,439	(22)
Mortgage whole loans held for sale (predominantly subprime)	233	556	422
Other-than-temporary impairment on securities available-for-sale	124	231	-
Leverage acquisition finance loans held for sale	(284)	431	85
Total losses	\$ 444	\$ 3,677	\$ 772

The recent market events have created stress for certain counterparties with whom we conduct business as part of our lending and client intermediation activities. We assess, monitor and control credit risk with formal standards, policies and procedures that are designed to ensure credit risks are assessed accurately, approved properly, monitored regularly and managed actively. Consequently, we believe any loss exposure related to counterparties with whom we conduct business has been adequately reflected in our financial statements for all periods presented.

Deterioration in the U.S. economy continued to impact the credit quality of our consumer loan portfolio throughout 2009, which resulted in a significant increase in our provision for credit losses. Depreciating home prices, rising unemployment and tighter credit resulted in higher levels of bankruptcy filings as well as higher levels of delinquency and charge-off in our consumer loan portfolios. Higher provision for credit losses during 2009 also reflect higher levels of credit card receivables in 2009 as discussed below. Provision for credit losses on our commercial loan portfolio also increased due to higher levels of criticized loans, including higher levels of substandard loans, and overall deterioration in the U.S. economy which has led to customer credit downgrades across all commercial business lines.

As part of our initiative to reduce risk from our residential mortgage loan exposure, we sold approximately \$4.5 billion of prime adjustable and fixed-rate residential mortgage loans to third parties in 2009 and recognized a net pre-tax gain of \$70 million. We also continued to sell the majority of our new residential loan originations through the secondary markets and have allowed the existing loan portfolio to run-off, resulting in lower residential mortgage loan balances at December 31, 2009.

In January 2009, we purchased a \$6.3 billion portfolio of General Motors (GM) MasterCard receivables, a \$6.1 billion portfolio of Union Plus (UP) MasterCard/Visa credit card receivables (collectively the GM and UP Portfolios) and a \$3 billion portfolio of auto finance receivables from HSBC Finance at fair market value in order to maximize the efficient use of liquidity at each entity. HSBC Finance retained the customer account relationships associated with the credit card portfolios. We purchase additional credit card loan originations generated under new and existing accounts on a daily basis at a sales price for each type of portfolio determined using a fair value which is calculated semi-annually. HSBC Finance continues to service the purchased portfolios for a fee. In connection with the purchases, we received capital contributions from our

immediate parent, HSBC North America Inc. (HNAI), in an aggregate amount of approximately \$1.1 billion in January 2009. This amount, along with an additional \$0.6 billion received by us from HNAI in December 2008, was subsequently contributed to our subsidiary, HSBC Bank USA, to provide capital support for the receivables purchased. While the receivable purchases have resulted in increases to our net interest income and other revenues (losses), they have also contributed to higher credit loss provisions and higher operating expenses compared to the prior year periods.

In January 2009, Fitch, Inc. affirmed our debt ratings, however our outlook was changed from stable to negative. In March 2009, Moody's Investors Services (Moody's) downgraded the long-term debt ratings

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of both HUSI and HSBC Bank USA by one level to A1 and Aa3, respectively and reaffirmed the short-term ratings for each entity at Prime-1. Moody's also changed their outlook for both entities from stable to negative. In April 2009, Dominion Bond Rating Service (DBRS) re-affirmed the long and short-term debt ratings of HUSI and HSBC Bank USA at AA and R-1, respectively, with a negative outlook. In August 2009, Standard and Poor's re-affirmed the long-term and short-term debt ratings of both HUSI and HSBC Bank USA at AA-/A-1+ (HUSI) and AA/A-1+ (HSBC Bank USA).

In March 2009, we recognized an \$85 million gain relating to the resolution of a lawsuit the proceeds of which were used to redeem the 100 preferred shares issued to CT Financial Services, Inc. The obligation to redeem the preferred shares upon receipt of the litigation settlement proceeds represented a contractual arrangement established in connection with our purchase of a community bank from CT Financial Services Inc. in 1997 at which time this litigation remained outstanding. The \$85 million received, net of applicable taxes, was remitted to Toronto Dominion, who held the beneficial ownership interest in CT Financial Services Inc., and the preferred shares were redeemed.

In October 2009, we announced that we had agreed to sell our 452 Fifth Avenue property in New York City, including the 1W, 39th Street building, for \$330 million in cash. Under the terms of the deal, we will lease back the entire 452 Fifth Avenue building for one year and floors one to eleven for a total of 10 years along with the 1W 39th Street building. The decision to sell these buildings is consistent with HSBC's strategy to lease office buildings rather than own. The transaction is expected to close in the second quarter of 2010. We currently estimate the sale will result in a gain of approximately \$150 million, which will be deferred and recognized over a number of years due to our continuing involvement. The headquarters of HSBC Bank USA will remain in New York.

In 2009, we received capital contributions from HSBC North America Inc. (HNAI) in an aggregate amount of \$2.2 billion (\$1.1 billion received in each of the first two quarters) in exchange for 3 shares of common stock. During 2009, we contributed \$2.7 billion to our subsidiary, HSBC Bank USA, which was used to support ongoing operations and to maintain capital at levels we believe are prudent in the current market conditions, including \$1.1 billion to provide capital support for the receivables purchased from HSBC Finance in January 2009. See Note 7, Loans, for additional information.

Performance, Developments and Trends Our net loss was \$142 million in 2009 compared to a net loss of \$1.7 billion in 2008 and net income of \$138 million in 2007. Loss before income tax was \$226 million in 2009 compared to a loss before income tax of \$2.6 billion in 2008 and income before income tax of \$137 million in 2007. Our results in certain years were significantly impacted by the change in the fair value of our own debt and the related derivatives for which we have elected fair value option due largely to changes in credit spreads and several other items which distort the ability of investors to compare the underlying performance trends of our business. The following table summarizes the collective impact of these items on our income (loss) before income tax for all periods presented:

Year Ended December 31,	2009	2008	2007
	(in millions)		
Income (loss) before income tax, as reported	\$ (226)	\$ (2,608)	\$ 137
Change in value of own fair value option debt and related derivatives	494	(670)	-
Gain on sale of MasterCard Class B or Visa Class B shares	(48)	(83)	(45)

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Gain relating to resolution of lawsuit ⁽¹⁾	(85)	-	-
Establishment (release) of VISA litigation accrual	(9)	(36)	70
Gain on sale of equity interest in HSBC Private Bank (Suisse) S.A.	(33)	-	-
Income (loss) before income tax, excluding above items ⁽²⁾	\$ 93	\$ (3,397)	\$ 162

(1) The proceeds of the resolution of this lawsuit were used to redeem 100 preferred shares held by CT Financial Services, Inc. as provided under the terms of the preferred shares.

(2) Represents a non-U.S. GAAP financial measure.

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Although our overall results for 2009 improved compared to 2008, they continued to be impacted by reductions in other revenues (losses), largely trading revenue associated with credit derivative products due to the adverse financial market conditions described above, although the magnitude of such reductions declined significantly in 2009. Overall, our 2009 results improved compared to 2008, as higher net interest income and higher other revenues (losses) more than offset higher provisions for credit losses and higher operating expenses including higher FDIC insurance premiums. In 2008, our results declined markedly, largely relating to a significant decrease in trading revenue due to the adverse financial market conditions described above.

Net interest income was \$5.1 billion in 2009, an increase of 19 percent over 2008. This increase primarily resulted from the impact of higher credit card receivable levels associated with the purchase of the GM and UP Portfolios in January 2009 discussed above, lower promotional balances on private label credit cards, a reduction in the amortization of private label credit card premiums due largely to lower premiums being paid and a lower cost of funds, all of which contributed to higher net interest margin. These increases were partially offset by a narrowing of interest rate spreads on deposit products primarily due to lower market interest rates and competitive pressures as customers migrated to higher yielding deposit products, higher amortization of credit card premium due to the purchase of the GM and UP portfolios and the runoff of the residential mortgage and other consumer loan portfolios, including the sale of \$4.5 billion of residential mortgage loans in 2009 as discussed above.

The increase in other revenues (losses) during 2009 reflects increased credit card fees resulting from the purchase of the GM and UP Portfolios discussed above, higher gains on sales of mortgage backed and asset backed securities due to our efforts to reduce exposure to these investments, higher trading revenue, higher transaction fees in Global Banking and Markets and higher gains on leveraged acquisition finance loans held for sale for which we elected to apply fair value option. Although other revenues (losses) were overall higher during 2009, we continue to be impacted by reductions in other revenues (losses), largely trading revenue associated with credit derivative products due to the adverse financial market conditions discussed above, although the magnitude of such reductions declined significantly from 2008. Partially offsetting the increase in other revenues (losses) was \$537 million in losses on the fair value of financial instruments and the related derivative contracts (excluding leveraged acquisition finance loans held for sale) for which fair value option was elected as compared to gains of \$717 million in 2008.

Our provision for credit losses increased \$1.6 billion in 2009 primarily due to a higher provision for credit card receivables due to significantly higher credit card balances as a result of the purchase of the GM and UP Portfolios from HSBC Finance, higher delinquency and credit loss estimates relating to prime residential mortgage loans as conditions in the housing markets worsened and the U.S. economy deteriorated and higher credit loss provision in our commercial loan portfolio. Partially offsetting these increases was the impact from stabilization in the credit performance of private label credit card loans in the second half of the year and an improved outlook on future loss estimates as the impact of higher unemployment levels on losses has not been as severe as previously anticipated. Provision for credit losses increased for both loans and loan commitments in the commercial loan portfolio due to higher delinquency and loss estimates and higher levels of criticized loans, including higher levels of substandard loans caused by customer credit downgrades and deteriorating economic conditions, particularly in real estate lending and corporate banking.

Operating expenses increased \$326 million in 2009, an increase of nine percent over 2008. Lower salaries and employee benefit expense due to continued cost management efforts, including the impact of global resourcing initiatives, which have resulted in lower headcount were more than offset by higher FDIC insurance premiums which were \$208 million in 2009, as compared to \$58 million in 2008, an increase of \$150 million (including \$82 million relating to a special assessment), higher pension costs, higher servicing fees paid to HSBC Finance as a result of the

purchase of the GM, UP and Auto finance portfolios, higher fees paid to HTSU and increased costs related to the expansion of the retail banking network. Additionally in 2009, operating expenses includes an impairment write down of a data center building as part of our ongoing strategy to consolidate operations and improve efficiencies. Operating expenses in the prior year reflects a goodwill impairment charge of \$54 million relating to the residential mortgage reporting unit in PFS and, in both years, a release in the VISA litigation accrual that reduced operating expenses by \$9 million in 2009 and \$36 million in 2008.

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Our efficiency ratio was 50.08 percent during 2009 as compared to 101.83 percent in 2008 and 68.34 percent in 2007. The improvement in the efficiency ratio in 2009 resulted primarily from the significant increase in revenues as discussed above. Deterioration in the efficiency ratio in 2008 resulted primarily from a decrease in other revenues (losses) due to the adverse financial market conditions, partially offset by higher net interest income as expenses remained relatively flat.

Our effective tax rate was (37.2) percent in 2009 as compared to (35.2) percent in 2008 and (.7) percent in 2007. The effective tax rate for 2009 was significantly impacted by the relative level of pre-tax income, the sale of a minority stock interest that was treated as a dividend for tax purposes, settlement of an IRS audit, increase in the state and local income tax valuation allowance and an increased level of low income housing credits. The effective tax rate for 2008 compared with 2007 was significantly impacted by the relative level of pre-tax income, a goodwill impairment recorded in 2008, an adjustment in 2007 for the validation of deferred tax balances, valuation allowances related to the realizability of excess tax credits and foreign losses, as well as a change in estimate in the state tax rate.

Loans excluding loans held for sale were \$79.5 billion, \$81.1 billion and \$90.6 billion at December 31, 2009, 2008 and 2007, respectively. Loans decreased modestly at December 31, 2009 as higher receivable levels due to the purchase of the GM and UP Portfolios and the auto finance loans previously described were more than offset by decreases in residential mortgage loans, including the sale of approximately \$4.5 billion of prime adjustable and fixed rate residential mortgage loans during 2009, reductions in private label credit card receivables driven by the tightening of underwriting criteria to lower the risk profile of the portfolio including the termination of certain unprofitable retail partners and reduced customer spending, as well as lower commercial loans. Lower commercial loan balances reflect increased paydowns on loans across all commercial businesses, managed reductions in certain exposures, including higher underwriting standards, as well as lower overall demand from our core customer base. See Balance Sheet Review for a more detailed discussion of the changes in loan balances.

2008 vs. 2007 Net interest income increased in 2008 primarily due to higher balance sheet management income due in large part to positions taken in expectation of decreased funding rates. The reduction in the amortization of private label credit card premiums paid also resulted in increased net interest income. These increases were partially offset by narrowing of interest rate spreads on deposit products primarily due to competitive pressures as customers migrated to higher yielding deposit products and the runoff of the residential mortgage and other consumer loan portfolios, including the sale of \$7 billion of residential mortgage loans in 2008.

Other revenues (losses) were significantly lower in 2008, largely relating to a significant decrease in trading revenue due to adverse financial market conditions, including a loss of \$130 million reflecting our exposure resulting from clients that were impacted by the fraud at Madoff Investment Securities and higher securities losses due to other-than-temporary impairment charges. The decreases to revenue were partially offset by increased payments and cash management revenues, increased foreign exchange trading revenue, increased fees from the credit card receivable portfolio and the sale of MasterCard B shares, including gains on the related economic hedge as well as a gain on the sale of a portion of our investment in Visa Class B shares, which collectively increased revenues \$217 million. We also realized \$286 million in gains relating to financial instruments for which we elected fair value option.

Our provision for credit losses increased significantly in 2008, primarily due to growing delinquencies and charge-offs within the private label credit card portfolio as well as higher delinquency and credit loss estimates relating to home equity lines of credit, home equity loans and prime residential mortgage loans for which provisions increased markedly as conditions in the housing markets worsened and the U.S. economy continued to deteriorate. Provisions for credit losses also increased for both loans and loan commitments in the commercial loan portfolio due to higher levels of criticized assets caused by customer credit downgrades and deteriorating economic conditions.

Operating expenses increased modestly in 2008 and, excluding one-time impacts described below, operating expenses decreased compared to 2007, largely due to lower headcount including the impact of global resourcing initiatives. During 2008, we experienced an increase in reserves related to off-balance sheet credit exposures including letters of credit, unused commitments to extend credit and financial guarantees as well as increased FDIC insurance premiums and higher debit card fraud expense. Operating expenses in 2008 also reflect the impact of

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several one-off items including a goodwill impairment charge, an increase in employee benefits expense resulting from a review of our employee benefit accruals and increased severance expense due to ongoing efficiency initiatives as discussed above.

Credit Quality Our allowance for credit losses as a percentage of total loans increased to 4.86 percent at December 31, 2009, as compared to 2.96 percent at December 31, 2008. The increase reflects a higher allowance on our residential mortgage loan and commercial loan portfolios and lower outstanding balances in these portfolios as discussed above, as well as a higher allowance on our private label card portfolio due in part to higher charge-off levels due to portfolio seasoning, continued deterioration in the U.S. economy including rising unemployment rates and lower balances outstanding as a result of the actions previously taken to lower the risk profile of the portfolio and lower customer spending. These increases were partially offset by a lower credit card allowance percentage reflecting the impact on credit card mix of the prime GM and UP Portfolios that were purchased in January 2009.

Our consumer two-months-and-over contractual delinquency as a percentage of loans and loans held for sale (delinquency ratio) for consumer loans increased to 5.97 percent at December 31, 2009 as compared to 4.57 percent at December 31, 2008 due largely to higher residential mortgage loan delinquency as a result of continued deterioration in the housing markets, as well as the overall continued deterioration in the U.S. economy including rising unemployment rates which impacted all of our consumer portfolios. Our delinquency ratio at December 31, 2009 was also impacted by lower levels of private label credit card and residential mortgage loans outstanding. Our two-months-and-over contractual delinquency ratio for commercial loans increased due to continued deterioration of economic conditions. Criticized commercial loan balances also increased \$1.0 billion during 2009 to \$7.0 billion largely due to deteriorating economic conditions. See *Credit Quality* for a more detailed discussion of the increase in our delinquency ratios.

Net charge-offs as a percentage of average loans (net charge-off ratio) increased to 3.59 percent in 2009, compared to 1.79 percent during 2008 due to continued deterioration in the U.S. economy including continued declines in the housing markets, rising unemployment rates, the impact from lower outstanding loan balances as discussed above and as it relates to the prior year, higher bankruptcy filings. The net charge-off ratio for our credit card portfolio in 2009 was positively impacted by the GM and UP portfolio acquired from HSBC Finance, a portion of which was subject to the application of accounting principles that require certain loans with evidence of credit deterioration since origination to be recorded at an amount based on the net cash flows expected to be collected which reduced the overall level of charge-off reported in the first half of 2009. The portion of the portfolio not subject to this accounting began to season resulting in increased charge-offs during the second half of 2009. See *Credit Quality* for a more detailed discussion of the increase in the net charge-off ratio and criticized asset balances.

Funding and Capital Capital amounts and ratios are calculated in accordance with current banking regulations. Our Tier 1 capital ratio was 9.61 percent and 7.60 percent at December 31, 2009 and 2008, respectively. Our capital levels remain well above levels established by current banking regulations as well capitalized. We received capital contributions from our immediate parent, HNAI of \$2.2 billion during 2009 as compared to \$3.6 billion during 2008.

As part of the regulatory approvals with respect to the aforementioned receivable purchases completed in January 2009, we and our ultimate parent HSBC committed that HSBC Bank USA will maintain a Tier 1 risk-based capital ratio of at least 7.62 percent, a total capital ratio of at least 11.55 percent and a Tier 1 leverage ratio of at least 6.45 percent for one year following the date of transfer. In addition, we and HSBC have made certain additional capital commitments to ensure that HSBC Bank USA holds sufficient capital with respect to purchased receivables that are or may become low-quality assets, as defined by the Federal Reserve Act. In May 2009, we received further clarification from the Federal Reserve regarding HSBC Bank USA's regulatory reporting requirements with respect to

these capital commitments in that the additional capital requirements, (which require a risk-based capital charge of 100 percent for each low-quality asset transferred or arising in the purchased portfolios rather than the eight percent capital charge applied to similar assets that are not part of the transferred portfolios), should be applied both for purposes of satisfying the terms of the commitments and for purposes of measuring and reporting HSBC

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Bank USA's risk-based capital and related ratios. During 2009, HSBC Bank USA sold low-quality auto finance loans with a net book value of approximately \$455 million to a non-bank subsidiary of HSBC USA Inc. to reduce this capital requirement. Capital ratios at December 31, 2009 reflect this revised regulatory reporting. At December 31, 2009, we have exceeded our committed ratios and would have done so without the benefit associated with these low-quality asset sales.

Subject to regulatory approval, HSBC North America will be required to adopt Basel II provisions no later than April 1, 2011. HSBC USA will not report separately under the new rules, but HSBC Bank USA will report under the new rules on a stand-alone basis. Whether any increase in regulatory capital will be required prior to the Basel II adoption date will depend upon our prevailing risk profile. Adoption must be preceded by a parallel run period of at least four quarters, and requires the approval of U.S. regulators. This parallel run was initiated in January 2010.

Future Prospects Our operations are dependent upon access to the global capital markets and our ability to attract and retain deposits. Numerous factors, both internal and external, may impact our access to, and the costs associated with, both sources of funding. These factors may include our debt ratings, overall economic conditions, overall market volatility, the counterparty credit limits of investors to the HSBC Group and the effectiveness of our management of credit risks inherent in our customer base.

In 2008 and continuing into the early part of 2009, financial markets were extremely volatile. New issue term debt markets were extremely challenging with issues attracting higher rates of interest than had historically been experienced and credit spreads for all issuers continuing to trade at historically wide levels. While the on-going financial market disruptions continued to impact credit spreads and liquidity, we have seen significant improvements in liquidity beginning in the second quarter of 2009 which continued through the end of the year. Credit spreads have narrowed due to increased market confidence stemming largely from the various government actions taken to restore faith in the capital markets. Financial institutions are now able to issue longer term debt without government guarantees and the FDIC was able to allow the Debt Guarantee Program to expire. Similarly, many asset backed securitizations that were not eligible for the Federal Reserve Board's Term Asset Backed Securities Loan Facility Program have been issued at favorable rates since the second quarter of 2009.

Our results are also impacted by general economic conditions, including unemployment, weakness in the housing market and property valuations, as well as interest rates, all of which are beyond our control. When unemployment increases or changes in the rate of home value appreciation or depreciation occurs, a higher percentage of our customers default on their loans and our charge-offs increase. Changes in interest rates generally affect both the rates we charge to our customers and the rates we must pay on our borrowings. The primary risks to achieving our business goals in 2010 are largely dependent upon macro-economic conditions which include a weak housing market, high unemployment rates, the nature and timing of any economic recovery, reduced consumer spending, volatility in the capital and debt markets and our ability to attract and retain customers, loans and deposits, all of which could impact trading and other revenue, net interest income, loan volume, charge-offs and ultimately our results of operations.

Basis of Reporting

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

In addition to the U.S. GAAP financial results reported in our consolidated financial statements, MD&A includes reference to the following information which is presented on a non-U.S. GAAP basis:

International Financial Reporting Standards (*IFRSs*) Because HSBC reports results in accordance with IFRSs and IFRSs results are used in measuring and rewarding performance of employees, our management also

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separately monitors net income under IFRSs (a non-U.S. GAAP financial measure). The following table reconciles our net income on a U.S. GAAP basis to net income on an IFRSs basis.

Year Ended December 31,	2009	2008	2007
	(in millions)		
Net income (loss) U.S. GAAP basis	\$ (142)	\$ (1,689)	\$ 138
Adjustments, net of tax:			
Unquoted equity securities	(19)	(65)	58
Fair value option	-	-	124
Reclassification of financial assets	(398)	576	-
Securities	(79)	(61)	(1)
Derivatives	17	10	-
Loan impairment	9	1	3
Property	14	15	13
Pension costs	38	1	16
Purchased loan portfolios	66	-	-
Servicing assets	2	10	(1)
Return of capital	(55)	-	-
Interest recognition	(2)	3	6
Other	(23)	(9)	30
Net income (loss) IFRSs basis	(572)	(1,208)	386
Tax benefit (expense) IFRSs basis	254	648	(111)
Profit (loss) before tax IFRSs basis	\$ (826)	\$ (1,856)	\$ 497

A summary of the significant differences between U.S. GAAP and IFRSs as they impact our results are presented below:

Unquoted equity securities Under IFRSs, equity securities which are not quoted on a recognized exchange (MasterCard Class B shares and Visa Class B shares), but for which fair value can be reliably measured, are required to be measured at fair value. Securities measured at fair value under IFRSs are classified as either available-for-sale securities, with changes in fair value recognized in shareholders' equity, or as trading securities, with changes in fair value recognized in income. Under U.S. GAAP, equity securities that are not quoted on a recognized exchange are not considered to have a readily determinable fair value and are required to be measured at cost, less any provisions for known impairment, in other assets.

Fair value option Reflects the impact of applying the fair value option under IFRSs to certain debt instruments issued, and includes an adjustment of the initial valuation of the debt instruments. Prior to January 1, 2008, the debt was accounted for at amortized cost under U.S. GAAP. This difference was eliminated upon the adoption of fair value option under U.S. GAAP on January 1, 2008. Also under IFRSs, net interest income includes the interest element for derivatives which corresponds to debt designated at fair value. For U.S. GAAP, this is included in the gain (loss) on instruments at fair value and related derivatives, which is a component of other revenues.

Reclassification of financial assets Certain securities were reclassified from trading assets to loans and receivables under IFRSs as of July 1, 2008 pursuant to an amendment to IAS 39, Financial Instruments: Recognition and Measurement (IAS 39), and are no longer marked to market under IFRSs. In November 2008, additional securities were similarly transferred to loans and receivables. These securities continue to be classified as trading assets under U.S. GAAP.

Additionally, certain Leverage Acquisition Finance (LAF) loans were classified as Trading Assets for IFRSs and to be consistent, an irrevocable fair value option was elected on these loans under U.S. GAAP on January 1,

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2008. These loans were reclassified to loans and advances as of July 1, 2008 pursuant to the IAS 39 amendment discussed above. Under U.S. GAAP, these loans are classified as held for sale and carried at fair value due to the irrevocable nature of the fair value option.

Securities Effective January 1, 2009 under U.S. GAAP, the credit loss component of an other-than-temporary impairment of a debt security is recognized in earnings while the remaining portion of the impairment loss is recognized in accumulated other comprehensive income provided we have concluded we do not intend to sell the security and it is more-likely-than-not that we will not have to sell the security prior to recovery. Under IFRSs, there is no bifurcation of other-than-temporary impairment and the entire portion is recognized in earnings. There are also less significant differences in measuring other-than-temporary impairment under IFRSs versus U.S. GAAP.

Under IFRSs, securities include HSBC shares held for stock plans at fair value. These shares held for stock plans are recorded at fair value through other comprehensive income. If it is determined these shares have become impaired, the fair value loss is recognized in profit and loss and any fair value loss recorded in other comprehensive income is reversed. There is no similar requirement under U.S. GAAP. Also during the second quarter of 2009 under IFRSs, we recorded income for the value of additional shares attributed to HSBC shares held for stock plans as a result of HSBC's rights offering earlier in 2009. The additional shares are not recorded under U.S. GAAP.

Derivatives Effective January 1, 2008, U.S. GAAP removed the observability requirement of valuation inputs to allow up-front recognition of the difference between transaction price and fair value in the consolidated statement of loss. Under IFRSs, recognition is permissible only if the inputs used in calculating fair value are based on observable inputs. If the inputs are not observable, profit and loss is deferred and is recognized 1) over the period of contract, 2) when the data becomes observable, or 3) when the contract is settled.

Loan impairment IFRSs requires a discounted cash flow methodology for estimating impairment on pools of homogeneous consumer loans which requires the incorporation of the time value of money relating to recovery estimates. Also under IFRSs, future recoveries on charged-off loans are accounted for on a discounted basis and a recovery asset is recorded. Subsequent recoveries are recorded to earnings under U.S. GAAP, but are adjusted against the recovery asset under IFRSs.

Property Under IFRSs, the value of property held for own use reflects revaluation surpluses recorded prior to January 1, 2004. Consequently, the values of tangible fixed assets and shareholders' equity are lower under U.S. GAAP than under IFRSs. There is a correspondingly lower depreciation charge and higher net income as well as higher gains (or smaller losses) on the disposal of fixed assets under U.S. GAAP. For investment properties, net income under U.S. GAAP does not reflect the unrealized gain or loss recorded under IFRSs for the period.

Pension costs Net income under U.S. GAAP is lower than under IFRSs as a result of the amortization of the amount by which actuarial losses exceed gains beyond the 10 percent corridor.

Purchased Loan Portfolios Under US GAAP, purchased loans for which there has been evidence of credit deterioration at the time of acquisition are recorded at an amount based on the net cash flows expected to be collected. This generally results in only a portion of the loans in the acquired portfolio being recorded at fair value. Under IFRSs, the entire purchased portfolio is recorded at fair value. When recording purchased loans at fair value, the difference between all estimated future cash collections and the purchase price paid is recognized into income using the effective interest method. An allowance for loan loss is not established unless the original estimate of expected future cash collections declines.

Servicing assets Under IAS 38, servicing assets are initially recorded on the balance sheet at cost and amortized over the projected life of the assets. Servicing assets are periodically tested for impairment with impairment adjustments charged against current earnings. Under U.S. GAAP, we generally record servicing assets on the balance sheet at fair value. All subsequent adjustments to fair value are reflected in current period earnings.

Return of capital In 2009, this includes the recognition of \$55 million relating to the payment to CT Financial Services, Inc. in connection with the resolution of a lawsuit which for IFRS was treated as the satisfaction of a liability and not as revenue and a subsequent capital transaction as was the case under U.S. GAAP.

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Interest recognition The calculation of effective interest rates under IAS 39 requires an estimate of all fees and points paid or recovered between parties to the contract that are an integral part of the effective interest rate be included. U.S. GAAP generally prohibits recognition of interest income to the extent the net interest in the loan would increase to an amount greater than the amount at which the borrower could settle the obligation. Also under U.S. GAAP, prepayment penalties are generally recognized as received.

Other Other includes the net impact of certain adjustments which represent differences between U.S. GAAP and IFRSs that were not individually material, including deferred loan origination costs and fees, goodwill and loans held for sale. In 2008, other includes the impact of a difference in the write off amount of goodwill related to our residential mortgage banking business unit and a timing difference with respect to the adoption of fair value measurement accounting principles for U.S. GAAP which resulted in the recognition of \$10 million of net income relating to structured products.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with U.S. GAAP. We believe our policies are appropriate and fairly present the financial position of HSBC USA Inc.

The significant accounting policies used in the preparation of our consolidated financial statements are more fully described in Note 2, Summary of Significant Accounting Policies and New Accounting Pronouncements, to the accompanying consolidated financial statements. Certain critical accounting policies, which affect the reported amounts of assets, liabilities, revenues and expenses, are complex and involve significant judgment by our management, including the use of estimates and assumptions. We base and establish our accounting estimates on historical experience, observable market data, inputs derived from or corroborated by observable market data by correlation or other means and on various other assumptions including those based on unobservable inputs that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. In addition, to the extent we use certain modeling techniques to assist us in measuring the fair value of a particular asset or liability, we strive to use such techniques which are consistent with those used by other market participants. Actual results may differ from these estimates due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change. The impact of estimates and assumptions on the financial condition or operating performance may be material.

We believe that of the significant accounting policies used in the preparation of our consolidated financial statements, the items discussed below require critical accounting estimates involving a high degree of judgment and complexity. Our management has discussed these critical accounting policies with the Audit Committee of our Board of Directors, including the underlying estimates and assumptions, and the Audit Committee has reviewed our disclosure relating to these accounting policies and practices in this MD&A.

Allowance for Credit Losses Because we lend money to others, we are exposed to the risk that borrowers may not repay amounts owed when they become contractually due. Consequently, we maintain an allowance for credit losses at a level that we consider adequate, but not excessive, to cover our estimate of probable incurred losses in the existing loan portfolio. Allowance estimates are reviewed periodically and adjustments are reflected through the provision for credit losses in the period when they become known. The accounting estimate relating to the allowance for credit losses is a critical accounting estimate for the following reasons:

Changes in such estimates could significantly impact our allowance and provision for credit losses and therefore could materially affect net income;

Estimates related to the allowance for credit losses require us to project future delinquency and charge off trends, which are uncertain and require a high degree of judgment; and

The allowance for credit losses is influenced by factors outside of our control such as customer payment patterns, economic conditions such as national and local trends in housing markets, interest rates, unemployment rates, bankruptcy trends and changes in laws and regulations all of which have an impact on our estimates.

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Because our estimate of the allowance for credit losses involves judgment and is influenced by factors outside of our control, there is uncertainty inherent in these estimates, making it reasonably possible such estimates could change. Our estimate of probable incurred credit losses is inherently uncertain because it is highly sensitive to changes in economic conditions which influence growth, portfolio seasoning, bankruptcy trends, trends in housing markets, delinquency rates and the flow of loans through various stages of delinquency, the realizability of any collateral and actual loss exposure. Changes in such estimates could significantly impact our allowance and provision for credit losses. For example, a 10% change in our projection of probable net credit losses on our loans could have resulted in a change of approximately \$386 million in our allowance for credit losses at December 31, 2009. The allowance for credit losses is a critical accounting estimate for our Consumer Finance, Personal Financial Services, Commercial Banking, Global Banking and Markets and Private Banking segments.

Our allowance for credit losses is based on estimates and is intended to be adequate but not excessive. The allowance for credit losses is regularly assessed for adequacy through a detailed review of the loan portfolio. The allowance is comprised of two balance sheet components:

The allowance for credit losses, which is carried as a reduction to loans on the balance sheet, includes reserves for inherent probable credit losses associated with all loans outstanding; and

The reserve for off-balance sheet risk, which is recorded in other liabilities, includes probable and reasonably estimable credit losses arising from off-balance sheet arrangements such as letters of credit and undrawn commitments to lend.

Both components include amounts calculated for specific individual loan balances and for collective loan portfolios depending on the nature of the exposure and the manner in which risks inherent in that exposure are managed.

All commercial loans that exceed \$500,000 are evaluated individually for impairment. When a loan is found to be impaired, a specific reserve is calculated. Reserves against impaired loans are determined primarily by an analysis of discounted expected cash flows with reference to independent valuations of underlying loan collateral and considering secondary market prices for distressed debt where appropriate.

Loans which are not individually evaluated for impairment are pooled into homogeneous categories of loans and evaluated to determine if it is deemed probable, based on historical data and other environmental factors, that a loss has been realized even though it has not yet been manifested in a specific loan.

For consumer receivables and certain small business loans, we utilize a roll rate migration analysis that estimates the likelihood that a loan will progress through the various stages of delinquency and ultimately be charged-off based on recent historical experience. These estimates also take into consideration the loss severity expected based on the underlying collateral for the loan, if any, in the event of default. In addition, loss reserves are maintained on consumer receivables to reflect our judgment of portfolio risk factors which may not be fully reflected in the statistical roll rate calculation or when historical trends are not reflective of current inherent losses in the loan portfolio. Risk factors considered in establishing the allowance for credit losses on consumer receivables include recent growth, product mix and risk selection, unemployment rates, bankruptcy trends, geographic concentrations, loan product features such as adjustable rate loans, economic conditions such as national and local trends in unemployment, housing markets and interest rates, portfolio seasoning, changes in underwriting practices, current levels of charge-offs and delinquencies, changes in laws and regulations and other items which can affect consumer payment patterns on outstanding receivables such as natural disasters. We also consider key ratios such as number of months of loss coverage in developing our allowance estimates. The resulting loss coverage ratio varies by portfolio based on inherent risk and,

where applicable, regulatory guidance. Roll rates are regularly updated and benchmarked against actual outcomes to ensure that they remain appropriate.

An advanced credit risk methodology is utilized to support the estimation of incurred losses inherent in pools of homogeneous commercial loans, leases and off-balance sheet risk. This methodology uses the probability of default from the customer rating assigned to each counterparty, the Loss Given Default rating assigned to each transaction or facility based on the collateral securing the transaction, and the measure of exposure based on the transaction. A suite of models, tools and templates is maintained using quantitative and statistical techniques,

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which are combined with management's judgment to support the assessment of each transaction. These were developed using internal data and supplemented with data from external sources which was judged to be consistent with our internal credit standards. These advanced measures are applied to the homogeneous credit pools to estimate the required allowance for credit losses.

The results from the commercial analysis, consumer roll rate analysis and the specific impairment reserving process are reviewed each quarter by the Credit Reserve Committee. This committee also considers other observable factors, both internal and external to us in the general economy, to ensure that the estimates provided by the various models adequately include all known information at each reporting period. Loss reserves are maintained to reflect the committee's judgment of portfolio risk factors which may not be fully reflected in statistical models or when historical trends are not reflective of current inherent incurred losses in the loan portfolio. The allowance for credit losses are reviewed with our Risk Management Committee and the Audit Committee of the Board of Directors each quarter.

Goodwill Impairment Goodwill is not subject to amortization but is tested for possible impairment at least annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each reporting unit be compared to its carrying amount, including the goodwill. Significant and long-term changes in industry and economic conditions are considered to be primary indicators of potential impairment due to their impact on expected future cash flows. In addition, shorter-term changes may impact the discount rate applied to such cash flows based on changes in investor requirements or market uncertainties.

The impairment testing of our goodwill is a critical accounting estimate due to the significant judgment required in the use of discounted cash flow models to determine fair value. Discounted cash flow models include such variables as revenue growth rates, expense trends, interest rates and terminal values. Based on an evaluation of key data and market factors, management's judgment is required to select the specific variables to be incorporated into the models. Additionally, the estimated fair value can be significantly impacted by the risk adjusted cost of capital used to discount future cash flows. The risk adjusted cost of capital percentage is generally derived from an appropriate capital asset pricing model, which itself depends on a number of financial and economic variables which are established on the basis of that used by market participants which involves management's judgment. Because our fair value estimate involves judgment and is influenced by factors outside our control, it is reasonably possible such estimate could change. When management's judgment is that the anticipated cash flows have decreased and/or the cost of capital has increased, the effect will be a lower estimate of fair value. If the fair value is determined to be lower than the carrying value, an impairment charge may be recorded and net income will be negatively impacted.

Impairment testing of goodwill requires that the fair value of each reporting unit be compared to its carrying amount. Reporting units were identified based upon an analysis of each of our individual operating segments. A reporting unit is defined as any distinct, separately identifiable component of an operating segment for which complete, discrete financial information is available that management regularly reviews. Goodwill was allocated to the carrying value of each reporting unit based on its relative fair value.

We have established July 1 of each year as the date for conducting our annual goodwill impairment assessment. Fair value calculations used in goodwill impairment testing are also tested for sensitivity to reflect reasonable variations, including stress testing of certain attributes such as cost savings, terminal values and the discount rate. Results of these tests are taken into consideration by management during the review of the annual goodwill impairment test.

As a result of the continued deterioration in economic and credit conditions in the U.S., we performed interim impairment tests of the goodwill of our Global Banking and Markets reporting unit as of December 31, 2009, September 30, 2009, June 30, 2009 and March 31, 2009. We also performed interim impairment tests of the goodwill

of our Private Banking reporting unit as of December 31, 2009 and September 30, 2009. As a result of these tests, the fair value of our Global Banking and Markets and Private Banking reporting units continue to exceed their carrying value including goodwill at each of these testing dates. At December 31, 2009, goodwill totaling \$633 million and \$415 million has been allocated to our Global Banking and Markets and Private Banking reporting

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units, respectively. As of the December 31, 2009 interim impairment testing date, the percentage by which fair value of our Global Banking and Markets and Private Banking reporting units exceeded their carrying value including goodwill was 81 percent and 53 percent, respectively. Our goodwill impairment testing is however, highly sensitive to certain assumptions and estimates used as discussed above. We continue to perform periodic analyses of the risks and strategies of our business and product offerings. In the event that further significant deterioration in the economic and credit conditions beyond the levels already reflected in our cash flow forecasts occur, or changes in the strategy or performance of our business or product offerings occur, additional interim impairment tests will again be required in 2010.

Valuation of Financial Instruments A substantial portion of our financial assets and liabilities are carried at fair value. These include trading assets and liabilities, including derivatives held for trading, derivatives used for hedging and securities available-for-sale. Certain loans held for sale, which are carried at the lower of amortized cost or fair value, are also reported at fair value when their amortized cost exceeds their current fair value.

Where available, we use quoted market prices to determine fair value. If quoted market prices are not available, fair value is determined using internally developed valuation models based on inputs that are either directly observable or derived from and corroborated by market data. These inputs include, but are not limited to, interest rate yield curves, option volatilities, option adjusted spreads and currency rates. Where neither quoted market prices nor observable market parameters are available, fair value is determined using valuation models that feature one or more significant unobservable inputs based on management's expectation that market participants would use in determining the fair value of the asset or liability. However, these unobservable inputs must incorporate market participants' assumptions about risks in the asset or liability and the risk premium required by market participants in order to bear the risks. The determination of appropriate unobservable inputs requires exercise of management judgment. A significant majority of our assets and liabilities that are reported at fair value are measured based on quoted market prices and observable market-based or independently-sourced inputs.

We review and update our fair value hierarchy classifications at the end of each quarter. Quarterly changes related to the observability of the inputs to a fair value measurement may result in a reclassification between hierarchy levels. Level 3 assets (including assets measured at the lower of cost or fair value) were eight percent of total assets measured at fair value at December 31, 2009. Imprecision in estimating unobservable market inputs can impact the amount of revenue, loss or changes in common shareholder's equity recorded for a particular financial instrument. Furthermore, while we believe our valuation methods are appropriate, the use of different methodologies or assumptions to determine the fair value of certain financial assets and liabilities could result in a different estimate of fair value at the reporting date. For a more detailed discussion of the determination of fair value for individual financial assets and liabilities carried at fair value see Fair Value under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following is a description of the significant estimates used in the valuation of financial assets and liabilities for which quoted market prices and observable market parameters are not available.

Complex Derivatives Held for Trading Fair value for the majority of our derivative instruments are based on internally developed models that utilize independently sourced market parameters. For complex or long-dated derivative products where market data is not available, fair value may be affected by the choice of valuation model and the underlying assumptions about the timing of cash flows and credit spreads. The fair values of certain structured credit and structured equity derivative products are sensitive to unobservable inputs such as default correlations and volatilities. These estimates are susceptible to significant changes in future periods as market conditions evolve.

We may adjust certain fair value estimates to ensure that those estimates appropriately represent fair value. These adjustments, which are applied consistently over time, are generally required to reflect factors such as market liquidity and counterparty credit risk. Where relevant, a liquidity adjustment is applied to determine the measurement of an asset or a liability that is required to be reported at fair value. Assessing the appropriate level of liquidity adjustment requires management judgment and is often affected by the product type, transaction-specific terms and the level of liquidity for the product in the market. For financial liabilities, including derivatives measured

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at fair value, we consider the effect of our own non-performance risk on fair values. In assessing the credit risk relating to derivative assets and liabilities, we take into account the impact of risk mitigants including, but not limited to, master netting and collateral arrangements. Finally, other transaction specific factors such as the selection of valuation models available, the range of unobservable model inputs and other model assumptions can affect fair value estimates. Imprecision in estimating these factors can impact the amount of revenue or loss recorded for a particular position.

Derivatives Held for Hedging Derivatives designated as qualified hedges are tested for effectiveness of the hedge. For these transactions, assessments are made at the inception of the hedge and on a recurring basis, whether the derivative used in the hedging transaction has been and is expected to continue to be highly effective in offsetting changes in fair values or cash flows of the hedged item. This assessment is conducted using statistical regression analysis.

If we determine as a result of this assessment that a derivative is not expected to be a highly effective hedge or that it has ceased to be a highly effective hedge, hedge accounting is discontinued as of the quarter in which such determination was made. The assessment of the effectiveness of the derivatives used in hedging transactions is considered to be a critical accounting estimate due to the use of statistical regression analysis in making this determination. Similar to discounted cash flow modeling techniques, statistical regression analysis requires the use of estimates regarding the amount and timing of future cash flows which are susceptible to significant changes in future periods based on changes in market rates. Statistical regression analysis also involves the use of additional assumptions including the determination of the period over which the analysis should occur as well as selecting a convention for the treatment of credit spreads in the analysis.

The outcome of the statistical regression analysis serves as the foundation for determining whether or not a derivative is highly effective as a hedging instrument. This can result in earnings volatility as the mark-to-market on derivatives which do not qualify as effective hedges and the ineffectiveness associated with qualifying hedges are recorded in current period earnings.

Loans held for sale Certain residential mortgage whole loans are classified as held for sale and are accounted for at lower of cost or fair value. The fair value of certain of these loans is determined based on valuations of mortgage-backed securities that would be observed in a hypothetical securitization adjusted for dissimilarity in the underlying collateral, market liquidity, and direct transaction costs to convert mortgage loans into securities. During the recent market turmoil, pricing information on mortgage related assets became less available. In an inactive market where securitizations of mortgage whole loans may not regularly occur, we utilize alternative market information by reference to different exit markets to determine or validate the fair value of our mortgage whole loans. The determination of fair value for mortgage whole loans takes into account factors such as the location of the collateral, the loan-to-value ratio, the estimated rate and timing of delinquency, the probability of foreclosure and loss severity if foreclosure does occur.

Loans elected for the fair value option We elected to measure certain leveraged finance loans and commercial loans at fair value under the fair value option provided by U.S. GAAP. Where available, market-based consensus pricing obtained from independent sources is used to estimate the fair value of leveraged loans. Where consensus pricing information is not available, fair value is estimated using observable market prices of similar instruments, including bonds, credit derivatives, and loans with similar characteristics. Where observable market parameters are not available, fair value is determined based on contractual cash flows adjusted for estimates of prepayments, defaults, and recoveries, discounted at management's estimate of the rate that would be required by market participants in the current market conditions. We attempt to corroborate estimates of prepayments, defaults, and recoveries using

observable data by correlation or other means. We also consider the specific loan characteristics and inherent credit risk and risk mitigating factors such as the nature and characteristics of the collateral arrangements in determining fair value. Continued lack of liquidity in credit markets has resulted in a significant decrease in the availability of observable market data, which has resulted in an increased level of management judgment required to estimate fair value for loans held for sale.

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Structured Deposits and Structured Notes Certain hybrid instruments, primarily structured notes and structured certificates of deposit, were elected to be measured at fair value in their entirety under the fair value option provided by U.S. GAAP. As a result, derivative features embedded in those instruments are included in the fair value measurement of the instrument. Depending on the complexity of the embedded derivative, the same elements of valuation uncertainty and adjustments described in the derivative sections above would apply to hybrid instruments. Additionally, cash flows for the funded notes and deposits are discounted at the appropriate rate for the applicable duration of the instrument adjusted for our own credit spreads. The credit spreads applied to these instruments are derived from the spreads at which institutions of similar credit standing would be charged for issuing similar structured instruments as of the measurement date.

Own debt issuances for which the fair value option has been elected are traded in the OTC market. The fair value of our own debt issuances is determined based on the observed prices for the specific debt instrument transacted in the secondary market. To the extent the inputs are observable, less judgment is required in determining the fair value. In many cases, management can obtain quoted prices for identical or similar liabilities. However, the markets may become inactive at various times where prices are not current or price quotations vary over time or among market makers. In these situations, valuation estimates involve using inputs other than quoted prices to value both the interest rate component and the credit component of the debt. Changes in such estimates, and in particular the credit component of the valuation, can be volatile from period to period and may markedly impact the total mark-to-market on debt designated at fair value recorded in our consolidated statement of income (loss).

Asset-backed securities Mortgage-backed securities and other asset-backed securities including Collateralized Debt Obligations (CDOs) and Collateralized Loan Obligations (CLOs) are classified as either available-for-sale or held for trading and are measured at fair value. The fair value measurements of these asset classes are primarily determined or validated by inputs obtained from independent pricing sources adjusted for the differences in the characteristics and performance of the underlying collateral, such as prepayments and defaults. During the recent credit crisis, the valuations of certain mortgage-backed and asset-backed securities have become less transparent. For these securities, internal valuation estimates are used to validate the pricing information obtained from independent pricing sources which measure fair value based on information derived from both observable and unobservable inputs.

We have established a control framework designed to ensure that fair values are either determined or validated by a function independent of the risk-taker. Controls over the valuation process are summarized in Item 7, **Management Discussion and Analysis of Financial Condition and Results of Operations** under the heading **Fair Value**.

Because the fair value of certain financial assets and liabilities are significantly impacted by the use of estimates, the use of different assumptions can result in changes in the estimated fair value of those assets and liabilities, which can result in equity and earnings volatility as follows:

Changes in the fair value of trading assets and liabilities are recorded in current period earnings;

Changes in the fair value of securities available-for-sale are recorded in other comprehensive income;

Changes in the fair value of loans held for sale when their amortized cost exceeds fair value are recorded in current period earnings;

Changes in the fair value of a derivative that has been designated and qualifies as a fair value hedge, along with the changes in the fair value of the hedged asset or liability (including losses or gains on firm commitments), are recorded in current period earnings; and

Changes in the fair value of a derivative that has been designated and qualifies as a cash flow hedge are recorded in other comprehensive income to the extent of its effectiveness, until earnings are impacted by the variability of cash flows from the hedged item.

Impairment of Securities Available-for-sale Securities available-for-sale are measured at fair value and changes in fair value, net of related income taxes, are recognized in equity in other comprehensive income until the securities are either sold or an other-than-temporary impairment loss is recognized. Where the amount recognized in other

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comprehensive income related to a security available-for-sale represents a loss, the security is deemed to be impaired. To the extent that the impairment is deemed to be other-than-temporary, an other-than-temporary impairment loss is recognized. However for financial statement presentation purposes, only the credit loss component of such difference is recognized in earnings for a debt security that we do not intend to sell and for which it is not more-likely-than-not that we will be required to sell prior to recovery of its amortized cost basis.

Total securities available-for-sale amounted to \$27.8 billion and \$24.9 billion at December 31, 2009 and 2008, respectively, of which \$26.5 billion or 95.5 percent at December 31, 2009 and \$24.9 billion or 99.8 percent at December 31, 2008 were debt securities. The amount recorded in other comprehensive income relating to debt securities available-for-sale amounted to an increase of \$526 million and a reduction of \$471 million at December 31, 2009 and 2008, respectively. A reduction in other comprehensive income relating to a debt security available-for-sale occurs when the fair value of the security is less than the security's acquisition cost (net of any principal repayments and amortization) less any other-than-temporary impairment loss recognized in earnings.

Management is required to exercise judgment in determining whether an impairment is other-than-temporary or reflects a credit loss that must be recognized in earnings. For debt securities available-for-sale, the objective evidence required to determine whether an impairment is other-than-temporary or reflects a credit loss comprises evidence of the occurrence of a loss event that results in a decrease in estimated future cash flows. Where cash flows are readily determinable, a low level of judgment may be involved. Where determination of estimated future cash flows requires consideration of a number of variables, some of which may be unobservable in current market conditions, more significant judgment is required.

The most significant judgments concern more complex instruments, such as asset-backed securities (ABSs), where it is necessary to consider factors such as the estimated future cash flows on underlying pools of collateral, the extent and depth of market price declines and changes in credit ratings. The review of estimated future cash flows on underlying collateral is subject to estimation uncertainties where the assessment is based on historical information on pools of assets, and judgment is required to determine whether historical performance is likely to be representative of current economic and credit conditions.

There is no single factor to which our charge for other-than-temporary impairment of debt securities available-for-sale is particularly sensitive, because of the range of different types of securities held, the range of geographical areas in which those securities are held, and the wide range of factors which can affect the occurrence of loss events and cash flows of securities, including different types of collateral.

Management's current assessment of the holdings of available-for-sale ABSs with the most sensitivity to possible future impairment is focused on subprime and Alt-A residential mortgage-backed securities (MBSs). Our principal exposure to these securities is in the Global Banking and Markets business. Excluding holdings in certain special purpose entities where significant first loss risks are borne by external investors, the available-for-sale holdings in these categories within Global Banking and Markets amounted to \$136 million at December 31, 2009 (\$38 million at December 31, 2008). The available-for-sale fair value adjustment as at December 31, 2009 in relation to these securities was an unrealized gain of \$7 million and at December 31, 2008, an unrealized loss of \$23 million.

The main factors in the reduction in fair value of these securities over the period were the effects of reduced market liquidity and negative market sentiment. The level of actual credit losses experienced was relatively low in both 2009 and 2008, notwithstanding the deterioration in the performance of the underlying mortgages in the period as U.S. house prices fell and defaults increased. The absence of significant credit losses is judged to be attributable to the seniority of the tranches we held as well as the priority for cash flow held by these tranches. In 2009, we recognized

other-than-temporary impairment of \$208 million of which \$124 million related to credit losses which was recorded through earnings. In 2008, we recognized other-than-temporary impairment of \$231 million, all of which was recorded through earnings.

It is reasonably possible that outcomes in the future could be different from the assumptions and estimates used in identifying impairment on available-for-sale debt securities and, as a result, impairment may be identified in available-for-sale debt securities which had previously been determined not to be impaired. It is possible that this could result in the recognition of material impairment losses in future periods.

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Mortgage Servicing Rights (MSRs) We recognize retained rights to service mortgage loans as a separate and distinct asset at the time the loans are sold. We initially value Mortgage Servicing Rights (MSRs) at fair value at the time the related loans are sold and subsequently measure MSRs at fair value at each reporting date with changes in fair value reflected in income in the period that the changes occur.

MSRs are subject to interest rate risk in that their fair value will fluctuate as a result of changes in the interest rate environment. Fair value is determined based upon the application of valuation models and other inputs. The valuation models incorporate assumptions market participants would use in estimating future cash flows. These assumptions include expected prepayments, default rates and market-based option adjusted spreads. The estimate of fair value is considered to be a critical accounting estimate because the assumptions used in the valuation models involve a high degree of subjectivity that is dependent upon future interest rate movements. The reasonableness of these pricing models is periodically validated by reference to external independent broker valuations and industry surveys.

Because the fair values of MSRs are significantly impacted by the use of estimates, the use of different estimates can result in changes in the estimated fair values of those MSRs, which can result in equity and earnings volatility because such changes are reported in current period earnings.

Deferred Tax Assets We recognize deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for tax credits and state net operating losses. Our deferred tax assets, net of valuation allowances, totaled \$2.1 billion and \$1.7 billion as of December 31, 2009 and 2008, respectively. We evaluate our deferred tax assets for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including our historical financial performance, projections of future taxable income, future reversals of existing taxable temporary differences and any carryback availability. We are required to establish a valuation allowance for deferred tax assets and record a charge to income or shareholders' equity if we determine, based on available evidence at the time the determination is made, that it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we estimate future taxable income based on management approved business plans, future capital requirements and ongoing tax planning strategies, including capital support from HSBC necessary as part of such plans and strategies. This process involves significant management judgment about assumptions that are subject to change from period to period. Because the recognition of deferred tax assets requires management to make significant judgments about future earnings, the periods in which items will impact taxable income, and the application of inherently complex tax laws, we have included the assessment of deferred tax assets and the need for any related valuation allowance as a critical accounting estimate.

Since recent market conditions have created significant downward pressure and volatility on our near-term pretax book income, our analysis of the realizability of deferred tax assets significantly discounts any future taxable income expected from operations and relies to a greater extent on continued liquidity and capital support from our parent, HSBC, including tax planning strategies implemented in relation to such support. We are included in HSBC North America's consolidated Federal income tax return and in certain combined state returns. As we have entered into tax allocation agreements with HSBC North America and its subsidiary entities included in the consolidated return which govern the current amount of taxes to be paid or received by the various entities, we look at HSBC North America and its affiliates, together with the tax planning strategies identified, in reaching our conclusion on recoverability. Absent capital support from HSBC and implementation of the related tax planning strategies, we would be required to record a valuation allowance against our deferred tax assets.

The use of different estimates can result in changes in the amounts of deferred tax items recognized, which can result in equity and earnings volatility because such changes are reported in current period earnings. Furthermore, if future

events differ from our current forecasts, valuation allowances may need to be established or adjusted, which could have a material adverse effect on our results of operations, financial condition and capital position. We will continue to update our assumptions and forecasts of future taxable income and assess the need and adequacy of any valuation allowance.

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Additional detail on our assumptions with respect to the judgments made in evaluating the realizability of our deferred tax assets and on the components of our deferred tax assets and deferred tax liabilities as of December 31, 2009 and 2008 can be found in Note 18, *Income Taxes*, of this Form 10-K.

Balance Sheet Review

We utilize deposits and borrowings from various sources to provide liquidity, fund balance sheet growth, meet cash and capital needs, and fund investments in subsidiaries. Balance sheet totals at December 31, 2009, and movements in comparison with prior periods, are summarized in the table below.

	December 31, 2009	Increase (Decrease) From December 31, 2008		December 31, 2007	
		Amount	%	Amount	%
(dollars are in millions)					
Period end assets:					
Short-term investments	\$ 24,314	\$ (5,411)	(18.2)%	\$ 2,329	10.6%
Loans, net	75,628	(3,088)	(3.9)	(13,514)	(15.2)
Loans held for sale	2,908	(1,523)	(34.4)	(2,362)	(44.8)
Trading assets	25,815	(5,477)	(17.5)	(10,813)	(29.5)
Securities	30,568	2,785	10.0	7,715	33.8
Other assets	11,846	(1,776)	(13.0)	(241)	(2.0)
	\$ 171,079	\$ (14,490)	(7.8)%	\$ (16,886)	(9.0)%
Funding sources:					
Total deposits	\$ 118,337	\$ (701)	(.6)%	\$ 2,167	1.9%
Trading liabilities	8,010	(8,313)	(50.9)	(8,243)	(50.7)
Short-term borrowings	6,512	(3,983)	(38.0)	(5,320)	(45.0)
Interest, taxes and other liabilities	5,035	128	2.6	830	19.7
Long-term debt	18,008	(4,081)	(18.5)	(10,260)	(36.3)
Shareholders' equity	15,177	2,460	19.3	3,940	35.1
	\$ 171,079	\$ (14,490)	(7.8)%	\$ (16,886)	(9.0)%

Short-Term Investments Short-term investments include cash and due from banks, interest bearing deposits with banks, Federal funds sold and securities purchased under resale agreements. Balances will fluctuate from year to year depending upon our liquidity position at the time. Overall balances decreased in 2009 as 2008 balances reflect our positioning for the anticipated purchase of the credit card and auto finance receivable portfolios from HSBC Finance which was completed in January 2009.

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Loans, Net Loan balances at December 31, 2009, and increases (decreases) over prior periods, are summarized in the following table.

	December 31, 2009	Increase (Decrease) From December 31, 2008		December 31, 2007	
		Amount	%	Amount	%
(dollars are in millions)					
Total commercial loans	\$ 30,304	\$ (7,125)	(19.0)%	\$ (6,531)	(17.7)%
Consumer loans:					
Residential mortgages excluding home equity mortgages	13,722	(4,226)	(23.5)	(14,377)	(51.2)
Home equity mortgages	4,164	(385)	(8.5)	(230)	(5.2)
Total residential mortgages	17,886	(4,611)	(20.5)	(14,607)	(45.0)
Auto finance	1,701	1,547	100+	1,377	100+
Private label	15,091	(1,983)	(11.6)	(2,336)	(13.4)
Credit Card	13,048	10,911	100+	11,232	100+
Other consumer	1,459	(363)	(19.9)	(202)	(12.2)
Total consumer loans	49,185	5,501	12.6	(4,536)	(8.4)
Total loans	79,489	(1,624)	(2.0)	(11,067)	(12.2)
Allowance for credit losses	3,861	1,464	61.1	2,447	100+
Loans, net	\$ 75,628	\$ (3,088)	(3.9)%	\$ (13,514)	(15.2)%

Commercial loans have decreased compared to 2008 and 2007 due to increased paydowns on loans across all commercial businesses, managed reductions in certain exposures, including higher underwriting standards, as well as lower overall demand from our core customer base.

Residential mortgage loans have decreased since December 31, 2008 and 2007. As a result of balance sheet initiatives to more effectively manage interest rate risk and improve the structural liquidity of HSBC Bank USA, we sell a majority of our new residential loan originations through the secondary markets and have allowed the existing loan portfolio to run off, resulting in reductions in loan balances. Additionally, lower residential mortgage loan balances reflect the sale of approximately \$4.5 billion of prime adjustable and fixed rate residential mortgage loans during 2009 and approximately \$7.0 billion of prime adjustable and fixed rate residential mortgage loans during 2008.

As previously discussed, real estate markets in a large portion of the United States have been and continues to be affected by stagnation or declines in property values. As such, the loan-to-value (LTV) ratios for our mortgage loan portfolio have generally deteriorated since origination. Refreshed loan-to-value ratios for our mortgage loan portfolio, excluding subprime residential mortgage loans held for sale, are presented in the table below.

	Refreshed LTVs⁽¹⁾⁽²⁾ at December 31, 2009		Refreshed LTVs⁽¹⁾⁽²⁾ at December 31, 2008	
	First Lien	Second Lien	First Lien	Second Lien
LTV<80%	71.5%	62.8%	80.7%	63.7%
80%£LTV<90%	14.3	14.9	10.8	15.3
90%£LTV<100%	7.7	9.5	5.7	10.0
LTV³100%	6.5	12.8	2.8	11.0
Average LTV for portfolio	68.1%	74.2%	62.2%	73.4%

(1) Refreshed LTVs for first liens are calculated as the current estimated property value expressed as a percentage of the receivable balance as of the reporting date. Refreshed LTVs for second liens are calculated as the current estimated property value expressed as a percentage of the receivable balance as of the reporting date plus the senior lien amount at origination. Current estimated property values are derived from the

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property's appraised value at the time of receivable origination updated by the change in the Office of Federal Housing Enterprise Oversight's house pricing index (HPI) at either a Core Based Statistical Area (CBSA) or state level. The estimated value of the homes could vary from actual fair values due to changes in condition of the underlying property, variations in housing price changes within metropolitan statistical areas and other factors.

- (2) Current property values are calculated using the most current HPI's available and applied on an individual loan basis, which results in an approximately three month delay in the production of reportable statistics. Therefore, the information in the table above reflects current estimated property values using HPIs as of September 30, 2009. For 2008, the information in the table above reflects estimated property values using HPI's as of December 31, 2008.

Credit card receivable balances increased from 2008 and 2007 largely due to the purchase of the GM and UP Portfolios, with an outstanding principal balance of \$12.4 billion at the time of purchase in January 2009 from HSBC Finance as discussed above. Lower balances related to private label credit cards from 2008 and 2007 are due primarily to the tightening of underwriting criteria to lower the risk profile of the portfolio, the exit of certain merchant relationships and lower customer spending.

Auto finance loans have increased from both 2008 and 2007 as a result of the purchase of \$3.0 billion of auto finance loans in January 2009 from HSBC Finance as discussed above, partially offset by run-off, the transfer of \$353 million to loans held for sale in 2009 and the continued run-off of our indirect auto financing loans which we no longer originate.

Other consumer loans have decreased primarily due to the discontinuation of originations of student loans and run-off of our installment loan portfolio.

Loans Held for Sale Loans held for sale at December 31, 2009 and increases (decreases) over prior periods are summarized in the following table.

	December 31, 2009	Increase (Decrease) From December 31, 2008		December 31, 2007	
		Amount	%	Amount	%
(dollars are in millions)					
Total commercial loans	\$ 1,126	\$ 252	28.8%	\$ (839)	(42.7)%
Consumer loans:					
Residential mortgages	1,386	(2,126)	(60.5)	(1,501)	(52.0)
Auto finance	353	353	100.0	353	100.0
Other consumer	43	(2)	(4.4)	(375)	(89.7)
Total consumer loans	1,782	(1,775)	(49.9)	(1,523)	(46.1)
Total loans held for sale	\$ 2,908	\$ (1,523)	(34.4)%	\$ (2,362)	(44.8)%

We originate commercial loans in connection with our participation in a number of leveraged acquisition finance syndicates. A substantial majority of these loans were originated with the intent of selling them to unaffiliated third parties and are classified as commercial loans held for sale. Commercial loans held for sale under this program were \$1,126 million, \$874 million and \$1,939 million at December 31, 2009, 2008 and 2007, respectively, all of which are recorded at fair value. Commercial loan balances increased compared to December 31, 2008 primarily due to an increase in the fair value of the loans. Commercial loan balances decreased from December 31, 2007 primarily due to \$648 million of leveraged acquisition finance loans being converted to corporate bonds in 2008 and an overall decrease in the market value of these loans since 2007 due to the adverse conditions in the corporate credit markets.

Residential mortgage loans held for sale include subprime residential mortgage loans of \$757 million, \$1,182 million and \$1,869 million at December 31, 2009, 2008 and 2007, respectively, that were acquired from unaffiliated third parties and from HSBC Finance with the intent of securitizing or selling the loans to third parties. Also included in residential mortgage loans held for sale are first mortgage loans originated and held for sale primarily to various government sponsored enterprises. In addition to normal sale activity, during 2009 and 2008, we sold approximately \$4.5 billion and \$7.0 billion, respectively, of prime adjustable and fixed rate residential mortgage loans. We retained the servicing rights in relation to the mortgages upon sale.

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Auto finance loans held for sale at December 31, 2009 reflect the transfer of \$353 million of auto finance loans to loans held for sale during 2009.

Other consumer loans held for sale consist of student loans which we no longer originate.

Residential mortgage, auto finance and other consumer loans held for sale are recorded at the lower of cost or market value. The cost of loans held for sale exceeded market value at December 31, 2009 and 2008, resulting in increases to the related valuation allowance during 2009 and 2008. This was primarily a result of adverse conditions in the U.S. residential mortgage markets in 2009 and 2008, although the dollar magnitude of the increases to the valuation allowance was lower during 2009 as compared to the prior year.

Trading Assets and Liabilities Trading assets and liabilities balances at December 31, 2009, and increases (decreases) over prior periods, are summarized in the following table.

	December 31, 2009	Increase (Decrease) From December 31, 2008		December 31, 2007	
		Amount	%	Amount	%
(dollars are in millions)					
Trading assets:					
Securities ⁽¹⁾	\$ 5,340	\$ 227	4.4%	\$ (7,785)	(59.3)%
Precious metals	12,256	7,351	100+	3,468	39.5
Derivatives	8,219	(13,055)	(61.4)	(6,496)	(44.1)
	\$ 25,815	\$ (5,477)	(17.5)%	\$ (10,813)	(29.5)%
Trading liabilities:					
Securities sold, not yet purchased	\$ 131	\$ (275)	(67.7)%	\$ (1,313)	(90.9)%
Payables for precious metals	2,556	957	59.8	1,033	67.8
Derivatives	5,323	(8,995)	(62.8)	(7,963)	(59.9)
	\$ 8,010	\$ (8,313)	(50.9)%	\$ (8,243)	(50.7)%

(1) Includes U.S. Treasury securities, securities issued by U.S. government agencies and U.S. government sponsored enterprises, other asset backed securities, corporate bonds and debt securities.

Securities balances at December 31, 2009 increased slightly from 2008 as the impact of sales of mortgage backed and asset backed securities held for trading purposes in 2009 was more than offset by increased market values as the market rallied for asset backed securities. Securities balances decreased from 2007 reflecting lower outstandings due to sales and lower overall market values due to the adverse conditions experienced by the U.S. residential mortgage markets since 2007.

Higher precious metals balances at December 31, 2009 as compared to 2008 and 2007 were primarily due to higher prices on most metals and, compared to 2007, partially offset by lower inventory levels.

Derivative assets and liabilities balances from December 31, 2008 were impacted by market volatilities as valuations of foreign exchange, interest rate and credit derivatives all reduced from significant spreads tightening in all sectors. In addition, credit derivatives had a large decrease as a number of transaction unwinds and commutations reduced the outstanding market value as management sought to actively reduce exposure. Changes in derivative assets and liabilities balances from 2007 were impacted by increased values on derivative products including credit default swaps, foreign currency forward contracts and total return swaps as a result of movements in credit spreads and currency curves.

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Deposits Deposit balances by major depositor categories at December 31, 2009, and increases (decreases) over prior periods, are summarized in the following table.

	December 31, 2009	Increase (Decrease) From December 31, 2008		December 31, 2007	
		Amount	%	Amount	%
(dollars are in millions)					
Individuals, partnerships and corporations	\$ 98,407	\$ (226)	(.2)%	\$ 6,996	7.7%
Domestic and foreign banks	13,549	(2,927)	(17.8)	(6,199)	(31.4)
U.S. government and states and political subdivisions	4,414	1,464	49.6	1,953	79.4
Foreign governments and official institutions	1,967	988	100+	(583)	(22.9)
Total deposits	\$ 118,337	\$ (701)	(.6)%	\$ 2,167	1.9%
Total core deposits ⁽¹⁾	\$ 83,227	\$ 14,447	21.0%	\$ 18,148	27.9%

⁽¹⁾ We monitor core deposits as a key measure for assessing results of our core banking network. Core deposits generally include all domestic demand, money market and other savings accounts, as well as time deposits with balances not exceeding \$100,000.

Deposits were a significant source of funding during 2009, 2008 and 2007. Total deposits at December 31, 2009 decreased slightly as compared to 2008 as a result of the maturing of several large time deposits that were not renewed, which was largely offset by growth in branch-based deposit products primarily driven by our Premier and branch expansion strategies and continued growth in the online savings product. Given our overall liquidity position, we continue to manage down low margin wholesale deposits in order to maximize profitability. Our relative liquidity strength has also allowed us to lower rates to be in line with our competition on several low margin deposit products. Deposits from foreign and domestic banks and financial institutions as well as foreign government and official institution deposits, which had decreased during the first half of 2009, collectively returned to more normalized levels during the second half of 2009. Core domestic deposits, which are the substantial source of our core liquidity, are significantly higher from December 31, 2008 and 2007.

Increased deposit balances from 2007 are a result of general growth across a range of our deposit products including in the online savings account, Premier Investor and certificates of deposits in both the core PFS and commercial banking businesses. Partially offsetting this were decreased deposits by foreign and domestic banks and foreign government and official institution deposits.

We maintain a growth strategy for our core retail banking business, which includes building deposits and wealth management across multiple markets, channels and segments. This strategy includes various initiatives, such as:

HSBC Premier, HSBC's global banking service that offers internationally minded mass affluent customers unique international services seamlessly delivered through HSBC's global network coupled with a premium

local service with a dedicated premier relationship manager. In 2009, Premier Investor savings has grown to \$7.4 billion at December 31, 2009 from \$5.5 billion at December 31, 2008 and Premier Checking has grown to almost \$4.2 billion at December 31, 2009 from \$2.6 billion at December 31, 2008;

Internet based products, including Online Savings, Online Payment and Online Certificate of Deposit accounts. Since their introduction in 2005, Online Savings balances have grown to \$15.6 billion at December 31, 2009 as compared to \$14.5 billion at December 31, 2008. Online certificates of deposit have decreased during 2009 to \$741 million at December 31, 2009 from \$1.0 billion at December 31, 2008;

Retail branch expansion in existing and new geographic markets to largely support the needs of our internationally minded customers. During 2009, we opened 18 new branches in the states of New Jersey, California, Washington, New York and in the District of Columbia; and

Driving cross-sell through closer alignment across all lines of business.

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On August 26, 2009, the FDIC announced that the Transaction Account Guarantee (the TAG) portion of the Temporary Liquidity Guarantee Program would be extended to June 30, 2010. In connection with the extension, the fee payable to the FDIC under the TAG will be increased from 10 basis points on any deposit amounts exceeding the \$250,000 deposit insurance limit to 15, 20 or 25 basis points depending on the risk category assigned to the institution under the FDIC's risk-based premium system. On November 2, 2009, HSBC Bank USA and its affiliated banks advised the FDIC of their election to opt out of the six-month extension of the TAG. Our participation in the TAG ended on December 31, 2009.

Short-Term Borrowings Increased retail deposits and transaction banking sweeps reduced the need for short-term borrowings in 2009 compared to 2008. In addition, balances for securities sold under repurchase agreements and precious metals borrowings continued to decrease. Short-term borrowings were higher in 2007 due to an increase in federal funds purchased and an increase in precious metals borrowings in response to favorable precious metals market conditions.

Long-Term Debt Long-term debt has continued to decline compared to 2008 and 2007 as our overall asset levels have decreased and we continue to focus on deposit gathering activities. Incremental issuances from the \$40.0 billion HSBC Bank USA Global Bank Note Program totaled \$552 million during 2009 and \$1.0 billion during 2008. Total debt outstanding under this program was \$3.5 billion and \$7.3 billion at December 31, 2009 and 2008, respectively.

Incremental long-term debt issuances from our shelf registration statement with the Securities and Exchange Commission totaled \$2.0 billion during 2009, none of which were issued as part of the FDIC's Debt Guarantee Program. Incremental long-term debt issuances in 2008 from our shelf registration statement with the Securities and Exchange Commission totaled \$5.8 billion, which included \$2.7 billion of guaranteed senior notes issued in December 2008 as part of the FDIC's Debt Guarantee Program. Total long-term debt outstanding under this shelf were \$5.5 billion and \$6.0 billion at December 31, 2009 and 2008, respectively.

We had borrowings from the Federal Home Loan Bank of New York (FHLB) of \$1.0 billion and \$2.0 billion at December 31, 2009 and 2008, respectively. At December 31, 2009, we had the ability to access further borrowings of up to \$2.3 billion based on the amount pledged as collateral with the FHLB.

In January 2009, as part of the purchase of the GM and UP Portfolio from HSBC Finance, we assumed \$6.1 billion of securities backed by credit card receivables that were accounted for as secured financings. Borrowings under these facilities totaled \$2.4 billion at December 31, 2009.

We have entered into a series of transactions with Variable Interest Entities (VIEs) organized by HSBC affiliates and unrelated third parties. We are the primary beneficiary of these VIEs under the applicable accounting literature and, accordingly, we have consolidated the assets and debt of the VIEs. Debt obligations of the VIEs, which totaled \$3.0 billion and \$1.2 billion at December 31, 2009 and 2008, respectively, were included in long-term debt. See Note 26, Special Purpose Entities, in the accompanying consolidated financial statements for additional information regarding VIE arrangements.

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Results of Operations

Net Interest Income Net interest income is the total interest income on earning assets less the total interest expense on deposits and borrowed funds. In the discussion that follows, interest income and rates are presented and analyzed on a taxable equivalent basis to permit comparisons of yields on tax-exempt and taxable assets. An analysis of consolidated average balances and interest rates on a taxable equivalent basis is presented in this MD&A under the caption

Consolidated Average Balances and Interest Rates.

The following table presents changes in the components of net interest income according to volume and rate.

Year Ended December 31	2009	2009 Compared to 2008		2008	2008 Compared to 2007		2007
		Increase (Decrease) Volume	Rate		Increase (Decrease) Volume	Rate	
(in millions)							
Interest income:							
Interest bearing deposits with banks	\$ 44	\$ 132	\$ (270)	\$ 182	\$ (10)	\$ (99)	\$ 291
Federal funds sold and securities purchased under resale agreements	45	(52)	(132)	229	(95)	(286)	610
Trading assets	219	(226)	(90)	535	(111)	13	633
Securities	997	152	(422)	1,267	73	(18)	1,212
Loans:							
Commercial	1,160	(188)	(567)	1,915	449	(603)	2,069
Consumer:							
Residential mortgages	884	(470)	(56)	1,410	(334)	15	1,729
Home equity mortgages	147	(4)	(71)	222	13	(102)	311
Private label cards	1,635	(78)	-	1,713	10	73	1,630
Credit cards	1,250	1,064	29	157	41	11	105
Auto finance	442	347	82	13	(13)	-	26
Other consumer	134	(29)	(25)	188	(17)	(14)	219
Total consumer	4,492	830	(41)	3,703	(300)	(17)	4,020
Other interest	46	(16)	(157)	219	176	(187)	230
Total interest income	7,003	632	(1,679)	8,050	182	(1,197)	9,065
Interest expense:							
Deposits in domestic offices:							
Savings deposits	583	63	(484)	1,004	52	(481)	1,433
Other time deposits	350	(175)	(344)	869	151	(507)	1,225
Deposits in foreign offices:							

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Foreign banks deposits	13	(41)	(164)	218	172	(479)	525
Other time and savings	45	9	(299)	335	(32)	(290)	657
Short-term borrowings	74	(34)	(175)	283	114	(188)	357
Long-term debt	782	(31)	(172)	985	(204)	(254)	1,443
Total interest expense	1,847	(209)	(1,638)	3,694	253	(2,199)	5,640
Net interest income - taxable equivalent basis	5,156	\$ 841	\$ (41)	4,356	\$ (71)	\$ 1,002	3,425
Tax equivalent adjustment	22			30			27
Net interest income - non taxable equivalent basis	\$ 5,134			\$ 4,326			\$ 3,398

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The significant components of net interest margin are summarized in the following table.

Year Ended December 31	2009	2008	2007
Yield on total earning assets	4.57%	5.39%	6.24%
Rate paid on interest bearing liabilities	1.46	2.72	4.35
Interest rate spread	3.11	2.67	1.89
Benefit from net non-interest or paying funds	.25	.25	.47
Net interest margin	3.36%	2.92%	2.36%

Significant trends affecting the comparability of 2009 and 2008 net interest income and interest rate spread are summarized in the following table. Net interest income in the table is presented on a taxable equivalent basis.

Year Ended December 31	2009		2008		2007	
	Amount	Interest Rate Spread	Amount	Interest Rate Spread	Amount	Interest Rate Spread
(dollars are in millions)						
Net interest income/interest rate spread from prior year	\$ 4,356	2.67%	\$ 3,425	1.89%	\$ 3,107	1.76%
Increase (decrease) in net interest income associated with:						
Trading related activities	(78)		300		20	
Balance sheet management activities ⁽¹⁾	(219)		634		(21)	
Private label receivable portfolio	237		260		285	
Credit card portfolio	1,068		77		(13)	
Commercial loans	143		317		48	
Deposits	(211)		(627)		(66)	
Residential mortgage banking	(6)		(5)		(70)	
Other activity	(134)		(25)		135	
Net interest income/interest rate spread for current year	\$ 5,156	3.11%	\$ 4,356	2.67%	\$ 3,425	1.89%

(1)

Represents our activities to manage interest rate risk associated with the repricing characteristics of balance sheet assets and liabilities. Interest rate risk, and our approach to manage such risk, are described under the caption Risk Management in this Form 10-K.

Trading related activities Net interest income for trading related activities decreased during 2009 due primarily to lower average balances of trading assets which was partially offset by lower cost of funds. Net interest income for trading related activities increased during 2008 and 2007, due primarily to decreased funding costs.

Balance sheet management activities Lower net interest income from balance sheet management activities during 2009 was due primarily to the sale of securities and the re-investment into lower margin securities, partially offset by positions taken in expectation of decreasing short-term rates. During 2008, higher net interest income from balance sheet management activities was due primarily to positions taken in expectation of decreasing short-term rates. We experienced lower net interest income in 2007 as a relatively flat yield curve and elevated short-term interest rates continued to limit opportunities to generate additional net funds income.

Private label credit card portfolio Net interest income on private label credit card receivables was higher during both 2009 and 2008 as a result of lower funding costs and lower amortization of premiums on the initial purchase as well as lower daily premiums. Net interest income was higher in 2007 due to increased balances due to the addition of new merchants, higher accrued income as a result of a more refined income recognition methodology on private

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label card promotional balances, repricing initiatives and lower premium amortization on the initial portfolio purchased.

Credit card portfolio Higher net interest income on credit card receivables during 2009 primarily reflects the impact of the purchase of the GM and UP Portfolios from HSBC Finance. Net interest income was higher in 2008 primarily due to the growing co-brand portfolio receivable balance and lower funding costs. Net interest income was lower in 2007 as a result of higher daily premiums and higher funding costs, partly mitigated by increased co-brand portfolio receivable balances.

Commercial loans Net interest income on commercial loans was higher during 2009 due primarily to loan repricing and lower funding costs, partially offset by lower balances. Net interest income was higher in 2008 and 2007 due to higher levels of commercial loans, particularly to middle-market customers.

Deposits Lower net interest income during 2009, 2008 and 2007 related to deposits is primarily due to spread compression on core banking activities in the PFS and CMB business segments. These segments have been affected by falling interest rates, growth in customer deposits in higher yielding deposit products, such as online savings and premier investor accounts, and an overall more competitive retail market.

Residential mortgage banking During 2009 and 2008, lower net interest income resulted from lower average residential loan outstandings partially offset by lower funding costs. Lower average residential loans outstanding resulted in part from the sale of approximately \$4.5 billion of prime adjustable and fixed rate residential mortgages during 2009 and approximately \$7 billion of prime residential mortgage loans in 2008.

Lower net interest income in 2007 primarily resulted from continuing narrowing of interest rate spreads and contraction of the residential mortgage loan portfolio as we continued to sell a majority of residential mortgage loan originations and allow the portfolio to run off as part of our strategy to reduce prepayment risk and improve liquidity.

Other activity Net interest income was lower in 2009 due to lower break funding charges charged back to specific loan portfolios which was partially offset by higher net interest income related to a portfolio of Auto finance loans purchased in January 2009 and lower funding costs on non-earning assets. Lower net interest income in 2008 was the result of lower interest income on consumer closed end loans, such as student loans and several run-off portfolios of direct and indirect consumer loans, as balances declined from 2007, which was partially offset but lower funding costs on non-earning assets. In 2007 lower funding costs on non-earning assets more than offset lower net interest income related to the above mentioned consumer closed end loans

Provision for Credit Losses The provision for credit losses associated with various loan portfolios is summarized in the following table:

Year Ended December 31,	2009	2008	2007
	(in millions)		
Commercial	\$ 665	\$ 428	\$ 205
Consumer:			
Residential mortgages, excluding home equity mortgages	364	286	77

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Home equity mortgages	195	219	49
Private label card receivables	1,280	1,282	972
Credit card receivables	1,450	223	123
Auto finance	104	4	8
Other consumer	86	101	88
Total consumer	3,479	2,115	1,317
Total provision for credit losses	\$ 4,144	\$ 2,543	\$ 1,522

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We increased our credit loss reserves in both 2009 and 2008 as the provision for credit losses was \$1,036 million greater than net charge-offs in 2009 and \$983 million greater than net charge-offs in 2008. The provision as a percentage of average receivables was 4.79 percent in 2009, 2.92 percent in 2008 and 1.80 percent in 2007. The increase in both 2009 and 2008 reflects higher loss estimates in our commercial and consumer loan portfolios as discussed in more detail below.

Commercial loan provision for credit losses increased during 2009 as a result of higher loss estimates on our commercial real estate, business banking and corporate banking portfolios due to higher criticized loan levels reflecting customer downgrades in certain counterparties largely due to deteriorating economic conditions. Increased provision in our commercial real estate portfolio was largely due to condominium loans and land loans in the condominium construction market in South Florida and California, as well as in hotel and office construction in all markets, especially in the large metropolitan markets where construction projects have been delayed. Our business banking portfolio experienced weakness particularly in small balance relationships. Although our corporate banking portfolio has deteriorated in most industry segments and geographies, consistent with the overall deterioration in the U.S. economy, customers in those areas of the economy that have experienced above average weakness such as apparel, auto related suppliers and construction related businesses have been particularly affected. Commercial loan provision also increased as a result of a specific provision relating to a single private banking client relationship recorded in the third quarter of 2009. These increases were partially offset by lower overall provisions in our middle market portfolio due to fewer downgrades in 2009. During 2008, our provision for credit losses on commercial loans also increased as increased provisions for our commercial real estate, middle market and corporate banking portfolios resulted from higher criticized asset levels reflecting customer downgrades due to deteriorating economic conditions.

The provision for credit losses on residential mortgages including home equity mortgages increased \$54 million and \$379 million during 2009 and 2008, respectively. The increase in provision for credit losses on residential mortgages during both years was attributable to increased delinquencies within the prime residential first mortgage loan portfolio and in 2008, higher loss estimates in our home equity mortgage loan portfolio due primarily to the continued deterioration in real estate values in certain markets. In 2008, the increase in provision for credit losses on residential mortgages also reflects, to a lesser extent, the impact of a portfolio of nonconforming residential mortgage loans which we purchased from HSBC Finance (the HMS Portfolio) in 2003 and 2004.

The provision for credit losses associated with credit card receivables in 2009 was significantly impacted by the purchase of the GM and UP Portfolios as previously discussed. Excluding these portfolios in 2009, provision remained higher in both years, primarily from higher delinquencies and charge offs within the co-brand credit card portfolios due to higher levels of personal bankruptcy filings, the impact from a weakened U.S. economy and lower recovery rates.

Provision expense associated with our private label card portfolio was relatively flat in 2009 as the impact of higher charge-off levels was largely offset by lower receivable levels, stable delinquency trends and an improved outlook on future loss estimates as the impact of higher unemployment levels on losses has not been as severe as previously anticipated due to signs of home price stability in the second half of the year and tighter underwriting. In 2008, provision expense increased in our private label card portfolio due to higher delinquency and charge-off levels as well as increased levels of personal bankruptcy filings, lower recovery rates on previously charged-off accounts and the impact from continued weakening in the U.S. economy also contributed to the increase.

Provision expense associated with our auto finance portfolio during 2009 increased primarily due to the purchase of \$3.0 billion in auto finance loans from HSBC Finance in January 2009. In 2008, provision expense associated with our auto finance portfolio declined due to run-off.

Our methodology and accounting policies related to the allowance for credit losses are presented in Critical Accounting Policies and Estimates in this MD&A and in Note 2, Summary of Significant Accounting Policies and New Accounting Pronouncements in the accompanying consolidated financial statements. See Credit Quality in this MD&A for additional commentary on the allowance for credit losses associated with our various loan portfolios.

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Other Revenues (Losses) The components of other revenues are summarized in the following tables.

Year Ended December 31,	2009	2008	2007
	(in millions)		
Credit card fees	\$ 1,356	\$ 879	\$ 817
Other fees and commissions	837	733	762
Trust income	125	150	101
Trading revenue (loss)	347	(2,558)	129
Net other-than-temporary impairment losses	(124)	(231)	-
Other securities gains (losses), net	304	82	112
HSBC affiliate income:			
Fees and commissions	136	117	130
Other affiliate income	11	20	34
Total HSBC affiliate income	147	137	164
Residential mortgage banking revenue ⁽¹⁾	172	(11)	74
Gain (loss) on instruments designated at fair value and related derivatives ⁽²⁾	(253)	286	-
Other income (loss):			
Valuation of loans held for sale	(250)	(513)	(504)
Insurance	24	37	36
Earnings from equity investments	30	61	78
Miscellaneous income	(1)	161	78
Total other income (loss)	(197)	(254)	(312)
Total other revenues (losses)	\$ 2,714	\$ (787)	\$ 1,847

(1) Includes servicing fees received from HSBC Finance of \$12 million and \$14 million during 2009 and 2008, respectively.

(2) Includes gains and losses associated with financial instruments elected to be measured at fair value and the associated economically hedging derivatives. See Note 17, Fair Value Option, in the accompanying consolidated financial statements for additional information.

Credit Card Fees Higher credit card fees during 2009 were due primarily to substantially higher outstanding credit card balances due to the purchase of the GM and UP Portfolios as previously discussed. Also contributing to the increase are higher late fees on private label cards due to increased average delinquency levels throughout 2009 partially offset by higher fee charge-offs due to increased loan defaults. Higher credit card fees in 2008 reflect higher late fees on private label cards due to increased delinquency levels and growth of the co-brand portfolio. These increases were partially offset by higher fee charge-offs due to increased loan defaults and the impact of changes in our credit card fee practices implemented in the fourth quarter of 2007.

Other Fees and Commissions Other fee-based income increased during 2009 due to higher customer referral fees, commercial loan commitment fees, loan syndication fees and fees generated by the Payments and Cash Management business. These same factors also drove the increase in 2008, excluding the impact of the sale of our Wealth and Tax Advisory Services (WTAS) subsidiary in 2007, which contributed \$104 million of fee based income during 2007.

Trust Income Trust income declined in 2009 primarily due to lower domestic custody fees from lower assets under management and margin pressures as money market assets have shifted from higher fee asset classes to lower fee institutional class funds. In 2008, higher trust income was due primarily to an increase in advisor fees related to HSBC money market investor funds from increased activity in the Asset Management business within the Global Banking and Markets segment. This activity increased significantly in 2008 due to the success of selling and retaining assets within domestic money market funds as customers have migrated to deposit products and larger, well-capitalized institutions.

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Trading Revenue (Loss) is generated by participation in the foreign exchange, rates, credit and precious metals markets. The following table presents trading related revenue (loss) by business. The data in the table includes net interest income earned on trading instruments, as well as an allocation of the funding benefit or cost associated with the trading positions. The trading related net interest income component is included in net interest income on the consolidated statement of income (loss). Trading revenues related to the mortgage banking business are included in residential mortgage banking revenue.

Year Ended December 31,	2009	2008	2007
	(in millions)		
Trading revenue (loss)	\$ 347	\$ (2,558)	\$ 129
Net interest income (loss)	186	264	(36)
Trading related revenue (loss)	\$ 533	\$ (2,294)	\$ 93
Business:			
Derivatives	\$ (364)	\$ (2,368)	\$ (179)
Balance sheet management	139	(460)	(82)
Foreign exchange and banknotes	328	496	245
Precious metals	67	96	77
Global banking	367	(78)	29
Other trading	(4)	20	3
Trading related revenue (loss)	\$ 533	\$ (2,294)	\$ 93

2009 Compared to 2008 Trading revenue (loss) during 2009 continued to be affected by reduced liquidity and volatility in the credit markets although the magnitude of such impacts was not as severe when compared to the year-ago period. While liquidity has improved in 2009, it continues to be lower than experienced before the financial crisis. Trading revenue (loss) for 2008 was significantly affected by reduced liquidity, widening spreads and higher volatility in the credit markets.

Trading revenue related to derivatives improved significantly during 2009 due to the performance of structured credit products which reported total losses of \$371 million during 2009 as compared to total losses of \$2.5 billion during 2008. The performance of credit derivatives improved in 2009 as credit spread volatility and the outlook for corporate defaults stabilized, and exposures to several counterparties, including monoline insurers, were reduced as a result of the early termination of transactions. As a result we recorded losses for monolines of \$152 million during 2009 compared to losses of \$1,020 million in 2008.

Trading income related to balance sheet management activities improved in 2009 primarily due to more favorable trends in credit spreads on asset backed securities held for trading purposes and increased sales of mortgage backed and other asset backed securities held for trading purposes.

Foreign exchange and Banknotes revenue declined in 2009 primarily due to lower volumes and narrower trading spreads in Foreign Exchange and a reduction in demand for physical currency in Banknotes.

Precious metals continued to deliver strong results in 2009, however revenue declined from 2008 levels which benefitted from a higher demand for metals due to economic instability, which eased somewhat in 2009.

Global banking revenue increased during 2009 primarily due to increased values on corporate bonds as credit spreads narrowed on these securities compared to 2008.

2008 Compared to 2007 Trading losses related to derivatives increased substantially during 2008. Structured credit products sustained losses of approximately \$2.5 billion during 2008, as compared to \$264 million in 2007, as credit spreads continued to widen and corporate defaults increased causing losses related to hedging the portfolio as well as related to counterparty exposures. Structured funds suffered losses of \$130 million from clients that were impacted by the fraud at Madoff Securities. Partially offsetting these reductions were improved results in Emerging

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Markets and Credit Flow trading, as well as gains in equity derivatives on the sale of MasterCard B shares during the second quarter of 2008, which resulted in trading revenue of \$134 million.

Trading losses related to balance sheet management activities increased primarily due to credit spreads widening on asset backed securities held for trading purposes.

The foreign exchange business contributed increased revenues in 2008 as a result of ongoing market volatility and increased customer activity. Banknotes revenues were also higher in 2008 due to wider margins and increased demand for physical currency driven by a volatile economic climate.

Precious metals trading benefitted from higher trading volumes in 2008 as customer demand for metals as an alternative investment increased in reaction to a weaker U.S. dollar.

Losses from Global Banking in 2008 primarily relate to losses on corporate bonds which is attributable to widening credit spreads on these bonds.

Net Other-Than-Temporary Impairment Losses During 2009, 28 debt securities were determined to be other-than-temporarily impaired. In accordance with the recently issued accounting guidance related to the recognition and presentation of other-than-temporary impairments on debt securities, only the credit loss component is shown in earnings. Prior to 2009, all other-than-temporary impairment losses were recorded in earnings. The following table presents the various components of other-than-temporary impairment.

Year Ended December 31,	2009	2008	2007
	(in millions)		
Total other-than-temporary impairment losses ⁽¹⁾	\$ (208)	\$ (231)	\$ -
Portion of loss recognized in other comprehensive income (loss), before taxes	84	-	-
Net other-than-temporary impairment losses recognized in consolidated statement of income (loss)	\$ (124)	\$ (231)	\$ -

⁽¹⁾ During the year ended December 31, 2008, three asset backed securities and the preferred securities of FNMA were determined to be other-than-temporarily impaired.

Other Securities Gains (Losses), Net We maintain various securities portfolios as part of our balance sheet diversification and risk management strategies. The following table summarizes the net other securities gains (losses) resulting from various strategies.

Year Ended December 31,	2009	2008	2007
	(in millions)		

Sale of MasterCard or Visa Class B Shares	\$ 48	\$ 83	\$ 55
Securities available-for-sale	256	-	-
Reduction of Latin and South American exposure	-	-	26
Sale of an equity investment to an HSBC affiliate ⁽¹⁾	-	-	9
Other	-	(1)	22
Total securities gains (losses), net	\$ 304	\$ 82	\$ 112

⁽¹⁾ Represents net gains realized from transfers of various available-for-sale securities, other non-marketable securities and equity investments as part of a strategy to consolidate certain investments into common HSBC entities.

During 2009, we sold \$11.2 billion of mortgage-backed and other asset-backed securities as part of a strategy to reduce prepayment risk as well as risk-weighted asset levels and recognized a gain of \$234 million, which is included as a component of other security gains, net above. Gross realized gains and losses from sales of securities are summarized in Note 6, Securities. In the accompanying consolidated financial statements.

HSBC Affiliate Income Affiliate income was higher during 2009 due largely to higher fees and commissions earned from HSBC Markets, USA (HMUS) and HSBC Securities, USA. These increases were partially offset by lower

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net sales credits received from affiliates for customer referrals and lower gains on tax refund anticipation loans due to lower origination volumes as there was an on-going relationship with only one third party provider during the 2009 tax season, as well as a shift in mix to lower revenue, lower risk products. During 2008, lower HSBC affiliate income reflects lower gains on the sale of mortgages to HMUS due to decreased activity under the programs driven by illiquidity in the credit and subprime markets causing a decrease in loans sold. Additionally lower HSBC affiliate income in 2008 reflects a decrease in gains related to lower volumes of tax refund anticipation loan originations, partially offset by higher customer referral and other fees.

Residential Mortgage Banking Revenue The following table presents the components of residential mortgage banking revenue. The net interest income component of the table is included in net interest income in the consolidated statement of income (loss) and reflects actual interest earned, net of interest expense and corporate transfer pricing.

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 249	\$ 255	\$ 260
Servicing related income:			
Servicing fee income	129	130	116
Changes in fair value of MSR due to:			
Changes in valuation inputs or assumptions used in valuation model	60	(213)	(18)
Realization of cash flows	(56)	(96)	(85)
Trading Derivative instruments used to offset changes in value of MSRs	(31)	160	10
Total servicing related income	102	(19)	23
Originations and sales related income:			
Gains (losses) on sales of residential mortgages	30	(17)	26
Trading and hedging activity	18	3	-
Total originations and sales related income	48	(14)	26
Other mortgage income	22	22	25
Total residential mortgage banking revenue included in other revenues (losses)	172	(11)	74
Total residential mortgage banking related revenue	\$ 421	\$ 244	\$ 334
Average owned residential mortgage loans	\$ 18,859	\$ 28,271	\$ 33,632

Lower net interest income during 2009 and 2008 reflects lower loan balances, partially offset by lower funding costs as well as reduced deferred cost amortization on lower average outstandings. Lower loan balances in each period reflect the sale of approximately \$4.5 billion of prime adjustable and fixed rate residential mortgages during 2009 and

approximately \$7.0 billion of prime residential mortgage loans in 2008, for which we retained the servicing rights. We continue to sell the majority of new loan originations to government sponsored enterprises and private investors and allow existing loans to runoff.

Total servicing related income increased in 2009 due to a better net hedged MSR performance following a very volatile mortgage market in 2008. Servicing fee income was flat to 2008 levels as payments owed to government sponsored enterprises increased significantly during 2009 as prepayments increased. The average serviced loans portfolio increased approximately 11 percent and 14 percent during 2009 and 2008 respectively. Servicing related income decreased in 2008 compared to 2007 largely due to unfavorable net hedged MSR performance primarily from increased market volatility in the mortgage market.

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Originations and sales related income increased in 2009 primarily due to gains from loan sales, partially offset by an increase in our reserve for potential repurchase liability exposures. In 2009, we recorded gains of \$70 million on sales of approximately \$4.5 billion in residential mortgage loans, compared to gains of \$17 million on sales of approximately \$7.0 billion in 2008. In 2008, originations and sales related income decreased compared to 2007 due to a negative mark on a pool of Alt-A loans classified as held for sale at year end as well as a lower basis point gain on recurring individual loan sales. The negative mark was driven by volatile market conditions. The decrease was partially offset by the gains on non-recurring loan sales described above.

Gain (loss) on instruments designated at fair value and related derivatives We have elected to apply fair value option accounting to commercial leveraged acquisition finance loans, unfunded commitments, certain own fixed-rate debt issuances and all structured notes and structured deposits issued after January 1, 2006 that contain embedded derivatives. We also use derivatives to economically hedge the interest rate risk associated with certain financial instruments for which fair value has been elected. See Note 17, Fair Value Option, in the accompanying consolidated financial statements for additional information including a breakout of these amounts by individual component.

Valuation of Loans Held for Sale Continued deterioration in the U.S. mortgage markets have resulted in negative valuation adjustments on loans held for sale during 2009 and 2008 although the valuation adjustments recorded in 2009 were not as severe as market conditions began to improve in the second half of 2009. Valuations on loans held for sale relate primarily to residential mortgage loans purchased from third parties and HSBC affiliates with the intent of securitization or sale. Included in this portfolio are sub-prime residential mortgage loans with a fair value of \$757 million and \$1.2 billion as of December 31, 2009 and 2008, respectively. Loans held for sale are recorded at the lower of their aggregate cost or market value, with adjustments to market value being recorded as a valuation allowance. Overall weakness and illiquidity in the U.S. residential mortgage market and continued delinquencies, particularly in the sub-prime market, resulted in valuation adjustments totaling \$233 million and \$505 million being recorded on these loans during 2009 and 2008, respectively. Valuations on residential mortgage loans we originate are recorded as a component of residential mortgage banking revenue in the consolidated statement of income (loss).

In addition, we recorded valuation adjustments on education loans held for sale of \$17 million and \$8 million during 2009 and 2008, respectively.

Other Income (Loss) Excluding the valuation of loans held for sale as discussed above, other income (loss) decreased during 2009 due to lower valuations on credit default swaps used to economically hedge credit exposures, combined with lower equity investment income driven by the sale of our equity interest in HSBC Private Bank (Suisse) S.A. in the first quarter of 2009. These decreases were partially offset by an \$85 million gain related to a judgment whose proceeds were used to redeem 100 preferred shares issued to CT Financial Services, Inc. The obligation to redeem the preferred shares upon our receipt of the proceeds from the judgment represented a contractual arrangement established in connection with our purchase of a community bank from CT Financial Services Inc. in 1997 at which time this litigation remained outstanding. The \$85 million we received, net of applicable taxes, was remitted in April to Toronto Dominion, who now holds beneficial ownership interest in CT Financial Services Inc., and the preferred shares were redeemed. The increase in other income (loss) during 2008 is primarily due to higher miscellaneous income, primarily due to increased valuations on credit default swaps used to economically hedge credit exposures.

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Operating Expenses The components of operating expenses are summarized in the following table.

Year Ended December 31	2009	2008	2007
	(dollars are in millions)		
Salaries and employee benefits			
Salaries	\$ 624	\$ 720	\$ 763
Employee benefits	501	508	589
Total salary and employee benefits	1,125	1,228	1,352
Occupancy expense, net	281	278	243
Support services from HSBC affiliates:			
Fees paid to HSBC Finance for loan servicing and other administrative support	725	473	468
Fees paid to HMUS	250	213	246
Fees paid to HTSU	471	255	260
Fees paid to other HSBC affiliates	172	243	188
Total support services from HSBC affiliates	1,618	1,184	1,162
Other expenses:			
Equipment and software	41	43	54
Marketing	116	137	140
Outside services	99	120	137
Professional fees	89	82	83
Telecommunications	14	20	20
Postage, printing and office supplies	16	36	39
Off-balance sheet credit reserves	20	81	6
FDIC assessment fee	208	58	9
Goodwill impairment ⁽¹⁾	-	54	-
Insurance business	51	42	24
Miscellaneous	252	241	317
Total other expenses	906	914	829
Total operating expenses	\$ 3,930	\$ 3,604	\$ 3,586
Personnel average number	9,710	11,731	12,336
Efficiency ratio	50.08%	101.83%	68.34%

⁽¹⁾ Represents the entire amount of goodwill allocated to the residential mortgage banking reporting unit.

Salaries and employee benefits Salaries and employee benefits expense were collectively lower during 2009 and 2008 due to the transfer of support services employees to an affiliate, as described below, as well as continued cost management efforts, including the impact of global resourcing initiatives undertaken by management, which have

resulted in lower headcount. The decrease in 2009 was partially offset by higher pension expense stemming from reduced plan asset values due to the volatile capital markets. During 2008, these decreases were partially offset by higher fringe benefits expense approximately \$21 million resulting from a review of our employee benefit accruals and severance expense of \$26 million due to ongoing efficiency initiatives.

Occupancy expense, net In 2009, occupancy expenses includes an impairment charge of \$20 million related to a data center building held for use as part of our ongoing strategy to consolidate operations and improve efficiencies. Excluding this impairment charge in 2009, occupancy expense declined due to the transfer of shared services employees and their related workspace expenses to an affiliate as discussed below, partially offset by higher

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occupancy expense due to the continued expansion of the core banking and commercial lending networks within the PFS and CMB business segments, a key component of recent business expansion initiatives. Higher occupancy expenses in 2008 relate to the expansion of the core banking and commercial lending networks discussed above. As a result of these expansion efforts in 2009 and 2008, we opened 18 and 14 new branches, respectively, which resulted in higher rental expenses, depreciation of leasehold improvements, utilities and other occupancy expenses. Expenses in 2008 also reflect \$14 million of costs associated with branch optimization in select areas.

Support services from HSBC affiliates includes technology and some centralized operational services and beginning in January 2009, human resources, corporate affairs and certain other shared services charged to us by HTSU, as well as servicing fees paid to HSBC Finance for servicing nonconforming residential mortgage loans, private label card receivables, credit card receivables and, during 2009, auto finance receivables.

Support services from HSBC affiliates increased in 2009 as a result of a significant increase in fees paid to HSBC Finance for servicing largely as a result of the purchase of the GM and UP Portfolios as well as certain auto finance loans from HSBC Finance in early January 2009 as well as higher fees paid to HTSU due to increased services being provided as previously discussed. Support services from HSBC affiliates also increased in 2009 and 2008 as a result from higher utilization of other HSBC affiliates in support of global resourcing initiatives, which has resulted in a corresponding reduction in salary and employee benefit expense. Higher support services from HSBC affiliates in 2008 reflects higher utilization of other HSBC affiliates in support of global resourcing initiatives which was partially offset by a decrease in fees paid to HMUS for treasury and traded markets services.

Marketing Expenses Lower marketing and promotional expenses in 2009 resulted from optimizing marketing spend as a result of general cost saving initiatives. This was partially offset by a continuing investment in HSBC brand activities and marketing support for branch expansion initiatives, primarily within the PFS business segment. Higher marketing expenses in 2008 resulted from continuing investment in HSBC brand activities, promotion of the internet savings account and marketing support for branch expansion initiatives, primarily within the PFS business segment and increased marketing for CMB products and services.

Other Expenses Other expenses (excluding marketing expenses) increased during 2009 primarily due to higher FDIC assessment fees, including a \$82 million special assessment recorded in the second quarter of 2009 and higher corporate insurance costs, partially offset by lower outside services fees, a release of off balance sheet credit reserves related to an advance by a large corporate customer and the impact of goodwill impairment charges recorded during 2008 with no similar charge being recorded in 2009.

Other expenses increased in 2008, primarily as a result of higher reserves on off-balance sheet credit exposures including letters of credit, unused commitments to extend credit and financial guarantees, a goodwill impairment charge of approximately \$54 million, higher FDIC assessment fees, higher corporate insurance costs and higher debit card fraud expenses. Additionally, we recognized expenses of \$6 million in 2008 relating to the purchase of Auction Rate Securities from customers and \$5 million relating to a systems outage in August that impacted several of our customer deposit and electronic payment systems, which were brought back on line within days. Other expenses in 2008 also reflect a \$36 million release of litigation expense accrual related to Visa that had originally been recorded during 2007, as compared to a \$9 million release in 2009.

Efficiency Ratio Our efficiency ratio was 50.08 percent in 2009 compared to 101.83 in 2008 and 68.34 percent in 2007. The improvement in the efficiency ratio in 2009 resulted primarily from an increase in other revenues (losses) and net interest income. The deterioration of the efficiency ratio in 2008 resulted primarily from a decrease in other revenues (losses), partially offset by higher net interest income as expenses remained relatively flat.

Segment Results IFRS Basis

We have five distinct segments that are utilized for management reporting and analysis purposes. The segments, which are based upon customer groupings as well as products and services offered, are described under Item 1, Business in this Form 10-K. There have been no changes in the basis of segmentation or measurement of segment profit (loss) as compared with the presentation in our 2008 Form 10-K.

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Our segment results are presented on an IFRSs Basis (a non-U.S. GAAP financial measure) as operating results are monitored and reviewed, trends are evaluated and decisions about allocating resources such as employees are made almost exclusively on an IFRSs basis since we report to our parent, HSBC, who prepares its consolidated financial statements in accordance with IFRSs. However, we continue to monitor capital adequacy, establish dividend policy and report to regulatory agencies on a U.S. GAAP basis. The significant differences between U.S. GAAP and IFRSs as they impact our results are summarized in Note 24, Business Segments, in the accompanying consolidated financial statements and under the caption Basis of Reporting in the MD&A section of this Form 10-K.

Personal Financial Services (PFS)

Overview During 2009, resources continued to be directed towards expansion of the core retail banking business, in particular, the growth of HSBC Premier, HSBC's global banking service that offers customers a seamless international service. In addition there was expansion of the branch network in existing and new geographic markets with international connectivity as well as investment in the HSBC brand. As a result, average personal deposits increased 12 percent during 2009 and Premier customers increased to 355,399 at December 31, 2009, a 37 percent increase from a year-ago. We remain focused on providing differentiated premium services to the internationally minded mass affluent and upwardly mobile customers.

We continue to sell the majority of new residential mortgage loan originations to government sponsored enterprises and to allow the existing on balance sheet portfolio to run-off. In addition to normal sale activity, during 2009, we sold approximately \$4.5 billion of prime adjustable and fixed rate residential mortgage loans. We retained the servicing rights in relation to the mortgages upon sale. As a result, average residential mortgage loans in 2009 decreased approximately 35 percent as compared to 2008.

The following table summarizes the IFRSs Basis results for our PFS segment:

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 916	\$ 849	\$ 1,102
Other operating income	262	327	559
Total operating income	1,178	1,176	1,661
Loan impairment charges	616	520	139
	562	656	1,522
Operating expenses	1,255	1,353	1,302
Profit (loss) before tax	\$ (693)	\$ (697)	\$ 220

2009 Profit (loss) before tax compared to 2008 Our PFS segment reported a decreased loss before tax in 2009 due to higher net interest income and lower operating expenses partially offset by lower other operating income and higher loan impairment charges.

Net interest income increased compared to prior year driven by a combination of customer rate cuts and additional funding credits on deposits as well as widening interest rate spreads on credit card balances due to reduced funding costs in the lower short term rate environment. This was partially offset by lower levels of mortgage loans outstanding driven by mortgage loan sales of approximately \$4.5 billion during 2009.

Other operating income decreased during 2009 primarily due to lower personal service charges, ATM and other fees, and, beginning in 2009, a reclassification of loyalty program expenses for cards as a reduction to revenue. Additionally, 2008 benefited from an \$83 million gain on the sale of Visa Class B shares. Also contributing to lower other operating income in 2009 was higher mortgage reinsurance costs and break funding charges from the Global Banking and Markets segment of \$170 million relating to costs associated with early termination of the funding associated with residential mortgage loan sales compared with a similar charge of \$142 million during 2008. These charges were partially offset by net gains on the sales of these same residential mortgage loans of \$73 million and

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\$22 million during 2009 and 2008, respectively, as well as better net hedged MSR performance following a very volatile mortgage market in 2008.

Deterioration in credit quality, particularly on prime residential mortgage loans and credit cards has negatively impacted results. Higher loan impairment charges in 2009 were driven by an increase in delinquencies, which resulted in significantly increased charge offs within the home equity mortgage loan and residential first mortgage loan portfolios due to increased loss severities as real estate values continued to deteriorate in certain markets. Loan impairment charges on credit card receivables and other consumer loans have also risen. The increase in charge offs within the prime residential mortgage loan portfolio was partially offset by a lower increase in overall reserve levels in 2009 compared to that experienced in 2008. Increased levels of personal bankruptcy filings and deterioration in the U.S. economy, including rising unemployment rates, have resulted in a deterioration in credit quality across all products as compared to the prior year.

Operating expenses decreased in 2009 as a result of efficiency programs in the branch network and a reclassification of customer loyalty expenses for credit cards to revenue, which more than offset growth in costs from branch expansion initiatives and higher FDIC assessment fees, including the special assessment in the second quarter of 2009. Operating expenses in 2009 also benefited from a \$9 million release related to the VISA litigation accrual set up in 2007. The prior year period was also impacted by a \$54 million goodwill impairment charge taken relating to the residential mortgage reporting unit, partially offset by a benefit from a release of \$36 million related to the Visa legal accrual set up in 2007. In addition, customer loyalty program expenses for credit cards of \$19 million were included in operating expense in the year-ago periods but were reclassified as reduction to revenue beginning in the first quarter of 2009 as discussed above.

2008 Profit (loss) before tax compared to 2007 Our PFS segment reported a loss before tax in 2008 due to significantly higher loan impairment charges, lower net interest income and lower other operating income as well as slightly higher operating expenses.

Net interest income decreased during 2008 due primarily to narrowing of interest rate spreads driven by the declining rate environment and competitive pricing pressures on savings and certificate of deposit products, which drove promotional rate offers for online savings and online certificate of deposit accounts in the second half of the year. Net interest income was also impacted by lower interest income on residential mortgage loan products due to residential mortgage loan sales and loan portfolio runoff. This was partially offset by widening interest rate spreads on MasterCard/Visa credit card balances.

Other operating income decreased during 2008 due primarily to a \$142 million intersegment charge from the Global Banking and Markets segment relating to the cost associated with early termination of the funding associated with mortgage loan sales throughout 2008, which was partially offset by a net gain on the sale of these residential mortgage loans of \$22 million. Additionally, other operating income was lower due to higher losses on instruments used to economically hedge MSR s and lower revenues of \$9 million resulting from lower volumes of federal income tax refund anticipation loans originated by HSBC Bank USA and HSBC Trust Company (Delaware) (HTCD) and sold to HSBC Finance. Partially offsetting these lower revenues was an \$83 million gain on the sale of Visa Class B shares recorded in the first quarter of 2008 and higher service charges and fee income for core banking and MasterCard/Visa credit card products. Additionally, 2007 revenue included a gain on the sale of MasterCard B shares of \$45 million and a gain on the sale of branch properties of \$21 million.

Higher loan impairment charges were driven by an increase in delinquencies, which resulted in significantly increased loan loss reserves as well as increased charge offs within the home equity mortgage loan and the residential first

mortgage loan portfolios due to increased loss severities as real estate values continued to deteriorate in certain markets. Provisions on MasterCard/Visa receivables and other consumer loans have also risen. Increased levels of personal bankruptcy filings and a deteriorating U.S. economy, including rising unemployment rates and lower recovery rates, have driven higher delinquencies across all products.

Increased operating expenses in 2008 were primarily related to a goodwill impairment charge associated with the Residential Mortgage reporting unit, higher mortgage reinsurance costs and higher FDIC assessment fees. Additionally, there were higher staff, marketing and occupancy costs reflecting investment in branch expansion

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as well as costs associated with branch optimization initiatives, which reduced branches in certain select areas, higher customer loyalty program expenses for credit cards, higher debit card fraud expense, an increase in employee benefit costs and unexpected costs reflecting estimated exposure associated with a systems outage in August 2008. Partially offsetting these cost increases was the release of a legal provision of \$36 million, representing a portion of the \$70 million Visa indemnification reserve that was recorded in the fourth quarter of 2007.

Consumer Finance (CF)

Overview The CF segment includes the private label and co-brand credit cards, as well as other loans acquired from HSBC Finance or its correspondents, including the GM and UP Portfolios and auto finance loans purchased in January 2009 and portfolios of nonconforming residential mortgage loans (the HMS Portfolio) purchased in 2003 and 2004.

On January 6, 2009 we received regulatory approval to purchase the General Motors MasterCard receivables portfolio, the Union Plus MasterCard/Visa portfolio and certain auto finance receivables from HSBC Finance. As a result, the following transactions occurred:

GM Portfolio and UP Portfolio. On January 8, 2009, we purchased the GM Portfolio from HSBC Finance for aggregate consideration of approximately \$6.2 billion, which included the assumption of approximately \$2.7 billion of indebtedness. The GM Portfolio purchased consisted of receivables with an aggregate balance of approximately \$6.3 billion. On January 9, 2009, we purchased the UP Portfolio from HSBC Finance for aggregate consideration of approximately \$6.0 billion, which included the assumption of approximately \$3.4 billion of indebtedness. The UP Portfolio consisted of receivables with an aggregate balance of approximately \$6.1 billion. HSBC Finance retained the customer account relationships and now sells additional receivable originations generated under existing and future GM and UP accounts to us daily at fair value.

Auto Finance Receivables. On January 9, 2009, we purchased auto finance receivables with an aggregate balance of approximately \$3.0 billion from HSBC Finance for an aggregate purchase price of approximately \$2.8 billion.

HSBC Finance services the receivables purchased for a fee. While the receivable purchases in 2009 have resulted in increases to our net interest income and other operating income, they have also contributed to higher loan impairment charges and, to a lesser extent, higher operating expenses which overall has resulted in higher profit before tax in 2009.

The following table summarizes the IFRSs Basis results for our CF segment:

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 2,101	\$ 1,250	\$ 951
Other operating income	353	325	294
Total operating income	2,454	1,575	1,245
Loan impairment charges	2,073	1,650	1,187

	381	(75)	58
Operating expenses	88	46	33
Profit (loss) before tax	\$ 293	\$ (121)	\$ 25

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2009 Profit (loss) before tax compared to 2008 Our CF segment reported a higher profit before tax during 2009 due to higher net interest income and higher other operating income, partially offset by higher loan impairment charges and higher operating expenses. The higher profit was driven by the impact of the GM and UP credit card portfolios as well as auto finance receivables purchased from HSBC Finance in early 2009 which collectively contributed profit before tax of \$284 million in 2009.

Net interest income increased during 2009 due to higher levels of receivables primarily due to the purchase of the GM and UP Portfolios and the auto finance receivables in January 2009, as well as lower amortization of premiums paid on the initial bulk and subsequent purchases of receivables associated with the private label portfolio, partially offset by higher charge offs of interest as a result of higher levels of credit card receivables outstanding and deterioration in credit quality. The original bulk purchase premium on the private label portfolio was fully amortized during 2008. Net interest income was also higher during 2009 due to higher yields as a result of repricing initiatives on the private label credit card portfolio and a lower cost of funds due to a declining interest rate environment.

Other operating income increased during 2009 primarily due to higher credit card fees associated with the purchase of the GM and UP credit card portfolios. This was partially offset by increased servicing fees on portfolios serviced by our affiliate, HSBC Finance (which are recorded as a reduction to other operating income), higher charge off of fees relating to private label cards due to deterioration in credit quality and credit cards due to higher levels of credit card receivables outstanding as well as lower late fees on co-brand credit card portfolios due to change in customer behavior.

Loan impairment charges associated with credit card receivables, including private label credit card receivables, increased substantially during 2009 due to higher receivable balances driven by our purchase of the GM and UP Portfolios from HSBC Finance as previously discussed, increased delinquencies and higher net charge-offs due to the impact of deterioration in the U.S. economy, including higher levels of personal bankruptcy filings and lower recovery rates on previously charged-off balances. Higher loan impairment charges were partially offset by an improved outlook on future loss estimates on private label credit card receivables as the impact of higher unemployment levels on losses has not been as severe as previously anticipated due to signs of home price stability in the second half of the year, tighter underwriting and as it relates to private label credit cards, the impact of lower receivable balances.

Operating expenses increased due to higher FDIC insurance premiums, including the special assessment recorded in the second quarter of 2009 and higher expenses related to the higher receivable levels and increased collection costs on late stage delinquent accounts.

As discussed under *Regulation and Competition* in Item 1., Business of this Form 10-K, on May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the *CARD Act*) was signed into law. Although we are already compliant with some provisions, other provisions, such as those addressing limitations on interest rate increases, over limit fees and payment allocation will require us to make changes to our business practices. This will likely require us and our competitors to manage risk differently than has historically been the case. We are compliant with the provisions of the *CARD Act* that took effect in August 2009 and February 2010 and continue to make changes to processes and systems in order to comply with the remaining provisions of the *CARD Act* by the applicable August 2010 effective date. Pricing, underwriting and product changes in response to the new legislation have either been implemented or are under analysis. We currently believe the implementation of these new rules will not have a material adverse impact to us as any impact would be limited to only a portion of the existing affected loan portfolio as the purchase price on future sales volume paid to HSBC Finance would be adjusted to fully reflect the new requirements.

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2008 Profit (loss) before tax compared to 2007 Our CF segment reported a loss before tax during 2008 primarily due to higher loan impairment charges, partially offset by higher net interest income and higher other operating income.

Net interest income increased in 2008, due primarily to lower amortization of premiums paid for daily purchases of receivables and lower amortization of the original bulk purchase premium included within the private label portfolio as well as lower funding costs due to a declining interest rate environment. The original bulk purchase premium was fully amortized by the end of 2008.

Other operating income increased during 2008, primarily due to increased late fees on higher delinquencies in the private label and co-brand credit card portfolios and higher credit card fees associated with the growing co-brand credit card portfolio. This was partially offset by higher servicing costs associated with the growing co-brand credit card portfolio and a \$10 million write down of deferred costs associated with a retail partner due to the retailer filing Chapter 11 bankruptcy in August 2008.

Loan impairment charges associated with credit card receivables, including private label credit card receivables increased during 2008, primarily due to increased delinquencies and higher net charge-offs including lower recoveries of previously charged-off balances, and higher levels of personal bankruptcy filings and the impact of a weakening U.S. economy. Provisions relating to the HMS portfolio also increased due to deterioration in the U.S. housing markets. This was partially offset by a refinement in the methodology used to estimate inherent losses on private label loans less than 30 days delinquent, which resulted in incremental impairment charges of \$107 million in 2007.

Operating expenses increased primarily due to the increased collection costs on late stage delinquent accounts.

Commercial Banking (CMB)

Overview Our Commercial Banking segment serves three client groups, notably Commercial (Middle Market Enterprises), Business Banking and Commercial Real Estate. CMB's business strategy is to be the leader in international banking in target markets. In the U.S., CMB strives to execute on that vision and strategy by proactively targeting the growing number of U.S. companies that are increasingly in need of international banking, financial products and services. The products and services provided to these client groups are offered through multiple delivery systems including the branch banking network.

In 2009, interest rate spreads continued to be pressured from a declining rate environment and loan impairment charges continued to increase due to overall deterioration in the credit environment. Tightened credit standards and increased paydowns have resulted in an eight percent decrease in loans outstanding to middle-market customers during 2009 while average deposits from middle-market customers have grown 18 percent during 2009. The business banking loan portfolio has seen a small decrease in loans outstanding due to tightened credit standards and the competitive environment while business banking customer deposits grew 13 percent during 2009 following successful spring and fall marketing campaigns. The commercial real estate business continues to focus on deal quality and portfolio management rather than volume, which resulted in an overall decline in outstanding receivables for this portfolio in 2009. Average customer deposit balances across all CMB business lines increased 12 percent during 2009 and average loans decreased four percent during 2009. In December 2009, we tentatively agreed to sell our interest in Wells Fargo HSBC Trade Bank (WHTB) to Wells Fargo which closed in the first quarter of 2010. In 2009, we recorded after-tax earnings from this equity investment of \$12 million.

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The following table summarizes the IFRSs Basis results for our CMB segment:

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 725	\$ 753	\$ 814
Other operating income	353	322	259
Total operating income	1,078	1,075	1,073
Loan impairment charges	309	288	126
	769	787	947
Operating expenses	634	594	558
Profit before tax	\$ 135	\$ 193	\$ 389

2009 Profit before tax compared to 2008 Our CMB segment reported a lower profit before tax during 2009 due to lower net interest income, higher loan impairment charges and higher operating expenses, partially offset by higher other operating income.

Net interest income decreased in 2009 due primarily to narrower spreads on deposits and lower loan balances, partially offset by growth in deposit balances and improved loan spreads from repricing. Loan impairment charges increased in 2009 as worsening economic conditions resulted in higher levels of criticized assets due to downward credit migration and specific credit reserves on impaired loans. Net charge-offs, although relatively low, were higher across all commercial business lines. Operating expenses increased due to higher FDIC insurance premiums, including the special assessment recorded in the second quarter of 2009, partially offset by reduced staff costs and efficiency savings, including lower marketing spend. Other operating income increased in 2009 largely due to higher fee income, partially offset by fewer syndications which resulted in lower fees and lower gains on sale of real estate loans.

2008 Profit before tax compared to 2007 Our CMB segment reported a lower profit before tax during 2008 primarily due to lower net interest income, higher loan impairment charges and higher operating expenses, partially offset by higher other operating income.

Net interest income decreased due primarily to narrower spreads on deposits as the declining interest rate environment impacted income growth, partially offset by higher average balance growth in loans and deposits. Loan impairment charges increased, due mainly to worsening economic conditions, leading to customer credit downgrades across all commercial business lines. Although net charge-offs increased moderately in the middle market business, there were no net charge-offs in the commercial real estate business. In small business, charge-offs were flat compared to 2007. Operating expenses increased due primarily to higher FDIC assessment fees, increased community investment activities and higher branch network costs. Other operating income increased mainly due to a combination of increased community investment activities, higher syndications business, higher gains on sales of commercial real estate loans, increased cross-sales of global markets products and higher investment management and service fees.

Global Banking and Markets

Overview Our Global Banking and Markets business segment supports HSBC's emerging markets-led and financing-focused global strategy by continuing to leverage HSBC Group advantages and scale, strength in emerging markets and Global Markets products expertise in order to focus on delivering international products to U.S. clients and local products to international clients with New York as the hub for the Americas business.

There are four major lines of business within Global Banking and Markets: Global Banking, Global Markets, Transaction Banking and Asset Management. The Global Banking business line includes corporate lending and investment banking activities, and this unit also coordinates client relationships across all Global Markets and

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Banking products. The Global Markets business services the requirements of the world's central banks, corporations, institutional investors and financial institutions through our global trading platforms and distribution capabilities. Transaction banking provides payments and cash management, trade finance, supply chain, security services and banknotes services primarily to corporations and financial institutions. Asset Management provides investment solutions to institutions, financial intermediaries and individual investors.

The Global Banking and Markets segment results in 2009 continued to be affected by reduced market liquidity and volatility in spreads in the corporate credit and residential mortgage lending markets, however the impact to other operating income has declined significantly as compared to the prior year as the credit market began to stabilize. This impacted trading revenue in the credit derivatives business and subprime mortgage loans in particular, and has led to substantial counterparty credit reserves for monoline exposure and significant valuation losses being taken in both the Trading and Available-for-sale securities portfolios, particularly in 2008. Additionally, the Global Banking and Markets segment benefited in 2009 from balance sheet management actions taken to reposition our interest rate risk profile. This included sales in the available-for-sale portfolio resulting in gains in 2009 and higher intersegment income from internal break funding fees on mortgage loan sales.

On October 11, 2008, the International Accounting Standards Board (IASB) issued an amendment to IAS 39 which permits entities to transfer financial assets from the Trading classification into the Available-for-sale or Loans and Receivables classifications if the entity has the intention and ability to hold the assets for the foreseeable future or until maturity. Temporary changes in the market value of re-classified assets will no longer impact current period earnings. Instead, these assets will only be marked-to-market (through other comprehensive income) if classified as Available-for-sale Securities and will be subject to on-going impairment tests.

Following careful analysis of the implications and with consideration given to industry and peer practices, we elected to re-classify \$1.8 billion in leveraged loans and high yield notes and \$892 million in securities held for balance sheet management purposes from trading assets to loans and available-for-sale investment securities, effective July 1, 2008. In November 2008, \$967 million in additional securities were also transferred from trading assets to available-for-sale investment securities. If these IFRS reclassifications had not been made, our profit before tax would have been \$617 million higher during 2009 and our loss before tax would have been greater by \$893 million in 2008.

The following table summarizes IFRSs Basis results for the Global Banking and Markets segment.

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 810	\$ 998	\$ 321
Other operating income	651	(1,895)	46
Total operating income	1,461	(897)	367
Loan impairment charges	591	165	35
Operating expenses	870	(1,062)	332
	794	774	803
Profit (loss) before tax	\$ 76	\$ (1,836)	\$ (471)

2009 Profit (loss) before tax compared to 2008 Our Global Banking and Markets segment performance improved considerably in 2009 due primarily to significantly higher other operating income, partially offset by lower net interest income, higher loan impairment charges and a slightly higher increase in operating expenses as a result of the business environment discussed above.

Net interest income declined during 2009 as a result of sales of higher yielding assets in our available-for-sale securities portfolio which were made for risk management purposes, and lower margins on deposit balances. Partially offsetting these declines was higher margin due to loan repricing in our commercial loan portfolio driven by wider credit spreads.

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Other operating income (loss) improved \$2.5 billion during 2009 due to lower valuation losses on credit derivatives and sub-prime mortgage loans held for sale, lower other-than-temporary impairments and valuation losses in the securities portfolio, gains on sales of available-for-sale securities, higher break funding fees from PFS as discussed more fully below and higher transaction fees in Corporate Banking and Transaction Banking. Other operating income overall continued to be affected by adverse market conditions but to a lesser extent than in the prior year period. Other operating income in 2009 would have been higher in 2009 had we not reclassified assets from trading to available-for-sale assets and to loans and receivables under the IAS 39 amendment as previously discussed.

Other operating income (loss) reflects losses on structured credit products of \$395 million during 2009 compared to total net losses of \$2.5 billion during 2008, as the credit markets began to stabilize resulting in lower losses from hedging activity and counterparty exposures. Exposure to insurance monoline continued to adversely impact revenues as deterioration in creditworthiness persisted, although the pace of such deterioration slowed significantly, resulting in losses of \$204 million during 2009 compared to losses of \$1 billion during 2008.

Valuation losses of \$233 million during 2009 were recorded against the fair values of sub-prime residential mortgage loans held for sale as compared to valuation losses of \$505 million during 2008. Fair value adjustments on our leveraged loan portfolio of \$2 million in 2009 reflects the classification of substantially all leveraged loans and notes as loans and receivables compared to losses of \$102 million during 2008 when these assets were subject to fair value accounting. Other operating income also benefited from gains of \$254 million on sales of securities, primarily during the second quarter of 2009 and from intersegment income of \$170 million from PFS in 2009 relating to the break funding fee charged for the early termination of funding associated with the sale of the residential mortgage loans compared to a similar benefit of \$142 million during 2008.

Other operating losses in 2008 included a reduction of \$203 million related to the other-than-temporary impairment of FNMA equity securities. There were no similar charges in 2009.

Loan impairment charges increased during 2009 due to a number of credit downgrades in Global Banking on our exposure to the financial services industry and other downgrades on specific accruing loans. In addition, impairments included a charge of \$208 million on securities determined to be other-than-temporarily impaired compared to \$28 million in the prior year.

Operating expenses increased modestly during 2009 as higher FDIC assessment charges, including the special assessment recorded during the second quarter of 2009 and higher performance related compensation costs due to improved results were offset by lower salary and other staff costs resulting from a decreased overall number of employees.

2008 Profit (loss) before tax compared to 2007 Our Global Banking and Markets segment reported a higher loss before tax during 2008 primarily due to significantly lower other operating income, higher loan impairment charges, partially offset by higher net interest income and lower operating expenses.

Increased net interest income was due primarily to balance sheet management initiatives to position for lower rates and also reflects higher held for sale leveraged commercial loan balances as loan syndication activities were negatively impacted by the decline in market liquidity.

Other operating income (loss) was affected by adverse market conditions. Specifically, other income (loss) reflects total losses on structured credit products of approximately \$2.5 billion during 2008 as compared to \$264 million in 2007, as credit spreads continued to widen and corporate defaults increased causing losses on net purchase positions

and greater costs related to hedging the portfolio as well as related to counterparty exposures. Exposure to insurance monoline structured credit products increased as asset levels continued to fall and creditworthiness continued to deteriorate resulting in a loss of approximately \$1 billion for 2008, as compared to \$287 million for 2007. Losses in correlation trading, including a portfolio of Leverage Super Senior Tranche Credit Default Swaps, resulted in losses of \$1.3 billion in 2008. Structured funds suffered losses related to the fraud at Madoff Investment Securities LLC of \$130 million on transactions with counterparties who were looking to gain leveraged exposure to reference funds that invested with Madoff as the investment manager.

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Valuation losses of \$505 million and \$418 million in 2008 and 2007, respectively, were also recorded against the fair values of subprime residential mortgage loans held for sale. Fair value adjustments on our leveraged loan portfolio resulted in losses of \$102 million in 2008, compared to losses of \$85 million in 2007. The losses in 2008 were mitigated somewhat due to the reclassification of \$1.8 billion in leveraged loans and high yield notes from trading assets to loans and receivables under the IAS 39 amendment.

During 2008, our FNMA preferred equity securities were determined to be other-than-temporarily impaired. This reduced other income by a further \$203 million during the year ended December 31, 2008. Also, three asset backed securities were determined to be other-than-temporarily impaired. As a result, we recorded an impairment charge of \$28 million during 2008 on these securities.

Partially offsetting the above mentioned declines, revenue from credit default swaps used to hedge commercial loan exposure generated \$297 million in gains during 2008, an increase of \$268 million from 2007. Revenues from the payments and cash management business were higher in 2008 due to higher deposit balances and higher transaction fee revenues. Foreign exchange, interest rate trading, emerging markets trading and precious metals trading revenues were all up as a result of ongoing market volatility and increased customer flow during 2008. Additionally, revenues benefited from higher fees related to the asset management business as well as intersegment charges to the PFS segment of \$142 million in 2008 relating to the cost associated with the early termination of the funding associated with the sale of residential mortgage loans previously discussed.

Increased loan impairment charges in 2008 reflect weaker credit fundamentals.

Operating expenses were lower in 2008 primarily resulting from lower salary and other staff costs due to a decreased overall number of employees from our ongoing efficiency initiatives, as well as decreased performance related compensation. Partially offsetting this are increased costs to support the growth in the payments and cash management and asset management businesses. Technology costs were also higher in 2008.

Private Banking (PB)

Overview As part of HSBC's global network, the PB segment offers an integrated/combined onshore and offshore service to clients, their families and their businesses through their resident and non-resident life cycles. Resources continue to be dedicated to expanding products and services provided to high net worth customers served by the PB business segment.

Client deposit levels decreased 11 percent during 2009 as domestic institutional clients began to invest their liquidity in investment products with low risk. Similarly, total average loans (mostly domestic consumer) decreased 11 percent during 2009 reflecting reduced client demand. Substantial reductions from a challenging economic environment and outflows from domestic custody clients affected market value of client assets under management, which decreased 7 percent during 2009. Assets under management declined to \$37 billion at December 31, 2009 as compared to \$40 billion at December 31, 2008, reflecting the loss of certain domestic custody clients.

The following table summarizes IFRSs Basis results for the PB segment.

Year Ended December 31	2009	2008	2007
	(in millions)		

Net interest income	\$ 172	\$ 192	\$ 198
Other operating income	106	156	291
Total operating income	278	348	489
Loan impairment charges	98	17	10
	180	331	479
Operating expenses	232	268	345
Profit (loss) before tax	\$ (52)	\$ 63	\$ 134

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2009 Profit (loss) before tax compared to 2008 Our PB segment reported a loss before tax during 2009 due largely to lower net interest income, higher loan impairment charges and lower other operating income, partially offset by lower operating expenses.

Net interest income was lower during 2009 primarily as a result of narrowing interest rate spreads due to declining market rates and lower outstanding loan and deposit balances.

Other operating income was lower primarily due to lower performance fees from equity investments, and lower fee income from credit derivatives, managed products, structured products and recurring fund fees and insurance commissions.

Loan impairment charges increased during 2009 largely to a specific provision relating to a single client relationship recorded in the third quarter of 2009 and higher reserve levels associated with the downgrade of a separate specific domestic client relationship.

Operating expenses decreased as a result of lower staff costs due to lower headcount resulting from efficiency initiatives. Travel and entertainment, marketing and communications costs were also lower, partially offset by higher FDIC assessment fees, including the special assessment recorded during the second quarter of 2009.

2008 Profit (loss) before tax compared to 2007 Other operating income was lower by \$135 million and operating expenses were lower by \$77 million in 2008, which includes the impact of lower other operating income of \$123 million and lower operating expenses of \$96 million due to the sale of the WTAS business in December 2007.

Net interest income was lower in 2008 primarily as a result of narrowing interest rate spreads due to declining market rates. This was partially offset by average balance growth in loans and deposits.

Excluding the impact of the WTAS business, other revenues (losses) in 2008 remained lower due primarily to lower income from an equity investment in a non-consolidated foreign HSBC affiliate sold during 2007 and losses of approximately \$6 million related to the repurchase of Auction Rate Securities from customers. Partially offsetting these items were higher commission and fee revenues from domestic custody fees, commissions from affiliates due to increased customer referral fees and asset management revenue share.

Loan impairment charges in 2008 were higher than the prior year. Higher economic cycle related loan impairment provisions in the second half of 2008 as well as a specific charge associated with cross border risk more than offset a provision on a specific client relationship in the first quarter of 2007.

Excluding the impact of the WTAS business, operating expenses increased as a result of higher staff costs to expand the services provided to high net worth domestic and foreign clients, an operational loss of approximately \$6 million related to a specific domestic client relationship, higher FDIC assessment fees and higher occupancy costs.

Other The other segment primarily includes adjustments made at the corporate level for fair value option accounting related to certain debt issued, as well as any adjustments to the fair value on HSBC shares held for stock plans. The results also include earnings on an equity investment in HSBC Private Bank (Suisse) S.A, through the first quarter of 2009. This investment was sold in March 2009 for a gain.

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The following table summarizes IFRSs Basis results for the Other segment.

Year Ended December 31	2009	2008	2007
	(in millions)		
Net interest income	\$ 17	\$ (5)	\$ (12)
Other operating income	(515)	547	216
Total operating income	(498)	542	204
Loan impairment charges	-	-	-
	(498)	542	204
Operating expenses	87	-	4
Profit (loss) before tax	\$ (585)	\$ 542	\$ 200

2009 Profit (loss) before tax compared to 2008 We reported lower profit before tax during 2009 largely due to lower other operating income and higher operating expenses.

Other operating income was negatively impacted in 2009 by an increase in the fair value of certain of our own debt instruments outstanding to which fair value option accounting is applied for which we recorded a loss in 2009 of \$565 million due to narrowing credit spreads. Additionally, 2009 was impacted by an impairment charge related to a building held for use. Partially offsetting this, we recorded a net gain of \$30 million relating to the resolution of a lawsuit whose proceeds were used in April to redeem a nominal amount of preferred stock issued to CT Financial Services, Inc. A gain of \$43 million was also recognized in 2009 on the sale of an equity interest, which was offset partially by lower equity earnings in HSBC Private Bank (Suisse) S.A. referred to above.

Operating expenses in 2009 largely reflect a funding credit provided to certain segments for holding certain low yielding assets.

2008 Profit (loss) before tax compared to 2007 The increase in other operating income during 2008 resulted from decreases in the fair value of certain debt instruments due to widening credit spreads to which fair value option accounting is applied.

Credit Quality

In the normal course of business, we enter into a variety of transactions that involve both on and off-balance sheet credit risk. Principal among these activities is lending to various commercial, institutional, governmental and individual customers. We participate in lending activity throughout the U.S. and, on a limited basis, internationally.

See *Credit Risk Management* in this MD&A for a detailed discussion of our approach toward credit risk management. Our methodology and accounting policies relating to our allowance for credit losses are presented in *Critical Accounting Policies* within this MD&A and in Note 2, *Summary of Significant Accounting Policies and New Accounting Pronouncements* in the accompanying consolidated financial statements.

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Delinquency The following table summarizes dollars of two-months-and-over contractual delinquency and two-months-and-over contractual delinquency as a percent of total loans and loans held for sale (delinquency ratio):

	2009				2008			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
(dollars are in millions)								
Dollars of delinquency:								
Commercial	\$ 954	\$ 938	\$ 709	\$ 360	\$ 385	\$ 290	\$ 220	\$ 217
Consumer:								
Residential mortgages, excluding home equity mortgages	1,595	1,445	1,335	1,259	1,189	1,028	945	783
Home equity mortgages	173	185	194	185	161	132	121	117
Total residential mortgages ⁽¹⁾	1,768	1,630	1,529	1,444	1,350	1,160	1,066	900
Private label card receivables	622	639	634	657	663	589	555	550
Credit card receivables	587	591	583	488	118	96	86	90
Auto finance	48	47	37	24	3	4	4	4
Other consumer	18	18	19	22	27	24	22	23
Total consumer	3,043	2,925	2,802	2,635	2,161	1,873	1,733	1,567
Total	\$ 3,997	\$ 3,863	\$ 3,511	\$ 2,995	\$ 2,546	\$ 2,163	\$ 1,953	\$ 1,784
Delinquency ratio:								
Commercial	3.04%	2.80%	2.03%	1.02%	1.01%	.69%	.55%	.58%
Consumer:								
Residential mortgages, excluding home equity mortgages	10.56	9.20	8.14	6.57	5.54	4.22	3.70	2.57
Home equity mortgages	4.15	4.24	4.35	4.07	3.54	2.88	2.66	2.63
Total residential mortgages ⁽¹⁾	9.17	8.12	7.33	8.10	5.19	4.01	3.54	2.58
Private label card receivables	4.12	4.37	4.21	4.21	3.88	3.61	3.43	3.40

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Credit card receivables	4.50	4.43	4.23	3.48	5.52	4.82	4.55	5.02
Auto finance	2.34	2.06	1.48	.88	1.95	2.14	1.76	1.48
Other consumer	1.20	1.14	1.15	1.26	1.45	1.23	1.10	1.12
Total consumer	5.97	5.64	5.20	4.56	4.57	3.79	3.44	2.84
Total	4.85%	4.53%	3.95%	3.21%	2.98%	2.36%	2.16%	1.93%

(1) The following reflects dollars of contractual delinquency and delinquency ratios for interest-only loans and ARM loans:

	2009				2008			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
(dollars are in millions)								
Dollars of delinquency:								
Interest-only loans	\$ 236	\$ 269	\$ 277	\$ 281	\$ 250	\$ 205	\$ 185	\$ 165
ARM loans	802	781	733	690	667	600	574	470
Delinquency ratio:								
Interest-only loans	6.94%	6.78%	6.44%	5.58%	4.53%	3.54%	3.09%	2.28%
ARM loans	9.58	8.99	8.22	6.32	5.39	4.61	4.06	2.50

Our total delinquency ratio increased 32 basis points compared to September 30, 2009. The overall increase in delinquency was impacted by the continued weakness in the U.S. economy and continued high unemployment rates. In addition, our residential mortgage portfolio, which includes our subprime mortgage whole loans held for

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sale for purposes of delinquency reporting, has continued to experience higher delinquency as a result of continued weakness in the housing markets. Lower loan balances for residential mortgage loans, credit card and auto finance loans compared to September 30, 2009 also contributed to the higher delinquency ratios in these portfolios. Increased delinquency in the auto finance loans purchased from HSBC Finance reflects the previously current loans beginning to season.

The increases in delinquency during the fourth quarter of 2009 were partially offset by lower delinquency levels in our private label card portfolio as credit quality remained stable, benefitting from the actions previously taken to tighten underwriting and reduce the risk profile of the portfolio, as well as higher levels of personal bankruptcy filings in the first half of 2009 which resulted in accounts migrating to charge-off more quickly, partially offset by the impact of continued increases in unemployment levels. Additionally, our private label card delinquency ratio in the fourth quarter benefitted from a higher level of outstanding receivables reflecting normal seasonal trends.

Our commercial portfolio experienced higher delinquency dollars and ratios during the fourth quarter of 2009 due to continued deterioration of economic conditions, as previously discussed.

Compared to December 31, 2008, our overall delinquency ratio increased 187 basis points largely due to higher residential mortgage delinquencies due to the factors described above. While dollars of delinquency increased in our credit card portfolio due to the impact of the GM and UP portfolios purchased in January 2009, our credit card delinquency ratio declined reflecting the impact of our prime GM and UP portfolios on overall credit card mix while overall credit quality remained relatively stable. In our private label card portfolio, dollars of delinquency declined due to lower receivable levels including actions previously taken to tighten underwriting and reduce the risk profile of the portfolio and lower customer spending. This was partially offset by the impact of continued economic pressure including rising unemployment rates and higher levels of personal bankruptcy in the first half of 2009 which resulted in accounts migrating to charge-off more quickly. Our private label card delinquency ratio increased however, as receivables declined at a faster pace than delinquency. The increase in our auto finance delinquency reflects seasoning of the portfolio purchased from HSBC Finance in January 2009. Increased delinquency in our commercial portfolio reflects continued deterioration of economic conditions.

dential	2.03	2.12	2.42	2.06	1.59	.76	.97	.90	.72	.49
s bel	8.07	8.20	8.13	8.31	7.77	5.81	6.22	5.96	5.93	5.14
vables	7.45	10.52	10.33	7.05	1.85	6.99	7.95	6.69	7.37	5.83
d	3.04	4.79	4.00	3.05	.62	3.02	2.35	5.80	1.59	2.66
es	5.99	6.88	5.99	5.33	5.93	4.54	5.50	4.31	3.84	4.55
nce	5.35	6.37	6.32	5.34	3.55	2.83	3.34	3.01	2.76	2.30
sumer	3.59%	4.45%	4.13%	3.56%	2.37%	1.79%	2.03%	1.91%	1.71%	1.51%

Our net charge-off ratio as a percentage of average loans increased 180 basis points for the full year of 2009 as compared to the full year of 2008 primarily due to higher residential mortgage, private label card, credit card and auto finance charge-offs. Higher net charge-off levels are a result of the following:

Higher delinquency levels migrating to charge-off due to:

Continued weakness in the U.S economy and housing markets;

Significantly higher unemployment rates;

Portfolio seasoning; and

Higher loss severities for secured loans.

Charge-off dollars and ratios increased in the residential mortgage portfolio reflecting continued weakness in the housing and mortgage industry, including marked decreases in home values in certain markets and, as it relates to the increase in the charge-off ratio, lower average receivables outstanding. Charge-off dollars and ratios for our

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private label card portfolio also increased due to higher bankruptcy levels, higher average delinquency levels and, as it relates to the charge-off ratio, lower average receivables outstanding.

Charge-off levels in our credit card portfolio in 2009 were favorably impacted by the GM and UP Portfolio purchased from HSBC Finance, a portion of which were subject to the application of accounting principles that require that purchased loans with evidence of credit deterioration since origination be recorded at an amount based on the net cash flows expected to be collected which reduced the overall level of credit card charge-off reported in the first half of 2009. This resulted in lower levels of credit card receivable charge-offs being reported in the first half of 2009. The portion of the portfolio not subject to this accounting is now seasoning resulting in increased charge-offs during the second half of 2009. Overall credit card charge-off levels in 2009 also reflect higher levels of personal bankruptcy filings.

Our auto finance net charge-off ratio was relatively flat as the purchase of \$3.0 billion of the auto loans purchased from HSBC Finance in January 2009 on charge-off was favorably impacted by the non-delinquent status of the loans purchased, which began to season and migrate to charge-off later in the year.

Commercial charge-off dollars and ratios increased largely due to a higher level of losses in the small business portfolio and an increase in losses in our commercial real estate portfolio.

Our net charge-off ratio as a percentage of average loans increased 60 basis points for the full year of 2008 as compared to the full year of 2007. We experienced higher charge-offs across all categories as listed above, particularly in private label card and in residential mortgage loans due to deterioration in the U.S. economy, rising unemployment rates, lower recovery rates on previously charged-off balances and deteriorating conditions in the housing markets.

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Nonperforming Assets Nonperforming assets are summarized in the following table.

At December 31,	2009	2008	2007
	(dollars are in millions)		
Nonaccrual loans:			
Commercial:			
Construction and other real estate	\$ 644	\$ 74	\$ 35
Other commercial	623	167	88
Total commercial	1,267	241	123
Consumer:			
Residential mortgages, excluding home equity mortgages	875	444	277
Home equity mortgages	107	122	58
Total residential mortgages	982	566	335
Credit card receivables	3	2	1
Auto finance	40	3	-
Others	9	-	-
Total consumer loans	1,034	571	336
Nonaccrual loans held for sale	446	441	305
Total nonaccruing loans	2,747	1,253	764
Accruing loans contractually past due 90 days or more:			
Total commercial	166	150	26
Consumer:			
Residential mortgages, excluding home equity mortgages	-	-	-
Home equity mortgages	-	-	-
Total residential mortgages	-	-	-
Private label card receivables	449	462	377
Credit card receivables	429	82	47
Auto finance	-	-	-
Other consumer	31	27	22
Total consumer loans	909	571	446
Accruing loans contractually past due 90 days or more held for sale	-	-	-
Total accruing loans contractually past due 90 days or more	1,075	721	472
Total nonperforming loans	3,822	1,974	1,236
Other real estate owned	72	80	69
Total nonperforming assets	\$ 3,894	\$ 2,054	\$ 1,305

Allowance for credit losses as a percent of nonperforming loans⁽¹⁾:

Commercial	65.44%	146.29%	201.43%
Consumer	150.45	159.81	142.41

(1) Ratio excludes nonperforming loans associated with loan portfolios which are considered held for sale as these loans are carried at the lower of cost or market.

Increases in nonperforming loans at December 31, 2009 are related primarily to commercial loans, residential mortgages, and credit card receivables 90 days or more past due and still accruing. Deterioration in the U.S. economy, including rising unemployment rates, contributed to the overall increase in nonperforming loans.

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Commercial nonaccrual loans increased due largely to continued deterioration of economic conditions and changes in the financial condition of specific customers, mainly financial institution counterparties and real estate customers as the increases in delinquencies and criticized loans reported in the prior year are migrating to non-accrual. Residential mortgage nonperforming loans increased largely due to deterioration in the housing markets. Increases in accruing loans past due 90 days or more reflect a significantly higher portfolio of credit card receivables. Our allowance for credit losses as a percentage of nonperforming commercial loans was significantly lower at December 31, 2009 as compared to the prior year due to loans which had previously been identified as an increased risk for loss and reserved for in accordance with our credit loss policies now beginning to migrate to nonaccrual.

The increase in nonperforming loans in 2008 was driven by higher consumer nonperforming loans, primarily residential mortgages due largely to deterioration in the housing markets.

Our policies and practices for problem loan management and placing loans on nonaccrual status are summarized in Note 2, *Summary of Significant Accounting Policies and New Accounting Pronouncements*, in the accompanying consolidated financial statements.

Accrued but unpaid interest on loans placed on nonaccrual status generally is reversed and reduces current income at the time loans are so categorized. Interest income on these loans may be recognized to the extent of cash payments received. In those instances where there is doubt as to collectability of principal, any cash interest payments received are applied as reductions of principal. Loans are not reclassified as accruing until interest and principal payments are brought current and future payments are reasonably assured.

Impaired Commercial Loans A commercial loan is considered to be impaired when it is deemed probable that all principal and interest amounts due, according to the contractual terms of the loan agreement, will not be collected. Probable losses from impaired loans are quantified and recorded as a component of the overall allowance for credit losses. Generally, impaired commercial loans include loans in nonaccrual status, loans that have been assigned a specific allowance for credit losses, loans that have been partially or wholly charged off and loans designated as troubled debt restructurings. Impaired commercial loan statistics are summarized in the following table:

At December 31,	2009	2008	2007
	(in millions)		
Impaired commercial loans:			
Balance at end of period	\$ 1,458	\$ 241	\$ 123
Amount with impairment reserve	1,127	150	41
Impairment reserve	336	43	15

Criticized Loan Criticized loan classifications are based on the risk rating standards of our primary regulator. Problem loans are assigned various criticized facility grades under our allowance for credit losses methodology. The following facility grades are deemed to be criticized.

Special Mention generally includes loans that are protected by collateral and/or the credit worthiness of the customer, but are potentially weak based upon economic or market circumstances which, if not checked or corrected, could weaken our credit position at some future date.

Substandard includes loans that are inadequately protected by the underlying collateral and/or general credit worthiness of the customer. These loans present a distinct possibility that we will sustain some loss if the deficiencies are not corrected. This category also includes certain non-investment grade securities, as required by our principal regulator.

Doubtful includes loans that have all the weaknesses exhibited by substandard loans, with the added characteristic that the weaknesses make collection or liquidation in full of the recorded loan highly improbable. However, although the possibility of loss is extremely high, certain factors exist which may strengthen the credit at some future date, and therefore the decision to charge off the loan is deferred. Loans graded as doubtful are required to be placed in nonaccruing status.

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Criticized loans are summarized in the following table.

At December 31,	2009	2008	2007
	(in millions)		
Special mention:			
Commercial loans	\$ 3,009	\$ 4,066	\$ 2,402
Substandard:			
Commercial loans	3,523	1,874	625
Consumer loans	2,109	1,231	862
Total substandard	5,632	3,105	1,487
Doubtful:			
Commercial loans	504	60	26
Total	\$ 9,145	\$ 7,231	\$ 3,915

The increase in criticized commercial loans in 2009 resulted primarily from further customer credit downgrades in financial institution counterparties and real estate customers. As previously mentioned, downgrades in our commercial real estate portfolio are continuing, particularly for condominium and land loans, as well as hotel and office construction where many construction projects have been delayed. Although our corporate banking portfolio has deteriorated in most industry segments and geographies, consistent with the overall deterioration in the U.S. economy, customers in those areas of the economy that have experienced above average weakness such as apparel, auto related suppliers and construction related businesses have been particularly affected. Higher substandard consumer loans since December 31, 2008 were largely driven by our purchase of the GM and UP Portfolios in January 2009 and to a lesser extent, residential mortgage loans.

The increase in criticized commercial loans in 2008 was driven by downgrades in financial institution counterparties as well as real estate and middle market customers. The downgrades resulted in part from continued deterioration of economic conditions and changes in financial conditions of specific customers within these portfolios. Higher criticized consumer loans in 2008 primarily relate to private label credit card receivables and, to a lesser extent, residential mortgage loans.

Allowance for Credit Losses For commercial and select consumer loans, we conduct a periodic assessment on a loan-by-loan basis of losses we believe to be inherent in the loan portfolio. When it is deemed probable based upon known facts and circumstances that full contractual interest and principal on an individual loan will not be collected in accordance with its contractual terms, the loan is considered impaired. An impairment reserve is established based on the present value of expected future cash flows, discounted at the loan's original effective interest rate, or as a practical expedient, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Updated appraisals for collateral dependent loans are generally obtained only when such loans are considered troubled and the frequency of such updates are generally based on management judgment under the specific circumstances on a case-by-case basis. Problem commercial loans are assigned various criticized facility grades under the allowance for credit losses methodology. Each credit grade has a probability of default estimate.

Probable losses for pools of homogeneous consumer loans are generally estimated using a roll rate migration analysis that estimates the likelihood that a loan will progress through the various stages of delinquency, or buckets, and ultimately charge off. This analysis considers delinquency status, loss experience and severity and takes into account whether loans are in bankruptcy, have been restructured, rewritten, or are subject to forbearance, an external debt management plan, hardship, modification, extension or deferment. The allowance for credit losses on consumer receivables also takes into consideration the loss severity expected based on the underlying collateral, if any, for the loan in the event of default based on historical and recent trends.

Our allowance for credit losses methodology and our accounting policies related to the allowance for credit losses are presented in further detail under the caption *Critical Accounting Policies and Estimates* in this MD&A and in Note 2, *Summary of Significant Accounting Policies and New Accounting Pronouncements*, in the

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accompanying consolidated financial statements. Our approach toward credit risk management is summarized under the caption Risk Management in this MD&A. There have been no material revisions to our policies or methodologies during 2009, although we continue to monitor current market conditions and will adjust credit policies as deemed necessary.

The following table sets forth the allowance for credit losses for the periods indicated:

At December 31,	2009	2008	2007	2006	2005
	(dollars are in millions)				
Allowance for credit losses	\$ 3,861	\$ 2,397	\$ 1,414	\$ 897	\$ 846
Ratio of Allowance for credit losses to:					
Loans: ⁽¹⁾					
Commercial	3.10%	1.53%	.81%	.73%	.64%
Consumer:					
Residential mortgages, excluding home equity mortgages	2.53	1.15	.19	.08	.09
Home equity mortgages	4.44	3.67	.80	.16	.06
Private label card receivables	7.85	6.86	4.84	3.21	3.44
Credit card receivables	8.48	9.73	6.55	4.12	4.92
Auto finance	2.12	3.25	2.47	1.72	2.03
Other consumer loans	4.46	3.68	3.31	2.57	3.67
Total consumer loans	5.94	4.18	2.07	1.22	1.15
Total	4.86%	2.96%	1.56%	1.05%	0.99%
Net charge-offs ⁽¹⁾ :					
Commercial	313.71%	366.67%	252.10%	218.37%	4,400.00%
Consumer	104.06	129.99	125.73	102.55	109.48
Total	124.23%	153.65%	140.70%	117.41%	137.34%
Nonperforming loans ⁽¹⁾ :					
Commercial	65.44%	146.29%	201.43%	153.20%	132.91%
Consumer	150.45	159.81	142.41	108.47	133.44
Total	114.36%	156.36%	151.85%	116.59%	133.33%

⁽¹⁾ Ratios exclude loans held for sale as these loans are carried at the lower of cost or market.

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Changes in the allowance for credit losses by general loan categories for the years ended December 31, 2009, 2008 and 2007 are summarized in the following table:

	Residential Mortgage, Excl		Private						
	Home Equity	Home Equity	Label Card	Credit Card	Auto Finance	Other Consumer			Total
Year ended									
December 31, 2009:									
Balances at beginning of period	\$ 572	\$ 207	\$ 167	\$ 1,171	\$ 208	\$ 5	\$ 67	\$ 2,397	
Charge offs	327	235	189	1,431	1,033	92	107	3,414	
Recoveries	28	11	12	164	54	18	19	306	
Net charge offs	299	224	177	1,267	979	74	88	3,108	
Provision charged to income	665	364	195	1,280	1,450	104	86	4,144	
Allowance on loans transferred to held for sale	-	-	-	-	-	12	-	12	
Allowance related to bulk loan purchases from HSBC Finance	-	-	-	-	424	13	-	437	
Other	-	-	-	-	3	-	-	3	
Balance at end of period	\$ 938	\$ 347	\$ 185	\$ 1,184	\$ 1,106	\$ 36	\$ 65	\$ 3,861	
Year ended									
December 31, 2008:									
Balance at beginning of period	\$ 300	\$ 53	\$ 35	\$ 844	\$ 119	\$ 8	\$ 55	\$ 1,414	
Charge offs	190	133	87	1,148	154	9	116	1,837	
Recoveries	34	1	-	193	20	2	27	277	
Net charge offs	156	132	87	955	134	7	89	1,560	
Allowance on loans transferred to held for sale	-	-	-	-	-	-	-	-	
Provision charged to income	428	286	219	1,282	223	4	101	2,543	

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Balance at end of period \$ 572 \$ 207 \$ 167 \$ 1,171 \$ 208 \$ 5 \$ 67 \$ 2,397

Year ended

December 31, 2007:

Balances at beginning of period	\$ 214	\$ 24	\$ 7	\$ 545	\$ 53	\$ 10	\$ 44	\$ 897
Charge offs	147	49	21	860	67	20	105	1,269
Recoveries	28	1	-	187	10	10	28	264
Net charge offs	119	48	21	673	57	10	77	1,005
Provision charged to income	205	77	49	972	123	8	88	1,522
Other	-	-	-	-	-	-	-	-
Balance at end of period	\$ 300	\$ 53	\$ 35	\$ 844	\$ 119	\$ 8	\$ 55	\$ 1,414

The allowance for credit losses at December 31, 2009 increased \$1,464 million, or 61 percent as compared to December 31, 2008 reflecting higher loss estimates on our residential mortgage portfolio driven largely by increased charge-off and delinquency in our prime residential mortgage loan portfolio due to deterioration in the housing markets, higher reserve requirements in our commercial loan portfolio as well as a significantly higher allowance on our credit card receivable portfolio due to the purchase of the GM and UP Portfolios in January 2009. Reserve levels for all loan categories were impacted by continued weakness in the U.S. economy, including rising unemployment rates, and for consumer loans, higher levels of personal bankruptcy filings.

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The increase in the allowance for credit losses in our residential mortgage portfolios since December 31, 2008 was driven largely by increased charge-offs and higher loss estimates in our prime residential mortgage and home equity mortgage loan portfolios due to continued deterioration in the housing markets. Higher reserve levels in our private label and credit card receivable portfolios is largely due to the purchase of the GM and UP Portfolio in January 2009, partially offset by an improved outlook for future losses as the impact of higher unemployment levels on losses has not been as severe as previously anticipated.

Loan loss allowances for commercial loans were higher at December 31, 2009 due to higher loss estimates associated with higher criticized loan balances caused by further downgrades in financial institution and certain other counterparties, as well as real estate customers. The downgrades resulted from continued deterioration of economic conditions and changes in financial conditions of specific customers within these portfolios. As previously mentioned, downgrades in our commercial real estate portfolio to substandard and doubtful are continuing, particularly for condominium loans and land loans, as well as in hotel and office construction in all markets, especially in the large metropolitan markets where construction projects have been delayed. Condominium projects in Florida and California have been negatively impacted by sharply declining prices and reduced availability for condominium mortgages. As such, many buyers are either walking away from purchase contracts and deposits, or cannot arrange mortgages or advance additional equity required to close purchases. Although our corporate banking portfolio has deteriorated in most industry segments and geographies consistent with the overall deterioration in the U.S. economy, customers in those areas of the economy that have expressed above average weakness, such as apparel, auto related suppliers and construction related businesses have been particularly affected. Also contributing to the increase was a specific provision relating to a single significant private banking relationship.

The allowance for credit losses at December 31, 2008 increased \$983 million, or 70 percent as compared to December 31, 2007, reflecting a higher allowance on all products, particularly in our private label card and residential mortgage loan portfolios. The higher allowance in our private label card portfolio was due in part to higher delinquency and charge-off levels as a result of portfolio seasoning, increased levels of personal bankruptcy filings, continued deterioration in the U.S. economy including rising unemployment levels and lower recovery rates on defaulted loans. The higher allowance in our residential mortgage loan portfolio reflects continued deterioration of the housing market.

The allowance for credit losses as a percentage of total loans at December 31, 2009 increased as compared to December 31, 2008 reflecting a higher allowance percentage on our residential mortgage loan and commercial loan portfolios and lower outstanding balances in these portfolios as discussed above, partially offset by a lower credit card ratio reflecting the impact of our prime GM and UP Portfolios on credit card mix. The allowance for credit losses as a percentage of total loans for our private label receivable portfolio also increased as compared to December 31, 2008 due in part to higher charge-off levels as a result of portfolio seasoning, continued deterioration in the U.S. economy including rising unemployment levels and lower receivable levels, including the actions previously taken to tighten underwriting and reduce the risk profile of the portfolio and lower customer spending. The allowance for credit losses as a percentage of total loans at December 31, 2008 increased as compared to December 31, 2007 due to the factors which led to the increase in the allowance for credit losses in 2008 as explained above.

The allowance for credit losses as a percentage of net charge-offs decreased in 2009 as compared to 2008 as the increase in the net charge-offs outpaced the increase in the allowance for credit losses due largely to credit card receivables, private label card receivables and commercial loans. The allowance for credit losses as a percentage of net charge-offs increased in 2008 as compared to 2007 due largely to private label card receivable allowance outpacing the increase in the private label card receivable charge-offs.

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An allocation of the allowance for credit losses by major loan categories, excluding loans held for sale, is presented in the following table:

At December 31,	2009		2008		2007	
	Amount	% of Loans to Total Loans ⁽¹⁾	Amount	% of Loans to Total Loans ⁽¹⁾	Amount	% of Loans to Total Loans ⁽¹⁾
(dollars are in millions)						
Commercial ⁽²⁾	\$ 938	38.12%	\$ 572	46.14%	\$ 300	40.68%
Consumer:						
Residential mortgages, excluding home equity mortgages	347	17.26	207	22.13	53	31.03
Home equity mortgages	185	5.24	167	5.61	35	4.85
Private label card receivables	1,184	18.99	1,171	21.05	844	19.24
Credit card receivables	1,106	16.41	208	2.63	119	2.01
Auto finance	36	2.14	5	.19	8	.36
Other consumer	65	1.84	67	2.25	55	1.83
Total consumer	2,923	61.88	1,825	53.86	1,114	59.32
Total	\$ 3,861	100.00%	\$ 2,397	100.00%	\$ 1,414	100.00%

(1) Excluding loans held for sale.

(2) Components of the commercial allowance for credit losses, including exposure relating to off-balance sheet credit risk, and the movements in comparison with prior years, are summarized in the following table:

At December 31,	2009	2008	2007
(in millions)			
On-balance sheet allowance:			
Specific	\$ 326	\$ 43	\$ 15
Collective	549	476	265
Transfer risk	-	5	-
Unallocated	63	48	20
Total on-balance sheet allowance	938	572	300

Off-balance sheet allowance	188	168	103
Total commercial allowances	\$ 1,126	\$ 740	\$ 403

While our allowance for credit loss is available to absorb losses in the entire portfolio, we specifically consider the credit quality and other risk factors for each of our products in establishing the allowance for credit loss.

Reserves for Off-Balance Sheet Credit Risk We also maintain a separate reserve for credit risk associated with certain off-balance sheet exposures, including letters of credit, unused commitments to extend credit and financial guarantees. This reserve, included in other liabilities, was \$188 million, \$180 million and \$105 million at December 31, 2009, 2008 and 2007, respectively. The related provision is recorded as a miscellaneous expense and is a component of operating expenses. Off-balance sheet exposures are summarized under the caption "Off-Balance Sheet Arrangements and Contractual Obligations" in this MD&A.

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Our commercial credit exposure is diversified across a broad range of industries. Commercial loans outstanding and unused commercial commitments by industry are presented in the table below.

At December 31,	Commercial Utilized		Unused Commercial Commitments	
	2009	2008	2009	2008
	(in millions)			
Real estate and related	\$ 8,076	\$ 8,526	\$ 1,772	\$ 2,393
Non bank holding companies	2,884	3,554	1,477	4,713
Recreational industry	1,561	1,796	1,287	1,241
Banks and depository institutions	1,402	2,858	1,217	931
Security brokers and dealers	1,283	2,105	2,706	1,968
Chemicals, plastics and rubber	1,224	1,203	1,495	2,758
Health, child care and education	1,036	1,350	3,024	2,477
Ferrous and non ferrous mining	1,016	1,598	1,745	1,442
Business and professional services	914	1,104	1,853	1,696
Non depository credit institutions	885	1,265	8,988	13,402
Food and kindred products	758	1,054	4,745	2,423
Petro/gas and related	705	959	1,527	1,528
Insurance business	671	803	2,562	2,703
Electronic and electrical equipment	660	865	3,497	3,570
Textile, apparel and leather goods	621	1,015	841	760
Automobiles and automotive products	609	423	290	1,026
Industrial machinery and equipment	582	814	676	816
Retail stores	562	1,256	1,784	2,320
Natural resources, precious metals and jewelry	421	617	107	143
Transportation services	332	486	711	598
Utilities	316	455	1,170	978
Durable consumer/household products	295	385	770	727
Telecommunications	227	519	211	245
Non-durable consumer products	222	290	1,433	1,450
Miscellaneous consumer services	202	271	222	158
Print, publishing and broadcasting	169	362	1,067	998
Container, packaging and glass	165	234	219	174
Government	164	232	328	152
Aerospace, aircraft and defense	153	80	326	407
Farming and agriculture	123	174	825	831
Manufacturing	83	80	86	120
Ecological	74	18	30	24
Foreign government	-	17	-	-
Total commercial credit exposure by industry classifiable	28,395	36,768	48,991	55,172
All other non classifiable	1,909	661	-	887

Total commercial credit exposure by industry	\$ 30,304	\$ 37,429	\$ 48,991	\$ 56,059
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Cross-Border Net Outstandings Cross-border net outstandings are amounts payable by residents of foreign countries regardless of the currency of claim and local country claims in excess of local country obligations. Cross-

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border net outstandings, as calculated in accordance with Federal Financial Institutions Examination Council (FFIEC) guidelines, include deposits placed with other banks, loans, acceptances, securities available-for-sale, trading securities, revaluation gains on foreign exchange and derivative contracts and accrued interest receivable. Excluded from cross-border net outstandings are, among other things, the following: local country claims funded by non-local country obligations (U.S. dollar or other non-local currencies), principally certificates of deposit issued by a foreign branch, where the providers of funds agree that, in the event of the occurrence of a sovereign default or the imposition of currency exchange restrictions in a given country, they will not be paid until such default is cured or currency restrictions lifted or, in certain circumstances, they may accept payment in local currency or assets denominated in local currency (hereinafter referred to as constraint certificates of deposit); and cross-border claims that are guaranteed by cash or other external liquid collateral. Cross-border net outstandings that exceed .75% of total assets at year-end are summarized in the following table.

	Banks and Other Financial Institutions	Commercial and Industrial	Total
	(in millions)		
December 31, 2009:			
France	\$ 303	\$ 1,189	\$ 1,492
Canada	892	494	1,386
United Kingdom	2,874	803	3,677
Brazil	1,275	12	1,287
Total	\$ 5,344	\$ 2,498	\$ 7,842
December 31, 2008:			
France	\$ 1,617	\$ 104	\$ 1,721
Canada	2,287	1,619	3,906
United Kingdom	3,387	651	4,038
Cayman Islands	21	2,068	2,089
Venezuela	-	2,426	2,426
Brazil	1,425	682	2,107
Total	\$ 8,737	\$ 7,550	\$ 16,287
December 31, 2007:			
France	\$ 1,562	\$ 21	\$ 1,583
Canada	833	1,011	1,844
United Kingdom	2,697	1,204	3,901
Germany	2,017	60	2,077
Brazil	1,741	715	2,456
Total	\$ 8,850	\$ 3,011	\$ 11,861

Credit and Market Risks Associated with Derivative Contracts Credit risk associated with derivatives is measured as the net replacement cost in the event the counterparties with contracts in a gain position to us fail to perform under the terms of those contracts. In managing derivative credit risk, both the current exposure, which is the replacement cost of contracts on the measurement date, as well as an estimate of the potential change in value of contracts over their remaining lives are considered. Counterparties to our derivative activities include financial institutions, foreign and domestic government agencies, corporations, funds (mutual funds, hedge funds, etc.), insurance companies and private clients as well as other HSBC entities. These counterparties are subject to regular credit review by the credit risk management department. To minimize credit risk, we enter into legally enforceable master netting agreements which reduce risk by permitting the closeout and netting of transactions with the same

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counterparty upon occurrence of certain events. In addition, we reduce credit risk by obtaining collateral from counterparties. The determination of the need for and the levels of collateral will vary based on an assessment of the credit risk of the counterparty.

The total risk in a derivative contract is a function of a number of variables, such as:

volatility of interest rates, currencies, equity or corporate reference entity used as the basis for determining contract payments;

current market events or trends;

country risk;

maturity and liquidity of contracts;

credit worthiness of the counterparties in the transaction;

the existence of a master netting agreement among the counterparties; and

existence and value of collateral received from counterparties to secure exposures.

The table below presents total credit risk exposure measured using rules contained in the risk-based capital guidelines published by U.S. banking regulatory agencies. Risk-based capital guidelines recognize that bilateral netting agreements reduce credit risk and, therefore, allow for reductions of risk-weighted assets when netting requirements have been met. As a result, risk-weighted amounts for regulatory capital purposes are a portion of the original gross exposures.

The risk exposure calculated in accordance with the risk-based capital guidelines potentially overstates actual credit exposure because: the risk-based capital guidelines ignore collateral that may have been received from counterparties to secure exposures; and the risk-based capital guidelines compute exposures over the life of derivative contracts. However, many contracts contain provisions that allow us to close out the transaction if the counterparty fails to post required collateral. In addition, many contracts give us the right to break the transactions earlier than the final maturity date. As a result, these contracts have potential future exposures that are often much smaller than the future exposures derived from the risk-based capital guidelines.

At December 31,	2009	2008
	(in millions)	
Risk associated with derivative contracts:		
Total credit risk exposure	\$ 39,856	\$ 102,342
Less: collateral held against exposure	3,890	8,228
Net credit risk exposure	\$ 35,966	\$ 94,114

The table below summarizes the risk profile of the counterparties of off-balance sheet exposure to derivative contracts, net of cash and other highly liquid collateral. The exposures in the unrated category are exposures to counterparties that have not been rated by an external rating agency. These counterparties are, however, rated according to our Internal Credit Rating System, as discussed above, and exposure is mostly equivalent to investment grade.

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Rating equivalent at December 31	Percent of Current Credit Risk Exposure, Net of Collateral	
	2009	2008
AAA to AA-	37%	49%
A+ to A-	35	29
BBB+ to BBB-	17	13
BB+ to B-	8	5
CCC+ and below	2	2
Unrated	1	2
Total	100%	100%

Our principal exposure to monoline insurance companies is through a number of OTC derivative transactions, primarily credit default swaps (CDS). We have entered into CDS to purchase credit protection against securities held within the trading portfolio. Due to downgrades in the internal credit ratings of monoline insurers, fair value adjustments have been recorded due to counterparty credit exposures. The table below sets out the mark-to-market value of the derivative contracts at December 31, 2009 and 2008. The Credit Risk Adjustment column indicates the valuation adjustment taken against the mark-to-market exposures, and reflects the deterioration in creditworthiness of the monoline insurers during 2009. The exposure relating to monoline insurance companies that are rated CCC+ and below has been fully written down as of December 31, 2009. These adjustments have been charged to the consolidated statement of income (loss).

	Net Exposure before Credit Risk Adjustment ⁽¹⁾	Credit Risk Adjustment ⁽²⁾	Net Exposure After Credit Risk Adjustment
December 31, 2009			
	(in millions)		
Derivative contracts with monoline counterparties:			
Monoline investment grade	\$ 721	\$ (72)	\$ 649
Monoline below investment grade	1,031	(641)	390
Total	\$ 1,752	\$ (713)	\$ 1,039
December 31, 2008			
Derivative contracts with monoline counterparties:			
Monoline investment grade	\$ 1,781	\$ (431)	\$ 1,350
Monoline below investment grade	746	(570)	176

Total	\$	2,527	\$	(1,001)	\$	1,526
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- (1) Net exposure after legal netting and any other relevant credit mitigation prior to deduction of credit risk adjustment.
- (2) Fair value adjustment recorded against the over-the-counter derivative counterparty exposures to reflect the credit worthiness of the counterparty.

Market risk is the adverse effect that a change in market liquidity, interest rates, currency or implied volatility rates has on the value of a financial instrument. We manage the market risk associated with interest rate and foreign exchange contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken. We also manage the market risk associated with trading derivatives through hedging strategies that correlate the rates, price and spread movements. This risk is measured daily by using Value at Risk and other methodologies. See

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the caption **Risk Management** in this MD&A for additional information regarding the use of Value at Risk analysis to monitor and manage interest rate and other market risks.

Liquidity and Capital Resources

Effective liquidity management is defined as making sure we can meet customer loan requests, customer deposit maturities/withdrawals and other cash commitments efficiently under both normal operating conditions and under unpredictable circumstances of industry or market stress. To achieve this objective, we have guidelines that require sufficient liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. Guidelines are set for the consolidated balance sheet of HSBC USA Inc. to ensure that it is a source of strength for our regulated, deposit-taking banking subsidiary, as well to address the more limited sources of liquidity available to us. Similar guidelines are set for the balance sheet of HSBC Bank USA to ensure that it can meet its liquidity needs in various stress scenarios. Cash flow analysis, including stress testing scenarios, forms the basis for liquidity management and contingency funding plans.

During 2008 and continuing into early 2009, financial markets were extremely volatile. New issue term debt markets were extremely challenging with issues attracting substantially higher rates of interest than had historically been experienced and credit spreads for all issuers continued to trade at historically wide levels. Liquidity for asset backed securities remained tight as spreads remained high, negatively impacting the ability to securitize credit card receivables. The Federal Reserve Board introduced the Term Asset Backed Securities Loan Facility Program (TALF) in late 2008 to improve liquidity in asset backed securities. While the on-going financial market disruptions continued to impact credit spreads and liquidity during 2009, we have seen significant improvements in liquidity beginning in the second quarter of 2009 which continued to improve through the end of the year. Additionally, credit spreads have continued to narrow due to increased market confidence stemming largely from the various government actions taken to restore faith in the capital markets and stimulate the economy. As a result, there has been some stabilization in the markets which enabled some financial institutions to issue longer term debt and the FDIC has been able to allow the Debt Guarantee Program to expire. Similarly, many non-TALF eligible asset backed securitizations have been issued at favorable rates since the second quarter of 2009.

During 2008 and continuing through 2009, we witnessed the systemic reduction in available liquidity in the market and took steps to reduce our reliance on debt capital markets and to increase deposits. Excluding the impact of the paydowns associated with the \$6.1 billion of debt acquired with the credit card portfolio purchases in 2009, we retired long-term debt of \$9.5 billion in 2009. In the latter part of 2008, we had grown deposits in anticipation of the asset purchases and December 31, 2008 balances also benefitted from clients choosing to place their surplus liquidity into banks. Subsequent to December 31, 2008 we managed our overall balance sheet downward by reducing low margin investments and deposits while continuing to manage the overall balance sheet risk.

Interest bearing deposits with banks totaled \$20.1 billion and \$15.9 billion at December 31, 2009 and 2008, respectively. Balances increased during 2009 as excess liquidity was placed in these accounts.

Federal funds sold and securities purchased under agreements to resell totaled \$1.0 billion and \$10.8 billion at December 31, 2009 and 2008, respectively. Balances decreased during 2009 as we redeployed surplus liquidity out of repurchase agreements into purchases of short term treasury bills.

Short-term borrowings totaled \$6.5 billion and \$10.5 billion at December 31, 2009 and 2008, respectively. See **Balance Sheet Review** in this MD&A for further analysis and discussion on short-term borrowing trends.

Deposits decreased to \$118.3 billion at December 31, 2009 from \$119.0 billion at December 31, 2008. See **Balance Sheet Review** in this MD&A for further analysis and discussion on deposit trends.

Long-term debt decreased to \$18.0 billion at December 31, 2009 from \$22.1 billion at December 31, 2008 as the assumption of debt from HSBC Finance relating to the credit card receivable purchases and additional issuances

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during 2009 were more than offset by maturities. The following table summarizes issuances and retirements of long-term debt during 2009 and 2008:

Year Ended December 31,	2009	2008
	(in millions)	
Long-term debt issued ⁽¹⁾	\$ 3,579	\$ 7,424
Long-term debt retired ⁽²⁾	(13,111)	(9,938)
Net long-term debt retired	\$ (9,532)	\$ (2,514)

(1) Excludes \$6.1 billion of indebtedness assumed in connection with the purchase of the GM and UP Portfolios as discussed below.

(2) Includes the retirement of \$3.6 billion of indebtedness assumed in connection with the purchase of the GM and UP Portfolios as discussed below.

Issuances of long-term debt during 2009 include:

\$1.0 billion of senior notes which was issued to HSBC North America,

\$250 million of two-year Senior Floating Rate Notes,

\$2.3 billion of medium term notes, of which \$552 million was issued by HSBC Bank USA, and

\$55 million of subordinated debt issued by a subsidiary of HSBC Bank USA.

None of the debt issued in 2009 was guaranteed by the FDIC.

As discussed above, as part of the purchase of the UP and GM Portfolio from HSBC Finance in January 2009, we assumed \$6.1 billion of indebtedness accounted for as secured financings. At December 31, 2009, \$2.4 billion was outstanding under these secured financings.

Under our shelf registration statement on file with the Securities and Exchange Commission, we may issue debt securities or preferred stock. The shelf has no dollar limit, but the ability to issue debt is limited by the issuance authority granted by the Board of Directors. At December 31, 2009, we were authorized to issue up to \$12.0 billion, of which \$3.3 billion was available. The Board of Directors increased this limit to \$15.0 billion on February 18, 2010. HSBC Bank USA also has a \$40.0 billion Global Bank Note Program of which \$19.8 billion was available at December 31, 2009 on a cumulative basis.

As a member of the New York Federal Home Loan Bank (FHLB), we have a secured borrowing facility which is collateralized by residential mortgage loans and investment securities. At December 31, 2009 and 2008, long-term debt included \$1.0 billion and \$2.0 billion, respectively, under this facility. The facility also allows access to further

borrowings of up to \$2.3 billion based upon the amount pledged as collateral with the FHLB.

At December 31, 2009 and 2008 we had a \$2.5 billion unused line of credit with HSBC Bank, plc, a U.K. based HSBC subsidiary to support issuances of commercial paper.

Preferred Equity In April 2009, the preferred stock issued to CT Financial Services Inc. in 1997 was redeemed. See Note 19, Preferred Stock, in the accompanying consolidated financial statements for information regarding all outstanding preferred share issues.

Common Equity During 2009, we received capital contributions from HSBC North America Inc. (HNAI) in an aggregate amount of \$2.2 billion (\$1.1 billion received in each of the first two quarters) in exchange for 3 shares of common stock. During 2009, we contributed \$2.7 billion to our subsidiary, HSBC Bank USA, in part to provide capital support for receivables purchased from our affiliate, HSBC Finance Corporation. See Note 7, Loans, for additional information.

Selected Capital Ratios Capital amounts and ratios are calculated in accordance with current banking regulations. In managing capital, we develop targets for Tier 1 capital to risk weighted assets and Tier 1 capital to average assets.

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Our targets may change from time to time to accommodate changes in the operating environment or other considerations such as those listed above. Selected capital ratios are summarized in the following table:

At December 31,	2009	2008
Tier 1 capital to risk weighted assets	9.61%	7.60%
Tier 1 capital to average assets	7.59	5.96
Total equity to total assets	8.87	6.85

HSBC USA manages capital in accordance with the HSBC Group policy. HNAH and HBUS have each approved an Internal Capital Adequacy Assessment Process (ICAAP) that work in conjunction with the HSBC Group's ICAAP. The ICAAP evaluates regulatory capital adequacy, economic capital adequacy, rating agency requirements and capital adequacy under a stress scenario. To the extent that sufficient capital resources are not available locally to meet these tests, we will generally rely on capital support from our parent, in accordance with HSBC's capital management policy.

We and HSBC Bank USA are required to meet minimum capital requirements by their principal regulators. Risk-based capital amounts and ratios are presented in Note 25, Regulatory Capital, in the accompanying consolidated financial statements.

HSBC USA Inc. We are an indirect wholly owned subsidiary of HSBC Holdings plc and the parent company of HSBC Bank USA and other subsidiaries through which we offer personal and commercial banking products and related financial services. Our main source of funds is cash received from operations and subsidiaries in the form of dividends. In addition, we receive cash from third parties and affiliates by issuing preferred stock and debt and from our parent by receiving capital contributions.

We received cash dividends from our subsidiaries of \$9 million and \$47 million in 2009 and 2008, respectively.

We have a number of obligations to meet with our available cash. We must be able to service our debt and meet the capital needs of our subsidiaries. We also must pay dividends on our preferred stock and may pay dividends on our common stock. Dividends paid on preferred stock totaled \$73 million in 2009 and \$80 million in 2008. No dividends were paid to HNAI, our immediate parent company, on our common stock during either 2009 or 2008. We may pay dividends to HNAI in the future, but will maintain our capital at levels that we perceive to be consistent with our current ratings either by limiting the dividends to, or through capital contributions from, our parent.

At various times, we will make capital contributions to our subsidiaries to comply with regulatory guidance, support receivable growth, maintain acceptable investment grade ratings at the subsidiary level, or provide funding for long-term facilities and technology improvements. We made capital contributions to certain subsidiaries of \$2.7 billion in 2009 and \$3.0 billion in 2008.

Subsidiaries At December 31, 2009, we had one major subsidiary, HSBC Bank USA. Prior to December 9, 2008, we had two primary subsidiaries: HSBC Bank USA and HSBC National Bank USA. On December 9, 2008, HSBC National Bank USA was merged into HSBC Bank USA.

We manage substantially all of our operations through HSBC Bank USA, which funds our businesses primarily through receiving deposits from customers; the collection of receivable balances; issuing short-term, medium-term and long-term debt; borrowing under secured financing facilities and selling residential mortgage receivables. The vast majority of our domestic medium-term notes and long-term debt is marketed through subsidiaries of HSBC. Intermediate and long-term debt may also be marketed through unaffiliated investment banks.

As part of the regulatory approvals with respect to the aforementioned receivable purchases completed in January 2009, we and our ultimate parent, HSBC, committed that HSBC Bank USA will maintain a Tier 1 risk-based capital ratio of at least 7.62 percent, a total capital ratio of at least 11.55 percent and a Tier 1 leverage ratio of at least 6.45 percent for one year following the date of transfer. In addition, we and HSBC made certain additional capital commitments to ensure that HSBC Bank USA holds sufficient capital with respect to the purchased receivables that are or become low-quality assets, as defined by the Federal Reserve Act. In May 2009, we received further

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clarification from the Federal Reserve regarding HSBC Bank USA's regulatory reporting requirements with respect to these capital commitments in that the additional capital requirements, (which require a risk-based capital charge of 100 percent for each low-quality asset transferred or arising in the purchased portfolios rather than the eight percent capital charge applied to similar assets that are not part of the transferred portfolios), should be applied both for purposes of satisfying the terms of the commitments and for purposes of measuring and reporting HSBC Bank USA's risk-based capital and related ratios. This treatment applies as long as the low-quality assets are owned by an insured bank. During 2009, HSBC Bank USA sold low-quality auto finance loans with a net book value of approximately \$455 million to one of HSBC USA's non-bank subsidiaries to reduce this capital requirement. Capital ratios and amounts reported above at December 31, 2009 reflect this revised regulatory reporting. At December 31, 2009, we have exceeded our committed ratios and would have done so without the benefit associated with these low-quality asset sales. In addition to the target capital ratios, we have established an Internal Capital Adequacy Assessment Process (ICAAP). Under ICAAP, capital adequacy is evaluated through the examination of regulatory capital ratios (measured under current and Basel II rules), economic capital and stress testing. The results of the ICAAP are forwarded to HSBC and, to the extent that this evaluation identifies potential capital needs, incorporated into the HSBC capital management process. HSBC has provided capital support in the past and had indicated its commitment and capacity to fund the needs of the business (under most foreseeable circumstances) in the future.

As part of the purchase of the GM and UP Portfolios from HSBC Finance in January 2009, we assumed \$6.1 billion of debt securities backed by credit card receivables. For accounting purposes, these transactions were structured as secured financings. Therefore, the receivables and the related debt remain on our balance sheet. At December 31, 2009, private label card receivables, credit card receivables and restricted available-for-sale investments totaling \$3.9 billion secured \$3.0 billion of outstanding public debt and conduit facilities. At December 31, 2008, private label card receivables totaling \$1.6 billion secured \$1.2 billion of outstanding debt.

At December 31, 2009, we had conduit credit facilities with commercial and investment banks under which our operations may issue securities up to \$2.3 billion backed with private label card and credit card receivables. The facilities are renewable at the providers' option. Our total conduit capacity increased by \$1.2 billion during 2009. The increase is primarily the result of the secured financing conduit facilities obtained as part of the purchase of the GM and UP Portfolios completed in the first quarter of 2009. At December 31, 2009, private label card and credit card receivables of \$1.7 billion were used to collateralize \$1.2 billion of funding transactions structured as secured financings under these funding programs. At December 31, 2008, private label card receivables of \$977 million were used to collateralize \$700 million of funding transactions structured as secured financings under these funding programs. For the conduit credit facilities that have renewed in 2009, credit performance requirements have generally been more restrictive and pricing has increased to reflect the perceived quality of the underlying assets although, beginning in the second quarter, we began to witness an easing of such terms. Available-for-sale investments at December 31, 2009 included \$1.1 billion which were restricted for the sole purpose of paying down certain secured financings at the established payment date. There were no restricted available-for-sale investments at December 31, 2008.

The securities issued in connection with collateralized funding transactions may pay off sooner than originally scheduled if certain events occur. Early payoff of securities may occur if established delinquency or loss levels are exceeded or if certain other events occur. For all other transactions, early payoff of the securities begins if the annualized portfolio yield drops below a base rate or if certain other events occur. Presently we do not anticipate that any early payoff will take place. If early payoff were to occur, our funding requirements would increase. These additional requirements could be met through issuance of various types of debt or borrowings under existing back-up lines of credit. We believe we would continue to have adequate sources of funds if an early payoff event were to occur. Further, we have significantly reduced our overall dependence on these sources as we shift to more stable

sources while reducing our overall cost of funding.

HSBC Bank USA is subject to restrictions that limit the transfer of funds from it to us and our nonbank subsidiaries (including affiliates) in so-called covered transactions. In general, covered transactions include loans and other extensions of credit, investments and asset purchases, as well as certain other transactions involving the transfer of

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value from a subsidiary bank to an affiliate or for the benefit of an affiliate. Unless an exemption applies, covered transactions by a subsidiary bank with a single affiliate are limited to 10% of the subsidiary bank's capital and surplus and, with respect to all covered transactions with affiliates in the aggregate, to 20% of the subsidiary bank's capital and surplus. Also, loans and extensions of credit to affiliates generally are required to be secured in specified amounts. A bank's transactions with its nonbank affiliates are also generally required to be on arm's length terms.

2010 Funding Strategy Our current estimate for funding needs and sources for 2010 are summarized in the following table.

	(in billions)
Funding needs:	
Net asset growth, excluding asset transfers	\$ 1
Net asset transfers	-
Long-term debt maturities	-
Investment portfolio	-
Secured financings, including conduit facility maturities	3
Total funding needs	\$ 4
Funding sources:	
Cash from operations	\$ -
Core deposit growth	3
Other deposit growth	1
Loan sales	-
Long-term debt issuance	3
Short-term funding/investments	(4)
Secured financings, including conduit facility renewals	1
Other, including capital infusions	-
Total funding sources	\$ 4

The above table reflects a long-term funding strategy. Daily balances fluctuate as we accommodate customer needs, while ensuring that we have liquidity in place to support the balance sheet maturity funding profile. Should market conditions worsen, we have contingency plans to generate additional liquidity through the sales of assets or financing transactions. Our prospects for growth are dependent upon access to the global capital markets and our ability to attract and retain deposits. We remain confident in our ability to access the market for long-term debt funding needs in the current market environment. Deposits are expected to grow as we continue to expand our core domestic banking network. We continue to seek well-priced and stable customer deposits as customers move funds to larger, well-capitalized institutions due to a volatile market.

We will continue to sell a majority of new mortgage loan originations to government sponsored enterprises and private investors.

For further discussion relating to our sources of liquidity and contingency funding plan, see the caption **Risk Management** in this MD&A.

Capital Expenditures We made capital expenditures of \$44 million and \$62 million during 2009 and 2008, respectively.

Commitments See **Off-Balance Sheet Arrangements** below for further information on our various commitments.

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Contractual Cash Obligations The following table summarizes our long-term contractual cash obligations at December 31, 2009 by period due.

	2010	2011	2012	2013	2014	Thereafter	Total
	(in millions)						
Subordinated long-term debt and perpetual capital notes ⁽¹⁾	\$ -	\$ 104	\$ 123	\$ -	\$ 1,176	\$ 4,214	\$ 5,617
Other long-term debt, including capital lease obligations ⁽¹⁾	3,729	4,617	398	402	1,064	2,181	12,391
Other postretirement benefit obligations ⁽²⁾	6	6	6	6	6	27	57
Obligation to the HSBC North America Pension Plan ⁽⁵⁾	35	36	42	41	41	-	195
Minimum future rental commitments on operating leases ⁽³⁾	117	113	107	104	97	305	843
Purchase obligations ⁽⁴⁾	76	17	2	-	-	-	95
Total	\$ 3,963	\$ 4,893	\$ 678	\$ 553	\$ 2,384	\$ 6,727	\$ 19,198

- (1) Represents future principal payments related to debt instruments included in Note 15, Long-Term Debt, of the accompanying consolidated financial statements.
- (2) Represents estimated future employee benefits expected to be paid over the next ten years based on assumptions used to measure our benefit obligation at December 31, 2009. See Note 22, Pension and Other Postretirement Benefits, in the accompanying consolidated financial statements.
- (3) Represents expected minimum lease payments, net of minimum sublease income under noncancelable operating leases for premises and equipment included in Note 29, Collateral, Commitments and Contingent Liabilities, in the accompanying consolidated financial statements.
- (4) Represents binding agreements for facilities management and maintenance contracts, custodial account processing services, internet banking services, consulting services, real estate services and other services.
- (5) Our contractual cash obligation to the HSBC North America Pension Plan included in the table above is based on the Pension Funding Policy which was revised during the third quarter of 2009 and established required annual contributions by HSBC North America through 2014. The amounts included in the table above, reflect an estimate of our portion of those annual contributions based on plan participants at December 31, 2009. The Pension Funding Policy adopted during the third quarter of 2009 does not take into consideration any changes to future benefit accruals subsequent to December 31, 2009. See Note, 22, Pension and Other Postretirement Benefits, in the accompanying consolidated financial statements for further information about the HSBC North America Pension Plan.

These cash obligations could be funded primarily through cash collections on receivables and from the issuance of new unsecured debt or receipt of deposits.

Our purchase obligations for goods and services at December 31, 2009 were not significant.

Off-Balance Sheet Arrangements and Contractual Obligations

As part of our normal operations, we enter into various off-balance sheet arrangements with affiliates and third parties. These arrangements arise principally in connection with our lending and client intermediation activities and involve primarily extensions of credit and guarantees.

As a financial services provider, we routinely extend credit through loan commitments and lines and letters of credit and provide financial guarantees, including derivative transactions that meet the definition of a guarantee. The contractual amounts of these financial instruments represent our maximum possible credit exposure in the event that a counterparty draws down the full commitment amount or we are required to fulfill our maximum obligation under a guarantee.

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The following table provides maturity information related to our off-balance sheet arrangements. Many of these commitments and guarantees expire unused or without default. As a result, we believe that the contractual amount is not representative of the actual future credit exposure or funding requirements.

	2010	2011	2012	2013	2014	Thereafter	Balance at December 31,	
							2009	2008
	(in billions)							
Standby letters of credit, net of participations ⁽¹⁾	\$ 5.6	\$.9	\$.7	\$.2	\$.2	\$ -	\$ 7.6	\$ 8.2
Commercial letters of credit	.7	-	-	-	-	-	.7	.6
Credit derivatives considered guarantees ⁽²⁾	57.4	42.0	92.6	73.2	65.8	56.2	387.2	493.6
Other commitments to extend credit:								
Commercial	20.6	9.0	14.2	4.1	.4	.6	48.9	56.1
Consumer	6.9	-	-	-	-	-	6.9	9.3
Total	\$ 91.2	\$ 51.9	\$ 107.5	\$ 77.5	\$ 66.4	\$ 56.8	\$ 451.3	\$ 567.8

(1) Includes \$774 million and \$732 million issued for the benefit of HSBC affiliates at December 31, 2009 and 2008, respectively.

(2) Includes \$57.3 billion and \$103.4 billion issued for the benefit of HSBC affiliates at December 31, 2009 and 2008, respectively.

Letters of Credit A letter of credit may be issued for the benefit of a customer, authorizing a third party to draw on the letter for specified amounts under certain terms and conditions. The issuance of a letter of credit is subject to our credit approval process and collateral requirements. We issue commercial and standby letters of credit.

A commercial letter of credit is drawn down on the occurrence of an expected underlying transaction, such as the delivery of goods. Upon the occurrence of the transaction, the amount drawn under the commercial letter of credit is recorded as a receivable from the customer in other assets and as a liability to the vendor in other liabilities until settled.

A standby letter of credit is issued to third parties for the benefit of a customer and is essentially a guarantee that the customer will perform, or satisfy some obligation, under a contract. It irrevocably obligates us to pay a third party beneficiary when a customer either: (1) in the case of a performance standby letter of credit, fails to perform some contractual non-financial obligation, or (2) in the case of a financial standby letter of credit, fails to repay an outstanding loan or debt instrument.

Fees are charged for issuing letters of credit commensurate with the customer's credit evaluation and the nature of any collateral. Included in other liabilities are deferred fees on standby letters of credit, representing the fair value of our stand ready obligation to perform under these arrangements, amounting to \$48 million and \$33 million at December 31, 2009 and 2008, respectively. Fees are recognized ratably over the term of the standby letter of credit. Also included in other liabilities is a credit loss reserve on unfunded standby letters of credit of \$27 million and \$30 million at December 31, 2009 and 2008, respectively. See Note 27, Guarantee Arrangements in the accompanying consolidated financial statements for further discussion on off-balance sheet guarantee arrangements.

Credit Derivatives Credit derivative contracts are entered into both for our own benefit and to satisfy the needs of our customers. Credit derivatives are arrangements that provide for one party (the beneficiary) to transfer the credit risk of a reference asset to another party (the guarantor). Under this arrangement the guarantor assumes the credit risk associated with the reference asset without directly purchasing it. The beneficiary agrees to pay to the guarantor a specified fee. In return, the guarantor agrees to pay the beneficiary an agreed upon amount if there is a default during the term of the contract.

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In accordance with our policy, we offset most of the market risk we assume in selling credit guarantees through a credit derivative contract with another counterparty. Credit derivatives, although having characteristics of a guarantee, are accounted for as derivative instruments and are carried at fair value. The commitment amount included in the table above is the maximum amount that we could be required to pay, without consideration of the approximately equal amount receivable from third parties and any associated collateral. See Note 27, *Guarantee Arrangements*, in the accompanying consolidated financial statements for further discussion on off-balance sheet guarantee arrangements.

Other Commitments to Extend Credit Other commitments to extend credit include arrangements whereby we are contractually obligated to extend credit in the form of loans, participations in loans, lease financing receivables, or similar transactions. Consumer commitments comprise unused private label or MasterCard/Visa credit card lines that are technically commitments of HSBC Finance, which we are committed to fund via purchase at fair market value from HSBC Finance, and commitments to extend credit secured by residential properties. We have the right to change or terminate any terms or conditions of a customer's credit card or home equity line of credit account, for cause, upon notification to the customer. Commercial commitments comprise primarily those related to secured and unsecured loans and lines of credit and certain asset purchase commitments. In connection with our commercial lending activities, we provide liquidity support to a number of multi-seller and single-seller asset backed commercial paper conduits (*ABCP conduits*) sponsored by affiliates and third parties. See Note 26, *Special Purpose Entities*, in the accompanying consolidated financial statements for additional information regarding these ABCP conduits and our variable interests in them.

Liquidity support is provided to certain ABCP conduits in the form of liquidity loan agreements and liquidity asset purchase agreements. Liquidity facilities provided to multi-seller conduits support transactions associated with a specific seller of assets to the conduit and we would only be expected to provide support in the event the multi-seller conduit is unable to issue or rollover maturing commercial paper because of a commercial paper market disruption or the supported transaction has breached certain triggers. Liquidity facilities provided to single-seller conduits are not identified with specific transactions or assets and we would be required to provide support upon the occurrence of a commercial paper market disruption or the breach of certain triggers that affect the single-seller conduit's ability to issue or rollover maturing commercial paper. Our obligations have generally the same terms as those of other institutions that also provide liquidity support to the same conduit or for the same transactions. We do not provide any program-wide credit enhancements to ABCP conduits.

Under the terms of these liquidity agreements, the ABCP conduits may call upon us to lend money or to purchase certain assets in the event the ABCP conduits are unable to issue or rollover maturing commercial paper because of a commercial paper market disruption or the supported transaction has breached certain triggers. These trigger events are generally limited to performance tests on the underlying portfolios of collateral securing the conduits' interests. With regard to a multi-seller liquidity facility, the maximum amount that we could be required to advance upon the occurrence of a trigger event is generally limited to the lesser of the amount of outstanding commercial paper related to the supported transaction and the balance of the assets underlying that transaction adjusted by a funding formula that excludes defaulted and impaired assets. Under a single-seller liquidity facility, the maximum amount that we and other liquidity providers could be required to advance is also generally limited to each provider's pro-rata share of the lesser of the amount of outstanding commercial paper and the balance of unimpaired performing assets held by the conduit. As a result, the maximum amount that we would be required to fund may be significantly less than the maximum contractual amount specified by the liquidity agreement.

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The tables below present information on our liquidity facilities with ABCP conduits at December 31, 2009. The maximum exposure to loss presented in the first table represents the maximum contractual amount of loans and asset purchases we could be required to make under the liquidity agreements. This amount does not reflect the funding limits discussed above and also assumes that we suffer a total loss on all amounts advanced and all assets purchased from the ABCP conduits. As such, we believe that this measure significantly overstates our expected loss exposure.

Conduit Type	Maximum	Conduit	Weighted	Conduit	Weighted
	Exposure	Assets ⁽¹⁾		Funding ⁽¹⁾	
	to Loss	Total	Life	Commercial	Life
		Assets	(Months)	Paper	(Days)
(dollars are in millions)					
HSBC affiliate sponsored (multi-seller)	\$ 6,237	\$ 4,171	29	\$ 4,159	19
Third-party sponsored:					
Single-seller	554	6,684	45	6,683	35
Total	\$ 6,791	\$ 10,855		\$ 10,842	

⁽¹⁾ For multi-seller conduits, the amounts presented represent only the specific assets and related funding supported by our liquidity facilities. For single-seller conduits, the amounts presented represent the total assets and funding of the conduit.

Asset Class	Average Asset Mix	Average Credit Quality ⁽¹⁾				
		AAA	AA+/AA	A	A-	BB/BB-
Multi-seller conduits						
Debt securities backed by:						
Auto loans and leases	34%	45%	25%	11%	19%	-%
Trade receivables	12	23	10	67	-	-
Credit card receivables	27	43	-	57	-	-
Other securities	13	-	-	-	-	100
Capital calls	5	-	-	100	-	-
Equipment loans	5	100	-	-	-	-
Auto dealer floor plan loans	4	-	-	100	-	-
Total	100%	34%	10%	36%	7%	13%

Single-seller conduits
Debt securities backed by:

Auto loans and leases	100%	99%	1%	-%	-%	-%
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(1) Credit quality is based on Standard and Poor's ratings at December 31, 2009 except for loans and trade receivables held by single-seller conduits, which are based on our internal ratings. For the single-seller conduits, external ratings are not available; however, our internal credit ratings were developed using similar methodologies and rating scales equivalent to the external credit ratings.

We receive fees for providing these liquidity facilities. Credit risk on these obligations is managed by subjecting them to our normal underwriting and risk management processes.

During 2009, U.S. asset backed commercial paper volumes declined, particularly in the first half of the year as most bank conduit sponsors reduced exposure to certain industry sectors and generally tightened credit availability. Despite the volume reduction, there are signs that most major bank conduits sponsors are extending new financing but at a slower pace. Credit spreads in the multi-seller conduit market have trended lower since the beginning of the year following a pattern that is prevalent across the U.S. credit markets. In the ABCP market, the success of the TALF program has revived the term ABS market and has been the primary catalyst for the lowering of spreads in the ABCP market. The lower supply of ABCP has led to greater investor liquidity for the large bank sponsors that are

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attracting demand from money fund investors. The improved demand for higher quality ABCP program has led to an improved market sentiment and less volatility in issuance spreads.

The preceding tables do not include information on liquidity facilities that we previously provided to certain Canadian multi-seller ABCP conduits that have been subject to restructuring agreements. As a result of specific difficulties in the Canadian asset backed commercial paper markets, we entered into various agreements during the second half of 2007 modifying obligations with respect to these facilities.

Under one of these agreements, known as the Montreal Accord, a restructuring proposal to convert outstanding commercial paper into longer term securities was approved by ABCP noteholders and endorsed by the Canadian justice system in 2008. The restructuring plan was formally executed during the first quarter of 2009. As part of the enhanced collateral pool established for the restructuring, we have provided a \$380 million Margin Funding Facility to new Master Conduit Vehicles, which is currently undrawn. HSBC Bank USA derivatives transactions with the previous conduit vehicles have been assigned to new Master Conduit Vehicles. Under the restructuring, collateral provided to us to mitigate the derivatives exposures is significantly higher than it was previously.

Also in Canada but separately from the Montreal Accord, as part of an ABCP conduit restructuring executed in the second quarter of 2008, we agreed to hold long-term securities of \$300 million (denominated in Canadian dollars) and provide a \$95 million Credit Facility. As of December 31, 2009, approximately \$1 million of the Credit Facility was drawn and \$285 million (U.S. dollars) of securities were held. As of December 31, 2008, approximately \$77 million of the Credit Facility was drawn and \$246 million (U.S. dollars) of securities were held. The change in the value of securities held from December 31, 2008 was due to a weaker U.S. dollar versus the Canadian dollar.

As of December 31, 2009 and 2008, other than the Margin Funding Facilities referenced above, we no longer have outstanding liquidity facilities to Canadian ABCP conduits subject to the Montreal Accord or other agreements referenced. However, we hold \$10 million of long-term securities that were converted from a liquidity drawing which fell under the Montreal Accord restructuring agreement.

In addition to the facilities provided to ABCP conduits, we also provided a \$50 million liquidity facility to a third-party sponsored multi-seller structured investment vehicle (SIV) in 2009. See Note 26, Special Purpose Entities, in the accompanying consolidated financial statements for a fuller description of this SIV and our involvement. As of October 1, 2009, the assets of the existing SIV were transferred to a newly formed SIV in order to foreclose upon the assets within the existing SIV. The transfer occurred as the creditors received their respective share in the new SIV transaction by exchanging the current exposure for notes in the new trust. The notes, which are recorded as available for sale investment securities on our consolidated balance sheet, will accrue interest at a spread over LIBOR to be determined based upon the collections (contingent interest).

We have established and manage a number of constant net asset value (CNAV) money market funds that invest in shorter-dated highly-rated money market securities to provide investors with a highly liquid and secure investment. These funds price the assets in their portfolio on an amortized cost basis, which enables them to create and liquidate shares at a constant price. The funds, however, are not permitted to price their portfolios at amortized cost if that amount varies by more than 50 basis points from the portfolio's market value. In that case, the fund would be required to price its portfolio at market value and consequently would no longer be able to create or liquidate shares at a constant price. We do not consolidate the CNAV funds as they are not VIEs and we do not hold a majority voting interest.

Fair Value

Fair value measurement accounting principles require a reporting entity to take into consideration its own credit risk in determining the fair value of financial liabilities. The incorporation of our own credit risk accounted for an increase of \$310 million during 2009 as compared with a decrease of \$552 million in the fair value of financial liabilities during 2008.

Net income volatility arising from changes in either interest rate or credit components of the mark-to-market on debt designated at fair value and related derivatives affects the comparability of reported results between periods.

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Accordingly, the loss on debt designated at fair value and related derivatives during 2009 should not be considered indicative of the results for any future period.

Control Over Valuation Process and Procedures A control framework has been established which is designed to ensure that fair values are either determined or validated by a function independent of the risk-taker. To that end, the ultimate responsibility for the determination of fair values rests with Finance. Finance establishes policies and procedures to ensure appropriate valuations. For fair values determined by reference to external quotations on the identical or similar assets or liabilities, an independent price validation process is utilized. For price validation purposes, quotations from at least two independent pricing sources are obtained for each financial instrument, where possible. We consider the following factors in determining fair values:

similarities between the asset or the liability under consideration and the asset or liability for which quotation is received;

consistency among different pricing sources;

the valuation approach and the methodologies used by the independent pricing sources in determining fair value;

the elapsed time between the date to which the market data relates and the measurement date; and

the source of the fair value information.

Greater weight is given to quotations of instruments with recent market transactions, pricing quotes from dealers who stand ready to transact, quotations provided by market-makers who originally structured such instruments, and market consensus pricing based on inputs from a large number of participants. Any significant discrepancies among the external quotations are reviewed by management and adjustments to fair values are recorded where appropriate.

For fair values determined by using internal valuation techniques, valuation models and inputs are developed by the business and are reviewed, validated and approved by the Quantitative Risk and Valuation Group (QRVG) or other independent valuation control teams within Finance. Any subsequent material changes are reviewed and approved by the Valuation Committee which is comprised of representatives from the business and various control groups. Where available, we also participate in pricing surveys administered by external pricing services to validate our valuation models and the model inputs. The fair values of the majority of financial assets and liabilities are determined using well developed valuation models based on observable market inputs. The fair value measurements of these assets and liabilities require less judgment. However, certain assets and liabilities are valued based on proprietary valuation models that use one or more significant unobservable inputs and judgment is required to determine the appropriate level of adjustments to the fair value to address, among other things, model and input uncertainty. Any material adjustments to the fair values are reported to management.

Fair Value Hierarchy Fair value measurement accounting principles establish a fair value hierarchy structure that prioritizes the inputs to determine the fair value of an asset or liability (the Fair Value Framework). The Fair Value Framework distinguishes between inputs that are based on observed market data and unobservable inputs that reflect market participants' assumptions. It emphasizes the use of valuation methodologies that maximize observable market inputs. For financial instruments carried at fair value, the best evidence of fair value is a quoted price in an actively traded market (Level 1). Where the market for a financial instrument is not active, valuation techniques are used. The majority of our valuation techniques use market inputs that are either observable or indirectly derived from and

corroborated by observable market data for substantially the full term of the financial instrument (Level 2). Because Level 1 and Level 2 instruments are determined by observable inputs, less judgment is applied in determining their fair values. In the absence of observable market inputs, the financial instrument is valued based on valuation techniques that feature one or more significant unobservable inputs (Level 3). The determination of the level of fair value hierarchy within which the fair value measurement of an asset or a liability is classified often requires judgment and may change over time as market conditions evolve. We consider the following factors in developing the fair value hierarchy:

whether the asset or liability is transacted in an active market with a quoted market price;

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the level of bid-ask spreads;

a lack of pricing transparency due to, among other things, complexity of the product and market liquidity;

whether only a few transactions are observed over a significant period of time;

whether the pricing quotations vary substantially among independent pricing services;

whether inputs to the valuation techniques can be derived from or corroborated with market data; and

whether significant adjustments are made to the observed pricing information or model output to determine the fair value.

Level 1 inputs are unadjusted quoted prices in active markets that the reporting entity has the ability to access for identical assets or liabilities. A financial instrument is classified as a Level 1 measurement if it is listed on an exchange or is an instrument actively traded in the over-the-counter (OTC) market where transactions occur with sufficient frequency and volume. We regard financial instruments such as equity securities and derivative contracts listed on the primary exchanges of a country to be actively traded. Non-exchange-traded instruments classified as Level 1 assets include securities issued by the U.S. Treasury or by other foreign governments, to-be-announced (TBA) securities and non-callable securities issued by U.S. government sponsored entities.

Level 2 inputs are inputs that are observable either directly or indirectly but do not qualify as Level 1 inputs. We classify mortgage pass-through securities, agency and certain non-agency mortgage collateralized obligations, certain derivative contracts, asset-backed securities, corporate debt, preferred securities and leveraged loans as Level 2 measurements. Where possible, at least two quotations from independent sources are obtained based on transactions involving comparable assets and liabilities to validate the fair value of these instruments. Where significant differences arise among the independent pricing quotes and the internally determined fair value, we investigate and reconcile the differences. If the investigation results in a significant adjustment to the fair value, the instrument will be classified as Level 3 within the fair value hierarchy. In general, we have observed that there is a correlation between the credit standing and the market liquidity of a non-derivative instrument.

Level 2 derivative instruments are generally valued based on discounted future cash flows or an option pricing model adjusted for counterparty credit risk and market liquidity. The fair value of certain structured derivative products is determined using valuation techniques based on inputs derived from observable benchmark index tranches traded in the OTC market. Appropriate control processes and procedures have been applied to ensure that the derived inputs are applied to value only those instruments that share similar risks to the relevant benchmark indices and therefore demonstrate a similar response to market factors. In addition, a validation process has been established, which includes participation in peer group consensus pricing surveys, to ensure that valuation inputs incorporate market participants' risk expectations and risk premium.

Level 3 inputs are unobservable estimates that management expects market participants would use to determine the fair value of the asset or liability. That is, Level 3 inputs incorporate market participants' assumptions about risk and the risk premium required by market participants in order to bear that risk. We develop Level 3 inputs based on the best information available in the circumstances. As of December 31, 2009 and 2008, our Level 3 instruments included the following: collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs) for which there is a lack of pricing transparency due to market illiquidity, certain structured credit and structured equity derivatives where significant inputs (e.g., volatility or default correlations) are not observable, credit default swaps with certain

monoline insurers where the deterioration in the creditworthiness of the counterparty has resulted in significant adjustments to fair value, U.S. subprime mortgage loans and subprime related asset-backed securities, mortgage servicing rights, and derivatives referenced to illiquid assets of less desirable credit quality.

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Level 3 Measurements

The following table provides information about Level 3 assets/liabilities in relation to total assets/liabilities measured at fair value as of December 31, 2009 and 2008.

At December 31,	2009	2008
	(dollars are in millions)	
Level 3 assets ^{(1),(2)}	\$ 9,179	\$ 12,126
Total assets measured at fair value ⁽³⁾	111,231	192,324
Level 3 liabilities	3,843	2,845
Total liabilities measured at fair value ⁽¹⁾	74,120	158,710
Level 3 assets as a percent of total assets measured at fair value	8.3%	6.3%
Level 3 liabilities as a percent of total liabilities measured at fair value	5.2%	1.8%

(1) Presented without netting which allow the offsetting of amounts relating to certain contracts if certain conditions are met.

(2) Includes \$7.4 billion of recurring Level 3 assets and \$1.8 billion of non-recurring Level 3 assets at December 31, 2009 and \$10.7 billion of recurring Level 3 assets and \$1.5 billion of non-recurring Level 3 assets at December 31, 2008.

(3) Includes \$108.6 billion of assets measured on a recurring basis and \$2.7 billion of assets measured on a non-recurring basis at December 31, 2009 and \$189.8 billion of non-recurring Level 3 assets and \$2.6 billion of non-recurring Level 3 assets at December 31, 2008.

Material Changes in Fair Value for Level 3 Assets and Liabilities

Derivative Assets and Counterparty Credit Risk We have entered into credit default swaps with monoline insurers to hedge our credit exposure in certain asset-backed securities and synthetic CDOs. Beginning in 2007 and continuing into 2009, the creditworthiness of the monoline insurers had deteriorated significantly. However, in the second half of 2009, the deterioration previously experienced began to ease. As a result, we made a \$152 million and \$1,020 million negative credit risk adjustment to the fair value of our credit default swap contracts, which is reflected in trading revenue (loss) for 2009 and 2008, respectively. We have recorded a cumulative credit loss adjustment of \$713 million against our monoline exposure as of December 31, 2009.

Loans As of December 31, 2009 and 2008, we have classified \$793 million and \$1,278 million, respectively, of mortgage whole loans held for sale as a non-recurring Level 3 financial asset. These mortgage loans are accounted for on a lower of cost or fair value basis. Based on our assessment, we recorded a loss of \$233 million and \$556 million for such mortgage loans during 2009 and 2008, respectively. The changes in fair value are recorded as other revenues (losses) in the consolidated statement of income (loss).

Material Additions to and Transfers Into (Out of) Level 3 Measurements During 2009, we transferred \$634 million of mortgage and other asset-backed securities and \$345 million of corporate bonds from Level 2 to Level 3 as the

availability of observable inputs continued to decline. In addition, we transferred \$69 million of credit derivatives from Level 2 to Level 3.

In 2008 we transferred \$1.8 billion of Leveraged Super Senior (LSS) credit derivatives from Level 2 into Level 3 as the gap risk the possibility that the collateral posted is not sufficient to cover the replacement cost as the trade is unwound when the counterparty chooses not to post additional collateral. During 2008, we also transferred \$668 million of collateralized debt obligations and collateralized loan obligations as well as \$719 million of total return swaps from Level 2 to Level 3 due to market illiquidity and the significant degree of subjectivity involved in determining fair value. Additionally, during 2008 we transferred \$982 million of certain non-agency trading and available-for-sale residential mortgage backed securities from Level 2 to Level 3 because significant in puts to the valuation became unobservable, largely because of reduced levels of market liquidity. During 2008 certain hedge funds placed restrictions on redemptions from investors as the liquidity in hedge funds has narrowed which resulted in a transfer from Level 2 to Level 3 of \$148 million of investment in hedge funds.

See Note 28, Fair Value Measurements, in the accompanying consolidated financial statements for information on additions to and transfers into (out of) Level 3 measurements during 2009 and 2008 as well as for further details including the classification hierarchy associated with assets and liabilities measured at fair value.

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During the third quarter of 2009, we transferred \$353 million of auto finance loans to held for sale which were classified as non-recurring Level 3 assets. As of December 31, 2009 these auto finance loans were transferred to non-recurring Level 2 financial assets based on an external bid received and are accounted for on a lower of cost or fair value basis.

Credit Quality of Assets Underlying Asset-backed Securities

The following tables summarize the types and credit quality of the assets underlying our asset-backed securities as well as certain collateralized debt obligations and collateralized loan obligations held as of December 31, 2009:

Asset-backed securities backed by consumer finance collateral:***Credit quality of collateral:***

Year of issuance:	Total	Prime		Alt-A		Sub-prime		
		Prior to 2006	After 2006	Prior to 2006	After 2006	Prior to 2006	After 2006	
(in millions)								
Rating of securities:	Collateral type:							
AAA	Home equity loans	\$ 202	\$ -	\$ -	\$ 4	\$ 196	\$ 2	\$ -
	Auto loans	22	-	-	22	-	-	-
	Student loans	37	-	-	37	-	-	-
	Residential mortgages	1,024	37	-	583	6	398	-
	Commercial mortgages	559	-	-	84	475	-	-
	Not specified	24	-	-	24	-	-	-
	Total AAA	1,868	37	-	754	677	400	-
AA	Home equity loans	8	-	-	-	8	-	-
	Residential mortgages	78	-	-	78	-	-	-
	Total AA	86	-	-	78	8	-	-
A	Home equity loans	3	-	-	2	-	1	-
	Commercial mortgages	8	-	-	-	8	-	-
	Residential mortgages	102	15	-	12	69	-	6
	Total A	113	15	-	14	77	1	6
BBB	Home equity loans	150	-	-	5	145	-	-
	Residential mortgages	76	-	-	40	36	-	-
	Not specified	-	-	-	-	-	-	-
	Total BBB	226	-	-	45	181	-	-
BB	Residential mortgages	40	-	-	16	24	-	-

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	Home equity loans	22	-	-	-	21	1	-
	Total BB	62	-	-	16	45	1	-
B	Auto loans	43	-	-	43	-	-	-
	Residential mortgages	46	-	-	27	19	-	-
	Total B	89	-	-	70	19	-	-
		98						

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HSBC USA Inc.

Year of issuance:		Total	Prime		Alt-A		Sub-prime	
			Prior to 2006	After 2006	Prior to 2006	After 2006	Prior to 2006	After 2006
(in millions)								
CCC	Home equity loans	7	-	-	-	7	-	-
	Residential mortgages	398	-	-	34	364	-	-
	Total CCC	405	-	-	34	371	-	-
CC	Residential mortgages	16	-	-	-	16	-	-
	Home equity loans	-	-	-	-	-	-	-
	Total CC	16	-	-	-	16	-	-
C	Residential mortgages	25	-	-	-	25	-	-
D	Home equity loans	6	-	-	-	-	-	6
Unrated	Residential mortgages	9	-	-	5	4	-	-
		\$ 2,905	\$ 52	\$ -	\$ 1,016	\$ 1,423	\$ 402	\$ 12

Collateralized debt obligations (CDO) and collateralized loan obligations (CLO):

Credit quality of collateral:		Total	A or Higher		BBB	BB/B	CCC	Unrated
(in millions)								
Rating of securities:	Collateral type:							
AAA	Corporate loans	\$ 367	\$ -	\$ -	\$ 367	\$ -	\$ -	
	Commercial mortgages	202	-	-	144	58	-	
	Trust preferred	190	-	190	-	-	-	
	Aircraft leasing	72	-	-	-	-	72	
	Others	-	-	-	-	-	-	
		831	\$ -	\$ 190	\$ 511	\$ 58	\$ 72	
	Total asset-backed securities	\$ 3,736						

Effect of Changes in Significant Unobservable Inputs The fair value of certain financial instruments is measured using valuation techniques that incorporate pricing assumptions not supported by, derived from or corroborated by observable market data. The resultant fair value measurements are dependent on unobservable input parameters which can be selected from a range of estimates and may be interdependent. Changes in one or more of the significant unobservable input parameters may change the fair value measurements of these financial instruments. For the purpose of preparing the financial statements, the final valuation inputs selected are based on management's best judgment that reflect the assumptions market participants would use in pricing similar assets or liabilities.

The unobservable input parameters selected are subject to the internal valuation control processes and procedures. When we perform a test of all the significant input parameters to the extreme values within the range at the same time, it could result in an increase of the overall fair value measurement of approximately \$451 million or a decrease of the overall fair value measurement of approximately \$313 million as of December 31, 2009. The effect of changes in significant unobservable input parameters are primarily driven by mortgage whole loans held for sale or securitization, certain asset-backed securities including CDOs, and the uncertainty in determining the fair value of credit derivatives executed against monoline insurers.

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HSBC USA Inc.

Risk Management

Overview Some degree of risk is inherent in virtually all of our activities. For the principal activities undertaken, the following are considered to be the most important types of risks:

Credit risk is the potential that a borrower or counterparty will default on a credit obligation, as well as the impact on the value of credit instruments due to changes in the probability of borrower default.

Liquidity risk is the potential that an institution will be unable to meet its obligations as they become due or fund its customers because of inadequate cash flow or the inability to liquidate assets or obtain funding itself.

Interest rate risk is the potential impairment of net interest income due to mismatched pricing between assets and liabilities.

Market risk is the potential for losses in daily mark to market positions (mostly trading) due to adverse movements in money, foreign exchange, equity or other markets and includes both interest rate risk and trading risk.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events (including legal and compliance risk but excluding strategic and reputational risk)

Fiduciary risk is the risk associated with offering services honestly and properly to clients in a fiduciary capacity in accordance with Regulation 12 CFR 9, Fiduciary Activity of National Banks.

Reputational risk involves the safeguarding of our reputation and can arise from social, ethical or environmental issues, or as a consequence of operational and other risk events.

Strategic risk is the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions.

The objective of our risk management system is to identify, measure, monitor and manage risks so that:

potential costs can be weighed against the expected rewards from taking the risks;

appropriate disclosures can be made to all concerned parties;

adequate protections, capital and other resources can be put in place to weather all significant risks; and

compliance with all relevant laws, regulations and regulatory requirements is ensured through staff education, adequate processes and controls, and ongoing monitoring efforts.

For all risk types, there are independent risk specialists that set standards, develop new risk methodologies, maintain central risk databases and conduct reviews and analysis. For instance, the Chief Risk Officer and the Executive Vice President for Compliance provide day-to-day oversight of these types of risk management activities within their respective areas and work closely with internal audit and other senior risk specialists at HSBC North America and HSBC. Market risk is managed by the HSBC North America Head of Market Risk. Operational risk is decentralized

and is the responsibility of each business and support unit under the direction of the HSBC North America Head of Operational Risk. Compliance risk is managed both on a decentralized basis, with staff who are aligned with and advise each business segment, as well as with an increasing level of centralized compliance services. This formal independent compliance function is under the direction of the HSBC North America Head of Legal and Compliance.

Historically, our approach toward risk management has emphasized a culture of business line responsibility combined with central requirements for diversification of customers and businesses. Our risk management policies are primarily carried out in accordance with practice and limits set by the HSBC Group Management Board, which consists of senior executives throughout the HSBC organization. As such, extensive centrally determined requirements for controls, limits, reporting and the escalation of issues have been detailed in our policies and procedures.

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HSBC USA Inc.

As a result of an increasingly complex business environment, increased regulatory scrutiny, and the evolution of improved risk management tools and standards, we have significantly upgraded, and continue to upgrade, our methodologies and systems. New practices and techniques have been developed that involve data development, modeling, simulation and analysis, management information systems development, self-assessment, and staff education programs.

In the course of our regular risk management activities, we use simulation models to help quantify the risk we are taking. The output from some of these models is included in this section of our filing. By their nature, models are based on various assumptions and relationships. We believe that the assumptions used in these models are reasonable, but events may unfold differently than what is assumed in the models. In actual stressed market conditions, these assumptions and relationships may no longer hold, causing actual experience to differ significantly from the results predicted in the model. Consequently, model results may be considered reasonable estimates, with the understanding that actual results may vary significantly from model projections.

Risk management oversight begins with our Board of Directors and its various committees, principally the Audit Committee. Management oversight is provided by corporate and business unit risk management committees with the participation of the Chief Executive Officer or her staff. An HSBC USA Risk Management Committee, chaired by the Chief Executive Officer, focuses on the management of all risks within HUSI including, but not limited to, credit, market, liquidity, operational, information technology, reputational and compliance risks as well as risks associated with our balance sheet.

In the first quarter of 2009, significant steps were taken to further strengthen our risk management organization, including the appointment of an HSBC North America Holdings Inc. Chief Risk Officer, who also serves as the HUSI Chief Risk Officer and the creation of a distinct, cross-disciplinary risk organization and integrated risk function. Additionally, a distinct position for an HSBC North America Holdings Anti-Money Laundering (AML) Director was established and the Director was appointed in the fourth quarter of 2009. He has also been appointed as the designated Anti-Money Laundering Director and Bank Secrecy Act Compliance Officer for HUSI. Specific oversight of various risk management processes is provided by the Risk Management Committee, with the assistance of the following principal HSBC USA subcommittees:

the Asset and Liability Policy Committee (ALCO);

the Fiduciary Risk Committee; and

the Operational Risk and Internal Control Committee.

Also in 2009, additional steps were taken to further strengthen our risk management framework through the formation of a number of specialized cross-functional North America risk management subcommittees, including the Risk Management Review Meeting, Operational Risk and Internal Control Committee, Credit Risk Analytics Oversight Committee, Capital Management Review Meeting, and Stress Testing and Scenario Oversight Committee.

While the charters of the Risk Management Committee and each sub-committee were tailored to reflect the roles and responsibilities of each committee, they all had the following common themes:

defining risk appetites, policies and limits;

monitoring and assessing exposures, trends and the effectiveness of risk management;

reporting to the Board of Directors; and

promulgating a suitable risk taking, risk management and compliance culture.

Oversight of all liquidity, interest rate and market risk is provided by ALCO which is chaired by the Chief Financial officer. Subject to the approval of our Board of Directors and HSBC, ALCO sets the limits of acceptable risk, monitors the adequacy of the tools used to measure risk and assesses the adequacy of reporting. In managing these risks, we seek to protect both our income stream and the value of our assets. ALCO also conducts contingency planning with regard to liquidity.

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Economic Capital (EC) is defined as the amount of capital required to sustain a business through a complete business cycle, enabling the business to absorb unexpected losses and thereby limit the probability of insolvency. As part of its ICAAP, HNAH and HBUS have developed an inventory of risks that we are subject to, and have established processes for quantifying those risks where possible. The quantified risks comprise economic capital, and include credit risk, operational risk, market risk, interest rate risk, pension risk, refinance risk, insurance risk and model risk. Economic capital is calibrated to calculate losses over a one year time horizon at a confidence level of 99.95%. The confidence level is consistent with HSBC USA's target rating of AA-, as AA-rated credits have historically defaulted at a rate of about .05% per year. The one year time horizon is consistent with traditional planning and budgeting time horizons.

Regulatory capital requirements are based on the amount of capital held, as defined by regulations, and the amount of risk weighted assets, also calculated based on regulatory definitions. Economic capital is a proprietary measure of risk, calculated on a basis tailored to the risks incurred. Quarterly, Economic Capital is compared to a calculation of available capital resources to assess capital adequacy as part of the ICAAP. In addition, Risk Adjusted Return On Economic Capital (RAROC) is computed for HUSI businesses on a quarterly basis, to allow for a comparison of return on risk.

In December 2007, U.S. regulators published a final rule regarding Risk-Based Capital Standards. This final rule represents the U.S. adoption of the Basel II Capital Accord. The final rule became effective April 1, 2008 and requires us to adopt its provisions no later than April 1, 2011. Final adoption must be preceded by a parallel run period of at least four quarters. We expect to begin a parallel run in 2010.

In addition, we continue to support the HSBC Group implementation of the Basel II framework, as adopted by the Financial Services Authority (FSA). Data regarding credit risk, operational risk, and market risk is supplied to support the Group's regulatory capital and risk weighted asset calculations.

Credit Risk Management

Credit risk is the potential that a borrower or counterparty will default on a credit obligation, as well as the impact on the value of credit instruments due to changes in the probability of borrower default.

Credit risk is inherent in various on- and off-balance sheet instruments and arrangements, such as:

loan portfolios;

investment portfolios;

unfunded commitments such as letters of credit and lines of credit that customers can draw upon; and

treasury instruments, such as interest rate swaps which, if more valuable today than when originally contracted, may represent an exposure to the counterparty to the contract.

While credit risk exists widely in our operations, diversification among various commercial and consumer portfolios helps to lessen risk exposure. Day-to-day management of credit and market risk is performed by the Chief Credit Officer, the HSBC North America Chief Retail Credit Officer and the Head of Market Risk, who report directly to the HSBC North America Chief Risk Officer and maintain independent risk functions. The credit risk associated with commercial portfolios is managed by the Chief Credit Officer, while credit risk associated with retail consumer loan

portfolios, such as credit cards, installment loans and residential mortgages, is managed by the HSBC North America Chief Retail Credit Officer. Further discussion of credit risk can be found under the Credit Quality caption in this MD&A.

Our credit risk management procedures are designed for all stages of economic and financial cycles, including the current protracted and challenging period of market volatility and economic downturn. The credit risk function continues to refine early warning indicators and reporting, including stress testing scenarios on the basis of current experience. These risk management tools are embedded within our business planning process. Action has been taken, where necessary, to improve our resilience to risks associated with the current market conditions by

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selectively discontinuing business lines or products, tightening underwriting criteria and investing in improved fraud prevention technologies.

The responsibilities of the credit risk function include:

Formulating credit risk policies - Our policies are designed to ensure that various retail and commercial business units operate within clear standards of acceptable credit risk. Our policies ensure that the HSBC standards are consistently implemented across all businesses and that all regulatory requirements are also considered. Credit policies are reviewed and approved annually by the Audit Committee.

Approving new credit exposures and independently assessing large exposures annually - The Chief Credit Officer delegates credit authority to our various lending units. However, most large credits are reviewed and approved centrally through a dedicated Credit Approval Unit that reports directly to the Chief Credit Officer. In addition, the Chief Credit Officer coordinates the approval of material credits with HSBC Group Credit Risk which, subject to certain agreed-upon limits, will review and concur on material new and renewal transactions.

Overseeing retail credit risk - The HSBC North America Chief Retail Credit Officer manages the credit risk associated with retail portfolios and is supported by expertise from a dedicated advanced risk analytics unit.

Maintaining and developing the governance and operation of the commercial risk rating system - A two-dimensional credit risk rating system is utilized in order to categorize exposures meaningfully and enable focused management of the risks involved. This ratings system is comprised of a 22 category Customer Risk Rating, which considers the probability of default of an obligor and a separate assessment of a transaction's potential loss given default. Each credit grade has a probability of default estimate. Rating methodologies are based upon a wide range of analytics and market data-based tools, which are core inputs to the assessment of counterparty risk. Although automated risk rating processes are increasingly used, for larger facilities the ultimate responsibility for setting risk grades rests in each case with the final approving executive. Risk grades are reviewed frequently and amendments, where necessary, are implemented promptly.

Measuring portfolio credit risk - Over the past few years, the advanced credit ratings system has been used to implement a credit economic capital risk measurement system to measure the risk in our credit portfolios, using the measure in certain internal and Board of Directors reporting. Simulation models are used to determine the amount of unexpected losses, beyond expected losses, that we must be prepared to support with capital given our targeted debt rating. Quarterly credit economic capital reports are generated and reviewed with management and the business units. Efforts continue to refine both the inputs and assumptions used in the credit economic capital model to increase its usefulness in pricing and the evaluation of large and small commercial and retail customer portfolio products and business unit return on risk.

Monitoring portfolio performance - A credit data warehouse has been implemented to centralize the reporting of its credit risk, support the analysis of risk using tools such as economic capital, and to calculate its credit loss reserves. This data warehouse also supports HSBC's wider effort to meet the requirements of Basel II and to generate credit reports for management and the Board of Directors.

Establishing counterparty and portfolio limits - We monitor and limit our exposure to individual counterparties and to the combined exposure of related counterparties. In addition, selected industry portfolios, such as real estate and structured products, are subject to caps that are established by the Chief Credit Officer and reviewed where appropriate by management committees and the Board of Directors. Counterparty credit exposure

related to derivative activities is also managed under approved limits. Since the exposure related to derivatives is variable and uncertain, internal risk management methodologies are used to calculate the 95% worst-case potential future exposure for each customer. These methodologies take into consideration, among other factors, cross-product close-out netting, collateral received from customers under Collateral Support Annexes (CSAs), termination clauses, and off-setting positions within the portfolio.

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Managing problem commercial loans - Special attention is paid to problem loans. When appropriate, our commercial Special Credits Unit and retail Default Services teams provide customers with intensive management and control support in order to help them avoid default wherever possible and maximize recoveries.

Establishing allowances for credit losses - The Chief Credit Officer and the HSBC North America Chief Retail Credit Officer share responsibility with the Chief Financial Officer for establishing appropriate levels of allowances for credit losses inherent in various loan portfolios.

A Credit Review and Risk Identification (CRRI) function is also in place in HSBC North America to identify and assess credit risk. The CRRI function consists of a Wholesale and Retail Credit Review function as well as functions responsible for the independent assessment of Wholesale and Retail models. The Credit Review function provides an ongoing independent assessment of credit risk, the quality of credit risk management and in the case of wholesale credit risk, the accuracy of individual credit risk ratings. The Credit Review functions independently and holistically assess the business units and risk management functions to ensure the business is operating in a manner that is consistent with HSBC Group strategy and appropriate local and HSBC Group credit policies, procedures and applicable regulatory guidelines. The Credit Risk Review functions examine asset quality, credit processes and procedures, as well as the risk management infra-structures in each commercial and retail lending unit. Selective capital markets based functions are included within this scope. Beginning in 2010, CRRI also independently assesses the retail and wholesale credit risk models to determine if they are fit for purpose and consistent with regulatory requirements and HSBC Group Policy.

Liquidity Risk Management Liquidity risk is the risk that an institution will be unable to meet its obligations as they become due or fund its customers because of an inability to liquidate assets or obtain adequate funding. We have been continuously monitoring the impact of market events on our liquidity positions. In general terms, the strains due to the credit crisis have been concentrated in the wholesale market as opposed to the retail market (the latter being the market from which we source core demand and time deposit accounts). Financial institutions with less reliance on the wholesale markets were in many respects less affected by the recent conditions. Our limited dependence upon the wholesale markets for funding has been a significant competitive advantage through the recent period of financial market turmoil. The liquidity framework as described in detail below will continue to adapt as we assimilate further knowledge from the recent disruptions in the marketplace.

Liquidity is managed to provide the ability to generate cash to meet lending, deposit withdrawal and other commitments at a reasonable cost in a reasonable amount of time, while maintaining routine operations and market confidence. Market funding is planned in conjunction with HSBC Finance and HSBC, as the markets increasingly view debt issuances from the separate companies within the context of their common parent company. Liquidity management is performed at both HSBC USA and HSBC Bank USA. Each entity is required to have sufficient liquidity for a crisis situation. ALCO is responsible for the development and implementation of related policies and procedures to ensure that the minimum liquidity ratios and a strong overall liquidity position are maintained.

In carrying out this responsibility, ALCO projects cash flow requirements and determines the level of liquid assets and available funding sources to have at our disposal, with consideration given to anticipated deposit and balance sheet growth, contingent liabilities, and the ability to access wholesale funding markets. Our liquidity management approach includes increased deposits, potential sales (e.g. residential mortgage loans), and securitizations/conduits (e.g. credit cards) in liquidity contingency plans. In addition, ALCO monitors the overall mix of deposit and funding concentrations to avoid undue reliance on individual funding sources and large deposit relationships. It must also maintain a liquidity management and contingency funding plan, which identifies certain potential early indicators of

liquidity problems, and actions that can be taken both initially and in the event of a liquidity crisis, to minimize the long-term impact on our businesses and customer relationships. In the event of a cash flow crisis, our objective is to fund cash requirements without access to the wholesale unsecured funding market for at least one year. Contingency funding needs will be satisfied primarily through the sale of the investment portfolio and liquidation of the residential mortgage portfolio. Securities may be sold or used as collateral in a repurchase agreement depending on the scenario. Portions of the mortgage portfolio may be sold, securitized, or used for collateral at the FHLB to increase borrowings.

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Given our overall liquidity position, during 2009, we have managed down low margin commercial and institutional deposits in order to maximize profitability.

Our ability to regularly attract wholesale funds at a competitive cost is enhanced by strong ratings from the major credit ratings agencies. At December 31, 2009, we and HSBC Bank USA maintained the following long and short-term debt ratings:

	Moody's	S&P	Fitch	DBRS⁽¹⁾
HSBC USA Inc.:				
Short-term borrowings	P-1	A-1+	F1+	R-1
Long-term debt	A1	AA-	AA	AA
HSBC Bank USA:				
Short-term borrowings	P-1	A-1+	F1+	R-1
Long-term debt	Aa3	AA	AA	AA

⁽¹⁾ Dominion Bond Rating Service.

In January 2009, Fitch, Inc. affirmed our debt ratings, however our outlook was changed from stable to negative. In March 2009, Moody's Investors Services (Moody's) downgraded the long-term debt ratings of both HSBC USA and HSBC Bank USA by one level to A1 and Aa3, respectively and reaffirmed the short-term ratings for each entity at Prime-1. Moody's also changed their outlook for both entities from stable to negative. In April 2009, DBRS re-affirmed the long and short-term debt ratings of HSBC USA and HSBC Bank USA at AA and R-1, respectively, with a negative outlook. In August 2009, Standard and Poor's re-affirmed the long-term and short-term debt ratings of both HSBC USA and HSBC Bank USA at AA-/A-1+ (HSBC USA) and AA/A-1+ (HSBC Bank USA).

Numerous factors, internal and external, may impact access to and costs associated with issuing debt in the global capital markets. These factors include our debt ratings, overall economic conditions, overall capital markets volatility and the effectiveness of the management of credit risks inherent in our customer base.

Cash resources, short-term investments and a trading asset portfolio are available to provide highly liquid funding for us. Additional liquidity is provided by available for sale debt securities. Approximately \$76 million of debt securities in this portfolio at December 31, 2009 are expected to mature in 2010. The remaining \$26.5 billion of debt securities not expected to mature in 2010 are available to provide liquidity by serving as collateral for secured borrowings, or if needed, by being sold. Further liquidity is available through our ability to sell or securitize loans in secondary markets through whole-loan sales and securitizations. In 2009, we sold residential mortgage loans of approximately \$4.5 billion.

The economics and long-term business impact of obtaining liquidity from assets must be weighed against the economics of obtaining liquidity from liabilities, along with consideration given to the associated capital ramifications of these two alternatives. Currently, assets would be used to supplement liquidity derived from liabilities only in a crisis scenario.

It is the policy of HSBC Bank USA to maintain both primary and secondary collateral in order to ensure precautionary borrowing availability from the Federal Reserve. Primary collateral is collateral that is physically maintained at the Federal Reserve, and serves as a safety net against any unexpected funding shortfalls that may occur. Secondary collateral is collateral that is acceptable to the Federal Reserve, but is not maintained there. If unutilized borrowing capacity were to be low, secondary collateral would be identified and maintained as necessary. Further liquidity is available from the Federal Home Loan Bank of New York. As of December 31, 2009, we had outstanding advances of \$1.0 billion. We have access to further borrowings based on the amount of mortgages and securities pledged as collateral to the FHLB.

As of December 31, 2009, dividends from HSBC Bank USA to us would require the approval of the OCC, in accordance with 12 USC 60. See Note 25 Retained Earnings and Regulatory Capital Requirements of the

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consolidated financial statements for further details. In determining the extent of dividends to pay, HSBC Bank USA must also consider the effect of dividend payments on applicable risk-based capital and leverage ratio requirements, as well as policy statements of federal regulatory agencies that indicate that banking organizations should generally pay dividends out of current operating earnings.

We filed a shelf registration statement with the Securities and Exchange Commission in April 2009, under which we may issue debt securities, preferred stock, either separately or represented by depositary shares, warrants, purchase contracts and units. We satisfy the eligibility requirements for designation as a well-known seasoned issuer, which allows us to file a registration statement that does not have a limit on issuance capacity. The ability to issue debt under the registration statement is limited by the debt issuance authority granted by the Board. We are currently authorized to issue up to \$15 billion, of which \$6.3 billion is available. During 2009, we issued \$2.0 billion of senior debt from this shelf.

HSBC Bank USA has a \$40 billion Global Bank Note Program, which provides for issuance of subordinated and senior notes. Borrowings from the Global Bank Note Program totaled \$0.6 billion in 2009, all of which was senior debt. There is approximately \$19.8 billion of availability remaining on a cumulative basis.

At December 31, 2009, we also had a \$2.5 billion back-up credit facility with HSBC Bank plc for issuances of commercial paper.

Interest Rate Risk Management Interest rate risk is the potential impairment of net interest income due to mismatched pricing between assets and liabilities. We are subject to interest rate risk associated with the repricing characteristics of our balance sheet assets and liabilities. Specifically, as interest rates change, amounts of interest earning assets and liabilities fluctuate, and interest earning assets reprice at intervals that do not correspond to the maturities or repricing patterns of interest bearing liabilities. This mismatch between assets and liabilities in repricing sensitivity results in shifts in net interest income as interest rates move. To help manage the risks associated with changes in interest rates, and to manage net interest income within ranges of interest rate risk that management considers acceptable, we use derivative instruments such as interest rate swaps, options, futures and forwards as hedges to modify the repricing characteristics of specific assets, liabilities, forecasted transactions or firm commitments. Day-to-day management of interest rate is centralized principally under the Treasurer.

We have substantial, but historically well controlled, interest rate risk in large part as a result of our portfolio of residential mortgages and mortgage backed securities, which consumers can prepay without penalty, and our large base of demand and savings deposits. These deposits can be withdrawn by consumers at will, but historically they have been a stable source of relatively low cost funds. Market risk exists principally in treasury businesses and to a lesser extent in the residential mortgage business where mortgage servicing rights and the pipeline of forward mortgage sales are hedged. We have little foreign currency exposure from investments in overseas operations, which are limited in scope. Total equity investments, excluding stock owned in the Federal Reserve and New York Federal Home Loan Bank, represent less than one percent of total available-for-sale securities.

The following table shows the repricing structure of assets and liabilities as of December 31, 2009. For assets and liabilities whose cash flows are subject to change due to movements in interest rates, such as the sensitivity of mortgage loans to prepayments, data is reported based on the earlier of expected repricing or maturity and reflects anticipated prepayments based on the current rate environment. The resulting gaps are reviewed to assess the

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potential sensitivity to earnings with respect to the direction, magnitude and timing of changes in market interest rates. Data shown is as of year end, and one-day figures can be distorted by temporary swings in assets or liabilities.

December 31, 2009	Within One Year	After One But Within Five Years	After Five But Within Ten Years	After Ten Years	Total
	(in millions)				
Commercial loans	\$ 29,132	\$ 1,780	\$ 458	\$ 60	\$ 31,430
Residential mortgages	11,797	4,381	1,802	1,292	19,272
Private label	11,854	3,237	-	-	15,091
Credit card receivables	11,701	1,346	1	-	13,048
Auto finance	466	1,588	-	-	2,054
Other consumer loans	883	324	253	42	1,502
Total loans⁽¹⁾	65,833	12,656	2,514	1,394	82,397
Securities available-for-sale and securities held to maturity	3,220	13,212	6,047	8,089	30,568
Other assets	54,434	2,829	851	-	58,114
Total assets	123,487	28,697	9,412	9,483	171,079
Domestic deposits ⁽²⁾ :					
Savings and demand	48,686	13,335	9,965	-	71,986
Certificates of deposit	10,697	801	117	46	11,661
Long-term debt	12,455	3,963	565	1,025	18,008
Other liabilities/equity	60,091	8,810	-	523	69,424
Total liabilities and equity	131,929	26,909	10,647	1,594	171,079
Total balance sheet gap	(8,442)	1,788	(1,235)	7,889	-
Effect of derivative contracts	(402)	500	34	(132)	-
Total gap position	\$ (8,844)	\$ 2,288	\$ (1,201)	\$ 7,757	\$ -

(1) Includes loans held for sale.

(2) Does not include purchased or wholesale deposits. For purposes of this table purchased and wholesale deposits are reflected in Other liabilities/equity .

Various techniques are utilized to quantify and monitor risks associated with the repricing characteristics of our assets, liabilities and derivative contracts.

In the course of managing interest rate risk, a present value of a basis point (PVBP) analysis is utilized in conjunction with a combination of other risk assessment techniques, including economic value of equity, dynamic simulation modeling, capital risk and Value at Risk (VAR) analyses. The combination of these tools enables management to identify and assess the potential impact of interest rate movements and take appropriate action. This combination of techniques, with some focusing on the impact of interest rate movements on the value of the balance sheet (PVBP, economic value of equity, VAR) and others focusing on the impact of interest rate movements on earnings (dynamic simulation modeling) allows for comprehensive analyses from different perspectives. Discussion of the use of VAR analyses to monitor and manage interest rate and other market risks is included in the discussion of market risk management below.

A key element of managing interest rate risk is the management of the convexity of the balance sheet, largely resulting from the mortgage related products on the balance sheet. Convexity risk arises as mortgage loan consumers change their behavior significantly in response to large movements in market rates, but do not change behavior appreciably for smaller changes in market rates. Certain of the interest rate management tools described

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below, such as dynamic simulation modeling and economic value of equity, better capture the embedded convexity in the balance sheet, while measures such as PVBP are designed to capture the risk of smaller changes in rates.

Refer to *Market Risk Management* for discussion regarding the use of VAR analyses to monitor and manage interest rate risk.

The assessment techniques discussed below act as a guide for managing interest rate risk associated with balance sheet composition and off-balance sheet hedging strategy (the risk position). Calculated values within limit ranges reflect an acceptable risk position, although possible future unfavorable trends may prompt adjustments to on or off-balance sheet exposure. Calculated values outside of limit ranges will result in consideration of adjustment of the risk position, or consideration of temporary dispensation from making adjustments.

Present value of a basis point is the change in value of the balance sheet for a one basis point upward movement in all interest rates. The following table reflects the PVBP position at December 31, 2009 and 2008.

At December 31,	2009	2008
	(in millions)	
Institutional PVBP movement limit	\$ 6.5	\$ 6.5
PVBP position at period end	0.5	4.3

Economic value of equity is the change in value of the assets and liabilities (excluding capital and goodwill) for either a 200 basis point immediate rate increase or decrease. The following table reflects the economic value of equity position at December 31, 2009 and 2008.

At December 31,	2009	2008
	(values as a percentage)	
Institutional economic value of equity limit	+/-20	+/-20
Projected change in value (reflects projected rate movements on January 1, 2010):		
Change resulting from an immediate 200 basis point increase in interest rates	(4)	(2)
Change resulting from an immediate 200 basis point decrease in interest rates	(3)	(18)

The loss in value for a 200 basis point increase or decrease in rates is a result of the negative convexity of the residential whole loan and mortgage backed securities portfolios. If rates decrease, the projected prepayments related to these portfolios will accelerate, causing less appreciation than a comparable term, non-convex instrument. If rates increase, projected prepayments will slow, which will cause the average lives of these positions to extend and result in a greater loss in market value. The level of convexity in the balance sheet was reduced in 2009 due to a reduction in residential whole loan levels and a restructuring of the investment portfolio.

Dynamic simulation modeling techniques are utilized to monitor a number of interest rate scenarios for their impact on net interest income. These techniques include both rate shock scenarios, which assume immediate market rate movements by as much as 200 basis points, as well as scenarios in which rates rise or fall by as much as 200 basis

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points over a twelve month period. The following table reflects the impact on net interest income of the scenarios utilized by these modeling techniques.

At December 31, 2009	Amount	%
	(dollars are in millions)	
Projected change in net interest income (reflects projected rate movements on January 1, 2010):		
Institutional base earnings movement limit		(10)
Change resulting from a gradual 100 basis point increase in the yield curve	\$ 17	-
Change resulting from a gradual 100 basis point decrease in the yield curve	(65)	(1)
Change resulting from a gradual 200 basis point increase in the yield curve	5	-
Change resulting from a gradual 200 basis point decrease in the yield curve	(105)	(2)
Other significant scenarios monitored (reflects projected rate movements on January 1, 2010):		
Change resulting from an immediate 100 basis point increase in the yield curve	20	-
Change resulting from an immediate 100 basis point decrease in the yield curve	(95)	(2)
Change resulting from an immediate 200 basis point increase in the yield curve	(14)	-
Change resulting from an immediate 200 basis point decrease in the yield curve	(179)	(3)

The projections do not take into consideration possible complicating factors such as the effect of changes in interest rates on the credit quality, size and composition of the balance sheet. Therefore, although this provides a reasonable estimate of interest rate sensitivity, actual results will vary from these estimates, possibly by significant amounts.

Capital Risk/Sensitivity of Other Comprehensive Income Large movements of interest rates could directly affect some reported capital balances and ratios. The mark-to-market valuation of available-for-sale securities is credited on a tax effective basis to accumulated other comprehensive income. Although this valuation mark is excluded from Tier 1 and Tier 2 capital ratios, it is included in two important accounting based capital ratios: the tangible common equity to tangible assets and the tangible common equity to risk weighted assets. As of December 31, 2009, we had an available-for-sale securities portfolio of approximately \$27.8 billion with a net negative mark-to-market of \$235 million included in tangible common equity of \$11.1 billion. An increase of 25 basis points in interest rates of all maturities would lower the mark to market by approximately \$248 million to a net loss of \$483 million with the following results on the tangible capital ratios.

At December 31, 2009	Actual	Proforma⁽¹⁾
Tangible common equity to tangible assets	6.60%	6.40%
Tangible common equity to risk weighted assets	8.26	8.00

⁽¹⁾ Proforma percentages reflect a 25 basis point increase in interest rates.

Market Risk Management 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 HSBC's income or the value of

its portfolios. 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 marked-to-market positions so designated. Non-trading portfolios primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments classified as available-for-sale and held to maturity. We use a range of tools to monitor and manage market risk exposures. These include sensitivity analysis, VAR and stress testing.

Sensitivity analysis Sensitivity measures are used to monitor the market risk positions within each risk type, for example, PVBP movement in interest rates for interest rate risk. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at Risk Overview VAR analysis is used to estimate the maximum potential loss 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

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confidence. VAR calculations are performed for all material trading activities and as a tool for managing interest rate risk inherent in non-trading activities. VAR is calculated daily for a one-day holding period to a 99 percent confidence level.

The VAR models are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rate and price changes, and applies these to their current rates and prices. The model also incorporates the effect of option features on the underlying exposures. The historical simulation models used by us incorporate the following features:

market movement scenarios are derived with reference to data from the past two years;

scenario profit and losses are calculated with the derived market scenarios for foreign exchange rates and commodity prices, interest rates, credit spreads equity prices, volatilities; and

VAR is calculated to a 99 percent confidence level for a one-day holding period.

We routinely validate the accuracy of our VAR models by back-testing the actual daily profit and loss results, adjusted to remove non-modeled items such as fees and commissions and intraday trading, against the corresponding VAR numbers. Statistically, we would expect to see losses in excess of VAR only one percent of the time. The number of backtesting breaches in a period is used to assess how well the model is performing and, occasionally, new parameters are evaluated and introduced to improve the models fit. Although a valuable guide to risk, VAR must always be viewed in the context of its limitations.

That is:

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 the risks offset in one day. This 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 fully hedge all positions;

the use of a 99 percent 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 recognition of the limitations of VAR, we complement VAR with stress testing to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. Stress testing is performed at a portfolio level, as well as on the consolidated positions of the Group, and covers the following scenarios:

Sensitivity scenarios, which consider the impact of market moves to any single risk factor or a set of factors. For example the impact resulting from a break of a currency peg that will not be captured within the VAR

models;

Technical scenarios, which consider the largest move in each risk factor, without consideration of any underlying market correlation;

Hypothetical scenarios, which consider potential macro economic events; and

Historical scenarios, which incorporate historical observations of market moves during previous periods of stress which would not be captured within VAR.

Stress testing is governed by the Stress Testing Review Group forum that coordinates the Group stress testing scenarios in conjunction with the regional risk managers. Consideration is given to the actual market risk exposures, along with market events in determining the stress scenarios.

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Stress testing results are reported to senior management and provide them with an assessment of the financial impact such events would have on our profits.

The years preceding the current market turmoil were characterized by historically low levels of volatility, with ample market liquidity. This period was associated with falling levels of VAR as the level of observed market volatility is a key determinant in the VAR calculation. The increase in market volatility throughout 2008 and into 2009 was most noticeable in the credit spreads of financial institutions and asset backed securities (ABSs) and mortgage backed securities (MBSs). The increase in the volatility of credit spreads reflected the market's continued uncertainty with respect to the exposure of financial institutions to the U.S. subprime market, either directly or through structured products, and spread to more concerns about the wider economy. The tightening of both credit and liquidity within the wholesale markets prompted remedial action from the central banks, which included injecting liquidity into the wholesale markets, taking equity stakes and cutting rates. Macro economic uncertainty also fed through into increases in volatility in other risk types such as interest rates and foreign exchange prices.

The major contributor to the trading and non-trading VAR for us was our Global Banking and Markets operations.

VAR Trading Activities Our management of market risk is based on a policy of restricting individual operations to trading within a list of permissible instruments authorized, enforcing new product approval procedures and restricting trading in the more complex derivative products to offices with appropriate levels of product expertise and robust control systems. Market making and proprietary position-taking is undertaken within Global Banking and Markets.

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques, including VAR and a variety of interest rate risk monitoring techniques as discussed above. These techniques quantify the impact on capital of defined market movements.

Trading portfolios reside primarily within the Markets unit of the Global Banking and Markets business segment, which include warehoused residential mortgage loans purchased with the intent of selling them, and within the mortgage banking subsidiary included within the PFS business segment. Portfolios include foreign exchange, interest rate swaps and credit derivatives, precious metals (i.e. gold, silver, platinum), equities and money market instruments including repos and securities. Trading occurs as a result of customer facilitation, proprietary position taking and economic hedging. In this context, economic hedging may include, forward contracts to sell residential mortgages and derivative contracts which, while economically viable, may not satisfy the hedge accounting requirements.

The trading portfolios have defined limits pertaining to items such as permissible investments, risk exposures, loss review, balance sheet size and product concentrations. Loss review refers to the maximum amount of loss that may be incurred before senior management intervention is required.

The following table summarizes trading VAR for 2009:

	December 31, 2009	Minimum	Full Year 2009 Maximum	Average	December 31, 2008
	(in millions)				
Total trading	\$ 38	\$ 34	\$ 120	\$ 67	\$ 52
Equities	-	-	2	1	1

Foreign exchange	2	1	10	3	2
Interest rate directional and credit spread	33	27	82	47	44

The following table summarizes the frequency distribution of daily market risk-related revenues for Treasury trading activities during calendar year 2009. Market risk-related Treasury trading revenues include realized and unrealized gains (losses) related to Treasury trading activities, but exclude the related net interest income. Analysis

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of the gain (loss) data for 2009 shows that the largest daily gain was \$83 million and the largest daily loss was \$48 million.

Ranges of daily treasury trading revenue earned from market risk-related activities	Below \$(10)	\$(10) to \$0	\$0 to \$10	\$10 to \$20	Over \$20
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(dollars are in millions)

Number of trading days market risk-related revenue was within the stated range	36	86	84	32	9
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The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR on those portfolios where it is calculated. Over the course of 2009, HSBC introduced credit spread as a separate risk type within its VAR models and, at December 31, 2009, credit spread VAR was calculated for credit derivatives portfolios. The total VAR for the trading activities, including credit spread VAR for the above portfolios, was \$38 million and \$52 million for December 31, 2009 and 2008, respectively.

The sensitivity of trading income to the effect of movements in credit spreads on the total trading activities was \$1 million for December 31, 2009 and 2008. This sensitivity was calculated using simplified assumptions based on one-day movements in market credit spreads over a two-year period at a confidence level of 99 percent.

The increase in the sensitivity during 2009, as compared with 2008 was mainly due to the effect of higher volatility in credit spreads. Credit spread risk also arises on credit derivative transactions entered into by Global Banking in order to manage the risk concentrations within the corporate loan portfolio and enhance capital efficiency. The mark-to-market of these transactions is taken through the income statement.

Certain transactions are structured such that the risk is negligible under a wide range of market conditions or events, but in which there exists a remote possibility that a significant gap event could lead to loss. A gap event could be seen as a change in market price from one level to another with no trading opportunity in between, and where the price change breaches the threshold beyond which the risk profile changes from having no open risk to having full exposure to the underlying structure. Such movements may occur, for example, when there are adverse news announcements and the market for a specific investment becomes illiquid, making hedging impossible. Given the characteristics of these transactions, they will make little or no contribution to VAR or to traditional market risk sensitivity measures. We capture the risks for such transactions within our stress testing scenarios. Gap risk arising is monitored on an ongoing basis, and we incurred no gap losses on such transactions in 2009.

The ABSs/MBSs exposures within the trading portfolios are managed within sensitivity and VAR limits and are included within the stress testing scenarios as described above.

VAR Non-trading Activities Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage repayments, and from behavioral assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realizable value of these positions, should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets

or to separate books managed under the supervision of the local ALCO. Once market risk has been consolidated in Global Markets or ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

The following table summarizes non-trading VAR for 2009, assuming a 99 percent confidence level for a two-year observation period and a one-day holding period .

	December 31, 2009	Minimum	Full Year 2009 Maximum	Average	December 31, 2008
	(in millions)				
Interest rate	\$ 114	\$ 76	\$ 154	\$ 121	\$ 92

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The sensitivity of equity to the effect of movements in credit spreads on our available-for-sale debt securities was \$8 million and \$6 million at December 31, 2009 and 2008, respectively. The sensitivity was calculated on the same basis as that applied to the trading portfolio.

Market risk also arises on fixed-rate securities we issue. These securities are issued to support long-term capital investments in subsidiaries and include non-cumulative preferred shares, noncumulative perpetual preferred securities and fixed rate subordinated debt.

Market risk arises on debt securities held as available-for-sale. The fair value of these securities was \$27.8 billion and \$24.9 billion at December 31, 2009 and 2008, respectively.

A principal part of our management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modeling). We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream. See Interest Rate Risk Management above for further discussion.

Trading Activities *HSBC Mortgage Corporation (USA) (HSBC Mortgage Corp)* HSBC Mortgage Corp is a mortgage banking subsidiary of HSBC Bank USA. Trading occurs in mortgage banking operations as a result of an economic hedging program intended to offset changes in value of mortgage servicing rights and the salable loan pipeline. Economic hedging may include, for example, forward contracts to sell residential mortgages and derivative instruments used to protect the value of MSRs.

MSRs are assets that represent the present value of net servicing income (servicing fees, ancillary income, escrow and deposit float, net of servicing costs). MSRs are separately recognized upon the sale of the underlying loans or at the time that servicing rights are purchased. MSRs are subject to interest rate risk, in that their value will decline as a result of actual and expected acceleration of prepayment of the underlying loans in a falling interest rate environment.

Interest rate risk is mitigated through an active hedging program that uses trading securities and derivative instruments to offset changes in value of MSRs. Since the hedging program involves trading activity, risk is quantified and managed using a number of risk assessment techniques.

Modeling techniques, primarily rate shock analyses, are used to monitor certain interest rate scenarios for their impact on the economic value of net hedged MSRs, as reflected in the following table.

At December 31, 2009**Value****(in millions)**

Projected change in net market value of hedged MSRs portfolio (reflects projected rate movements on July 1):

Value of hedged MSRs portfolio	\$ 450
Change resulting from an immediate 50 basis point decrease in the yield curve:	
Change limit (no worse than)	(16)
Calculated change in net market value	(1)
Change resulting from an immediate 50 basis point increase in the yield curve:	

Change limit (no worse than)	(8)
Calculated change in net market value	2
Change resulting from an immediate 100 basis point increase in the yield curve:	
Change limit (no worse than)	(12)
Calculated change in net market value	4

The economic value of the net, hedged MSRs portfolio is monitored on a daily basis for interest rate sensitivity. If the economic value declines by more than established limits for one day or one month, various levels of management review, intervention and/or corrective actions are required.

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The following table summarized the frequency distribution of the weekly economic value of the MSR asset during 2009. This includes the change in the market value of the MSR asset net of changes in the market value of the underlying hedging positions used to hedge the asset. The changes in economic value are adjusted for changes in MSR valuation assumptions that were made during 2009.

Ranges of mortgage economic value from market risk-related activities	Below	to	\$0 to	\$2 to	Over
	\$(2)	\$(2)	\$2	\$4	\$4
	(\$ in millions)				
Number of trading weeks market risk-related revenue was within the stated range	16	7	3	11	15

Operational Risk Operational risk results from inadequate or failed internal processes, people and systems or from external events, including legal and compliance risk, but excluding strategic and reputation risk. Operational risk is inherent in all of our business activities and, as with other types of risk, is managed through our overall framework designed to balance strong corporate oversight with well defined independent risk management.

We have established an independent Operational Risk Management discipline in North America, which reports to the HSBC North America Chief Risk Officer. The Operational Risk and Internal Control Committee, chaired by the HSBC North America Head of Operational Risk and Internal Control, is responsible for oversight of operational risk management, including internal controls to mitigate risk exposure and comprehensive reporting. Results from this Committee are communicated to the Risk Management Committee and subsequently to the Audit Committee of the Board of Directors. Business unit line management is responsible for managing and controlling all risks and for communicating and implementing all control standards. A central Operational Risk and Internal Control function provides functional oversight by coordinating the following activities:

- developing Operational Risk Management policies and procedures;
- developing and managing operational risk identification, scoring and assessment tools and databases;
- providing firm-wide operational risk and control reporting and facilitating resulting action plan development;
- assessing emerging risk areas and monitoring operational risk internal controls to reduce loss exposure;
- perform root-cause analysis on large operational risk losses;
- providing general and/or specific operational risk training and awareness programs for employees throughout the firm;
- maintaining a network of business line operational risk coordinators;
- independently reviewing and reporting the assessments of operational risks; and
- modeling operational risk losses and scenarios for capital management purposes.

Management of operational risk includes identification, assessment, monitoring, management and mitigation, rectification and reporting of the results of risk events, including losses and compliance with local regulatory requirements. These key components of the Operational Risk Management process have been communicated by issuance of a high level standard. Key features within the standard that have been addressed in our Operational Risk Management and Internal Control process have been communicated by issuance of a HSBC North America regional policy. Key features within the policy and our Operational Risk and Internal Control framework include:

each business and support department is responsible for the assessment, identification and management of their operational risks;

each risk is evaluated and scored by its likelihood to occur, its potential impact on shareholder value and by exposure based on the effectiveness of current controls to prevent or mitigate losses. An operational risk automated database is used to record risk assessments and track risk mitigation action plans. The risk assessments are reviewed at least annually, or as business conditions change;

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key risk indicators are established where appropriate, and monitored/tracked; and

the database is also used to track operational losses for analysis of root causes, comparison with risk assessments, lessons learned and capital modeling.

Management practices include standard monthly reporting to business line managers, senior management and the Operational Risk and Internal Control Committee of high risks, control deficiencies, risk mitigation action plans, losses and key risk indicators. Monthly certification of internal controls includes an operational risk attestation. We also monitor external operational risk events which take place to ensure that the firm remains in line with best practice and takes into account lessons learned from publicized operational failures within the financial services industry. Operational Risk management is an integral part of the product development process and the employee performance measurement process. An online certification process, attesting to the completeness and accuracy of operational risk, is completed by senior business management on an annual basis.

Internal audits, including audits by specialist teams in information technology and treasury, provide an important independent check on controls and test institutional compliance with the Operational Risk and Internal Control policy. Internal audit utilizes a risk-based approach to determine its audit coverage in order to provide an independent assessment of the design and effectiveness of key controls over our operations, regulatory compliance and reporting. This includes reviews of the operational risk framework, the effectiveness and accuracy of the risk assessment process and the loss data collection and reporting activities.

A HSBC North America Operational Risk and Internal Control Committee (ORIC) is responsible for oversight of operational risk management, including internal controls, to mitigate risk exposure and comprehensive reporting. Business unit line management is responsible for identifying, managing and controlling all risks and for communicating and implementing all control standards. This is supported by an independent program of periodic reviews undertaken by Internal Audit. We also monitor external operational risk events which take place to ensure that we remain in line with best practice and take into account lessons learned from publicized operational failures within the financial services industry. We also maintain and test emergency policies and procedures to support operations and our personnel in the event of disasters.

Compliance risk, which is a component of operational risk, is the risk arising from failure to comply with relevant laws, regulations and regulatory requirements governing the conduct of specific businesses. It is a composite risk that can result in regulatory sanctions, financial penalties, litigation exposure and loss of reputation. Compliance risk is inherent throughout our organization. HSBC has a formal independent compliance function, which, in North America, is under the direction of the HSBC North America Head of Legal and Compliance.

Consistent with HSBC's commitment to ensure adherence with applicable regulatory requirements for all of its world-wide affiliates, we have implemented a multi-faceted Compliance Risk Management program. This program addresses a number of regulatory priorities, including the following:

- anti-money laundering (AML) regulations;
- economic sanctions requirements;
- consumer protection regulations;
- community reinvestment requirements;

privacy; and

dealings with affiliates.

Oversight of the Compliance Risk Management program is provided by the Audit Committee of the Board of Directors through the Risk Management Committee, which is advised of significant potential compliance issues, strategic policy-making decisions and reputational risk matters. Internal audit, through continuous monitoring and periodic audits, tests the effectiveness of the overall Compliance Risk Management program.

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The Compliance Risk Management program elements include identification and assessment of compliance risk (using operational risk methodology), as well as monitoring, control and mitigation of such risk and timely resolution of the results of risk events. The execution of the program is generally performed by line management, with oversight provided by Compliance. Controls for mitigating compliance risk are incorporated into business operating policies and procedures. Processes are in place to ensure controls are appropriately updated to reflect changes in regulatory requirements as well as changes in business practices, including new or revised products, services and marketing programs. A wide range of compliance training is provided to relevant staff, including mandated programs for such areas as anti-money laundering, fair and responsible lending and privacy.

The independent Compliance function is comprised of compliance teams supporting specific business units, as well as centralized teams providing subject matter and operational compliance expertise in specific areas, notably AML compliance. A distinct position for an HSBC North America Holdings Anti-Money Laundering Director was established and the Director was appointed in the fourth quarter of 2009. He also serves as the designated Anti-Money Laundering Director and Bank Secrecy Act Compliance Officer for HUSI.

The Compliance function is responsible for the following activities:

advising management on compliance matters;

developing compliance risk management policies and procedures, inclusive of a compliance risk assessment program;

providing independent assessment, monitoring and review; and

reporting compliance issues to senior management and Board of Directors, as well as to HSBC Group Compliance.

The Compliance function has established a rigorous independent review program which includes assessing the effectiveness of controls and testing for adherence to compliance policies and procedures. The review program is executed by a centralized compliance review unit, with the assistance of business compliance officers, as necessary.

Fiduciary Risk Fiduciary risk is the risk associated with offering services honestly and properly to clients in a fiduciary capacity in accordance with Regulation 12 CFR 9, Fiduciary Activity of National Banks. Fiduciary capacity is defined in the regulation as:

serving traditional fiduciary duties such as trustee, executor, administrator, registrar of stocks and bonds, guardian, receiver or assignee;

providing investment advice for a fee; or

processing investment discretion on behalf of another.

Fiduciary risks, as defined above, reside in Private Banking businesses (including Investment Management, Personal Trust, Custody, Middle Office Operations) and other business lines outside of Private Banking (including Corporate Trust). However, our Fiduciary Risk Management infrastructure is also responsible for fiduciary risks associated with certain SEC regulated Registered Investment Advisors (RIA), which lie outside of the traditional regulatory fiduciary risk definition for banks. The fiduciary risks present in both banking and RIA business lines almost always occur

where we are entrusted to handle and execute client business affairs and transactions in a fiduciary capacity. Our policies and procedures for addressing fiduciary risks generally address various risk categories including suitability, conflicts, fairness, disclosure, fees, AML, operational, safekeeping, efficiencies, etc.

Oversight for the Fiduciary Risk Management function falls to the Fiduciary Risk Management Committee of the Risk Management Committee. This committee is chaired by the Managing Director Private Banking. The Senior Vice President - Fiduciary Risk is responsible for an independent Fiduciary Risk Management Unit that is

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responsible for day to day oversight of the Fiduciary Risk Management function. The main goals and objectives of this unit include:

development and implementation of control self assessments, which have been completed for all fiduciary businesses;

developing, tracking and collecting rudimentary key risk indicators (KRIs), and collecting data regarding errors associated with these risks. KRIs for each fiduciary business are in the process of being expanded;

designing, developing and implementing risk monitoring tools, approaches and programs for the relevant business lines and senior management that will facilitate the identification, evaluation, monitoring, measurement, management and reporting of fiduciary risks. In this regard, a common database is used for compliance, operational and fiduciary risks; and

ongoing development and implementation of more robust and enhanced key risk indicator/key performance indicator process with improved risk focused reporting.

Reputational Risk The safeguarding of our reputation is of paramount importance to our continued prosperity and is the responsibility of every member of our staff. Reputational risk can arise from social, ethical or environmental issues, or as a consequence of operational and other risk events. Our good reputation depends upon the way in which we conduct our business, but can also be affected by the way in which customers, to whom we provide financial services, conduct themselves.

Reputational risk is considered and assessed by the HSBC Group Management Board, our Board of Directors and senior management during the establishment of standards for all major aspects of business and the formulation of policy and products. These policies, which are an integral part of the internal control systems, are communicated through manuals and statements of policy, internal communication and training. The policies set out operational procedures in all areas of reputational risk, including money laundering deterrence, economic sanctions, environmental impact, anti-corruption measures and employee relations.

We have established a strong internal control structure to minimize the risk of operational and financial failure and to ensure that a full appraisal of reputational risk is made before strategic decisions are taken. The HSBC Internal Audit function monitors compliance with our policies and standards.

Strategic risk This risk is a function of the compatibility of our strategic goals, the business strategies developed to achieve those goals, the resources deployed against those goals and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks and managerial capacities and capabilities.

Strategic risk focuses on more than an analysis of the written strategic plan. It focuses on how plans, systems and implementation affect our value. It also incorporates how we analyze external factors that impact our strategic direction.

We have established a strong internal control structure to minimize the impact of strategic risk to our earnings and capital. All changes in strategy as well as the process in which new strategies are implemented are subject to detailed reviews and approvals at business line, functional, regional, board and HSBC Group levels. This process is monitored by the Strategic Initiatives Group to ensure compliance with our policies and standards.

Business Continuity Planning We are committed to the protection of employees, customers and shareholders by a quick response to all threats to the organization, whether they are of a physical or financial nature. We are governed by the HSBC North America Crisis Management Framework, which provides an enterprise-wide response and communication approach for managing major business continuity events or incidents. It is designed to be flexible and is scaled to the scope and magnitude of the event or incident.

The Crisis Management Framework works in tandem with the HSBC North America Corporate Contingency Planning Policy, business continuity plans and key business continuity committees to manage events. The North American Crisis Management Committee, a 24/7 standing committee, is activated to manage the Crisis Management process in concert with our senior management. This committee provides critical strategic management of

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business continuity crisis issues, risk management, communication, coordination and recovery management. In particular, the HSBC North America Crisis Management Committee has implemented an enterprise-wide plan, response and communication approach for pandemic preparedness. This was tested in 2008 as part of the U.S. Pandemic Simulations exercise. Tactical management of business continuity issues is handled by the Corporate and Local Incident Response Teams in place at each major site. We have also designated an Institutional Manager for Business Continuity who plays a key role on the Crisis Management Committee. All major business and support functions have a senior representative assigned to our Business Continuity Planning Committee, which is chaired by the Institutional Manager.

Certain work areas have been dedicated as hot and warm backup sites, which serve as primary business recovery locations. We have concentrations of major operations in both upstate and downstate New York. This geographic split of major operations is leveraged to provide secondary business recovery sites for many critical business and support areas. Remote working arrangements are also a key component of our business continuity approach.

We have built our own data centers with the intention of developing the highest level of resiliency for disaster recovery as defined by industry standards. Data is mirrored synchronously to disaster recovery sites across duplicate dark fiber loops. A high level of network backup resiliency has been established. In a disaster situation, we are positioned to bring main systems and server applications online within predetermined timeframes.

We test business continuity and disaster recovery resiliency and capability through routine contingency tests and actual events. Business continuity and disaster recovery programs have been strengthened in numerous areas as a result of these tests or actual events. There is a continuing effort to enhance the program well beyond the traditional business resumption and disaster recovery model.

New Accounting Pronouncements to be Adopted in Future Periods

Accounting for transfers of financial assets In June 2009, the FASB issued guidance which amends the accounting for transfers of financial assets by eliminating the concept of a qualifying special-purpose entity (QSPE) and provides additional guidance with regard to the accounting for transfers of financial assets. The guidance is effective for all interim and annual periods beginning after November 15, 2009. We adopted this guidance on January 1, 2010. Adoption did not have a material impact on our financial position or results of operations.

Accounting for consolidation of variable interest entities In June 2009, the FASB issued guidance which amends the accounting rules related to the consolidation of variable interest entities (VIE). The guidance changes the approach for determining the primary beneficiary of a VIE from a quantitative model focusing on risk and reward to a qualitative model focusing on control and obligation to absorb losses or right to receive benefits of the entity. On the effective date, certain VIEs which are not consolidated currently will be required to be consolidated. The guidance is effective for all interim and annual periods beginning after November 15, 2009. Under this new guidance, we expect to consolidate an asset-backed commercial paper conduit where we provide substantially all of the liquidity facilities and through our affiliate have the ability to direct most significant activities. The impact of consolidating this entity on January 1, 2010 was to increase assets and liabilities by approximately \$3.5 billion and \$3.8 billion, respectively, which resulted in an immaterial adjustment to decrease the opening balance of common shareholder s equity. Consolidation of this entity on January 1, 2010 did not result in a material impact to our risk weighted assets or capital ratios.

Improving disclosures about fair value measurements In January 2010, the FASB issued guidance to improve disclosures about fair value measurements. The guidance requires entities to disclose separately the amounts of

significant transfers in and out of Level 1 and Level 2 fair measurements and describe the reasons for the same. It also requires Level 3 reconciliation to be presented on a gross basis disclosing purchase, sales, issuances and settlements separately. The guidance is effective for interim and annual financial periods beginning after December 15, 2009 except for gross basis presentation for Level 3 reconciliation, which is effective for interim and annual periods beginning after December 15, 2010.

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GLOSSARY OF TERMS

Balance Sheet Management Represents our activities to manage interest rate risk associated with the repricing characteristics of balance sheet assets and liabilities.

Basis point A unit that is commonly used to calculate changes in interest rates. The relationship between percentage changes and basis points can be summarized as a 1 percent change equals a 100 basis point change or .01 percent change equals 1 basis point.

Collateralized Funding Transaction A transaction in which we use a pool of our consumer receivables as a source of funding and liquidity through either a Secured Financing or Securitization. Collateralized funding transactions allow us to limit our reliance on unsecured debt markets and can be a more cost-effective source of funding.

Contractual Delinquency A method of determining aging of past due accounts based on the past due status of payments under the loan. Delinquency status may be affected by customer account management policies and practices such as the restructure of accounts, forbearance agreements, extended payment plans, modification arrangements, external debt management plans, loan rewrites and deferments.

Delinquency Ratio Two-months-and-over contractual delinquency expressed as a percentage of loans and loans held for sale at a given date.

Efficiency Ratio Total operating expenses, reduced by minority interests, expressed as a percentage of the sum of net interest income and other revenues (losses).

Federal Reserve the Federal Reserve Board; our principal regulator.

Fee Income Income associated with interchange on credit cards and late and other fees from the origination, acquisition or servicing of loans.

Foreign Exchange Contract A contract used to minimize our exposure to changes in foreign currency exchange rates.

Futures Contract An exchange-traded contract to buy or sell a stated amount of a financial instrument or index at a specified future date and price.

Global Bank Note Program A \$40 billion note program, under which HSBC Bank USA issues senior and subordinated debt.

GM Portfolio A portfolio of General Motors MasterCard receivables we purchased from HSBC Finance in January 2009. New loan originations subsequent to the initial purchase are purchased daily by HSBC Bank USA.

Goodwill The excess of purchase price over the fair value of identifiable net assets acquired, reduced by liabilities assumed in a business combination.

HELOC A revolving line of credit with an adjustable interest rate secured by a lien on the borrower's home which reduces the borrower's equity in the home. HELOCs are classified as home equity mortgages, which are reported within Residential Mortgage Loans.

HMUS HSBC Markets (USA) Inc.; an indirect wholly-owned subsidiary of HSBC North America, and a holding company for investment banking and markets subsidiaries in the U.S.

HMS Portfolio A portfolio of nonconforming residential mortgage loans which we purchased from HSBC Finance in 2003 and 2004.

HNAI HSBC North America Inc.; an indirect wholly-owned subsidiary of HSBC North America.

HSBC or HSBC Group HSBC Holdings plc.; HSBC North America's U.K. parent company.

HSBC Affiliate any direct or indirect subsidiary of HSBC outside of our consolidated group of entities.

HSBC Bank USA HSBC Bank, USA, National Association; our principal wholly-owned U.S. banking subsidiary.

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HSBC Finance HSBC Finance Corporation; an indirect wholly-owned consumer finance subsidiary of HSBC North America.

HSBC North America HSBC North America Holdings Inc.; a wholly-owned subsidiary of HSBC and HSBC's top-tier bank holding company in North America.

Home Equity Mortgage A closed- or open- ended loan in which the borrower uses the equity in their home as collateral. Home equity mortgages are secured by a lien against the borrower's home which reduces the borrower's equity in the home. Home equity mortgages may be either fixed rate or adjustable rate loans. Home equity mortgages are reported within Residential Mortgage Loans.

HTCD HSBC Trust Company (Delaware); one of our wholly-owned U.S. banking subsidiaries.

HTSU HSBC Technology & Services (USA) Inc., an indirect wholly-owned subsidiary of HSBC North America which provides information technology and some centralized operational services, as well as human resources, corporate affairs and other services shared among HSBC Affiliates, primarily in North America.

Intangible Assets Assets, excluding financial assets, that lack physical substance. Our intangible assets include mortgage servicing rights and favorable lease arrangements.

Interest Rate Swap Contract between two parties to exchange interest payments on a stated principal amount (notional principal) for a specified period. Typically, one party makes fixed rate payments, while the other party makes payments using a variable rate.

LIBOR London Interbank Offered Rate; A widely quoted market rate which is frequently the index used to determine the rate at which we borrow funds.

Liquidity A measure of how quickly we can convert assets to cash or raise additional cash by issuing debt.

Loan-to-Value (LTV) Ratio The appraised property value at the time of origination expressed as a percentage of the loan balance at time of origination.

Mortgage Servicing Rights (MSRs) An intangible asset which represents the right to service mortgage loans. These rights are recognized at the time the related loans are sold or the rights are acquired.

Net Charge-off Ratio Net charge-offs of loans expressed as a percentage of average loans outstanding for a given period.

Net Interest Income Interest income earned on interest-bearing assets less interest expense on deposits and borrowed funds.

Net Interest Margin Net interest income expressed as a percentage of average interest earning assets for a given period.

Net Interest Income to Total Assets Net interest income expressed as a percentage of average total assets for a given period.

Nonaccruing Loans Loans on which we no longer accrue interest because ultimate collection is unlikely.

OCC The Office of the Comptroller of the Currency; the principal regulator for HSBC Bank USA.

Options A contract giving the owner the right, but not the obligation, to buy or sell a specified item at a fixed price for a specified period.

Portfolio Seasoning Relates to the aging of origination vintages. Loss patterns emerge slowly over time as new accounts are booked.

Private Label Credit Card A line of credit made available to customers of retail merchants evidenced by a credit card bearing the merchant's name.

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Private Label Card Receivable Portfolio (PLRP) Loan and credit card receivable portfolio acquired from HSBC Finance on December 29, 2004.

Rate of Return on Common Shareholder s Equity Net income, reduced by preferred dividends, divided by average common shareholder s equity for a given period.

Rate of Return on Total Assets Net income after taxes divided by average total assets for a given period.

Refreshed Loan-to-Value For first liens, the current property value expressed as a percentage of the current loan balance. For second liens, the current property value expressed as a percentage of the current loan balance plus the senior lien amount at origination. Current property values are derived from the property s appraised value at the time of loan origination updated by the change in the Office of Federal Housing Enterprise Oversight s house pricing index (HPI) at either a Core Based Statistical Area or state level. The estimated current value of the home could vary from actual fair values due to changes in condition of the underlying property, variations in housing price changes within metropolitan statistical areas and other factors.

Residential Mortgage Loan Closed-end loans and revolving lines of credit secured by first or second liens on residential real estate. Depending on the type of residential mortgage, interest can either be fixed or adjustable.

SEC The Securities and Exchange Commission.

Secured Financing A Collateralized Funding Transaction in which the interests in a dedicated pool of consumer receivables, typically credit card, auto or personal non-credit card receivables, are sold to investors. Generally, the pool of consumer receivables is sold to a special purpose entity which then issues securities that are sold to investors. Secured Financings do not receive sale treatment and, as a result, the receivables and related debt remain on our balance sheet.

Securitization A Collateralized Funding Transaction in which the interests in a dedicated pool of consumer receivables, typically credit card, auto or personal non-credit card receivables, are sold to investors. Generally, the pool of consumer receivables is sold to a special purpose entity which then issues securities that are sold to investors. Securitizations are structured to receive sale treatment and, as a result, the receivables are then removed from our balance sheet.

Tangible Common Shareholder s Equity to Total Tangible Assets Common shareholder s equity less goodwill, other intangibles and derivatives classified as cash flow hedges expressed as a percentage of total assets less goodwill and other intangibles.

Total Average Shareholders Equity to Total Assets Average total shareholders equity expressed as a percentage of average total assets for a given period.

Total Period End Shareholders Equity to Total Assets Total shareholders equity expressed as a percentage of total assets as of a given date.

UP Portfolio A portfolio of AFL-CIO Union Plus MasterCard/Visa receivables that we purchased from HSBC Finance in January 2009. New loan originations subsequent to the initial purchase are purchased daily by HSBC Bank USA.

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CONSOLIDATED AVERAGE BALANCES AND INTEREST RATES

The following table shows the year-to-date average balances of the principal components of assets, liabilities and shareholders' equity together with their respective interest amounts and rates earned or paid for 2009, 2008 and 2007, presented on a taxable equivalent basis.

	2009	2009	2009	2008	2008	2008	2007	2007	2007
	Balance	Interest	Rate⁽¹⁾	Balance	Interest	Rate⁽¹⁾	Balance	Interest	Rate⁽¹⁾
	(dollars are in millions)								
Investments bearing interest with banks	\$ 15,614	\$ 44	.28%	\$ 5,359	\$ 182	3.40 %	\$ 5,555	\$ 291	5.2%
Real estate funds sold and securities purchased for resale	6,860	45	.66	9,560	229	2.39	11,671	610	5.2%
Investments	4,797	219	4.56	9,425	535	5.68	11,380	633	5.5%
Securities	27,778	997	3.59	24,538	1,267	5.16	23,156	1,212	5.2%
Commercial mortgages:	35,017	1,160	3.32	39,209	1,915	4.89	31,398	2,069	6.5%
Commercial mortgages:	17,641	884	5.01	26,972	1,410	5.23	33,365	1,729	5.1%
Commercial mortgages:	4,446	147	3.30	4,521	222	4.91	4,329	311	7.2%
Commercial mortgages:	15,698	1,635	10.42	16,436	1,713	10.42	16,332	1,630	9.9%
Commercial mortgages:	13,138	1,250	9.52	1,917	157	8.19	1,404	105	7.5%
Commercial mortgages:	2,435	442	18.16	232	13	5.85	447	26	5.7%
Commercial mortgages:	1,677	134	8.01	2,013	188	9.37	2,189	219	10.0%
Commercial mortgages:	55,035	4,492	8.16	52,091	3,703	7.11	58,066	4,020	6.9%
Commercial mortgages:	90,052	5,652	6.28	91,300	5,618	6.15	89,464	6,089	6.8%
Commercial mortgages:	8,309	46	.55	9,041	219	2.43	3,977	230	5.7%
Commercial mortgages:	153,410	\$ 7,003	4.57%	149,223	\$ 8,050	5.39 %	145,203	\$ 9,065	6.2%
Commercial mortgages:	(3,645)			(1,837)			(1,006)		
Commercial mortgages:	2,604			6,358			3,019		
Commercial mortgages:	23,869			29,700			24,713		
Commercial mortgages:	\$ 176,238			\$ 183,444			\$ 171,929		

**Liabilities and
Shareholders' Equity**

Deposits in domestic branches:										
Time deposits	\$ 48,129	\$ 583	1.21%	\$ 45,143	\$ 1,004	2.22 %	\$ 43,517	\$ 1,433	3.28	
Other time deposits	19,375	350	1.81	25,450	869	3.42	22,375	1,225	5.44	
Deposits in foreign branches:										
Foreign banks deposits	11,033	13	.12	14,336	218	1.52	9,876	525	5.33	
Other interest bearing deposits	15,087	45	.30	14,677	335	2.28	15,464	657	4.23	
Other interest bearing deposits	93,624	991	1.06	99,606	2,426	2.44	91,232	3,840	4.21	
Short-term borrowings	9,600	74	.77	12,183	283	2.32	9,987	357	3.57	
Long-term debt	23,320	782	3.35	24,100	985	4.09	28,480	1,443	5.07	
Other interest bearing liabilities	126,544	1,847	1.46	135,889	3,694	2.72	129,699	5,640	4.33	