HSBC Bank Malta p.l.c.

Annual Report and Accounts 2010

HSBC

The world's local bank

The HSBC Group

HSBC Bank Malta p.l.c. is a member of the HSBC Group, whose ultimate parent company is HSBC Holdings plc. Headquartered in London, HSBC Holdings plc is one of the largest banking and financial services organisations in the world. The HSBC Group's international network comprises around 7,500 offices in 87 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

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Chairman's Statement

I am pleased to advise that 2010 was a successful year for HSBC Bank Malta p.l.c. during which it delivered a strong performance in a challenging environment.

Results

Profit before taxation was €83.1 million, representing an increase of 16.7 per cent. This formidable result was underpinned by a strong performance across the organisation in spite of continued low interest rates, heightened competition, economic uncertainty, crisis in a number of eurozone countries, and ongoing market volatility.

HSBC Bank Malta has managed to successfully weather the storm of the global crisis by being proactive and taking decisive action. As a result it has not suffered any direct repercussions and has managed to grow its business on both sides of the balance sheet.

Profit attributable to shareholders increased by 17.2 per cent to €53.8 million. On the basis of these results the Board is recommending a final gross ordinary dividend of 7.7 euro cent per share. Together with the interim gross dividend of 7.9 euro cent per share (5.1 euro cent net of tax) paid in August 2010, the total dividend for the year is 15.6 euro cent.

During 2010 the number of the bank's shareholders continued to grow and now stands at over 10,400. This is a vote of confidence from the investment public in our organisation and its future potential.

HSBC Bank Malta p.l.c. is a subsidiary of London-based HSBC Holdings plc, one of the world's top financial brands, and remains the largest company listed on the Malta Stock Exchange with a market capitalisation around the €1.0 billion mark.

Strategy

HSBC Bank Malta forms an integral part of HSBC Continental Europe, the Group's regional centre which was established in Paris, France in early 2010.

During the year under review the bank successfully completed its strategic plan which establishes the key priorities and strategic imperatives for the next four years. The objective is to consolidate our position as Malta's leading international bank by sustaining our strong domestic franchise and growing internationally by leveraging connectivity through the HSBC Group and global brand.

The strategy revolves around the bank's main customer groups utilising a segmentation approach to provide an unrivalled service. This is supported by a major investment in technology, distribution channels and processes which will transform the bank and generate greater efficiencies and make it easier for customers to interact and conduct their business with us.

It is by putting our customers at the heart of everything we do that we can realise our vision.

In 2010 we were fortunate to have both HSBC's Global Group Chief Executive, Michael Geoghegan and Group Chairman, Stephen Green, visit our islands. During their separate visits they met members of staff and provided updates on the Group's performance and future strategy, met with government and customers and also supported a number of the bank's philanthropic activities.

HSBC is one of the most strongly capitalised and liquid banks in the world serving over 100 million customers who entrust over US$1.1 trillion in deposits. HSBC has more deposits than loans and operates in 87 countries and territories worldwide.

Corporate Sustainability

Sustainability for HSBC Bank Malta means managing our business for the long term. HSBC recognises that to achieve sustainable profits for our shareholders and to build long-lasting relationships with customers we must respect the environment, invest in the community and our heritage, and foster culture and arts.

In 2010, the HSBC Malta Foundation was set up to consolidate three successful funds, namely for children, the environment and Malta's heritage. This was necessary to better coordinate activities and ensure social and environmental issues are embedded into what we do. The Foundation works hand-in-hand with the HSBC Group's corporate sustainability team and shapes the approach to sustainable business opportunities and risks, our own operational environmental and social footprint, and community investment.

We recognise that a thriving society is critical to our future success as a bank. Towards this aim, HSBC makes a direct contribution to the community through donations of time, money and resources. We partner with reputable charities that are making a difference and we remain involved in the decisions taken. Our employees are also encouraged to get involved in local community programmes and philanthropic causes.

Children who come from a disadvantaged background have always been a focus of attention for HSBC. Since 2000, HSBC Bank Malta has donated almost €2.0 million for specialised programmes to help children with inclusive education, recreation and rehabilitation. This has continued in 2010. There is no better way to support the future than by supporting our children.

Throughout the year, the HSBC Malta Foundation has supported a number of worthy causes and activities ranging from support to schools, educational programmes, and helping specialised associations to afforestation, conservation and ecological projects that protect the environment.

HSBC is the official patron of the National Museum of Fine Arts and a long-term patron of the Fondazzjoni Patrimonju Malti. In 2010, the HSBC Malta Foundation honoured its continuous support to The Malta Community Chest Fund in its fund-raising initiatives and contributed significantly to the Rockestra concert and l-Istrina.

In total, HSBC invested in excess of €500,000 in corporate sustainability throughout 2010.

Board

During 2010 there was one change to the Board of Directors from the majority shareholder. Mr Anthony Mahoney, Deputy CEO Continental Europe, was replaced by Mr Peter Boyles, CEO Continental Europe.

I would like to express my thanks to Mr Mahoney for his loyal contribution to our organisation over these past years. Mr Mahoney was instrumental in the acquisition of the bank in 1999 and integrating it into the HSBC Group and remains a true friend of Malta. I also warmly welcome Mr Boyles. I am certain that he will use his vast experience and knowledge for the benefit and future success of the bank.

The Board has a distinctive mix of members who through their collective skills, local and international knowledge and experience managed to provide the required stewardship for a successful year.

HSBC staff members entering the Presidential Palace in Attard at the end of a fund raising triathlon.

Chairman's Statement (continued)

I would also like to wish a happy retirement to our former Director Mrs Sally Robson after a long and distinguished career with HSBC. Mrs Robson served as Chief Technology and Services Officer of the bank. I thank her for her contribution to our organisation.

I am Chairman of a Board composed of an expatriate Director who is the Chief Executive Officer of the bank, one Executive Director and five Non-Executive Directors, who are all Maltese, and one overseas-based Director who is CEO Continental Europe.

I look to the future with confidence in working with these Directors and building on our achievements for a successful future.

Outlook

The economic climate remains challenging and while we will always be open for quality business, we must also be prudent. We must maintain our strong capital and liquidity position and retain our conservative approach to risk management.

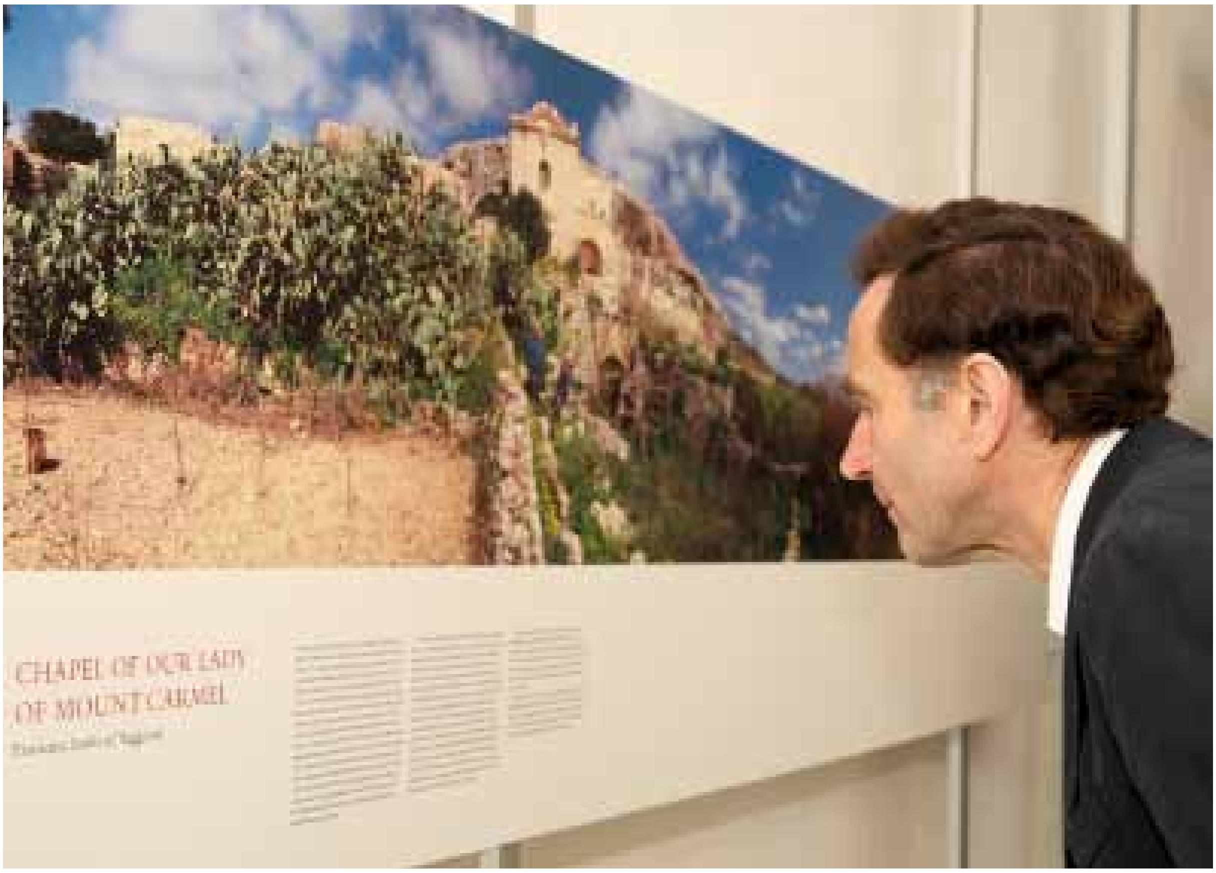
To benefit in the future we must play on our strengths and focus on where we have a comparative advantage. We must be at the forefront to exploit the opportunities arising from change. We must also continue to invest in our staff, who are our greatest asset.

I would like to express my gratitude and appreciation to the Board of Directors, Management and Staff of the organisation for their ongoing efforts, hard work, dedication and commitment in making 2010 such a successful year.

I thank our growing number of shareholders for their support and our customers for their continued trust in our organisation.

With a clear strategy and the backing of the HSBC Group I am confident we can continue building on the success achieved in 2010 in the future.

Albert Mizzi, *Chairman*
18 February 2011



HSBC Group Chairman Stephen Green at the launch of The Historic Chapels of Malta & Gozo 360° exhibition.

Chief Executive Officer's Review

2010 was a successful year for the bank in Malta during which profit before tax increased by 16.7 per cent to €83.1 million and our return on equity improved to 16.1 per cent. 2010 was also a year in which we managed significant amounts of complex change right across the bank as we continued to invest for the future.

In spite of increasing competition, the low interest rate environment, a softening in demand for corporate lending and ongoing volatility in equity and bond markets, all our principal customer groups – Personal Financial Services, Commercial Banking and Global Banking and Markets – together with principal subsidiary companies, saw improved results year on year and contributed to the bank's strong results for the benefit of our shareholders. The results are testimony to the hard work and professionalism of our staff who performed admirably in challenging circumstances.

Performance

Profit before taxation for 2010 amounted to €83.1 million, a significant increase of 16.7 per cent over the previous year. This is a strong result considering the ongoing volatility in international markets, a weakened global economy and the competitive low interest environment we are operating in.

In 2010, net operating income increased by €16.5 million or 10.4 per cent when compared to prior year. This was the result of a 17.0 per cent increase in net interest income attributable to growth in our balance sheet and more effective balance sheet management. Net fees and commission income of €34.3 million increased by 5.9 per cent, up €1.9 million compared to €32.4 million in 2009. Strong growth was recorded in card issuance and usage fees and from trust and retail brokerage trading.

Cost discipline has been a key focus during the year. Whilst operating expenses increased by €3.8 million or 4.6 per cent, this was mainly due to costs related to investments in infrastructure which will lead to productivity improvements in the future and enable us to provide a better customer service in a market where competition is increasing. On the back of higher income levels, our cost-to-income ratio improved to 49.7 per cent from 52.5 per cent in prior year.

In a challenging economic environment loan impairments increased modestly by €1.0 million to €5.3 million. This is from an extremely low historic base and remains at the modest level of 16 basis points of the overall loan book. Overall, credit risk remains well managed and portfolio quality has been maintained.

The outlook for the global economy and in particular for Europe remains challenging and the bank will continue to focus on credit standards.

We remain very well capitalised. Our capital adequacy ratio is 10.2 per cent which is well in excess of the regulatory requirement of 8.0 per cent. We also remain very liquid with an advances to deposits ratio of 74.0 per cent and remain supportive of the local economy and our customers.

Profit attributable to shareholders was €53.8 million, a significant increase of 17.2 per cent over prior year reflecting the bank's strong performance.

Total assets increased to €5,664.6 million which include a net increase of €77.4 million in lending activity. In fact, gross new lending to customers amounted to €682.0 million which reflects our continued support to our customers and the local economy. Total liabilities increased by €519.5 million during the year. This includes a considerable increase of €376.2 million in deposits. Given the competitive environment this is an impressive result and reflects well on our reputation as a safe place to bank.

Chief Executive Officer's Review (continued)

In light of these commendable financial results the Board is recommending a final gross ordinary dividend of 7.7 euro cent per share.

Personal Financial Services

The Personal Financial Services business continued to invest for the future with further upgrades to the branch network, call centre and self service infrastructure. The €8.0 million investment programme announced in 2010 is aimed at providing superior customer service. In 2010 we delivered four new branch refurbishments based on HSBC's global designs including the first full Premier centre for Malta at Swieqi.

In these new branches our customers receive the same excellent service and 'look and feel' that they experience in any of our key branches across the globe. A dedicated telephone based relationship management service was launched for our Premier customers and we commenced the upgrading of our self service machines to provide real time value for cash deposits. Customer feedback has been very positive and we have seen a continuing trend away from branch counter transactions to the use of self service machines and internet banking.

We also introduced our global market leading customer relationship management system so that we can build deeper relationships by better identifying financial needs and therefore engaging in more relevant and timely conversations with our customers. We have already started to see the benefit of this system investment.

Wealth Management continues to be a key growth area and during 2010 we achieved record growth in our Premier customer portfolio from the local market and from overseas customers moving to Malta. Premier is HSBC's unique global proposition for our best customers with investment needs.

The Advance service was also launched in the latter part of 2010. This 'value for money' service is HSBC's second global proposition after Premier which clearly demonstrates the benefits of banking with an international bank which can provide its customers with a unique range of travel-related benefits, global money transfers, overseas assistance and an exclusive reward scheme. The take up of this service has been encouraging and has exceeded expectations.

The bank's Financial Planning Advisors and Private Client Managers have access to a wide range of HSBC and other third party products which provide a full range of investment solutions including life protection and investing for retirement. In 2010 we conducted in excess of 20,000 financial planning reviews to ensure that we continued to meet customer needs. HSBC's Trust business continues to be the market leader and we have seen strong growth in assets under management. Our global brand strength has provided the opportunity to grow trust business from the existing customer base but also from overseas customers, many of whom are introduced to Malta from the wider HSBC Group.

Our Shareshop provides access to international stock exchanges making the buying and selling of bonds and equities available over the telephone.

Insurance profitability has improved with investment and protection sales performing strongly. A new 'easy to buy' Life protection product was launched whereby customers can buy instant Life Cover with a minimum number of underwriting questions.

Commercial Banking

The Commercial Banking business has continued to deliver year on year income growth and has once again made a significant contribution to the bank's underlying profits.

The slowdown in the economy, particularly in the first half of the year, and the subdued demand for new real estate lending, did result in a reduction in the lending book. The position recovered in the second half of the year as the economy expanded. The lending book remains well secured and of excellent quality. Financial services companies relocating to Malta have made a significant contribution to commercial deposits enhancing our image as the leading international bank.

Within the small business market, Business Direct continues to perform strongly and we continue to see a trend for client preference to move to phone and internet banking service, rather than traditional face-to-face relationship management. Domestically, the card acquiring business performed well with turnover and income levels ahead of previous years.

The leading international business strategy continues to be implemented and we are pleased with the volume of new business from Maltese companies expanding overseas and international companies relocating to Malta. We launched two new annual awards programmes during 2010: the European Business awards, and the HSBC/Vodafone Export and Innovation awards. Both were well received by the business community and presented the bank with an excellent opportunity to recognise successful local companies, many of whom are competing on the international stage.

Global Banking and Markets

Global Banking and Markets has generated significantly higher profits in 2010 and continues to successfully deliver on its strategy to provide best in class services to local and international customers. By focusing on HSBC's competitive advantages as the largest international bank in Malta and by leveraging expertise across the HSBC Group worldwide, the Global Banking and Markets team are playing a key role in the development of Malta's international financial services industry.

The Treasury and Capital Markets team has carefully positioned the bank's investment portfolio to benefit from the 'flight to quality' that we have witnessed in the European bond markets. Indeed, 95% of our investment portfolio is invested in AAA-rated assets and Maltese sovereign paper. We have combined this prudent investment policy with sophisticated risk management techniques to protect net interest margins. During 2010 we offered tailored investments products, drawing on HSBC's expertise in the emerging markets. We have also helped our customers to protect against losses arising from movements in both currencies and interest rates.

Through our Stockbroking subsidiary, HSBC continues to be the largest broker in the domestic Maltese securities market. Another successful year for this business was highlighted by record levels of corporate bonds issued where, once again, HSBC played a market leading role.

HSBC Global Asset Management achieved a strong performance across the range of fund products with an increase of over 50.0 per cent in the value of assets under management. We have also continued to grow the number of individually managed portfolios for our high net worth and institutional customers. In 2010, we took the opportunity to recruit local and overseas talent to add further to our professional investment expertise. This business continues to draw upon the global expertise of HSBC Group. One such example has been the roll-out of the Group's World Selection Fund which provides Maltese customers with international investment products tailored to their specific needs.

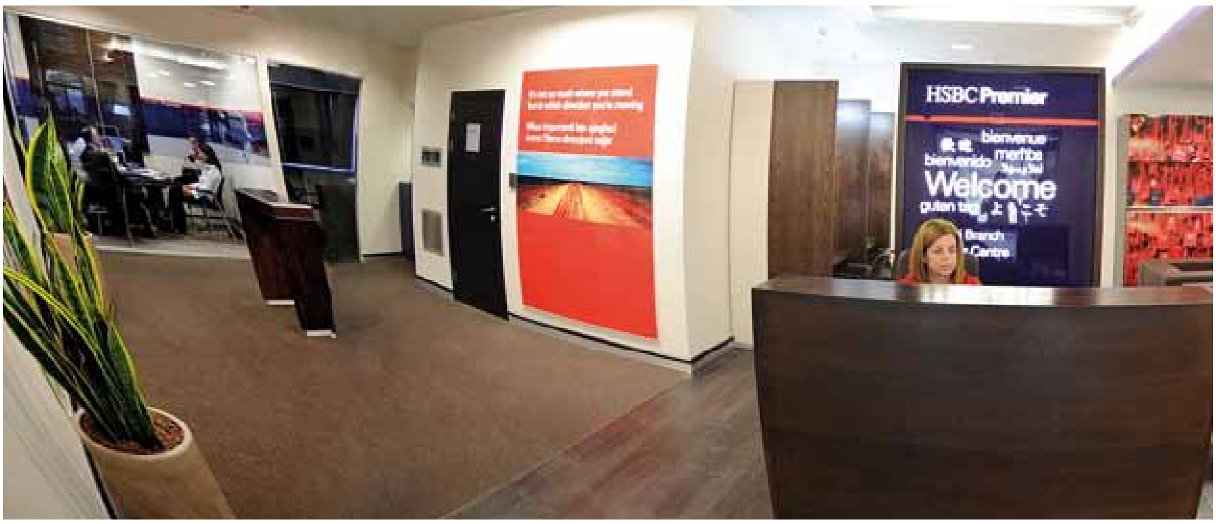
HSBC's Custody and Fund Administration businesses have also experienced dynamic growth in 2010. We have invested significantly in these businesses to ensure that HSBC continues to play a pivotal role in the growth of Malta's international funds sector. By leveraging the Group's extensive international network and partnering with Malta's professional community, we have seen assets under administration grow by over 70.0 per cent. During 2010 we have migrated our custody business to the Group's Global Custody Service/HSBCnet platform which provides our customers with access to securities markets across the HSBC global footprint. We remain confident that the rapid growth of Malta's funds sector is sustainable, and is therefore a major investment opportunity for HSBC.

Technology and Services

We continue to invest heavily in improving our systems, streamlining our processes and using the latest technology to offer a better customer experience and at the same time improve shareholder return.

In 2010, we embarked on an ambitious transformation programme consisting of a number of workstreams that will revolutionise the way we operate internally and will improve the service we deliver to customers.

HSBC Internet Banking has continued to be the channel of choice of an increasing number of our customers who find it secure, convenient and fast.



The first full HSBC Premier Centre for Malta in Swieqi.

Chief Executive Officer's Review (continued)

Throughout 2010 we continued to invest in this important channel by providing the facility to HSBC Advance customers to view and transact on their accounts held with HSBC across the world. We continued to expand the range of online applications and financial tools for the convenience of customers with the introduction of the Personal Protector Plan, and Retirement Planning Calculator, amongst others. We have introduced a simpler account opening process for new customers which makes it easier for them to apply for Internet Banking, Phone Banking and Mobile Service.

In 2010 we continued to invest in technology, maintained robust internal controls and revisited our internal processes to ensure that these are in line with our strategy to reduce our unit cost of production whilst providing an efficient and quality service to our customers.

We continued our journey of upgrading our core systems onto the Group's core technology platforms. This project will enable us improve our productivity, deliver better service quality and allow us to introduce further global propositions in the future.

Process re-engineering continued to be given focus to increase cost efficiencies and improve the overall Customer Experience. Through the use of technology and sharing of Group best practice we re-designed our customer onboarding process, making it simpler and faster to open an account with HSBC. In line with our strategy to increase operational controls and lower our unit cost of production we also continued to migrate standard processes into Group Centres of Excellence.

In 2010 we implemented the Consumer Credit Directive that aims to improve the fairness and competitiveness of consumer credit across Europe and maintain a high level of consumer protection. In line with European regulations we also upgraded our payments capability to meet the Single Euro Payments Area (SEPA) requirements. These changes enable a customer to perform a recall of a SEPA credit transfer in case of duplicate payments or system malfunction. Furthermore the bank joined other banks within the Eurozone and has started to accept SEPA Direct Debits from any Eurozone country.

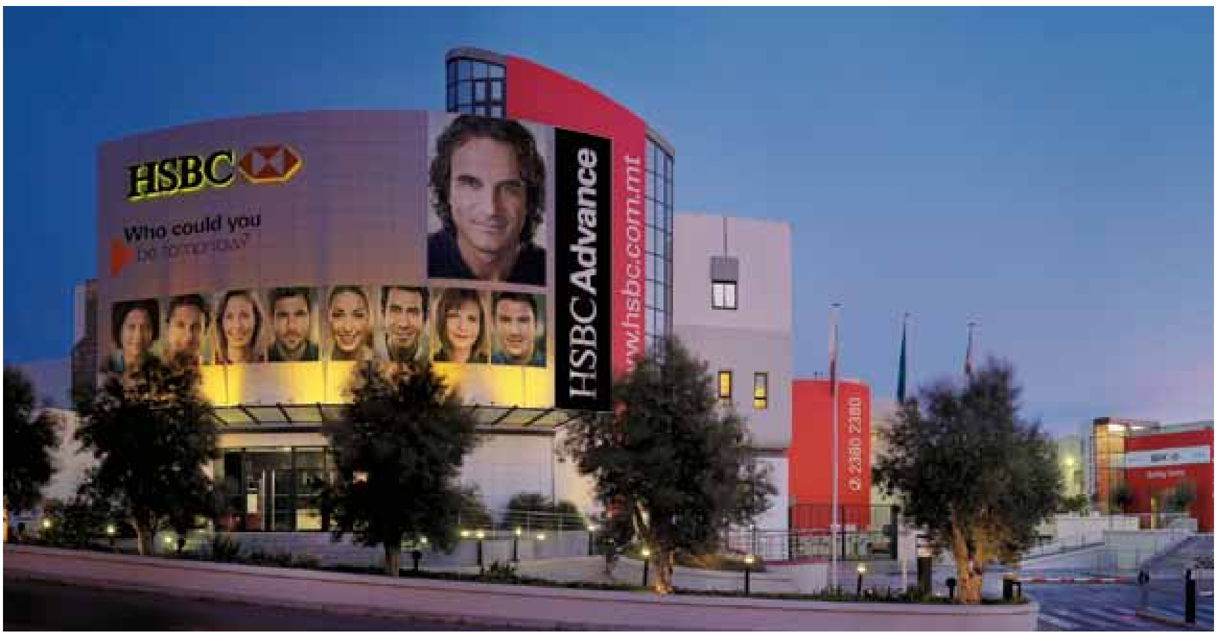
People

Our staff of course remain our greatest asset. It is through our talented and professional workforce that we managed to accomplish so much in 2010.

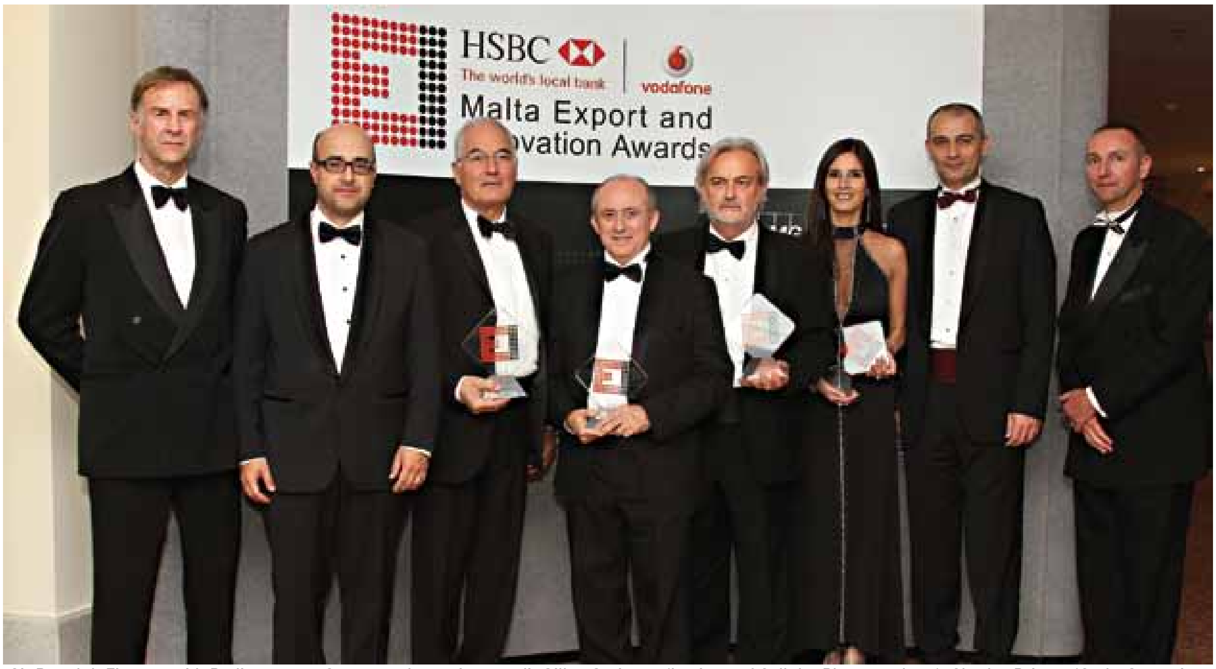
During 2010 we continued to invest in our people through training and professional development and talent management which led to a number of overseas attachments, secondments and training opportunities. We have also implemented more family-friendly policies to improve the working environment. We have more staff-related initiatives planned for 2011 and we will continue investing in our people as it is through them that we can continue achieving success.

We are also working closely with the unions to improve conditions and opportunities for our staff through negotiating a new Collective Agreement.

2010 saw the retirement of Sally Robson after five years in Malta as a Director, Chief Operating Officer and subsequently Chief Technology and Services Officer. Sally is retiring from the HSBC Group after a long and successful career and we wish her and her husband Charles all the very best for the future.



The HSBC Operations Centre featuring Advance branding on the occasion of the launch of the new proposition in Malta.



Sir Ranulph Fiennes with Parliamentary Secretary Jason Azzopardi, Gilles Gutierrez (Institute of Cellular Pharmacology), Charles Brincat (Carlo Gavazzi (Malta), Anthony Diacono (Medserv), Liz Barbaro Sant (ISTC), Joseph Cuschieri (Vodafone Malta Ltd), and Richard Cottell (HSBC Bank Malta) at the gala presentation of the HSBC-Vodafone Export and Innovation Awards at the Hilton Malta.

In Philip Farrugia we have a worthy successor and I am delighted to also welcome Philip to the Board as an Executive Director.

Our performance in 2010 is testament to the talent and dedication of the teams that work for HSBC and I would like to thank them all for their contribution during such a challenging year.

Outlook

The Maltese economy has proved to be resilient and has performed relatively well throughout the global recession. However, we are not entirely out of the woods as the recent Eurozone Sovereign bond crisis has shown.

2011 is likely to see softer growth across Europe, not least because of the impact of a number of austerity packages announced across the European region. As a trading nation with an open economy a further slowdown in Europe may inevitably impact Malta.

Profitability will remain under pressure for as long as the low interest rate environment remains and impairments may yet increase further as trading conditions will remain challenging for the foreseeable future.

The introduction of new regulations will require the industry to hold more capital although our enduring commitment to liquidity and strong capital and a conservative approach to risk management means HSBC is well positioned.

We have a clear strategy and we will continue to emphasise our competitive advantages as an international bank. We remain committed to Malta's development as an international financial services centre. HSBC is well capitalised, liquid and well positioned to support the local economy and its future growth and we can look forward to 2011 with confidence.

Alan Richards, *Chief Executive Officer*
18 February 2011

Board of Directors

The directors who served on the Board as at 31 December 2010 were:

Albert Mizzi, NON-EXECUTIVE CHAIRMAN
Non-Executive Chairman of HSBC Bank Malta p.l.c. since June 1999. In 1946, joined family business Alf. Mizzi & Sons Ltd. and was Chairman for several years. In the 1960s he was heavily involved in private banking and appointed director of Medport. Established a number of Malta's important parastatal businesses: Air Malta, Sea Malta, Medserv, Mediterranean Insurance Brokers and Middle Sea Insurance. Following the setting up of Air Malta in 1973, he served as its Chairman for 19 years.

Alan Richards, DIRECTOR AND CHIEF EXECUTIVE OFFICER
Director and Chief Executive Officer of HSBC Bank Malta p.l.c. since May 2008. Chairman of HSBC's Life Company, Stockbroking, Fund Management and Fund Administration businesses in Malta. Prior to moving to Malta, he was Deputy Chief Executive Officer for HSBC Australia based in Sydney. Joined HSBC in 1984 as a graduate entrant and has also worked for HSBC in the United Kingdom, Hong Kong, Malaysia and Turkey.

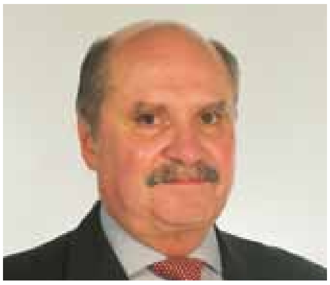
Sally Robson, DIRECTOR AND CHIEF TECHNOLOGY AND SERVICES OFFICER
Director and Chief Technology and Services Officer of HSBC Bank Malta p.l.c. since March 2006. A professional banker and a fellow of the Chartered Institute of Bankers. Joined the then Midland Bank plc in 1979. Since 1983 she has held a number of key managerial positions within the HSBC Group in the United Kingdom, with the last post held being that of Area Director for Greater Manchester. Retired from the bank in January 2011 and resigned from the Board on 9 February 2011.

Peter William Boyles, NON-EXECUTIVE DIRECTOR
Non-Executive Director since May 2010. Director of HSBC Bank plc and Chief Executive Officer Continental Europe, responsible for HSBC's businesses in 25 countries. He is also Chairman of HSBC Bank A.S., Deputy Chairman HSBC France and a member of the HSBC Trinkaus Supervisory Board. Commenced his career with HSBC as an International Manager in London. His most recent roles include Chief Executive Officer, HSBC France and Head of Human Resources, HSBC Group.

Philip Farrugia Randon, NON-EXECUTIVE DIRECTOR
Director of HSBC Bank Malta p.l.c. since June 2004. Graduated LL.D. in 1973 and joined the bank in 1974 as a legal adviser. Held the post of Company Secretary and the post of Head of Group Legal Department of HSBC Bank Malta p.l.c. for several years. Retired from the bank in May 2008.

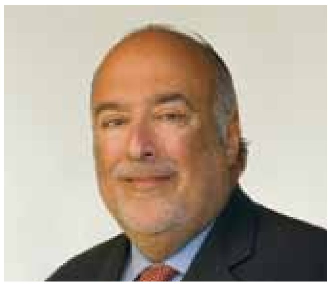
Charles John Farrugia, NON-EXECUTIVE DIRECTOR
Director of HSBC Bank Malta p.l.c. since November 2004. Joined the bank in 1975. Was appointed Chief Dealer in 1995, Group Senior Treasury Manager in 1999 and Managing Director of HSBC Stockbrokers (Malta) Ltd in 2001. Held the post of Head of Global Banking and Markets of HSBC Bank Malta p.l.c. for several years. Retired from the bank in January 2010.

Peter Paul Testaferrata Moroni Viani, NON-EXECUTIVE DIRECTOR
Non-Executive Director of HSBC Bank Malta p.l.c. since March 2001. Holds various executive positions and directorships within the Testaferrata Group of companies.



Saviour sive Sonny Portelli, NON-EXECUTIVE DIRECTOR
Non-Executive Director of HSBC Bank Malta p.l.c. since October 2006. A senior Maltese businessman who is currently the Chairman of Air Malta p.l.c. and of The Malta Council for Economic and Social Development. Had an early career in the Malta civil service which he left to join the tourist sector. A marketing specialist and sits as non-executive director on the boards of various Maltese companies.

James Dunbar Cousin, NON-EXECUTIVE DIRECTOR
Appointed Non-Executive Director of HSBC Bank Malta p.l.c. in April 2009. Joined Barclays Bank D.C.O. in 1968. Occupied various managerial roles within the branch network of Mid-Med Bank Limited. Subsequently, he occupied the roles of Executive Manager and later Head of Commercial Banking of HSBC Bank Malta p.l.c. Retired from the bank at the end of 2008.



George Brancaleone, COMPANY SECRETARY
Company Secretary of HSBC Bank Malta p.l.c. since June 2004. Joined the bank in 1980 and graduated LL.D. in 1988. Company Secretary of various HSBC subsidiaries in Malta since 2001. Presently holds the post of Senior Manager at Audit, Compliance and Legal Department of HSBC Bank Malta p.l.c.

Financial Review

Summary of Financial Performance

Group profit

During the year ended 31 December 2010, HSBC Bank Malta p.l.c. and its subsidiaries generated a profit before tax of €83.1 million. This represents an increase of 16.7 per cent or €11.9 million compared to 2009, substantially driven by an improved level of revenues.

Profit attributable to shareholders was €53.8 million, an increase of €7.9 million over prior year figures.

Net operating income of €176.2 milllion increased by €16.5 million compared with €159.7 million in 2009. Net interest income increased by €17.9 million to €122.8 million.

Operating expenses were €87.6 million, an increase of €3.8 million over prior year.

The group's cost to income ratio is 49.7 per cent compared to a prior year ratio of 52.5 per cent.

Shareholders' ratios

Earnings per share at 18.4 euro cent compared to 15.7 euro cent for the same period in 2009, with the pre-tax return on shareholders' funds at 24.9 per cent up from a prior year of 23.2 per cent.

The Directors propose a final gross dividend of 7.7 euro cent per share. This follows on the gross interim dividend of 7.9 euro cent paid in August 2010.

Net interest income

Net interest income was significantly ahead of last year and has improved by 17.0 per cent to €122.8 million, compared to €105.0 million in 2009, attributable to growth in our balance sheet and the unwinding of term deposits.

Non-interest income

Non-interest income of €53.3 million decreased by 2.5 per cent or €1.3 million compared to €54.7 million in 2009. A stable performance with the increase in net fee and commission income of €1.9 million offset by declines in trading profits and life insurance activities and net losses recorded on the sale of available-for-sale investments.

Net fees and commission income of €34.3 million increased by 5.9 per cent or €1.9 million compared to €32.4 million recorded in 2009. Strong growth was recorded in card issuance and usage fees and from trust and retail brokerage trading activities.

Trading profits of €6.8 million decreased by 5.6 per cent or €0.4 million compared to €7.2 million in 2009. Profit on foreign exchange activities were stable on prior year at €7.1 million. Fair value movements on derivatives declined by €0.5 million. This decline represented a one-off credit risk fair value adjustment on derivatives held with third parties and related to a potential risk of counterparty default over and above that implicitly factored into the core valuation model.

The group uses the fair value designation for financial assets held by Life insurance operations amounting to €306.3 million. A positive movement of €19.7 million was recorded in the fair value of assets held to back insurance and investment contracts compared with a gain of €26.7 million in 2009 reflecting the volatility in the European financial markets during 2010. This gain related predominantly to the value of assets held in unit-linked and with profit funds. The decrease in fair value movement is offset by a corresponding increase in Net other operating income and a decrease in Net insurance claims incurred and movement in policyholders' liabilities.

Life insurance activities, generated a profit before tax of €12.6 million, up €0.8 million or 7.2 per cent compared to 2009 profit before tax of €11.7 million.

Operating expenses

Operating expenses of €87.6 million were €3.8 million or 4.6 per cent higher compared to the previous year with a cost to income ratio of 49.7 per cent compared to 52.5 per cent in 2009.

Employee compensation and benefits increased by €1.5 million driven primarily by an increase in bonus costs reflecting the group's improved level of performance over 2009.

General and administrative expenses increased by €3.0 million to €30.1 million as a result of investment in branch refurbishments, customer segmentation, channel and process migration, IT systems as well as the cost of increased business volumes.

Depreciation and amortisation charges of €6.8 million decreased by €0.7 million compared to the previous year.

The cost efficiency ratio improved to 49.7 per cent compared to 52.5 per cent in 2009 as growth in operating income outpaced the increased expenditure resulting in positive jaws.

Net impairment

In a challenging economic environment, loan impairments increased modestly by €1.0 million to €5.3 million.

Impairment reversals contributed €5.1 million to profitability. New impairment allowances of €9.1 million were raised and bad debt write-offs of €1.3 million were effected.

The quality of the overall loan book remains good with non-performing loans at 3.0 per cent of net loans (2009: 2.9 per cent).

Taxation

The 2010 effective rate of tax was 35.3 per cent. Tax expense for 2010 amounted to €29.3 million.

Assets

Total assets amounted to €5,664.6 million, 10.7 per cent higher than at 31 December 2009. This liability driven growth was invested in Treasury Bills and debt securities investments as deposit growth exceeded loan demand and as part of the bank's liquidity management.

Balances with Central Bank of Malta, Treasury Bills and cash holdings increased from a prior year end level of €172.7 million to a year end level of €380.0 million.

Net loans and advances to customers increased by €77.4 million to €3,303.8 million supported by growth in both the personal and commercial sectors.

Advances to deposits ratio improved to 74.0 per cent from 79.0 per cent in 2009 as a result of strong deposits growth.

The available-for-sale investment portfolio increased by €220.5 million to €690.6 million. This portfolio remained well diversified and conservative. A fair value gain of €1.2 million on this portfolio was credited to revaluation reserve, net of tax.

Life insurance business assets, are primarily designated as financial assets at fair value through profit or loss. This portfolio increased by €57.7 million to €306.3 million from a prior year end level of €248.6 million.

Liabilities

Total liabilities increased by €519.5 million to €5,330.7 million.

Amounts owed to customers increased by €376.2 million to €4,462.9 million compared to €4,086.7 million as at 31 December 2009 in a period characterised by a number of bond issues and growing competitive pressures.

Funds under management by the group increased to a year end closing level of €704.7 million, up from an opening year level of €419.0 million.

Liabilities under insurance contracts issued increased by €58.9 million during the year to reach a year end level of €410.5 million.

Shareholders' funds

Equity totalled €333.8 million at year end following dividend payments of €30.2 million during 2010.

The number of shareholders increased from 10,362 to 10,454 as at 31 December 2010.

Capital adequacy ratio at 10.2 per cent is well above regulatory capital requirements.

Report of the Directors

Results for 2010

The group reported a profit on ordinary activities before tax of €83.1 million for the year under review. The group's profit attributable to shareholders of the bank was €53.8 million.

A gross interim ordinary dividend of 7.9 euro cent was paid on 24 August 2010. The Directors have proposed a gross final dividend of 7.7 euro cent per ordinary share. The final dividend will be payable to shareholders on the bank's register as at 8 March 2011.

Further information about the results is provided in the income statement and statement of comprehensive income on pages 24 and 25.

Principal activities

Principal activities of parent company

The bank is authorised to carry on the business of banking under the Banking Act, 1994 as a credit institution. It is also an authorised dealer in terms of the Exchange Control Act and a licensed financial intermediary in terms of the Financial Markets Act, 1990. The bank also holds Category 3 and Category 4 Investment Services licenses issued by the Malta Financial Services Authority in terms of the Investment Services Act, 1994. These licenses authorise the bank to provide both investment services to third parties and trustee or custodian services for collective investment schemes.

The bank provides a comprehensive range of banking and financial related services through its various branches and offices. Refer to the list of branches and offices on page 94.

The bank had the following subsidiaries at 31 December 2010: HSBC Life Assurance (Malta) Limited, HSBC Global Asset Management (Malta) Limited, HSBC Securities Services (Malta) Limited and HSBC Stockbrokers (Malta) Limited.

Principal activities of subsidiaries

HSBC Life Assurance (Malta) Limited is authorised by the Malta Financial Services Authority to carry on business of insurance in Malta under the Insurance Business Act, 1998. HSBC Bank Malta p.l.c. is enrolled as a tied insurance intermediary for HSBC Life Assurance (Malta) Limited under the Insurance Act 2006.

HSBC Global Asset Management (Malta) Limited is the investment management arm of the bank. It manages a range of domestic and international funds, specialising in the development of structured capital secured investment products, and in the provision of tailor-made discretionary portfolio management services. The company offers both Open and Close ended types of funds and investments.

HSBC Securities Services (Malta) Limited is licensed under the Investment Services Act, 1994 and its main business activity is the provision of fund administration services to proprietary and third party investment funds. It also provides back office support to HSBC Bank Malta p.l.c. in the distribution of third party investment funds through the bank network.

HSBC Stockbrokers (Malta) Limited is a member of the Malta Stock Exchange and is regulated under the Investment Services Act, 1994 by the Malta Financial Services Authority. The company is principally engaged in providing stockbroking business on the Malta Stock Exchange and to arrange/support the listing of stocks and shares on the Exchange.

Business review

A review of the business of the bank and its subsidiaries during the year under review and an indication of likely future developments are given in the 'Chief Executive Officer's Review' on pages 5 to 9.

Transactions in own shares

The bank holds units in a mutual fund which invests in the bank's shares. During the year, the bank indirectly disposed 14,435 own shares bringing the total number of shares indirectly held at 31 December 2010 to 35,617.

Shareholder Register Information pursuant to Listing Rule 5.64

HSBC Bank Malta p.l.c. (the 'bank') authorised share capital is €141,000,000. The issued and fully paid up capital is €87,552,000 divided into 291,840,000 Ordinary Shares of a nominal value of 30.0 euro cent each. The issued share capital consists of one class of ordinary shares with equal voting rights attached and freely transferable.

HSBC Europe B.V. holds 70.03% of the bank's shares.

The largest single shareholder of the company, provided it holds at least thirty three per cent (33%) of the ordinary issued share capital of the company, shall be entitled to appoint the Chairman from amongst the Directors appointed or elected to the Board.

Every shareholder owning eleven per cent (11%) of the ordinary issued share capital, shall be entitled to appoint one Director for each and every eleven per cent (11%) of the ordinary issued share capital of the company owned by such shareholder. Any fractional shareholding not so utilised in the appointment of Director(s) shall be entitled to participate in the voting for the election of further Directors.

There is an Achievement Shares scheme in existence whereby employees in the GCB4 grade and higher can be awarded shares in HSBC Holdings plc, depending on their performance. Share awards will be released to the individual after 3 years, provided the participant remains continuously employed within the Group. During the 3-year period the employee has no voting rights whatsoever.

The rules governing the appointment of Board members are contained in the bank's Articles of Association, Articles 77 to 80. An extraordinary resolution approved by the shareholders in the general meeting is required to amend the Articles of Association.

The powers of the Directors are outlined in Articles 73, 74 and 85 of the bank's Articles of Association. In terms of Article 12 of said Articles of Association the bank may, subject to the provisions of the Companies Act 1995, acquire or hold any of its shares.

The Collective Agreement regulates redundancies, early retirement, resignation or termination of employment of employees. There are no contracts between the bank and the Directors on the bank's Board.

It is hereby declared that, as at 31 December 2010, the requirements pursuant to Listing Rules 5.64.7 and 5.64.10 did not apply to the bank.

Shareholder Register Information

Directors' interest in the share capital of the company or in related companies at 31 December 2010:

Albert Mizzi	8,000 shares
Saviour sive Sonny Portelli	4,860 shares
Philip Farrugia Randon	6,400 shares

Mr Charles John Farrugia has a non-beneficial interest of 7,511,587 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding held by Amalgamated Investments Sicav p.l.c. and a non-beneficial interest of 15,000 ordinary shares through the shareholding held by Industrial Management Ltd.

Mr Peter Paul Testaferrata Moroni Viani has a beneficial interest of 58,800 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding of Testaferrata Moroni Viani (Holdings) Limited, 40,000 ordinary shares through the shareholding of Capps Ltd, 40,000 ordinary shares through the shareholding of Viani Limited and 5,000 ordinary shares through the shareholding of Sales and Letting Limited. He also has a non-beneficial interest of 130,680 ordinary shares in HSBC Bank Malta p.l.c. through the shareholding of Santumas Shareholdings p.l.c. under Custodianship HSBC Bank Malta p.l.c.

There were no changes to Directors' interest from 31 December 2010 to 31 January 2011.

Shareholders holding five per cent (5%) or more of the equity capital at 31 January 2011:

HSBC Europe B.V.	70.03%

Number of shareholders at 31 January 2011:

One class of shares (All shares have equal voting rights)	10,434 shareholders

Report of the Directors (continued)

Number of shareholders analysed by range

	31 January 2011	
Range of shareholding	Total shareholders	Shares
1 – 500	2,151	668,237
501 – 1,000	1,620	1,312,758
1,001 – 5,000	4,214	10,589,556
5,001 and over	2,449	279,269,449
Total Shareholding	**10,434**	**291,840,000**

Standard licence conditions

In accordance with the Investment Services Rules For Investment Services Providers regulated by the Malta Financial Services Authority, licence holders are required to include in the Report of the Directors breaches of standard licence conditions or other regulatory requirements. Accordingly, the Directors confirm that no breaches of the standard licence conditions and no other breach of regulatory requirements, which were subject to administrative penalty or regulatory sanction were reported.

Board of Directors

The Directors who served during the year and after year end are as follows:

Albert Mizzi (Chairman)
Alan Richards
Sally Robson (resigned on 9 February 2011)
Philip Farrugia (appointed on 15 February 2011)
Anthony Mahoney (resigned on 6 May 2010)
Peter William Boyles (appointed on 6 May 2010)
Philip Farrugia Randon
Charles John Farrugia
Peter Paul Testaferrata Moroni Viani
Saviour sive Sonny Portelli
James Dunbar Cousin

Senior management

As at 31 December 2010, the senior management of the group was composed of the following:

Alan Richards	Chief Executive Officer
Sally Robson	Chief Technology and Services Officer
Philip Farrugia	Head of Service Delivery
Stewart Luscott-Evans	Chief Risk Officer
Josephine Magri	Chief Financial Officer
Andrew Ripley	Head of Personal Financial Services
Richard Cottell	Head of Commercial Banking
Chris Bond	Head of Global Banking and Markets
Mark Sims	Head of Human Resources
John Sammut	Head of Audit, Compliance and Legal
Joseph Borg	Head of IT
Brian Tortell	Head of Marketing
Richard Philip Jones	Head of Insurance Services
Charles Azzopardi	Head of Funds Administration
Nicolò Baldacchino Orland	Head of Customer Experience and Deputy Head of Service Delivery
Gail Mohammed	Head of Capital Management and Planning
Peter Calleya	Head of Strategic Planning
Ray Briffa	Head of Branch Banking and Direct Channels
Martin Scicluna	Head of Wealth Management
Michel Cordina	Deputy Head of Commercial Banking
Stephen Pandolfino	Head of Global Markets and Investment Banking
Reuben Fenech	Head of Global Asset Management
Monica Dick	Head of Financial Institutions
Josef Camilleri	Head of Public Affairs and CSR

Auditors

KPMG have expressed their willingness to continue in office. A resolution proposing the reappointment of KPMG as auditors of the bank will be submitted at the forthcoming Annual General Meeting.

Going Concern

As required by Listing Rule 5.62, upon due consideration of the bank's profitability and statement of financial position, capital adequacy and solvency, the Directors confirm the bank's ability to continue operating as a going concern for the foreseeable future.

Statement by the Directors pursuant to Listing Rule 5.70.1

Pursuant to Listing Rule 5.70.1 there were no material contracts to which the bank, or anyone of its subsidiary undertakings, was party to and in which anyone of the Directors was directly or indirectly interested.

Statement by the Directors pursuant to Listing Rule 5.68

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the requirements of International Financial Reporting Standards as adopted by the EU give a true and fair view of the assets, liabilities, financial position and profit or loss of the bank and its subsidiaries included in the consolidation taken as a whole and that this report includes a fair review of the development and performance of the business and the position of the bank and its subsidiaries included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Signed on behalf of the Board on 18 February 2011 by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

Statement of Compliance with the Principles of Good Corporate Governance

As required by the Listing Rules of the Listing Authority, HSBC Bank Malta p.l.c. (the 'bank') hereby includes a Statement of Compliance which deals with the extent to which the bank has adopted the Code of Principles of Good Corporate Governance (the 'Principles') and the effective measures that the bank has taken to ensure compliance with these Principles as issued by the Malta Listing Authority as at 16 November 2010.

Compliance with the Principles

Although the Principles are not mandatory, the Board of Directors (the 'Board') of the bank believes in their adoption, and has endorsed them except where there exist particular circumstances that warrant non-adherence thereto.

In line with the Principles, the Board's composition is a mixture of a non-executive Chairman, two executive Directors, three non-executive Directors and three independent non-executive Directors. All the Directors, individually and collectively, are of the appropriate calibre, with the necessary skills and experience to assist them in providing leadership, integrity and judgement in directing the bank. Furthermore, the roles of the Chief Executive Officer and the Chairman are separate.

Internal control

The Board is ultimately responsible for the bank's system of internal control and for reviewing its effectiveness. Such procedures are designed to manage rather than to eliminate the risk of failure, to achieve business objectives and can only provide reasonable and not absolute assurance against material error, losses or fraud.

– Authority to operate the bank is delegated to the Chief Executive Officer within the limits set by the Board of the bank. Functional, operating and financial reporting standards are applicable within all entities of the HSBC Group. These are supplemented by operating standards set by the bank's management, as required.

– Systems and procedures are in place in the bank to identify, control and to report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error and fraud. Exposure to these risks is monitored by the Asset and Liability Management Committee, Credit Risk Management Committee and by the Group Risk Management Committee.

– Comprehensive annual financial plans are prepared, reviewed and approved by the Board. Results are monitored and reports on progress compared with plan are prepared monthly. Financial accounting and reporting and certain management reporting standards have been established. Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes.

– Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in the bank has been given the responsibility to implement HSBC policies, procedures and standards in the areas of finance; legal and regulatory compliance; internal audit; human resources; credit; market risk; operational risk; computer systems and operations; property management; and for certain HSBC Group business and product lines.

– The internal audit function monitors compliance with policies and standards and the effectiveness of internal control structures within the bank and its subsidiaries. The work of the internal audit function focuses on areas of greatest risk as determined by a risk management approach.

– The bank's Compliance Department ensures that HSBC Bank Malta group complies with all the local and international regulatory obligations and HSBC Group standards and regulations.

Through the Audit Committee, the Board reviews the processes and procedures to ensure the effectiveness of the system of internal control of the bank and its subsidiaries, which are monitored by internal audit.

Appointment/election of Directors

The Memorandum of Association of the bank specifically regulates the appointment of Directors. The Board consists of not more than nine Directors who are appointed/elected by the shareholders. Unless appointed for a shorter or longer period but not exceeding three years, a Director shall hold office from the end of one Annual General Meeting to the end of the next. Every shareholder owning eleven per cent (11%) of the ordinary share capital is entitled to appoint one Director for each eleven per cent (11%) shareholding. The majority shareholder therefore has the right to appoint six Directors. Furthermore, any excess fractional shareholding not so utilised may be used to participate in the voting for the election of further Directors. Shareholders who own less than 11 per cent (11%) of the ordinary share capital participate in the election of the remaining three Directors.

The largest single shareholder (subject to a minimum thirty three per cent (33%) holding of the ordinary issued share capital of the company), is entitled to appoint a chairman from amongst the Directors appointed or elected to the Board. Every poll for the election of Directors is overseen by the bank's external auditors.

Responsibilities of the Board

The Board meets on a quarterly basis, unless further meetings are required, to review and evaluate corporate strategy, major operational and financial plans, risk policy and financial performance objectives. It also monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice.

The Board has delegated specific authority to the Chief Executive Officer to manage activities of the bank within the limits set by it.

Board meetings are at times attended by the Chief Risk Officer Europe and by the Global Head of Commercial Banking. They provide the Board with an insight over the Group's best practice in their respective sectors.

During the year an evaluation of Board performance was carried out under the supervision of the company secretary through the completion of a Board self-evaluation questionnaire by all the Directors. Observations arising from this exercise will be followed upon, and certain changes implemented so as to maximise Board effectiveness.

Directors' attendance at Board Meetings during 2010:

Members	*Attended*
Albert Mizzi	4
Alan Richards	4
Sally Robson	4
Charles John Farrugia	4
Anthony Mahoney (resigned on 6 May 2010)	1 (out of 1)
Peter William Boyles (appointed on 6 May 2010)	2 (out of 3)
Philip Farrugia Randon	4
Peter Paul Testaferrata Moroni Viani	4
Saviour sive Sonny Portelli	4
James Dunbar Cousin	4

Directors have access to independent legal advice at the bank's expense where the Board deems appropriate. The Board concentrates primarily on strategy, policy setting, business plans and financial information.

On joining the Board, a Director is provided with a handbook containing the main provisions of law, which regulate his office. The Director also attends a presentation made by the functional heads on the activities of their respective business units in the bank. The Directors also receive updates on changes, if any, to group's short term strategic and operational plans and quarterly updates by the Heads of Personal Financial Services, Commercial Banking, Global Banking and Markets and Marketing.

As part of the bank's succession planning the Board implements appropriate schemes to recruit, retain and motivate high quality executive officers and management to move to the higher ranks of the organisation. Several initiatives are being taken to further progress staff's development, amongst them Springboard, Navigator, Bridge To Success and Career Adventure, all HSBC staff development programmes.

Directors' dealings

On joining the Board and regularly thereafter, Directors are informed and reminded of their obligations on dealing in securities of the bank within the parameters of law and the Listing Rules. A proper procedure of reporting advanced notices to the Chairman by a director who intends to deal in the bank's shares has been endorsed by the Board in line with the Principles, the Listing Rules and the internal code of dealing.

Statement of Compliance with the Principles of Good Corporate Governance (continued)

Committees

Executive committee (EXCO)

The executive committee meets on a monthly basis to oversee the overall day to day management of the bank in accordance with such policies and directions as the Board may from time to time determine. The Chief Executive Officer chairs this committee which is composed of the Chief Technology and Services Officer together with the top management of the bank.

Asset and liability management committee (ALCO)

This committee reviews the financial risks of the group in Malta and ensures their prudent management: interest rate risk, liquidity and funding risk, foreign exchange risk, capital solvency, market sector risk and country risk. Furthermore, ALCO monitors the external environment and measures the impact on profitability of factors such as interest rate volatility, market liquidity, exchange rate volatility, monetary and fiscal policies and competitor banks' activity.

The Chief Executive Officer has primary responsibility for ensuring efficient development of asset and liability management. Membership consists of senior executives with responsibility for the following functions: corporate banking, retail banking, treasury, financial control, marketing and credit. The ALCO, which is chaired by the Chief Executive Officer and deputised by the Chief Technology and Services Officer, meets once a month.

Credit risk management committee

This committee reviews the credit risk management issues of the group in Malta. It meets on a monthly basis and is chaired by the Chief Executive Officer and deputised by the Chief Technology and Services Officer. Membership consists of senior executives with responsibility for the following functions: credit and risk management, corporate banking, retail banking, treasury, consumer finance and audit and compliance.

Group risk management committee

This committee reviews the operational risks of the group in Malta: the identification, measurement, monitoring and controlling operational business risks and determines and agrees strategies and policies to mitigate these risks.

This committee which meets on a monthly basis is chaired by the Chief Technology and Services Officer and is composed of the Chief Financial Officer, the Chief Risk Officer, the Head of Audit, Compliance and Legal, Head of Security and Fraud Risk and other business heads.

Audit committee

This committee met five times during this year. Its terms of reference were originally modelled mainly on the recommendations in the Cadbury Report and are compliant with the Listing Rules. This year these terms of reference have been broadened to extend the committee's increased focus over risk factors and over the bank's risk appetite as recommended by the UK Walker Review of corporate governance in UK banks and other financial industry entities. As a direct result of these amendments the Chief Risk Officer started to attend the meetings of this committee.

The primary purpose of this committee is to protect the interests of the bank's shareholders and assist the directors in conducting their role effectively so that the bank's decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times.

The Audit committee also scrutinises and monitors related party transactions. It considers the materiality and the nature of the related party transactions carried out by the bank to ensure that the arm's length principle is adhered to at all times. Its members are Messrs Saviour sive Sonny Portelli (Chairman) and Peter Paul Testaferrata Moroni Viani who are independent non-executive directors and Dr Philip Farrugia Randon LL.D. who is a non-executive director. Executives of the bank are available to attend any of the meetings as directed by the committee. The Chief Executive Officer, the Chief Technology and Services Officer and a representative of the external auditors attend the meetings. In line with Listing Rule 5.129, the Head of Internal Audit is always present for the Audit committee meetings and has a right of direct access to the Chairman of the Committee at all times. The Head of Continental Europe Audit also attends these meetings.

Mr Saviour sive Sonny Portelli was appointed by the Board in terms of Listing Rule 5.117 on the basis that he has a long and distinguished career in both public companies and private enterprise. Presently, Mr Portelli is also Chairman of the Malta Council for Economic and Social Development and Chairman of Air Malta p.l.c. Mr Portelli has served on the bank's Board of Directors since October 2006 where his contributions have demonstrated that he is highly competent in accounting and au courant with accounting standards and practices and that he also possesses the qualities and experience required to discharge his duties as Chairman of this Committee. Despite the fact that Mr Portelli has indirect significant business relationship with the bank the fact that he chairs the boards of various high profile entities is testimony to the fact that he is deemed to be a person who is capable to exercise his free and independent judgement in all circumstances.

As Chairman of the Committee Mr Portelli attends the Group's annual Audit Committee Chairmen's Forum. This provides the Chairman with the latest updates on key considerations, priorities and challenges facing the Committee.

In terms of Listing Rule 5.125.6, the Audit committee is responsible for developing and implementing a policy on the engagement of the external auditor to supply non-audit services. Since HSBC Holdings plc is a Securities Exchange Commission (SEC) registered company, non-audit services provided by the external auditor are regulated in terms of the SEC rules.

Remuneration Committee (REMCO)

The remuneration committee established within HSBC Bank Malta p.l.c. is set up on a similar basis to its counterparts in the HSBC Group and hence is different in character from the 'remuneration committee' envisaged under the Code of Principles of Good Corporate Governance. Namely the Board does not appoint a committee to fix the remuneration packages of the individual Directors.

This remuneration committee meets primarily to review the compensation policy of HSBC Bank Malta p.l.c. and to make annual recommendations which are then sent to HSBC Bank plc for concurrence on pay review, salary increases and bonuses for key management personnel. It is presently chaired by Mr Albert Mizzi (non-executive director) and comprises Messrs Peter Paul Testaferrata Moroni Viani, Saviour sive Sonny Portelli and Dr Philip Farrugia Randon LL.D. During 2010 one meeting was held by this committee.

Shareholders

The principal contact with shareholders takes place via the annual and extraordinary general meetings. These meetings are called with sufficient notice and enable the use of proxies to attend, vote or abstain. Matters before an extraordinary general meeting are considered extraordinary business and sufficient explanation of the proposals is provided in advance of the meeting for proper evaluation by the shareholders.

Regular contact with shareholders is also maintained via company and media announcements.

In terms of the bank's Articles of Association the Directors shall on the requisition of members of the company holding not less than one-tenth of the paid up share capital proceed duly to convene an extraordinary general meeting of the company.

Corporate Social Responsibility

HSBC's Corporate Social Responsibility (CSR) activities take place within the context of the Group wide strategy. In Malta the bank fulfils the Group's CSR strategy primarily through the HSBC Malta Foundation.

This charitable Foundation deals with issues that concern the public in general by supervising projects in relation to underprivileged children, the environment and Malta's national heritage. These activities have a significant impact on a large majority of Maltese citizens and show the bank's strong commitment towards social investment.

Signed on behalf of the Board on 18 February 2011 by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

Remuneration Report

None of the Directors are employed with the bank on a definite service contract. Those Directors who are employed with the bank are so employed on an indefinite basis.

Directors' remuneration for the financial year under review:

	€
– Directors' fees	135,380
– Directors' salaries and bonuses as full-time bank employees	409,771

Details of Directors' fees for the financial year under review were as follows:

	€
Albert Mizzi	31,450
Saviour sive Sonny Portelli	27,375
Philip Farrugia Randon	27,050
Peter Paul Testaferrata Moroni Viani	20,385
James Dunbar Cousin	14,560
Charles John Farrugia	14,560
Total	135,380

Directors' salaries and bonuses are being disclosed in aggregate rather than as separate figures for each Director as required by the Principles of Good Corporate Governance.

No Director is entitled to profit sharing, share options, pension benefits (other than performance-related bonus awards) or any other remuneration, directly from the bank.

Executive Directors may be entitled to HSBC Holdings plc share options as detailed in note 13 of the Notes on the Financial Statements and certain pension and early retirement benefits.

The Directors' fees are approved in aggregate by shareholders at the Annual General Meeting. Those Directors who are employed with the bank are not paid any fees for their directorship.

Directors' Responsibilities Statement

The Companies Act, 1995 requires the Directors of HSBC Bank Malta p.l.c. (the 'bank') to prepare financial statements for each financial period which give a true and fair view of the financial position of the bank and the group as at the end of the financial period and of the profit or loss of the bank and the group for that period in accordance with the requirements of International Financial Reporting Standards as adopted by the EU.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the bank and the group and to enable them to ensure that the financial statements have been properly prepared in accordance with the provisions of the Companies Act, 1995 and the Banking Act, 1994.

The Directors are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors, through oversight of management, are responsible to ensure that the bank establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Management is responsible, with oversight from the Directors, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the group's business. This responsibility includes establishing and maintaining controls pertaining to the bank's objective of preparing financial statements as required by the Companies Act, 1995 and managing risks that may give rise to material misstatements in those financial statements. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

Signed on behalf of the Board of Directors by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

Income Statements for the year 1 January 2010 to 31 December 2010

		Group		*Bank*	
		2010	2009	**2010**	2009
	Note	**€000**	€000	**€000**	€000
Interest receivable and similar income					
– on loans and advances, balances with Central Bank of Malta, Treasury Bills and other instruments	*6*	**151,585**	155,408	**151,583**	155,401
– on debt and other fixed income instruments	*6*	**17,427**	13,630	**13,607**	11,535
Interest payable	*7*	**(46,170)**	(64,068)	**(46,813)**	(65,319)
Net interest income		**122,842**	104,970	**118,377**	101,617
Fees and commissions receivable		**36,993**	34,259	**32,702**	31,148
Fees and commissions payable		**(2,713)**	(1,895)	**(2,448)**	(1,637)
Net fee and commission income	*8*	**34,280**	32,364	**30,254**	29,511
Dividend income	*9*	**–**	43	**7,538**	10,581
Trading profits	*10*	**6,816**	7,221	**6,816**	7,221
Net income from insurance financial instruments designated at fair value through profit or loss	*12*	**19,707**	26,717	**–**	–
Net (losses)/gains on sale of available-for-sale financial investments	*11*	**(369)**	1,268	**(370)**	1,184
Net earned insurance premiums	*12*	**58,738**	52,878	**–**	–
Net other operating income	*12*	**5,162**	(2,232)	**1,061**	892
Total operating income		**247,176**	223,229	**163,676**	151,006
Net insurance claims incurred and movement in policyholders' liabilities	*12*	**(70,988)**	(63,570)	**–**	–
Net operating income	*12*	**176,188**	159,659	**163,676**	151,006
Employee compensation and benefits	*13*	**(50,723)**	(49,252)	**(48,380)**	(46,680)
General and administrative expenses		**(30,081)**	(27,047)	**(28,357)**	(25,599)
Depreciation		**(5,821)**	(6,322)	**(5,802)**	(6,301)
Amortisation		**(980)**	(1,148)	**(896)**	(1,041)
Net operating income before impairment charges and provisions		**88,583**	75,890	**80,241**	71,385
Net impairment	*14*	**(5,496)**	(4,429)	**(5,266)**	(4,232)
Net provisions for liabilities and other charges		**1**	(265)	**20**	(237)
Profit before tax	*15*	**83,088**	71,196	**74,995**	66,916
Tax expense	*16*	**(29,327)**	(25,329)	**(24,696)**	(22,261)
Profit for the year		**53,761**	45,867	**50,299**	44,655
Profit attributable to shareholders		**53,761**	45,867	**50,299**	44,655
Earnings per share	*17*	**18.4c**	15.7c	**17.2c**	15.3c

The notes on pages 30 to 86 are an integral part of these financial statements.

Statements of Comprehensive Income for the year 1 January 2010 to 31 December 2010

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Profit attributable to shareholders	**53,761**	45,867	**50,299**	44,655
Other comprehensive income				
Available-for-sale investments:				
– change in fair value	**1,178**	17,496	**1,997**	16,132
– change in fair value transferred to profit or loss	**567**	(1,071)	**370**	(1,184)
– income taxes	**(610)**	(5,749)	**(828)**	(5,232)
Properties:				
– revaluation	**2,117**	–	**2,117**	–
– income taxes	**(89)**	–	**(89)**	–
Other comprehensive income for the year, net of tax	**3,163**	10,676	**3,567**	9,716
Total comprehensive income for the year, net of tax	**56,924**	56,543	**53,866**	54,371

The notes on pages 30 to 86 are an integral part of these financial statements.

Statements of Financial Position at 31 December 2010

		Group		Bank	
		2010	2009	**2010**	2009
	Note	**€000**	€000	**€000**	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	*18*	**379,985**	172,671	**379,984**	172,670
Cheques in course of collection		**9,011**	10,764	**9,011**	10,764
Derivatives	*19*	**11,489**	11,746	**11,686**	11,964
Financial assets designated at fair value through profit or loss	*20*	**306,299**	248,553	**–**	–
Financial investments	*21*	**690,606**	478,975	**593,107**	380,275
Loans and advances to banks	*22*	**714,901**	747,657	**714,850**	747,582
Loans and advances to customers	*23*	**3,303,835**	3,226,477	**3,303,835**	3,226,477
Shares in subsidiary companies	*24*	**–**	–	**35,707**	35,707
Intangible assets	*25*	**70,655**	60,691	**7,583**	1,741
Property and equipment	*26*	**65,487**	65,397	**65,580**	65,470
Investment property	*27*	**14,591**	14,588	**11,668**	11,665
Assets held for sale	*28*	**9,674**	10,604	**9,674**	10,604
Current tax assets		**4,712**	6,164	**4,516**	4,516
Deferred tax assets	*33*	**10,181**	9,053	**9,902**	8,766
Other assets	*29*	**34,425**	20,712	**9,439**	7,931
Prepayments and accrued income	*30*	**38,710**	33,748	**34,256**	30,006
Total assets		**5,664,561**	5,117,800	**5,200,798**	4,726,138
Liabilities					
Derivatives	*19*	**12,311**	11,044	**12,313**	11,046
Amounts owed to banks	*31*	**232,790**	168,771	**232,790**	168,771
Amounts owed to customers	*32*	**4,462,861**	4,086,669	**4,517,763**	4,146,295
Provision for current tax		**2,603**	207	**953**	–
Deferred tax liabilities	*33*	**19,604**	18,851	**–**	–
Liabilities to customers under investment contracts	*34*	**18,962**	16,853	**–**	–
Liabilities under insurance contracts issued	*35*	**410,461**	351,513	**–**	–
Other liabilities	*36*	**46,424**	35,479	**42,721**	32,221
Accruals and deferred income	*37*	**36,304**	33,422	**35,327**	33,068
Provisions for liabilities and other charges	*38*	**531**	577	**494**	514
Subordinated liabilities	*39*	**87,880**	87,827	**87,880**	87,827
Total liabilities		**5,330,731**	4,811,213	**4,930,241**	4,479,742
Equity					
Share capital	*40*	**87,552**	87,552	**87,552**	87,552
Revaluation reserve	*41*	**28,674**	25,825	**28,283**	25,030
Retained earnings	*41*	**217,604**	193,210	**154,722**	133,814
Total equity		**333,830**	306,587	**270,557**	246,396
Total liabilities and equity		**5,664,561**	5,117,800	**5,200,798**	4,726,138
Memorandum items					
Contingent liabilities	*42*	**128,947**	119,917	**128,970**	119,940
Commitments	*43*	**977,718**	923,900	**977,718**	923,900

The notes on pages 30 to 86 are an integral part of these financial statements.

The financial statements on pages 24 to 86 were approved and authorised for issue by the Board of Directors on 18 February 2011 and signed on its behalf by:

Albert Mizzi, *Chairman*

Alan Richards, *Chief Executive Officer*

Statements of Changes in Equity for the year 1 January 2010 to 31 December 2010

	Note	*Share capital* €000	*Revaluation reserve* €000	*Retained earnings* €000	*Total equity* €000
Group					
At 1 January 2010		**87,552**	**25,825**	**193,210**	**306,587**
Profit for the year		**–**	**–**	**53,761**	**53,761**
Other comprehensive income					
Available-for-sale investments:					
– change in fair value, net of tax		**–**	**766**	**–**	**766**
– change in fair value transferred to profit or loss, net of tax		**–**	**369**	**–**	**369**
Properties:					
– release of revaluation reserve upon disposal, net of tax		**–**	**(314)**	**314**	**–**
– revaluation of properties, net of tax		**–**	**2,028**	**–**	**2,028**
Total other comprehensive income		**–**	**2,849**	**314**	**3,163**
Total comprehensive income for the year		**–**	**2,849**	**54,075**	**56,924**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners:					
– share-based payments		**–**	**–**	**481**	**481**
– dividends	*45*	**–**	**–**	**(30,162)**	**(30,162)**
Total contributions by and distributions to owners		**–**	**–**	**(29,681)**	**(29,681)**
At 31 December 2010		**87,552**	**28,674**	**217,604**	**333,830**
At 1 January 2009		87,552	15,149	179,776	282,477
Profit for the year		–	–	45,867	45,867
Other comprehensive income					
Available-for-sale investments:					
– change in fair value, net of tax		–	11,500	–	11,500
– change in fair value transferred to profit or loss, net of tax		–	(824)	–	(824)
Total other comprehensive income		–	10,676	–	10,676
Total comprehensive income for the year		–	10,676	45,867	56,543
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners:					
– share-based payments		–	–	384	384
– dividends	*45*	–	–	(32,817)	(32,817)
Total contributions by and distributions to owners		–	–	(32,433)	(32,433)
At 31 December 2009		87,552	25,825	193,210	306,587

The notes on pages 30 to 86 are an integral part of these financial statements.

Statements of Changes in Equity for the year 1 January 2010 to 31 December 2010 (continued)

	Note	*Share capital* €000	*Revaluation reserve* €000	*Retained earnings* €000	*Total equity* €000
Bank					
At 1 January 2010		**87,552**	**25,030**	**133,814**	**246,396**
Profit for the year		**–**	**–**	**50,299**	**50,299**
Other comprehensive income					
Available-for-sale investments:					
– change in fair value, net of tax		**–**	**1,298**	**–**	**1,298**
– change in fair value transferred to profit or loss, net of tax		**–**	**241**	**–**	**241**
Properties:					
– release of revaluation reserve upon disposal, net of tax		**–**	**(314)**	**314**	**–**
– revaluation of properties, net of tax		**–**	**2,028**	**–**	**2,028**
Total other comprehensive income		**–**	**3,253**	**314**	**3,567**
Total comprehensive income for the year		**–**	**3,253**	**50,613**	**53,866**
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners:					
– share-based payments		**–**	**–**	**457**	**457**
– dividends	*45*	**–**	**–**	**(30,162)**	**(30,162)**
Total contributions by and distributions to owners		**–**	**–**	**(29,705)**	**(29,705)**
At 31 December 2010		**87,552**	**28,283**	**154,722**	**270,557**
At 1 January 2009		87,552	15,314	121,606	224,472
Profit for the year		–	–	44,655	44,655
Other comprehensive income					
Available-for-sale investments:					
– change in fair value, net of tax		–	10,485	–	10,485
– change in fair value transferred to profit or loss, net of tax		–	(769)	–	(769)
Total other comprehensive income		–	9,716	–	9,716
Total comprehensive income for the year		–	9,716	44,655	54,371
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners:					
– share-based payments		–	–	370	370
– dividends	*45*	–	–	(32,817)	(32,817)
Total contributions by and distributions to owners		–	–	(32,447)	(32,447)
At 31 December 2009		87,552	25,030	133,814	246,396

The notes on pages 30 to 86 are an integral part of these financial statements.

Statements of Cash Flows for the year 1 January 2010 to 31 December 2010

		Group		*Bank*	
		2010	2009	**2010**	2009
	Note	**€000**	€000	**€000**	€000
Cash flows from operating activities					
Interest, commission and premium receipts		**254,711**	265,609	**187,992**	206,526
Interest, commission and claims payments		**(70,799)**	(103,916)	**(48,109)**	(83,838)
Payments to employees and suppliers		**(81,139)**	(80,017)	**(75,101)**	(75,910)
Operating profit before changes in operating assets/liabilities		**102,773**	81,676	**64,782**	46,778
(Increase)/decrease in operating assets:					
Trading instruments		**(43,064)**	36,917	**–**	391
Reserve deposit with Central Bank of Malta		**(8,335)**	4,575	**(8,335)**	4,575
Loans and advances to customers and banks		**(104,527)**	174,561	**(104,591)**	174,774
Treasury Bills		**(202,915)**	(32,931)	**(197,099)**	(48,690)
Other receivables		**(21,249)**	(3,814)	**3,173**	(2,983)
Increase in operating liabilities:					
Amounts owed to customers and banks		**374,995**	51,665	**370,291**	53,076
Other payables		**32,313**	7,728	**7,573**	359
Net cash from operating activities before tax		**129,991**	320,377	**135,794**	228,280
Tax paid		**(26,840)**	(26,879)	**(25,183)**	(21,167)
Net cash from operating activities		**103,151**	293,498	**110,611**	207,113
Cash flows (used in)/from investing activities					
Dividends received		**281**	387	**6,650**	8,628
Interest received from financial investments		**25,575**	16,115	**16,036**	15,444
Purchase of financial investments		**(307,715)**	(218,285)	**(307,688)**	(132,135)
Proceeds from sale and maturity of financial investments		**94,246**	187,399	**94,246**	180,805
Purchase of property and equipment, investment property and intangible assets		**(11,038)**	(4,174)	**(10,998)**	(4,112)
Proceeds on sale of property and equipment and intangible assets		**453**	2,097	**412**	1,949
Net cash (used in)/from investing activities		**(198,198)**	(16,461)	**(201,342)**	70,579
Cash flows used in financing activities					
Dividends paid		**(30,162)**	(32,817)	**(30,162)**	(32,817)
Cash used in financing activities		**(30,162)**	(32,817)	**(30,162)**	(32,817)
(Decrease)/increase in cash and cash equivalents		**(125,209)**	244,220	**(120,893)**	244,875
Effect of exchange rate changes on cash and cash equivalents		**31,624**	6,911	**31,624**	6,911
Net (decrease)/increase in cash and cash equivalents		**(156,833)**	237,309	**(152,517)**	237,964
		(125,209)	244,220	**(120,893)**	244,875
Cash and cash equivalents at beginning of year		**548,815**	304,595	**544,447**	299,572
Cash and cash equivalents at end of year	*46*	**423,606**	548,815	**423,554**	544,447

The notes on pages 30 to 86 are an integral part of these financial statements.

Notes on the Financial Statements

1 Reporting entity

HSBC Bank Malta p.l.c. (the 'bank') is a limited liability company domiciled and incorporated in Malta.

The consolidated financial statements of the bank as at and for the year ended 31 December 2010 comprise the bank and its subsidiaries (together referred to as the 'group' and individually as 'group entities').

2 Basis of preparation

a *Statement of compliance*

These financial statements have been prepared and presented in accordance with International Financial Reporting Standards as adopted by the EU ('the applicable framework'). All references in these financial statements to IAS, IFRS or SIC/IFRIC interpretations refer to those adopted by the EU.

They have also been drawn up in accordance with the provisions of the Banking Act, 1994 and the Companies Act, 1995, enacted in Malta to the extent that such provisions do not conflict with the applicable framework.

b *Basis of measurement*

Assets and liabilities are measured at historical cost except for certain intangible assets measured at the present value of in-force long-term insurance business, and the following that are measured at fair value:

- Derivatives;
- Financial instruments designated at fair value through profit or loss;
- Available-for-sale financial investments; and
- Property.

c *Functional and presentation currency*

The financial statements are presented in euro (€), which is the group's functional currency.

d *Use of estimates and assumptions*

The preparation of financial statements in conformity with IFRSs requires the use of estimates and assumptions about future conditions. The use of available information and application of judgement are inherent in the formation of estimates, actual results in the future may differ from those reported.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in notes 4, 25 and 53.

3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by group entities.

a *Basis of consolidation*

i Subsidiaries

Subsidiaries are entities controlled by the bank. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii Transactions eliminated on consolidation

Intra-group balances and income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3 Significant accounting policies *(continued)*

b *Financial instruments*

i Non-derivative financial instruments

Non-derivative financial instruments are recognised on trade date when the group enters into contractual arrangements with counterparties. These financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below:

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and deposits with contractual maturity of less than three months. Loans and advances to banks and Amounts owed to banks that are repayable on demand or have a contractual maturity of three months or less and which form an integral part of the group's cash management are included as a component of cash and cash equivalents for the purpose of the Statement of Cash Flows. Subsequent to initial recognition cash and cash equivalents are measured at amortised cost.

Trading assets and trading liabilities

Treasury Bills, debt securities, equity shares and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. Subsequent to initial recognition, their fair values are remeasured, and all gains and losses from changes therein are recognised in profit or loss in Trading profits as they arise.

Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. The group designates financial instruments at fair value when the designation:

- eliminates or significantly reduces valuation or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different basis. Under this criterion, the only class of financial instruments designated by the group is financial assets and financial liabilities under investment contracts.

  Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in profit or loss. Liabilities to customers under other types of investment contracts would be measured at amortised cost. If no designation was made for the assets relating to the customer liabilities they would be classified as available-for-sale and the changes in fair value would be recorded directly in other comprehensive income. These financial instruments are managed on a fair value basis and management information is also prepared on this basis. Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair values to be recorded in profit or loss and presented in the same line.

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion certain financial assets held to meet liabilities under insurance contracts are the main class of financial instruments so designated. The group has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets.

The fair value designation, once made, is irrevocable. Subsequent to initial recognition, the fair values are remeasured, and gains and losses from changes therein are recognised in Net income from insurance financial instruments designated at fair value through profit or loss.

Treasury Bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity.

3 Significant accounting policies *(continued)*

b *Financial instruments (continued)*

i Non-derivative financial instruments (continued)

Available-for-sale

Available-for-sale financial investments are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income until the financial assets are either sold or become impaired. When available-for-sale financial investments are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in profit or loss as Net (losses)/gains on sale of available-for-sale financial investments.

Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group positively intends, and is able, to hold until maturity. Held-to-maturity investments are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

Loans and advances to banks and customers

Loans and advances to banks and customers are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are recognised when the cash is advanced to the borrowers. They are subsequently measured at amortised cost using the effective interest method, less impairment losses.

ii Derivative financial instruments

Derivatives are recognised initially and are subsequently remeasured at fair value. Fair values of exchange traded derivatives are obtained from quoted market prices. Fair value of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models. All derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative.

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

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in profit or loss. These gains and losses are reported in Trading profits, except where derivatives are managed in conjunction with financial instruments designated at fair value in which case gains and losses are reported in Net income from insurance financial instruments designated at fair value through profit or loss.

Fair value hedge accounting

When derivatives are designated as hedges, the bank classifies them as either:

– hedges of the change in fair value of recognised assets or liabilities or firm commitments (‘fair value hedges’); or

– hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (‘cash flow hedges’).

Hedge accounting is applied to derivatives designated as hedging instruments in a fair value or cash flow hedge provided certain criteria are met.

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

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

3 Significant accounting policies *(continued)*

b *Financial instruments (continued)*

ii Derivative financial instruments (continued)

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

Hedge effectiveness testing

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

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

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80.0 per cent to 125.0 per cent.

Hedge ineffectiveness is recognised in profit or loss in Trading profits.

iii Derecognition of financial assets and liabilities

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

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

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

iv Offsetting financial assets and financial liabilities

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

v Repurchase transactions

The group enters into purchases of investments under agreement to resell substantially identical investments at a certain date in the future at a fixed price. Investments purchased subject to commitments to resell at future dates are not recognised. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for either assets held for trading or available-for-sale as appropriate. The proceeds from sale of the investments are reported as liabilities to either banks or customers.

The difference between the sale and repurchase consideration is recognised using the effective interest method over the period of the transactions and is included in interest.

c *Investment in subsidiaries*

Investment in subsidiaries is shown in the separate statement of financial position at cost less any impairment losses. Dividend income is recognised in profit or loss on the date that the bank's right to receive payment is established.

d *Intangible assets*

Intangible assets include software and the present value of in-force long-term insurance business.

Software acquired by the group is initially measured at cost and subsequently stated net of accumulated amortisation and any impairment losses. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in profit or loss as incurred.

3 Significant accounting policies *(continued)*

d *Intangible assets (continued)*

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of software, from the date it is available for use. The estimated useful life of software ranges between 3 – 5 years.

For the accounting policy governing the present value of in-force long-term insurance business see note 3i (iv).

e *Property and equipment*

i Owned assets

Property and equipment are initially measured at cost. Freehold and long leasehold properties are remeasured to fair value on the basis of their existing use. Revaluations are performed by a professionally qualified architect with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the reporting date. Any surpluses arising on revaluation are credited to a revaluation reserve, net of deferred tax. Any deficiencies resulting from decreases in value are deducted from this reserve to the extent that it is sufficient to absorb them, with any excess charged to profit or loss.

Items of property and equipment are stated net of accumulated depreciation and any impairment losses.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognised net in profit or loss within Net other operating income. When revalued assets are sold, the amounts included in the revaluation surplus reserve are transferred to retained earnings.

ii Finance and operating leases

Leases in terms of which the group assumes substantially all the risks and rewards of ownership are classified as finance leases.

When the group is a lessee under finance leases, the leased assets are capitalised and included in Property and Equipment and the corresponding liability to the lessor is included in Other liabilities. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in Net interest income over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When the group is the lessee, leased assets are not recognised on the statement of financial position. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in General and administrative expenses and Net other operating income respectively.

iii Subsequent costs

The cost of replacing a component of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

iv Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. Land is not depreciated. The estimated useful lives for the current and comparative period are as follows:

– long leaseholds, freehold buildings and improvements	50 years
– short leaseholds and improvements to rented property	over term of lease
– equipment, furniture and fittings	3 – 10 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date, if appropriate.

f *Investment property*

Property held for long-term rental yields or for capital appreciation or both that is not occupied by the group is classified as investment property.

3 Significant accounting policies *(continued)*

f *Investment property (continued)*

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

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g *Impairment*

i *Financial assets not at fair value through profit or loss*

At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial investment is calculated as the difference between the financial investment's acquisition cost (net of any principal repayments and amortisation) and the current fair value (less any previous impairment loss recognised in profit or loss).

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial investment recognised previously in equity is removed from other comprehensive income and transferred to profit or loss.

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Impairment losses are recorded as charges to profit or loss. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowances accounts. Losses expected as a result of future events, no matter how likely, are not recognised in profit or loss.

ii *Calculation of recoverable amount*

At each reporting date, the group assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining impairment losses on these loans, the following factors are considered:

- the group's aggregate exposure to the customer;
- the viability of the customer's business model and their capability to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the group and the likelihood of other creditors continuing to support the customer;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit risk mitigants) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's carrying amount.

Impairment is assessed on a collective basis in two circumstances:

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

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses incurred at the reporting date which will only be individually identified in the future.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);

3 Significant accounting policies *(continued)*

g *Impairment (continued)*

ii Calculation of recoverable amount (continued)

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the loss on an individual loan; and

– management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

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

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis:

– When appropriate empirical information is available, the group utilises roll rate methodology. This methodology employs a statistical analysis of historical trends of delinquency and default to estimate the likelihood that loans will progress through the various stages of delinquency and ultimately prove irrecoverable. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss.

– In other cases, when the portfolio size is small or when information is insufficient or not sufficiently reliable to adopt a roll rate methodology, the group adopts a formulaic approach which allocates progressively higher percentage loss rates the longer a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio.

  In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio. In certain circumstances, historical loss experience provides less relevant information about the inherent loss in a given portfolio at the reporting date, for example, where there have been changes in economic, regulatory or behavioural conditions, such that the most recent trends in the portfolio risk factors are not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

  Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

iii Non-financial assets

The carrying amounts of the group's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

The recoverable amount of non-financial assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

iv Reversals of impairment

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised.

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. For financial assets measured at amortised cost and available-for-sale financial investments that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial investments that are equity securities, the reversal is recognised directly in other comprehensive income.

3 Significant accounting policies *(continued)*

g *Impairment (continued)*

iv Reversals of impairment (continued)

An impairment loss on non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

v Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from realising the security have been received.

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h *Assets held for sale*

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the group's accounting policies. Thereafter generally the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

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i *Insurance and investment contracts*

Through its insurance subsidiary, the group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

Insurance contracts are accounted for as follows:

i Premiums

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are established.

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

ii Claims and reinsurance recoveries

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims. Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

iii Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated based on actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared against the carrying value of the liability. Where a shortfall is identified it is charged immediately to profit or loss.

Notes on the Financial Statements (continued)

3 Significant accounting policies *(continued)*

i *Insurance and investment contracts (continued)*

iv Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business, and are in force at the reporting date is recognised as an asset.

The present value of in-force long-term insurance business is determined by discounting future cash flows expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. Movements in the present value of in-force long-term insurance business are included in Net other operating income on a gross of tax basis.

v Investment contracts

Investment contracts are those contracts where there is no significant insurance risk.

Customer liabilities under unit-linked investment contracts and the linked financial assets are designated at fair value through profit or loss, and the movements in fair value are recognised in profit or loss in Net income from insurance financial instruments designated at fair value through profit or loss.

Premiums receivable and amounts withdrawn are accounted for as increases/decreases in the liability recorded in respect of investment contracts.

Liabilities under unit-linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Investment management fees receivable are recognised in profit or loss over the period of the provision of the investment management services in Net fee and commission income.

The incremental costs directly related to the acquisition of new investment contracts or renewal of existing investment contracts are deferred and amortised over the period of the provision of the investment management services.

j *Provisions*

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

k *Financial guarantee contracts*

Financial guarantees are contracts that require the group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The financial guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment when a payment under the guarantee has become probable. Financial guarantees are included within Amounts owed to customers.

l *Interest income and expense*

Interest income and expense for all interest-bearing financial instruments except those classified as held for trading or designated at fair value through profit or loss are recognised in Interest receivable and Interest payable in profit or loss using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the Interest receivable or Interest payable over the relevant period.

The calculation of the effective interest rate includes all fees paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest on impaired financial assets is recognised using the original effective interest rate.

3 Significant accounting policies *(continued)*

m *Non-interest income*

i Net fee and commission income

Fee income is recognised as follows:

- on the execution of a significant act when the significant act has been completed; and
- as the services are provided except where the fee is charged to cover the cost of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised on an appropriate basis over the relevant period.

Income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in Net interest income.

Other fee and commission expense, which relates mainly to transaction and service fees are expensed as the services are received.

ii Dividend income

Dividend income is recognised on the date the entity's right to receive income is established which in the case of quoted securities is usually the ex-dividend date.

iii Net income from insurance financial instruments designated at fair value

Net income from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss; and
- interest income and expense and dividend income arising on these financial instruments.

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n *Employee benefits*

i Defined contribution plan

The group contributes towards the State pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions are recognised as an employee benefit in profit or loss in the periods during which services are rendered by employees.

ii Termination benefits

Termination benefits are recognised as an expense when the group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the group has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

iii Share-based payment transactions

Share-based payment arrangements in which the group receives goods or services as consideration for equity instruments in the ultimate parent company are accounted for as equity-settled share-based payment transactions.

The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

Notes on the Financial Statements (continued)

3 Significant accounting policies *(continued)*

o *Foreign currencies*

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the reporting date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss except for differences arising on retranslation of available-for-sale equity instruments, which are recognised directly in equity.

p *Income tax*

Income tax expense comprises current and deferred tax which are recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

q *Segmental reporting*

The group's operating segments are organised into three customer groups, Personal Financial Services (PFS), Commercial Banking (CMB) and Global Banking and Markets (GBM). The group's chief decision maker regularly reviews operating activity by customer group. The group's operating segments were determined to be customer groups because the chief decision maker uses information on customer group segments in order to make decisions about allocating resources and assessing performance. The group's chief decision maker is the Executive committee.

Measurement of segment assets, liabilities, income and expenses is based on the group's accounting policies. Segment income and expenses include transfers between segments. Shared costs are included in segment on the basis of the actual recharges made.

r *New standards and interpretations not adopted*

A number of new standards, amendments to standards and interpretations are effective for annual periods after 1 January 2010, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements.

4 Financial instruments and risk management

a *Use of financial instruments*

The nature of the group's core banking operations implies that financial instruments are extensively used in the course of its routine business. The group's financial instruments consist of primary instruments and include cash balances with banks, loans and advances to customers, securities and amounts due to banks and customers.

The group is exposed to a mixed blend of risks and hence operates a risk management strategy with the objective of controlling and minimising their impact on group financial performance and position.

The principal categories of risk are credit risk, market risk and liquidity risk. These categories of risk in relation to life insurance business are described in note 4(e) and excluded from group figures disclosed in notes 4(b) to 4(d).

4 Financial instruments and risk management *(continued)*

b *Credit risk*

i Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury business. It also arises when issuers of debt securities are downgraded and as a result the value of group's holdings of these assets fall. The group has standards, policies and procedures dedicated to control and monitor the risk arising from all such activities.

Within the overall framework of the group policy, the group has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. Management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentrations by market sector and product.

Special attention is paid to problem loans. Specialist units are established by the group to provide customers with support in order to help them avoid default wherever possible.

a Collateral and other credit enhancements

Collateral can be an important mitigant of credit risk. Nevertheless, it is group's policy to establish that loans are within the customer's capacity to repay rather than to over rely on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured.

The group is required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

At reporting date the principal type of collateral held consisted of immovable properties. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Financial investments are generally unsecured.

b Credit quality of loans and advances

Group's credit risk rating processes are designed to highlight exposures which require closer management attention because of their greater probability of default and potential loss. Risk ratings are reviewed regularly and amendments, where necessary, are implemented promptly. The credit quality of unimpaired loans is assessed by reference to the Group's standard credit rating system.

ii Credit exposure

Maximum exposure to credit risk

The group's maximum exposure to credit risk on financial instruments, whether recognised or unrecognised, before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Recognised financial assets comprise Balances with Central Bank of Malta, Treasury Bills and cash, Cheques in course of collection, Financial assets at fair value through profit or loss, Financial investments, loans and advances and acceptances and endorsements. The maximum exposure of these financial assets to credit risk, equals their carrying amount.
- Financial guarantees granted. The maximum exposure to credit risk is the full amount that the group would have to pay if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

Notes on the Financial Statements (continued)

4 Financial instruments and risk management *(continued)*

b *Credit risk (continued)*

ii Credit exposure (continued)

Concentration of credit risk exists when a number of counterparties are engaged in similar activities, or operate in the same industry sector and so their ability to meet contractual obligations is similarly affected by certain conditions.

The following industry concentrations are considered significant for Loans and advances to customers:

	2010	2009
	€000	€000
Group/Bank		
Agriculture	**4,834**	4,555
Fishing	**1,671**	4,262
Mining and quarrying	**3,283**	3,520
Manufacturing	**122,105**	134,891
Electricity, gas and water supply	**111,734**	72,303
Water supply, sewerage waste management and remediation activities	**30,667**	31,455
Construction	**434,219**	440,898
Wholesale and retail trade, repairs	**357,877**	395,093
Transport, storage and communication	**50,290**	47,419
Accommodation and food service activities	**153,303**	117,458
Information and communication	**77,766**	76,884
Financial and insurance activities	**63,575**	63,257
Real estate activities	**57,046**	58,314
Professional, scientific and technical activities	**37,948**	39,809
Administrative and support service activities	**16,730**	17,704
Public administration and defence, compulsory social security	**107,625**	101,446
Education	**1,578**	2,061
Human health and social work activities	**24,567**	25,445
Arts, entertainment and recreation	**3,525**	3,895
Other services activities	**6,065**	3,609
Household and individuals	**1,688,560**	1,627,153
Gross loans and advances to customers	**3,354,968**	3,271,431

Debt securities and Treasury Bills by rating agency (S&P Rating Agency) designation:

	Treasury Bills	*Debt securities*	*Total*
	€000	**€000**	**€000**
Group/Bank			
At 31 December 2010			
AAA	**20,707**	**138,242**	**158,949**
AA- to AA+	**–**	**11,797**	**11,797**
A- to A+	**244,193**	**406,166**	**650,359**
Lower than A-	**–**	**36,607**	**36,607**
	264,900	**592,812**	**857,712**
At 31 December 2009			
AAA	–	25,733	25,733
AA- to AA+	–	42,032	42,032
A- to A+	64,633	271,915	336,548
Lower than A-	–	31,379	31,379
Unrated	–	8,894	8,894
	64,633	379,953	444,586

4 Financial instruments and risk management *(continued)*

b *Credit risk (continued)*

iii Credit quality of financial assets

The following tables provide a detailed analysis of the credit quality of the group's lending portfolio:

a Distribution of loans and advances by credit quality

	Loans and advances to customers	*Loans and advances to banks*	*Loans and advances to customers*	*Loans and advances to banks*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Group/Bank				
Gross loans and advances:				
– neither past due nor impaired	**3,072,056**	**714,850**	3,008,761	747,582
– past due but not impaired	**163,893**	**–**	153,843	–
– impaired	**119,019**	**–**	108,827	–
	3,354,968	**714,850**	3,271,431	747,582

Loans and advances to banks booked in subsidiary undertakings are neither past due nor impaired.

b Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired at the reporting date can be assessed by reference to group's standard credit grading system. The following information is based on that system:

	Loans and advances to customers	*Loans and advances to banks*	*Loans and advances to customers*	*Loans and advances to banks*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Group/Bank				
Satisfactory risk	**2,715,325**	**714,850**	2,658,322	747,582
Watch list and special attention	**194,375**	**–**	220,168	–
Sub-standard but not impaired	**162,356**	**–**	130,271	–
	3,072,056	**714,850**	3,008,761	747,582

Loans and advances to banks booked in subsidiary undertakings are of satisfactory risk.

c Loans and advances which were past due but not impaired

The past due ageing analysis includes loans and advances less than 90 days past due amounting to €132,973,000 (2009: €136,551,000).

	Loans and advances to customers	
	2010	2009
	€000	€000
Group/Bank		
Past due up to 29 days	**104,172**	88,645
Past due 30 – 59 days	**20,624**	25,191
Past due 60 – 89 days	**8,177**	22,715
Past due 90 – 179 days	**3,976**	4,456
Past due over 180 days	**26,944**	12,836
	163,893	153,843

Renegotiated loans that would otherwise be past due or impaired totalled €93,669,000 (2009: €85,798,000).

Notes on the Financial Statements (continued)

4 Financial instruments and risk management *(continued)*

b *Credit risk (continued)*

iii Credit quality of financial assets (continued)

d Individually impaired gross loans by industry sector

	Loans and advances to customers	
	2010	2009
	€000	€000
Group/Bank		
Personal banking	**28,369**	21,137
Commercial and corporate	**83,614**	78,559
Other	**7,036**	9,131
	119,019	108,827

iv Movement in allowance accounts for loans and advances to customers

	Individually assessed allowances	*Collective allowances*	*Individually assessed allowances*	*Collective allowances*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Group/Bank				
At 1 January	**32,529**	**12,425**	28,365	13,756
Additions	**11,909**	**343**	8,524	–
Reversals	**(4,503)**	**–**	(2,885)	(1,331)
Discount unwind	**(1,570)**	**–**	(1,475)	–
At 31 December	**38,365**	**12,768**	32,529	12,425

v Settlement risk

The group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to failure of a counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions the group mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations.

c *Liquidity risk*

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its financial obligations when they fall due or will have to do so at excessive cost. This risk can arise from mismatches in timing of cash flows.

The objective of the group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the group's objective to maintain a diversified and stable funding base with the objective of enabling the group to respond quickly and smoothly to unforeseen liquidity requirements.

4 Financial instruments and risk management *(continued)*

c *Liquidity risk (continued)*

The group's liquidity and funding management process includes:

- projecting cash flows by considering the level of liquid assets necessary in relation thereto;
- monitoring liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systematic or other crisis while minimising adverse long-term implications for the business.

Current accounts and savings deposits payable on demand or at short notice form a significant part of the group's funding. The group places considerable importance on maintaining the stability of these deposits.

Cash flows payable by the group under financial liabilities by remaining contractual maturities

	Due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*	*Gross nominal outflow*
	€000	**€000**	**€000**	**€000**	**€000**
Group					
At 31 December 2010					
Amounts owed to banks	**231,866**	**788**	**70**	**368**	**233,092**
Amounts owed to customers	**3,272,792**	**954,127**	**261,159**	**–**	**4,488,078**
Subordinated liabilities	**2,224**	**2,224**	**17,795**	**97,562**	**119,805**
Other financial liabilities	**42,388**	**425**	**475**	**–**	**43,288**
	3,549,270	**957,564**	**279,499**	**97,930**	**4,884,263**
Loan commitments	**695,953**	**9,843**	**123,681**	**132,834**	**962,311**
At 31 December 2009					
Amounts owed to banks	168,127	578	10	375	169,090
Amounts owed to customers	2,901,317	948,737	275,263	–	4,125,317
Subordinated liabilities	1,339	3,109	17,795	102,011	124,254
Other financial liabilities	32,711	859	553	–	34,123
	3,103,494	953,283	293,621	102,386	4,452,784
Loan commitments	696,258	15,700	129,851	68,839	910,648

Cash flows payable by the group under investment contracts and insurance contracts issued are disclosed in note 4e(iii).

Derivatives are assumed to be payable on demand and not by contractual maturity because trading liabilities are typically held for short periods of time.

Notes on the Financial Statements (continued)

4 Financial instruments and risk management *(continued)*

c *Liquidity risk (continued)*

	Due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*	*Gross nominal outflow*
	€000	**€000**	**€000**	**€000**	**€000**
Bank					
At 31 December 2010					
Amounts owed to banks	**231,866**	**788**	**70**	**368**	**233,092**
Amounts owed to customers	**3,327,356**	**955,281**	**261,159**	**–**	**4,543,796**
Subordinated liabilities	**2,224**	**2,224**	**17,795**	**97,562**	**119,805**
Other financial liabilities	**38,685**	**425**	**475**	**–**	**39,585**
	3,600,131	**958,718**	**279,499**	**97,930**	**4,936,278**
Loan commitments	**695,953**	**9,843**	**123,681**	**132,834**	**962,311**
At 31 December 2009					
Amounts owed to banks	168,127	578	10	375	169,090
Amounts owed to customers	2,941,711	969,086	275,263	–	4,186,060
Subordinated liabilities	1,339	3,109	17,795	102,011	124,254
Other financial liabilities	29,438	859	553	–	30,850
	3,140,615	973,632	293,621	102,386	4,510,254
Loan commitments	696,258	15,700	129,851	68,839	910,648

The balances in the above table do not agree directly to the amounts in the financial position as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Furthermore, loan commitments are not recognised on the Statements of Financial Position.

Assets available to meet these liabilities and to cover outstanding commitments, include balances with Central Bank of Malta, Treasury Bills and cash, cheques in course of collection, loans to banks and to customers, marketable debt securities and undrawn credit lines.

The group would meet unexpected net cash outflows by accessing additional funding sources such as interbank lending, or by selling securities such as Treasury Bills or debt securities.

d *Market risk*

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates and market prices will reduce the group's income or the value of its portfolios.

The objective of the group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the group's status as a premier provider of financial products and services.

The group manages market risk through risk limits approved by HSBC Holdings plc. Limits are set by product and risk type with market liquidity being a principal factor in determining the level of limits set.

The group's interest rate exposures comprise those originating in its treasury activities and those originating in other banking activities. The primary source of interest rate risk originating in other banking activities arises from the employment of non-interest liabilities, such as shareholders' equity and current accounts, as well as fixed rate loans and liabilities, other than those generated by treasury business. The group's Asset and liability management Committee (ALCO) assesses the interest rate risks which arise in the business. The primary objective of such interest rate risk management is to limit potential adverse effects of interest rate movements on Net interest income.

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

i *Fair value and price verification control*

Where certain financial instruments are measured at fair value, the valuation and the related price verification processes are subject to independent validations. The determination of fair values is therefore a significant element in the reporting of the group's global market activities.

Certain financial assets and liabilities are carried at cost or amortised cost and not at fair value.

a Investments – Equity and other non-fixed income instruments available-for-sale

Certain unlisted equity investments are carried at cost and amount to €354,000 (2009: €354,000). There is no market for these investments and no recent transactions that provide evidence of the current fair value. Discounted cash flow techniques do not provide a reliable measure of the fair value of these investments.

b Loans and advances to banks and customers

This category of asset is reported net of impairment allowances to reflect the estimated recoverable amounts. As at 31 December 2010 the group's carrying amount was €4,018,736,000 (2009: €3,974,134,000), and the bank's carrying amount was €4,018,685,000 (2009: €3,974,059,000).

The loans and advances to customers category of asset amounts to €3,303,835,000 (2009: €3,226,477,000). This carrying value approximates to fair value in the case of loans which are repriceable at the group's discretion. These loans constitute a significant element of the total loan portfolio.

The loans and advances to banks category of asset amounts to €714,901,000 (2009: €747,657,000) for the group and €714,850,000 (2009: €747,582,000) for the bank. For loans and advances to banks within the 'less than one year' maturity band, fair value is taken to be the amount carried at the reporting date. As at 31 December 2010, 88.0 per cent of loans and advances to banks had a contractual repricing within the 'less than three months' band. Interest rates on these loans and advances reflect current market rates, and therefore the carrying amount approximates to fair value.

c Assets held for sale

Assets acquired in satisfaction of debt amounting to €7,662,000 as at 31 December 2010 (2009: €8,772,000) consist mainly of repossessed immovable property measured at the lower of cost and their forced-sale value.

d Amounts owed to banks and customers

This category of liability is carried at amortised cost and as at 31 December 2010 amounts to €4,695,651,000 (2009: €4,255,440,000) for the group and €4,750,553,000 (2009: €4,315,066,000) for the bank. Of this liability, 71.0 per cent has contractual repricing with the 'less than three months' band, 22.0 per cent reprices within the 'between three months and one year' band whilst 7.0 per cent reprices within the 'between one year and five years' band. For demand deposits and deposits maturing within one year, fair value is taken to be the amount payable on demand at the reporting date.

e Subordinated liabilities

This category of liability is carried at amortised cost. Fair value based on quoted market prices at the reporting date without deduction for transaction costs amounts to €91,631,000 as at 31 December 2010 (2009: €91,250,000).

Notes on the Financial Statements (continued)

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

ii Basis of valuing financial assets and liabilities measured at fair value

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

	Valuation techniques			
	Quoted market price	*Using observable inputs*	*With significant unobservable inputs*	
	Level 1	Level 2	Level 3	Total
	€000	**€000**	**€000**	**€000**
Group				
At 31 December 2010				
Assets				
Derivatives	**–**	**11,489**	**–**	**11,489**
Financial assets designated at fair value through profit or loss	**306,299**	**–**	**–**	**306,299**
Financial investments: available-for-sale	**690,239**	**367**	**–**	**690,606**
Liabilities				
Derivatives	**–**	**12,311**	**–**	**12,311**
Liabilities to customers under investment contracts	**18,962**	**–**	**–**	**18,962**
At 31 December 2009				
Assets				
Derivatives	–	11,746	–	11,746
Financial assets designated at fair value through profit or loss	248,553	–	–	248,553
Financial investments: available-for-sale	467,339	2,742	–	470,081
Liabilities				
Derivatives	–	11,044	–	11,044
Liabilities to customers under investment contracts	16,853	–	–	16,853

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

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

	Valuation techniques			
	Quoted market price	*Using observable inputs*	*With significant unobservable inputs*	
	Level 1	Level 2	Level 3	Total
	€000	**€000**	**€000**	**€000**
Bank				
At 31 December 2010				
Assets				
Derivatives	**–**	**11,686**	**–**	**11,686**
Financial investments: available-for-sale	**592,740**	**367**	**–**	**593,107**
Liabilities				
Derivatives	**–**	**12,313**	**–**	**12,313**
At 31 December 2009				
Assets				
Derivatives	–	11,964	–	11,964
Financial investments: available-for-sale	368,639	2,742	–	371,381
Liabilities				
Derivatives	–	11,046	–	11,046

iii Credit risk adjustment methodology

The Group adopts a credit risk adjustment against over the counter derivative transactions to reflect within fair value the possibility that the counterparty may default, and it may not receive the full market value of the transactions.

The Group calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default. The calculation is performed over the life of the potential exposure.

For most products, the Group uses a simulation methodology to calculate the expected positive exposure. The methodology simulates the range of potential exposures of the bank to the counterparty over the life of an instrument. The range of exposures is calculated across the portfolio of transactions with a counterparty to arrive at an expected overall exposure. The probability of default assumptions are based upon historic rating transition matrices. The credit rating used for a particular counterparty is that determined by the bank's internal credit process. Rating transition is taken account of throughout the duration of the exposure. A standard loss given default assumption is generally adopted. The Group considers that an appropriate spread to reflect its own probability of default within the credit risk adjustment calculation is currently zero. Consequently, HSBC does not derive the adjustment on a bilateral basis and has a zero adjustment against derivative liabilities, often referred to as a 'debit valuation adjustment'. The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

iv Value at risk (VAR)

One of the principal tools used by the group to monitor and limit market risk exposure is VAR. VAR is a technique that estimates potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VAR models used by the group are predominantly based on historical simulation. The historical simulation models derive plausible future scenarios from historical market rate time series, taking account of inter-relationships between different markets and rates, for example, between interest rates and foreign exchange rates.

The historical simulation models used by the group incorporate the following features:

- potential market movements are calculated with reference to data from the last two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- VAR is calculated to a 99.0 per cent confidence level; and
- VAR is calculated for a one-day holding period.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations, for example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. 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 hedge all positions fully;
- the use of a 99.0 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures.

The VAR for the group was as follows:

	2010	2009
	€000	€000
At 31 December	**1,074**	942
Average	**1,082**	1,015
Minimum	**825**	734
Maximum	**1,610**	1,289

The major cause of the increase in VAR at 31 December 2010 in comparison with 31 December 2009 was an increase in the investment portfolio as part of the balance sheet management strategy.

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

v *Sensitivity of net interest income*

A principal part of HSBC's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). For simulation modelling, business use a combination of scenarios relevant to local businesses and local markets and standard scenarios which are required throughout HSBC.

The table below sets out the impact on future net income/net assets of an incremental 50 basis points parallel fall or rise in all yield curves worldwide on the first day of the following year based on position/risk profiles as at the reporting date:

	Impact on profit for the year	*Impact on net assets*	*Impact on profit for the year*	*Impact on net assets*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Group/Bank				
+ 50 basis points	**5,315**	**(1,133)**	6,056	2,984
- 50 basis points	**(11,939)**	**(5,491)**	(11,643)	(8,571)

vi *Currency concentration*

	Euro	*Other currencies*	*Total*	*Euro*	*Other currencies*	*Total*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Group						
Assets						
Balances with Central Bank of Malta, Treasury Bills and cash	**373,863**	**6,122**	**379,985**	170,662	2,009	172,671
Cheques in course of collection	**8,709**	**302**	**9,011**	10,063	701	10,764
Derivatives	**10,546**	**943**	**11,489**	9,093	2,653	11,746
Financial assets designated at fair value through profit or loss	**224,570**	**81,729**	**306,299**	183,308	65,245	248,553
Financial investments	**671,883**	**18,723**	**690,606**	444,066	34,909	478,975
Loans and advances to banks	**48,200**	**666,701**	**714,901**	199,705	547,952	747,657
Loans and advances to customers	**3,261,610**	**42,225**	**3,303,835**	3,195,339	31,138	3,226,477
Other assets	**246,337**	**2,098**	**248,435**	218,158	2,799	220,957
Total assets	**4,845,718**	**818,843**	**5,664,561**	4,430,394	687,406	5,117,800

Notes on the Financial Statements (continued)

4 Financial instruments and risk management *(continued)*

d *Market risk (continued)*

vi Currency concentration (continued)

	Euro	*Other currencies*	*Total*	*Euro*	*Other currencies*	*Total*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Group						
Liabilities and equity						
Derivatives	**10,880**	**1,431**	**12,311**	9,009	2,035	11,044
Amounts owed to banks	**208,849**	**23,941**	**232,790**	161,550	7,221	168,771
Amounts owed to customers	**3,767,559**	**695,302**	**4,462,861**	3,484,990	601,679	4,086,669
Liabilities to customers under investment contracts	**18,962**	**–**	**18,962**	16,853	–	16,853
Liabilities under insurance contracts issued	**410,461**	**–**	**410,461**	351,513	–	351,513
Subordinated liabilities	**87,880**	**–**	**87,880**	87,827	–	87,827
Other liabilities	**100,574**	**4,892**	**105,466**	83,990	4,546	88,536
Total equity	**333,830**	**–**	**333,830**	306,587	–	306,587
Total liabilities and equity	**4,938,995**	**725,566**	**5,664,561**	4,502,319	615,481	5,117,800

	Euro	*Other currencies*	*Total*	*Euro*	*Other currencies*	*Total*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Bank						
Assets						
Balances with Central Bank of Malta, Treasury Bills and cash	**373,862**	**6,122**	**379,984**	170,661	2,009	172,670
Cheques in course of collection	**8,709**	**302**	**9,011**	10,063	701	10,764
Derivatives	**10,546**	**1,140**	**11,686**	9,093	2,871	11,964
Financial investments	**575,662**	**17,445**	**593,107**	346,579	33,696	380,275
Loans and advances to banks	**48,149**	**666,701**	**714,850**	199,630	547,952	747,582
Loans and advances to customers	**3,261,610**	**42,225**	**3,303,835**	3,195,339	31,138	3,226,477
Other assets	**186,426**	**1,899**	**188,325**	173,847	2,559	176,406
Total assets	**4,464,964**	**735,834**	**5,200,798**	4,105,212	620,926	4,726,138
Liabilities and equity						
Derivatives	**10,880**	**1,433**	**12,313**	9,009	2,037	11,046
Amounts owed to banks	**208,849**	**23,941**	**232,790**	161,550	7,221	168,771
Amounts owed to customers	**3,820,998**	**696,765**	**4,517,763**	3,542,083	604,212	4,146,295
Subordinated liabilities	**87,880**	**–**	**87,880**	87,827	–	87,827
Other liabilities	**74,603**	**4,892**	**79,495**	61,257	4,546	65,803
Total equity	**270,557**	**–**	**270,557**	246,396	–	246,396
Total liabilities and equity	**4,473,767**	**727,031**	**5,200,798**	4,108,122	618,016	4,726,138

4 Financial instruments and risk management *(continued)*

e *Insurance risk*

The insurance risk of the group represents that faced by the life insurance subsidiary company. The principal insurance risk is that the cost of claims combined with acquisition and administration costs may exceed the aggregate amount of premiums received and investment income. The group manages its insurance risks through the application of formal underwriting, reinsurance and claims procedures designed to ensure compliance with regulations.

The following table provides an analysis of the insurance risk exposures by type of business:

	Group	
	2010	2009
	€000	€000
Life insurance (non-linked)		
Insurance contracts with discretionary participation feature	**285,546**	224,988
Term assurance and other long-term contracts	**12,569**	37,669
Total non-linked	**298,115**	262,657
Life insurance (linked)	**112,346**	88,856
Liabilities under insurance contracts issued	**410,461**	351,513
Investment contracts	**18,962**	16,853
Total insurance liabilities	**429,423**	368,366

Present value of in-force long-term insurance business (PVIF)

The HSBC life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks.

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumptions across the life insurance business:

		PVIF Impact	
		2010	2009
Assumptions	**Movement**	**€000**	€000
As published			
Risk free rate	+100 basis points	**2,822**	2,897
Risk free rate	-100 basis points	**(700)**	(822)
Risk adjusted discount rate	+100 basis points	**(1,236)**	(1,061)
Risk adjusted discount rate	-100 basis points	**1,368**	1,171
Expenses inflation	+100 basis points	**(285)**	(327)
Expenses inflation	-100 basis points	**311**	298
Lapse rate	+100 basis points	**(537)**	(452)
Lapse rate	-100 basis points	**559**	479

HSBC's life insurance business is exposed to a range of financial risks, including market risk, credit risk and liquidity risk. The nature and management of these risks is described below.

i Market risk

a Interest rate risk

Life insurance business is exposed to interest rate risk when there is a mismatch in terms of duration or yields between assets and liabilities. The group manages the interest rate risk arising from its insurance underwriting business by establishing limits centrally. These govern the sensitivity of the net present values of expected future cash flows.

Interest rate risk is also assessed by measuring the impact of defined movements in interest yield curves on the profits after tax and net assets of the insurance underwriting business.

4 Financial instruments and risk management *(continued)*

e *Insurance risk (continued)*

i Market risk (continued)

b Equity risk

The group manages the equity risk arising from its holdings of equity securities centrally by setting limits on the maximum market value of equities that the insurance underwriting business may hold. Equity risk is also monitored by estimating the effect of predetermined movements in equity prices on the profit for the year and total net assets of the insurance underwriting business.

An immediate and permanent movement in interest yield curves as at the reporting date would have the following impact on the profit for the year and net assets at that date:

	2010		2009	
	Impact on profit for the year	*Impact on net assets*	*Impact on profit for the year*	*Impact on net assets*
	€000	**€000**	€000	€000
+100 basis points shift in yield curves	**(642)**	**(642)**	(210)	(210)
-100 basis points shift in yield curves	**(817)**	**(817)**	(281)	(281)
+10 per cent increase in equity prices	**182**	**182**	368	368
-10 per cent increase in equity prices	**(719)**	**(719)**	(546)	(546)

ii Credit risk

HSBC's life insurance underwriting business is exposed to credit risk in respect of its investment portfolios and reinsurance transactions. The Investment Committee is responsible for the quality and performance of the investment portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality.

The following table presents the analysis of debt securities within insurance business by rating agency (S & P Rating Agency):

	Treasury Bills	*Debt securities*	*Total*
	€000	**€000**	**€000**
At 31 December 2010			
AAA	**–**	**37,085**	**37,085**
AA- to AA+	**–**	**30,871**	**30,871**
A- to A+	**7,460**	**129,818**	**137,278**
Lower than A-	**–**	**19,373**	**19,373**
Unrated	**–**	**13,508**	**13,508**
	7,460	**230,655**	**238,115**
At 31 December 2009			
AAA	–	20,228	20,228
AA- to AA+	–	16,486	16,486
A- to A+	5,981	131,960	137,941
Lower than A-	–	11,510	11,510
Unrated	–	12,045	12,045
	5,981	192,229	198,210

4 Financial instruments and risk management *(continued)*

e *Insurance risk (continued)*

iii Liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk. As part of the management of this exposure, estimates are prepared for most lines of life insurance business of cash flows expected to arise from insurance funds at the reporting date.

The following table shows the expected maturity of insurance liabilities at the reporting date:

	Due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*	*Gross nominal outflow*
	€000	**€000**	**€000**	**€000**	**€000**
At 31 December 2010					
Liabilities to customers under investment contracts	**470**	**145**	**1,765**	**16,582**	**18,962**
Liabilities under insurance contracts issued	**2,203**	**7,173**	**81,559**	**306,957**	**397,892**
At 31 December 2009					
Liabilities to customers under investment contracts	–	–	1,753	15,100	16,853
Liabilities under insurance contracts issued	440	–	66,284	282,034	348,758

5 Capital management and allocation

HSBC's capital management approach is driven by its strategy taking into account the regulatory, economic and commercial environment in which it operates. HSBC's capital management policy is to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

Capital management policy is monitored by ALCO. An annual group capital plan is drawn up and approved by the Board with the objective of maintaining both the optimal amount of capital and the mix between the different components of capital. The group recognises the impact on shareholder returns by the level of equity capital employed and seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity from increased leverage.

In implementing the EU's directives which regulate capital requirements, the Malta Financial Services Authority (MFSA) supervises the group on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the group as a whole.

The group's capital base is divided in two tiers, as defined in BR/03 (the Own Funds of Credit Institutions Authorised under the Banking Act 1994):

- Original own funds comprise share capital, retained earnings and reserves created by appropriations of retained earnings. The book value of intangible assets, 50.0 per cent of investment in HSBC Life Assurance (Malta) Ltd and final dividend are deducted in arriving at original own funds calculation. Depositor compensation scheme reserve is excluded from original own funds.
- Additional own funds comprise qualifying subordinated loan capital, collective impairment allowances, and unrealised gains arising on the fair valuation of financial investments held as available-for-sale. Additional own funds also include reserves arising from the revaluation of properties. The remaining 50.0 per cent of the book value of the investment in HSBC Life Assurance (Malta) Ltd is deducted in arriving at additional own funds calculation.

Notes on the Financial Statements (continued)

5 Capital management and allocation *(continued)*

The group's risk and capital management policy is based on the Basel II framework which is structured on three pillars. These have been adopted by the MFSA by way of banking rules as follows:

– Pillar 1 – BR/04 (Capital Requirements of Credit Institutions Authorised under the Banking Act 1994) defines the minimum capital resources requirements for credit, counterparty, market and operational risks. The risk is expressed in Risk Weighted Assets (RWAs) terms. The group has adopted the Standardised Approach in determining the material risks on its banking operations and operational risk.

  Banking operations are categorised as either trading book or banking book and risk-weighted assets are determined accordingly. Banking book risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book contingent liabilities and commitments giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks and counterparty risk.

– Pillar 2 – BR/12 (The Supervisory Review Process of Credit Institutions Authorised under the Banking Act 1994) involves both the credit institution and the regulator in assessing whether the credit institution should hold additional capital against risks not covered under Pillar 1. An integral part of Pillar 2 is the Internal Capital Adequacy Assessment Process (ICAAP) which is the credit institution's self-assessment of the levels of capital that it needs to hold. An ICAAP was undertaken during the second half of the year and submitted to the MFSA for review. The results of the ICAAP show that the group maintains a comfortable level of excess capital and substantial liquidity that ensures the flexibility and resources needed to achieve the long-term strategic objectives of the group even under market stress situations.

– Pillar 3 – BR/07 (Publication of Annual Report and Audited Financial Statements of Credit Institutions Authorised under the Banking Act 1994) is related to market discipline and aims to make institutions more transparent by requiring them to publish specific disclosures on the institution's risk and capital management under the Basel II framework. The group is considered as a significant local subsidiary of HSBC Holdings plc and is therefore exempt in terms of article 23 of BR/07 from full risk disclosure requirements under Pillar 3. HSBC Holdings plc publishes Pillar 3 disclosures as a separate document on the Group Investor Relations website.

	Group			
	Face value	*Weighted amount*	*Face value*	*Weighted amount*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Assets				
Balances with Central Bank of Malta, Treasury Bills and cash	**379,984**	**–**	172,671	–
Cheques in course of collection	**9,011**	**1,802**	10,764	10,764
Loans and advances to banks	**714,850**	**142,970**	747,657	150,049
Loans and advances to customers	**3,303,835**	**2,092,137**	3,226,477	2,100,147
Debt securities and equities	**594,696**	**57,608**	381,862	80,285
Shares in subsidiary companies	**28,578**	**28,578**	28,578	28,578
Property and equipment and investment property	**77,149**	**77,149**	77,051	77,051
Other assets	**39,145**	**27,591**	44,067	36,926
Prepayments and accrued income	**34,390**	**30,129**	33,748	29,872
	5,181,638	**2,457,964**	4,722,875	2,513,672
Contingent liabilities and commitments	**1,194,875**	**190,582**	1,145,952	183,385
Credit and counterparty risk		**2,648,546**		2,697,057
Operational risk		**275,205**		304,276
Market risk		**14,750**		23,596
Total risk weighted assets		**2,938,501**		3,024,929

5 Capital management and allocation *(continued)*

	Group			
	Face value	*Weighted amount*	*Face value*	*Weighted amount*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Total own funds				
Original own funds				
Called up share capital	**87,552**		87,552	
Retained earnings	**159,584**		143,526	
Exclusions/deductions:				
– Depositor compensation scheme reserve	**(19,434)**		(19,434)	
– Investment in HSBC Life Assurance (Malta) Ltd	**(14,289)**		(14,289)	
– Final dividend	**(14,583)**		(15,176)	
– Intangible assets	**(7,622)**		(1,099)	
	191,208		181,080	
Additional own funds				
Revaluation reserves	**28,059**		24,652	
Collectively assessed allowances	**12,768**		12,425	
Subordinated liabilities	**87,880**		87,827	
Deductions:				
– Investment in HSBC Life Assurance (Malta) Ltd	**(14,289)**		(14,289)	
– Other	**(5,028)**		(9,712)	
	109,390		100,903	
Total own funds	**300,598**		281,983	
Capital adequacy ratio		**10.2%**		9.3%

	Bank			
	Face value	*Weighted amount*	*Face value*	*Weighted amount*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Assets				
Balances with Central Bank of Malta, Treasury Bills and cash	**379,984**	**–**	172,670	–
Cheques in course of collection	**9,011**	**1,802**	10,764	10,764
Loans and advances to banks	**714,850**	**142,970**	747,582	150,049
Loans and advances to customers	**3,303,835**	**2,077,137**	3,226,477	2,100,147
Debt securities and equities	**593,107**	**56,010**	380,275	78,698
Shares in subsidiary companies	**35,707**	**35,707**	35,707	35,707
Property and equipment and investment property	**77,248**	**77,248**	77,135	77,135
Other assets	**45,217**	**31,377**	44,141	30,499
Prepayments and accrued income	**34,256**	**33,380**	30,006	29,239
	5,193,215	**2,455,631**	4,724,757	2,512,238
Contingent liabilities and commitments	**1,194,875**	**190,582**	1,145,952	183,385
Credit and counterparty risk		**2,646,213**		2,695,623
Operational risk		**275,205**		301,805
Market risk		**14,750**		23,596
Total risk weighted assets		**2,936,168**		3,021,024

Notes on the Financial Statements (continued)

5 Capital management and allocation *(continued)*

	Bank			
	Face value	*Weighted amount*	*Face value*	*Weighted amount*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Total own funds				
Original own funds				
Called up share capital	**87,552**		87,552	
Retained earnings and other reserves	**154,722**		133,814	
Exclusions/deductions:				
– Depositor compensation scheme reserve	**(19,434)**		(19,434)	
– Investment in HSBC Life Assurance (Malta) Ltd	**(14,289)**		(14,289)	
– Final dividend	**(14,583)**		(15,176)	
– Intangible assets	**(7,583)**		(1,741)	
	186,385		170,726	
Additional own funds				
Revaluation reserves	**28,283**		25,030	
Collectively assessed allowances	**12,768**		12,425	
Subordinated liabilities	**87,880**		87,827	
Deductions:				
– Investment in HSBC Life Assurance (Malta) Ltd	**(14,289)**		(14,289)	
– Other	**(7,455)**		(14,889)	
	107,187		96,104	
Total own funds	**293,572**		266,830	
Capital adequacy ratio		**10.0%**		8.8%

6 Interest receivable and similar income

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
On loans and advances to banks	**2,875**	6,915	**2,875**	6,915
On loans and advances to customers	**144,951**	146,361	**144,949**	146,354
On balances with Central Bank of Malta	**848**	1,009	**848**	1,009
On Treasury Bills	**2,911**	1,123	**2,911**	1,123
	151,585	155,408	**151,583**	155,401
On debt and other fixed income instruments	**23,298**	15,864	**19,063**	13,650
Amortisation of net premiums	**(5,871)**	(2,234)	**(5,456)**	(2,115)
	17,427	13,630	**13,607**	11,535
	169,012	169,038	**165,190**	166,936
Interest receivable and similar income from:				
– Group companies	**2,843**	6,920	**2,843**	6,920
– subsidiary companies	**–**	–	**1**	2

Discount unwind on impaired loans and advances to customers included in interest receivable on loans and advances to customers amounted to €1,570,000 (2009: €1,475,000).

7 Interest payable

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
On amounts owed to banks	**1,433**	1,304	**1,433**	1,304
On amounts owed to customers	**40,225**	58,249	**40,868**	59,500
On subordinated liabilities	**4,502**	4,503	**4,502**	4,503
On finance leases	**10**	12	**10**	12
	46,170	64,068	**46,813**	65,319
Interest payable to:				
– Group companies	**1,384**	1,210	**1,384**	1,210
– subsidiary companies	**–**	–	**643**	1,251

8 Net fee and commission income

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Net fee and commission income that is not an integral part of the effective interest method on:				
– financial assets or liabilites not at fair value through profit or loss	**21,203**	21,572	**21,203**	21,572
– trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals and other institutions	**10,503**	9,509	**5,343**	4,774
– other	**2,574**	1,283	**3,708**	3,165
	34,280	32,364	**30,254**	29,511
Net fee and commission income from:				
– Group companies	**1,082**	1,094	**888**	802
– subsidiary companies	**–**	–	**3,312**	3,534

Net fee and commission income for the bank include €3,419,000 (2009: €3,071,000) derived from investment services activities.

9 Dividend income

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Available-for-sale financial investments	**–**	2	**–**	2
Financial assets held for trading	**–**	41	**–**	41
Subsidiary companies	**–**	–	**7,538**	10,538
	–	43	**7,538**	10,581

Notes on the Financial Statements (continued)

10 Trading profits

	2010	2009
	€000	€000
Group/Bank		
Profit on foreign exchange activities	**7,149**	7,063
Net (losses)/gains on financial instruments at fair value through profit or loss	**(333)**	158
	6,816	7,221

11 Net (losses)/gains on sale of available-for-sale financial investments

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Net revaluation (losses)/gains transferred from equity	**(369)**	1,268	**(370)**	1,184
	(369)	1,268	**(370)**	1,184

12 Net operating income

Net operating income includes net income from Life insurance business analysed as follows:

	Group	
	2010	2009
	€000	€000
Net fee and commission income	**577**	302
Net income from insurance financial instruments designated at fair value through profit or loss	**19,707**	26,717
Net earned insurance premiums	**58,738**	52,878
Net other operating income	**4,411**	(3,296)
	83,433	76,601
Net insurance claims incurred and movement in policyholders' liabilities	**(70,988)**	(63,570)
	12,445	13,031

a *Net earned insurance premiums*

	Group	
	2010	2009
	€000	€000
Life insurance		
Gross earned premium	**62,519**	55,898
Reinsurance paid	**(3,781)**	(3,020)
	58,738	52,878

12 Net operating income *(continued)*

b *Net insurance claims incurred and movement in policyholders' liabilities*

	Group					
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Life insurance						
Claims paid	**24,318**	**(1,121)**	**23,197**	18,847	(600)	18,247
Change in technical provision	**49,112**	**(2,307)**	**46,805**	39,068	5,721	44,789
Change in claims provision	**11,056**	**(10,070)**	**986**	1,785	(1,251)	534
	84,486	**(13,498)**	**70,988**	59,700	3,870	63,570

13 Employee compensation and benefits

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Wages, salaries and allowances	**46,015**	44,185	**43,793**	41,735
Defined contribution social security costs	**2,368**	2,403	**2,273**	2,303
Retirement benefits	**1,611**	2,073	**1,611**	2,073
Share-based payments	**729**	591	**703**	569
	50,723	49,252	**48,380**	46,680
	Number	*Number*	***Number***	*Number*
Average number of employees				
– executive and senior managerial	**267**	256	**248**	237
– other managerial, supervisory and clerical	**1,261**	1,281	**1,223**	1,240
– others	**47**	51	**47**	51
	1,575	1,588	**1,518**	1,528

In order to align the interests of staff with those of shareholders, share options in ordinary shares of the ultimate parent company are offered to group employees under all-employee share plans and achievement shares awarded to group middle management and above, under discretionary incentive plans. The company offered two types of share option schemes to its employees.

Under the HSBC Holdings savings-related share option plans, options are offered at nil consideration at an exercise price discounted at a rate of 20.0 per cent of the market value immediately preceding the date of invitation. The options are exercisable either on the first, third or fifth anniversary of the commencement of the relevant savings contract.

Options awarded up to 31 December 2004 under the discretionary HSBC Holdings Group Share Option Plan were offered for nil consideration and granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

Shares in HSBC Holdings plc awarded under the discretionary HSBC Holdings Group Achievement Share Scheme are offered at nil consideration. Shares are released to individuals after three years provided they remain employed by the group. There is no performance condition attached to these awards. For those receiving share awards, additional awards will be made during the three year life of the award, representing equivalent value to dividends reinvested in shares. At the end of the three year period, the value of the award will have grown in line with HSBC's total shareholder return over the same period.

Notes on the Financial Statements (continued)

13 Employee compensation and benefits *(continued)*

	Group			
	Options	*Weighted average exercise price (€)*	*Options*	*Weighted average exercise price (€)*
	2010	**2010**	2009	2009
Savings related Share Option Plans				
Outstanding at 1 January	**96,759**	**9.71**	237,623	8.51
Granted during the year	**821,708**	**3.65**	218,509	8.61
Effect of rights issue	**–**	**–**	51,664	8.54
Exercised during the year	**(86,717)**	**4.75**	(11,130)	6.02
Closed during the year	**(56,854)**	**6.34**	(399,907)	8.55
Outstanding at 31 December	**774,896**	**3.87**	96,759	9.71
Exercisable at 31 December	**5,438**	**8.03**	22,066	6.67

	Group			
	Options	*Weighted average exercise price (€)*	*Options*	*Weighted average exercise price (€)*
	2010	**2010**	2009	2009
Group Share Option Plans				
Outstanding at 1 January	**620,040**	**8.70**	545,200	7.95
Reinstated during the year	**–**	**–**	54,736	7.42
Effect of rights issue	**–**	**–**	79,765	8.77
Exercised during the year	**(10,443)**	**6.99**	(59,661)	6.91
Released during the year	**(7,804)**	**8.38**	–	–
Outstanding at 31 December	**601,793**	**7.88**	620,040	8.70
Exercisable at 31 December	**214,659**	**6.99**	225,102	7.78

The options outstanding at reporting date had a contractual life of between one and five years.

The weighted average share price and exercise price are denominated in pounds sterling and disclosed in euro equivalent using the exchange rates prevailing at reporting date.

Fair value of share option schemes

Fair values of share options awarded under all-employee share option plans in 2010, measured at the date of grant of the option, are calculated using a Black-Scholes model.

The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The significant weighted average assumptions used to estimate the fair value of the options granted in 2010 were as follows:

	1 year savings-related share option schemes	*3 year savings-related share option schemes*	*5 year savings-related share option schemes*
Risk-free interest rate (%)	0.7	1.9	2.5
Expected volatility (%)	50.0	35.0	30.0
Expected life (years)	1	3	5

The risk-free interest rate was determined from the UK gilts zero-coupon yield curve. Expected volatility is estimated by considering both historic average share price volatility and implied volatility for traded options over HSBC shares of similar maturity to those of the employee options. Expected life is not a single input parameter but a function of various behavioural assumptions. Expected dividend yield was determined to be 4.5 per cent per annum, in line with consensus analyst options.

14 Net impairment

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Write-downs				
Investments				
– available-for-sale equity instruments	**(198)**	(197)	**–**	–
Loans and advances to customers				
– specific allowances	**(8,744)**	(7,384)	**(8,744)**	(7,384)
– collective allowances	**(343)**	–	**(343)**	–
– bad debts written off	**(1,324)**	(1,380)	**(1,324)**	(1,380)
	(10,411)	(8,764)	**(10,411)**	(8,764)
Other assets				
– specific allowances	**(32)**	–	**–**	–
Reversals of write-downs				
Loans and advances to customers				
– specific allowances	**4,503**	2,885	**4,503**	2,885
– collective allowances	**–**	1,331	**–**	1,331
– bad debts recovered	**642**	316	**642**	316
	5,145	4,532	**5,145**	4,532
Net impairment	**(5,496)**	(4,429)	**(5,266)**	(4,232)

15 Profit before tax

	2010	2009
	€000	€000
Group/Bank		
Profit before tax is stated after charging:		
Directors' emoluments		
– fees	**135**	119
– other emoluments	**410**	404
	545	523

Profit before tax for the group is also stated after charging the following fees (excluding VAT) in relation to services provided by the external auditors of the bank:

– auditors' fees of €167,000;

– other assurance services fees of €7,000;

– tax advisory services fees of €15,000; and

– other non-audit services fees of €21,000.

Notes on the Financial Statements (continued)

16 Tax expense

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
The charge for income tax, which is based on the taxable profit for the year at a rate of 35%, comprises:				
– current	**30,651**	23,200	**26,987**	20,768
– deferred	**(1,324)**	2,129	**(2,291)**	1,493
	29,327	25,329	**24,696**	22,261

The tax on profit and the result of accounting profit multiplied by the applicable tax rate are reconciled as follows:

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Profit before tax	**83,088**	71,196	**74,995**	66,916
Tax at the applicable rate of 35%	**29,081**	24,919	**26,248**	23,420
Tax effect of non-taxable income	**(26)**	(19)	**–**	–
Tax effect of profits taxed at different rates	**–**	–	**(1,750)**	(1,750)
Tax effect of non-deductible expenses	**83**	157	**79**	140
Tax effect of depreciation charges not deductible by way of capital allowances	**294**	347	**294**	347
Tax effects of property sales tax consequences	**(33)**	(55)	**(33)**	65
Tax effect of bonus shares received	**89**	–	**–**	–
Tax effect of additional deductions	**(46)**	(40)	**(46)**	(39)
Tax effect of taxable temporary differences not previously recognised	**(115)**	20	**(96)**	78
Tax expense	**29,327**	25,329	**24,696**	22,261

17 Earnings per share

The calculation of earnings per share of the group and the bank is based on the profit attributable to shareholders of the bank as shown in profit or loss, divided by the number of shares in issue as at 31 December 2010.

18 Balances with Central Bank of Malta, Treasury Bills and cash

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Balances with Central Bank of Malta	**90,982**	83,029	**90,982**	83,029
Malta Government Treasury Bills	**264,900**	64,633	**264,900**	64,633
Cash	**24,103**	25,009	**24,102**	25,008
	379,985	172,671	**379,984**	172,670

Balances with Central Bank of Malta include a reserve deposit requirement in terms of Regulation (EC) No. 1745/2003 of the European Central Bank. The average reserve deposit requirement as at year end was €86,726,000 in respect of the group and the bank (2009: €78,392,000).

19 Derivatives

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Derivative assets				
Held for trading	**11,405**	11,746	**11,602**	11,964
Fair value hedging instruments	**84**	–	**84**	–
	11,489	11,746	**11,686**	11,964
Held for trading and fair value hedging instruments are held with:				
– Group companies	**1,783**	3,612	**1,783**	3,612
– subsidiary companies	**–**	–	**197**	218
Derivative liabilities				
Held for trading	**12,311**	11,044	**12,313**	11,046
Held for trading instruments are held with:				
– Group companies	**9,951**	7,274	**9,951**	7,274
– subsidiary companies	**–**	–	**2**	2

a *Derivatives held for trading*

	Notional	*Fair value assets*	*Fair value liabilities*	*Notional*	*Fair value assets*	*Fair value liabilities*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Group						
Interest rate derivatives						
Over the counter products						
– interest rate swaps purchased	**182,488**	**9,103**	**–**	167,662	7,140	–
– interest rate swaps written	**182,488**	**–**	**9,585**	167,662	–	7,098
Currency derivatives						
Over the counter products						
– foreign exchange contracts	**92,156**	**935**	**1,357**	82,759	2,112	1,452
– foreign exchange options purchased	**9,424**	**148**	**–**	20,356	484	–
– foreign exchange options written	**9,424**	**–**	**150**	20,356	–	484
Equity derivatives						
Over the counter products						
– equity index options purchased	**19,573**	**1,219**	**–**	25,205	2,010	–
– equity index options written	**19,573**	**–**	**1,219**	25,205	–	2,010
		11,405	**12,311**		11,746	11,044

Notes on the Financial Statements (continued)

19 Derivatives *(continued)*

a *Derivatives held for trading (continued)*

	Notional	*Fair value assets*	*Fair value liabilities*	*Notional*	*Fair value assets*	*Fair value liabilities*
	2010	**2010**	**2010**	2009	2009	2009
	€000	**€000**	**€000**	€000	€000	€000
Bank						
Interest rate derivatives						
Over the counter products						
– interest rate swaps purchased	**182,488**	**9,187**	**–**	167,662	7,140	–
– interest rate swaps written	**182,488**	**–**	**9,585**	167,662	–	7,098
Currency derivatives						
Over the counter products						
– foreign exchange contracts	**101,772**	**1,132**	**1,359**	93,122	2,330	1,454
– foreign exchange options purchased	**9,424**	**148**	**–**	20,356	484	–
– foreign exchange options written	**9,424**	**–**	**150**	20,356	–	484
Equity derivatives						
Over the counter products						
– equity index options purchased	**19,573**	**1,219**	**–**	25,205	2,010	–
– equity index options written	**19,573**	**–**	**1,219**	25,205	–	2,010
		11,686	**12,313**		11,964	11,046

b *Fair value hedging instruments*

	Notional	*Fair value assets*	*Fair value liabilities*
	2010	**2010**	**2010**
	€000	**€000**	**€000**
Group/Bank			
Fair value hedging instruments			
Over the counter products			
– interest rate swaps purchased	**66,042**	**84**	**–**

The group uses interest rate swaps to hedge its exposure to changes in fair value of certain fixed rate deposit liabilities attributable to changes in market interest rates.

20 Financial assets designated at fair value through profit or loss

	Group	
	2010	2009
	€000	€000
Debt, Treasury Bills and other fixed income instruments	**142,277**	101,097
Equity and other non-fixed income instruments	**164,022**	147,456
	306,299	248,553

20 Financial assets designated at fair value through profit or loss *(continued)*

a *Debt, Treasury Bills and other fixed income instruments*

	Group	
	2010	2009
	€000	€000
Issued by public bodies		
– local government	**54,599**	53,899
– foreign government	**45,188**	13,934
Issued by other issuers		
– local banks	**2,678**	729
– foreign banks	**9,230**	9,965
– others local	**4,710**	5,300
– others foreign	**25,872**	17,270
	142,277	101,097
Listing status		
– listed on the Malta Stock Exchange	**62,745**	60,661
– listed elsewhere	**79,532**	40,436
	142,277	101,097

	Group	
	2010	2009
	€000	€000
At 1 January	**101,097**	125,173
Exchange adjustments	**(49)**	4
Acquisitions	**66,654**	9,466
Disposals/Redemptions	**(24,781)**	(35,008)
Changes in fair value	**(644)**	1,462
At 31 December	**142,277**	101,097

b *Equity and other non-fixed income instruments*

	Group	
	2010	2009
	€000	€000
Issued by other issuers		
– others local	**35,553**	35,470
– others foreign	**128,469**	111,986
	164,022	147,456
Listing status		
– listed on the Malta Stock Exchange	**13,298**	14,528
– listed elsewhere	**150,724**	132,928
	164,022	147,456
At 1 January	**147,456**	154,541
Exchange adjustments	**2,393**	565
Acquisitions	**22,914**	25,886
Disposals	**(22,227)**	(54,491)
Changes in fair value	**13,486**	20,955
At 31 December	**164,022**	147,456

Notes on the Financial Statements (continued)

21 Financial investments

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Debt and other fixed income instruments				
– available-for-sale	**688,650**	468,172	**592,740**	371,014
– held-to-maturity	**–**	8,894	**–**	8,894
Equity and other non-fixed income instruments				
– available-for-sale	**1,956**	1,909	**367**	367
	690,606	478,975	**593,107**	380,275

a *Debt and other fixed income instruments available-for-sale*

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Issued by public bodies				
– local government	**409,624**	256,063	**353,608**	200,614
– foreign government	**88,341**	30,115	**64,670**	2,334
Issued by other issuers				
– foreign banks	**106,553**	146,673	**100,036**	141,026
– local others	**492**	488	**–**	–
– foreign others	**83,640**	34,833	**74,426**	27,040
	688,650	468,172	**592,740**	371,014
Amounts include:				
– issued by Group companies	**72**	42	**–**	–
Listing status				
– listed on the Malta Stock Exchange	**410,116**	256,551	**353,608**	200,614
– listed elsewhere	**278,534**	207,257	**239,132**	168,025
– foreign unlisted	**–**	4,364	**–**	2,375
	688,650	468,172	**592,740**	371,014
At 1 January	**468,172**	401,909	**371,014**	385,805
Exchange adjustments	**2,927**	2,738	**2,891**	2,735
Amortisation	**(5,884)**	(2,247)	**(5,470)**	(2,128)
Acquisitions	**307,684**	218,283	**307,688**	132,133
Disposals/Redemptions	**(85,338)**	(170,315)	**(85,338)**	(163,721)
Changes in fair value	**1,089**	17,804	**1,955**	16,190
At 31 December	**688,650**	468,172	**592,740**	371,014

Debt instruments with a carrying amount of €168,616,000 (2009: €54,516,000) have been pledged against the provision of credit lines by the Central Bank of Malta. At 31 December 2010, no balances were outstanding against these credit lines. In addition debt securities with a carrying amount of €14,826,000 have been pledged in terms of the Depositors compensation scheme (refer to note 41).

21 Financial investments *(continued)*

b *Debt and other fixed income instruments held-to-maturity*

	2010	2009
	€000	€000
Group/Bank		
Issued by other issuers		
– local others	**–**	8,894
	–	8,894
Listing status		
– listed on the Malta Stock Exchange	**–**	8,894
	–	8,894
At 1 January	**8,894**	25,240
Exchange adjustments	**–**	169
Amortisation	**14**	13
Redemptions	**(8,908)**	(16,528)
At 31 December	**–**	8,894

c *Equity and other non-fixed income instruments available-for-sale*

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Issued by other issuers				
– local others	**1,943**	1,896	**354**	354
– foreign others	**13**	13	**13**	13
	1,956	1,909	**367**	367
Listing status				
– local unlisted	**1,943**	1,896	**354**	354
– foreign unlisted	**13**	13	**13**	13
	1,956	1,909	**367**	367
At 1 January	**1,909**	2,763	**367**	971
Exchange adjustments	**–**	(75)	**–**	(75)
Disposals	**–**	(551)	**–**	(551)
Changes in fair value	**47**	(228)	**–**	22
At 31 December	**1,956**	1,909	**367**	367

As at the reporting date, total impairment loss on the group's equity and other non-fixed income instruments available-for-sale amounted to €395,000 (2009: €197,000).

Notes on the Financial Statements (continued)

22 Loans and advances to banks

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Repayable on call and at short notice	**72,978**	45,130	**72,927**	45,055
Term loans and advances	**641,923**	702,527	**641,923**	702,527
	714,901	747,657	**714,850**	747,582
Amounts include:				
– due from Group companies	**654,402**	734,734	**654,402**	734,734

23 Loans and advances to customers

	2010	2009
	€000	€000
Group/Bank		
Repayable on call and at short notice	**474,100**	489,719
Term loans and advances	**2,880,868**	2,781,712
Gross loans and advances to customers	**3,354,968**	3,271,431
Allowances for uncollectability	**(51,133)**	(44,954)
Net loans and advances to customers	**3,303,835**	3,226,477
Allowances for uncollectability		
– individually assessed allowances	**38,365**	32,529
– collectively assessed allowances	**12,768**	12,425
	51,133	44,954

The balance of individually assessed allowances at the reporting date includes €19,097,000 (2009: €15,932,000) in respect of interest in suspense which has been netted off against interest receivable.

24 Shares in subsidiary companies

Bank *Name of company*	*Incorporated in*	*Nature of business*	*Equity interest*	**2010**	2009
			%	**€000**	€000
HSBC Life Assurance (Malta) Limited	Malta	Life insurance	**99.99**	**28,578**	28,578
HSBC Global Asset Management (Malta) Limited	Malta	Portfolio management services	**99.99**	**5,940**	5,940
HSBC Securities Services (Malta) Limited	Malta	Fund administration services	**99.99**	**1,166**	1,166
HSBC Stockbrokers (Malta) Limited	Malta	Stockbroking services	**99.99**	**23**	23
				35,707	35,707

25 Intangible assets

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Software	**7,670**	1,912	**7,583**	1,741
Present value of in-force long-term insurance business	**62,985**	58,779	**–**	–
	70,655	60,691	**7,583**	1,741

a *Software*

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Cost				
At 1 January	**12,042**	11,001	**10,645**	9,665
Additions	**6,765**	1,046	**6,738**	985
Disposals	**(27)**	(5)	**–**	(5)
At 31 December	**18,780**	12,042	**17,383**	10,645
Amortisation				
At 1 January	**10,130**	8,987	**8,904**	7,868
Charge for the year	**980**	1,148	**896**	1,041
Disposals	**–**	(5)	**–**	(5)
At 31 December	**11,110**	10,130	**9,800**	8,904
Carrying amount at 1 January	**1,912**	2,014	**1,741**	1,797
Carrying amount at 31 December	**7,670**	1,912	**7,583**	1,741

b *Present value of in-force long-term insurance business*

	Group	
	2010	2009
	€000	€000
At 1 January	**58,779**	62,242
Addition from current year new business	**5,373**	5,427
Movement from in-force business	**(1,167)**	(8,890)
At 31 December	**62,985**	58,779

The following are the key assumptions used in the computation of the group's PVIF in the current and comparative periods:

Risk free rate	**Euro swap curve**
Risk adjusted discount rate	**8.00%**
Expenses inflation	**French inflation swap curve modified for Malta**
Lapse rate	**Different rates for different products**

Notes on the Financial Statements (continued)

26 Property and equipment

	Land and buildings	*Computer equipment*	*Others*	*Total*
	€000	**€000**	**€000**	**€000**
Group				
Cost/revaluation				
At 1 January 2010	**46,720**	**18,601**	**48,147**	**113,468**
Additions	**140**	**1,096**	**3,074**	**4,310**
Revaluation	**587**	**–**	**–**	**587**
Disposals	**(350)**	**(311)**	**(1,174)**	**(1,835)**
At 31 December 2010	**47,097**	**19,386**	**50,047**	**116,530**
Depreciation				
At 1 January 2010	**2,889**	**13,310**	**31,872**	**48,071**
Charge for the year	**553**	**1,328**	**3,940**	**5,821**
Revaluation	**(1,530)**	**–**	**–**	**(1,530)**
Disposals	**(18)**	**(309)**	**(992)**	**(1,319)**
At 31 December 2010	**1,894**	**14,329**	**34,820**	**51,043**
Carrying amount at 1 January 2010	**43,831**	**5,291**	**16,275**	**65,397**
Carrying amount at 31 December 2010	**45,203**	**5,057**	**15,227**	**65,487**
Cost/revaluation				
At 1 January 2009	48,703	18,303	47,743	114,749
Additions	57	2,157	895	3,109
Disposals	(2,040)	(1,859)	(491)	(4,390)
At 31 December 2009	46,720	18,601	48,147	113,468
Depreciation				
At 1 January 2009	2,349	13,654	28,062	44,065
Charge for the year	558	1,513	4,251	6,322
Disposals	(18)	(1,857)	(441)	(2,316)
At 31 December 2009	2,889	13,310	31,872	48,071
Carrying amount at 1 January 2009	46,354	4,649	19,681	70,684
Carrying amount at 31 December 2009	43,831	5,291	16,275	65,397

	Group	
	2010	2009
	€000	€000
Carrying amount of land and buildings occupied for own activities	**45,203**	43,831

	Land and buildings	*Computer equipment*	*Others*	*Total*
	€000	**€000**	**€000**	**€000**
Bank				
Cost/revaluation				
At 1 January 2010	**46,706**	**18,175**	**46,906**	**111,787**
Additions	**140**	**1,096**	**3,074**	**4,310**
Revaluation	**587**	**–**	**–**	**587**
Disposals	**(350)**	**(310)**	**(1,174)**	**(1,834)**
At 31 December 2010	**47,083**	**18,961**	**48,806**	**114,850**

26 Property and equipment *(continued)*

	Land and buildings	*Computer equipment*	*Others*	*Total*
	€000	**€000**	**€000**	**€000**
Bank				
Depreciation				
At 1 January 2010	**2,673**	**12,918**	**30,726**	**46,317**
Charge for the year	**553**	**1,309**	**3,940**	**5,802**
Revaluation	**(1,530)**	**–**	**–**	**(1,530)**
Disposals	**(18)**	**(309)**	**(992)**	**(1,319)**
At 31 December 2010	**1,678**	**13,918**	**33,674**	**49,270**
Carrying amount at 1 January 2010	**44,033**	**5,257**	**16,180**	**65,470**
Carrying amount at 31 December 2010	**49,270**	**5,043**	**15,132**	**65,580**
Cost/revaluation				
At 1 January 2009	48,689	17,874	46,499	113,062
Additions	57	2,157	895	3,109
Disposals	(2,040)	(1,856)	(488)	(4,384)
At 31 December 2009	46,706	18,175	46,906	111,787
Depreciation				
At 1 January 2009	2,133	13,282	26,916	42,331
Charge for the year	558	1,492	4,251	6,301
Disposals	(18)	(1,856)	(441)	(2,315)
At 31 December 2009	2,673	12,918	30,726	46,317
Carrying amount at 1 January 2009	46,556	4,592	19,583	70,731
Carrying amount at 31 December 2009	44,033	5,257	16,180	65,470

	Bank	
	2010	2009
	€000	€000
Carrying amount of land and buildings occupied for own activities	**45,405**	44,033

The carrying amount of land and buildings that would have been included in the financial statements had these assets been carried at cost less depreciation is €15,995,000 (2009: €16,426,000) for the group and the bank.

Land and buildings were revalued in September 2010.

27 Investment property

	Fair Value	*Cost*	*Fair Value*	*Cost*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Group				
Freehold land and buildings				
As at 1 January	**14,588**	**8,571**	14,050	8,553
Additions	**3**	**3**	18	18
Fair value adjustments	**–**	**–**	520	–
At 31 December	**14,591**	**8,574**	14,588	8,571

Notes on the Financial Statements (continued)

27 Investment property *(continued)*

	Fair Value	*Cost*	*Fair Value*	*Cost*
	2010	**2010**	2009	2009
	€000	**€000**	€000	€000
Bank				
Freehold land and buildings				
As at 1 January	**11,665**	**6,491**	11,647	6,473
Additions	**3**	**3**	18	18
Fair value adjustments	**–**	**–**	–	–
At 31 December	**11,668**	**6,494**	11,665	6,491

During the year ended 31 December 2010, €703,000 (2009: €671,000) was recognised as rental income in profit or loss relating to investment property for the group and bank. €573,000 (2009: €503,000) of the rental income was received from a Group company.

28 Assets held for sale

	Group/Bank	
	2010	2009
	€000	€000
Assets acquired in satisfaction of debt	**7,662**	8,772
Other	**2,012**	1,832
	9,674	10,604

Repossessed properties are made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. The group does not generally occupy repossessed properties for its business use. In the main, repossessed property consisted of immovable property.

29 Other assets

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Acceptances and endorsements	**5,139**	2,212	**5,139**	2,212
Reinsurance assets	**24,128**	12,140	**–**	–
Other	**5,158**	6,360	**4,300**	5,719
	34,425	20,712	**9,439**	7,931
Amounts include:				
– due from Group companies	**1,265**	1,894	**1,265**	1,894

30 Prepayments and accrued income

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Accrued income	**37,524**	32,562	**33,083**	28,828
Prepayments	**1,186**	1,186	**1,173**	1,178
	38,710	33,748	**34,256**	30,006
Amounts include:				
– due from Group companies	**508**	531	**435**	482
– due from subsidiary companies	**–**	–	**327**	285

31 Amounts owed to banks

	2010	2009
	€000	€000
Group/Bank		
Term deposits	**214,993**	157,817
Repayable on demand	**17,797**	10,954
	232,790	168,771
Amounts include:		
– due to Group companies	**208,315**	163,904

32 Amounts owed to customers

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Term deposits	**1,941,628**	1,995,524	**1,943,129**	2,016,423
Repayable on demand	**2,521,233**	2,091,145	**2,574,634**	2,129,872
	4,462,861	4,086,669	**4,517,763**	4,146,295
Amounts include:				
– due to Group companies	**744**	899	**744**	899
– due to subsidiary companies	**–**	–	**54,902**	59,626

33 Deferred tax

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Deferred tax liabilities and (assets) are attributable to the following:				
– excess of capital allowances over depreciation	**677**	852	**675**	842
– allowances for uncollectibility	**(15,682)**	(14,066)	**(15,533)**	(13,997)
– property sales tax consequences	**7,024**	6,961	**6,735**	6,672
– fair value movements on investments	**520**	(95)	**100**	(731)
– value of in-force life insurance business	**22,045**	20,573	**–**	–
– fair value movement on policyholders’ investments	**(3,268)**	(2,842)	**–**	–
– other	**(1,893)**	(1,585)	**(1,879)**	(1,552)
	9,423	9,798	**(9,902)**	(8,766)

	Group			
	At 1 January 2010	*Recognised in profit or loss*	*Recognised in equity*	*At 31 December 2010*
	€000	**€000**	**€000**	**€000**
Movement in temporary differences relating to:				
– excess of capital allowances over depreciation	**852**	**(175)**	**–**	**677**
– allowances for uncollectibility	**(14,066)**	**(1,616)**	**–**	**(15,682)**
– property sales tax consequences	**6,961**	**–**	**63**	**7,024**
– fair value movements on investments	**(95)**	**3**	**610**	**520**
– value of in-force life insurance business	**20,573**	**1,472**	**–**	**22,045**
– fair value movement on policyholders’ investments	**(2,842)**	**(426)**	**–**	**(3,268)**
– other	**(1,585)**	**(582)**	**276**	**(1,893)**
	9,798	**(1,324)**	**949**	**9,423**

Notes on the Financial Statements (continued)

33 Deferred tax *(continued)*

	Group			
	At 1 January 2009	*Recognised in profit or loss*	*Recognised in equity*	*At 31 December 2009*
	€000	€000	€000	€000
Movement in temporary differences relating to:				
– excess of capital allowances over depreciation	936	(84)	–	852
– allowances for uncollectibility	(13,770)	(296)	–	(14,066)
– property sales tax consequences	6,953	2	6	6,961
– fair value movements on investments	(6,030)	154	5,781	(95)
– value of in-force life insurance business	21,785	(1,212)	–	20,573
– fair value movement on policyholders' investments	(4,771)	1,929	–	(2,842)
– other	(3,419)	1,636	198	(1,585)
	1,684	2,129	5,985	9,798

	Bank			
	At 1 January 2010	*Recognised in profit or loss*	*Recognised in equity*	*At 31 December 2010*
	€000	**€000**	**€000**	**€000**
Movement in temporary differences relating to:				
– excess of capital allowances over depreciation	**842**	**(167)**	**–**	**675**
– allowances for uncollectibility	**(13,997)**	**(1,536)**	**–**	**(15,533)**
– property sales tax consequences	**6,672**	**–**	**63**	**6,735**
– fair value movements on investments	**(731)**	**3**	**828**	**100**
– other	**(1,552)**	**(591)**	**264**	**(1,879)**
	(8,766)	**(2,291)**	**1,155**	**(9,902)**

	Bank			
	At 1 January 2009	*Recognised in profit or loss*	*Recognised in equity*	*At 31 December 2009*
	€000	€000	€000	€000
Movement in temporary differences relating to:				
– excess of capital allowances over depreciation	928	(86)	–	842
– allowances for uncollectibility	(13,770)	(227)	–	(13,997)
– property sales tax consequences	6,664	2	6	6,672
– fair value movements on investments	(6,148)	154	5,263	(731)
– other	(3,400)	1,650	198	(1,552)
	(15,726)	1,493	5,467	(8,766)

The group's deferred tax assets and liabilities on the statement of financial position have not been off-set to the extent that there is no legally enforceable right of set-off with the tax authorities.

34 Liabilities to customers under investment contracts

	Group	
	2010	2009
	€000	€000
At 1 January	**16,853**	15,122
Premiums received	**1,653**	141
Amounts paid on surrender and other termination during the year	**(1,157)**	(710)
Changes in unit prices and other movements	**1,613**	2,300
At 31 December	**18,962**	16,853

35 Liabilities under insurance contracts issued

	Group	
	Gross	*Gross*
	2010	2009
	€000	€000
Life insurance (non-linked)		
Provisions for policyholders	**285,546**	260,187
Outstanding claims	**12,156**	2,470
Total non-linked	**297,702**	262,657
Life insurance (linked)		
Provisions for policyholders	**112,346**	88,572
Outstanding claims	**413**	284
Total linked	**112,759**	88,856
Total liabilities under insurance contracts	**410,461**	351,513

	Group			
	Non-linked business	*Linked business*	*All business*	*All business*
	Provisions for policy-holders	*Provisions for policy-holders*	*Outstanding claims*	*Total*
	2010	**2010**	**2010**	**2010**
	€000	**€000**	**€000**	**€000**
At 1 January	**260,187**	**88,572**	**2,754**	**351,513**
Claims in respect of new business	**–**	**333**	**12,988**	**13,321**
Movement for the year	**25,359**	**23,532**	**(1,897)**	**46,994**
Previous year claims paid	**–**	**(91)**	**(1,276)**	**(1,367)**
At 31 December	**285,546**	**112,346**	**12,569**	**410,461**

Notes on the Financial Statements (continued)

35 Liabilities under insurance contracts issued *(continued)*

	Group			
	Non-linked business	*Linked business*	*All business*	*All business*
	Provisions for policy-holders	*Provisions for policy-holders*	*Outstanding claims*	*Total*
	2009	2009	2009	2009
	€000	€000	€000	€000
At 1 January	250,467	59,614	1,169	311,250
Claims in respect of new business	–	–	3,410	3,410
Movement for the year	9,720	28,958	(1,227)	37,451
Previous year claims paid	–	–	(598)	(598)
At 31 December	260,187	88,572	2,754	351,513

36 Other liabilities

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Bills payable	**12,189**	10,605	**12,189**	10,605
Cash collateral for commitments	**136**	124	**136**	124
Obligations under finance leases	**136**	268	**136**	268
Acceptances and endorsements	**5,139**	2,212	**5,139**	2,212
Other	**28,824**	22,270	**25,121**	19,012
	46,424	35,479	**42,721**	32,221

37 Accruals and deferred income

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Accrued interest	**18,432**	17,134	**18,570**	17,471
Other	**17,872**	16,288	**16,757**	15,597
	36,304	33,422	**35,327**	33,068
Amounts include:				
– due to Group companies	**2,582**	2,552	**2,213**	2,417
– due to subsidiary companies	**–**	–	**138**	337

38 Provisions for liabilities and other charges

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
At 1 January	**577**	312	**514**	277
Provisions made during the year	**19**	265	**–**	237
Provisions reversed during the year	**(20)**	–	**(20)**	–
Provisions utilised during the year	**(45)**	–	**–**	–
At 31 December	**531**	577	**494**	514

Provisions for liabilities and other charges include amounts raised in relation to litigations. The bank is a party to legal actions arising from normal business operations. Management believe that adequate provisions have been made against these litigations, based on legal advice on the timing and amount of the possible economic outflows.

39 Subordinated liabilities

	2010	2009
	€000	€000
Group/Bank		
4.60% subordinated unsecured loan stock 2017	**58,052**	58,022
5.90% subordinated unsecured loan stock 2018	**29,828**	29,805
	87,880	87,827

The above liabilities will, in the event of the winding up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. The group did not have any defaults of interest or other breaches with respect to its subordinated liabilities during the current and comparative period.

40 Share capital

	2010	2009
	€000	€000
Authorised		
470,000,000 Ordinary shares of 30c each	**141,000**	141,000
Issued and fully paid up		
291,840,000 Ordinary shares of 30c each	**87,552**	87,552

41 Reserves

Revaluation reserve

The revaluation reserve comprises the surplus arising on the revaluation of the group's freehold and long leasehold properties and the cumulative net change in fair values of available-for-sale financial investments held by the group, net of deferred taxation. The revaluation reserve is not available for distribution.

Depositor compensation scheme reserve

Retained earnings is inclusive of Depositor compensation scheme reserve amounting to €19,434,000. This reserve is excluded from the Own Funds calculation (refer to note 5).

As at 31 December 2010, debt securities with a carrying amount of €14,826,000 had been pledged in terms of the Depositor compensation scheme (refer to note 21a). After year end, balances with the Central Bank of Malta amounting to €5,000,000 have also been pledged in favour of the Scheme.

42 Contingent liabilities

	Group Contract amount		*Bank Contract amount*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Guarantees and assets pledged as collateral security				
– guarantees	**98,070**	95,820	**98,093**	95,843
– standby letters of credit	**30,408**	23,629	**30,408**	23,629
– other	**469**	468	**469**	468
	128,947	119,917	**128,970**	119,940
Amounts include:				
– in favour of Group companies	**8,436**	6,934	**8,436**	6,934
– in favour of subsidiary companies	**–**	–	**23**	23

Notes on the Financial Statements (continued)

43 Commitments

	Contract amount	
	2010	2009
	€000	€000
Group/Bank		
Documentary credits	**15,405**	13,250
Undrawn formal standby facilities, credit facilities and other commitments to lend	**962,311**	910,648
Uncalled share capital in other companies	**2**	2
	977,718	923,900

44 Capital and lease commitments

a *Capital commitments*

Capital commitments are made up of:

	2010	2009
	€000	€000
Group/Bank		
Intangible assets	**158**	133
Property and equipment	**1,804**	497
	1,962	630

b *Operating leases*

Total future minimum lease payments under non-cancellable operating leases not provided for:

	2010	2009
	€000	€000
Group/Bank		
Less than one year	**1,957**	2,283
Between one year and five years	**1,376**	2,884
More than five years	**2,215**	2,260
	5,548	7,427

c *Finance leases*

Finance lease payments, both principal and finance charge, are payable as follows:

	2010	2009
	€000	€000
Group/Bank		
Less than one year	**70**	190
Between one year and five years	**77**	105
Total minimum lease payments	**147**	295
Finance charges	**(11)**	(27)
Present value of minimum lease payments	**136**	268

45 Dividends

	Bank			
	2010	2009	**2010**	2009
	% per share	% per share	**€000**	€000
Gross of income tax				
% per 30c share				
– prior year's final	**27**	32	**23,347**	28,016
– interim	**26**	26	**23,055**	22,472
	53	58	**46,402**	50,488
	Euro cent per share	Euro cent per share	**€000**	€000
Net of income tax				
euro cent per 30c share				
– prior year's final	**5.20**	6.24	**15,176**	18,210
– interim	**5.13**	5.01	**14,986**	14,607
	10.33	11.25	**30,162**	32,817

The Directors have proposed a final gross ordinary dividend of 7.7 euro cent (2009: 8.0 euro cent) per share. The final dividend will be payable to shareholders on the bank's register as at 8 March 2011.

46 Cash and cash equivalents

	Group		Bank	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Balances of cash and cash equivalents are analysed below:				
Cash	**24,103**	25,009	**24,102**	25,008
Balances with Central Bank of Malta (excluding reserve deposit)	**4,257**	4,638	**4,257**	4,638
Financial assets designated at fair value through profit or loss	**–**	4,356	**–**	–
Loans and advances to banks	**627,190**	683,010	**627,139**	682,999
Amounts owed to banks	**(231,944)**	(168,198)	**(231,944)**	(168,198)
Per Statements of Cash Flows	**423,606**	548,815	**423,554**	544,447
Adjustment to reflect balances with contractual maturity of more than three months	**658,064**	372,904	**351,765**	128,643
Per Statements of Financial Position	**1,081,670**	921,719	**775,319**	673,090
Analysed as follows:				
Cash and balances with Central Bank of Malta (excluding reserve deposit)	**28,360**	29,647	**28,359**	29,646
Malta Government Treasury Bills	**264,900**	64,633	**264,900**	64,633
Financial assets designated at fair value through profit or loss	**306,299**	248,553	**–**	–
Loans and advances to banks	**714,901**	747,657	**714,850**	747,582
Amounts owed to banks	**(232,790)**	(168,771)	**(232,790)**	(168,771)
	1,081,670	921,719	**775,319**	673,090

Notes on the Financial Statements (continued)

47 Segmental information

a *Class of business*

	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Intersegment*	*Group Total*
	2010	**2010**	**2010**	**2010**	**2010**
	€000	**€000**	**€000**	**€000**	**€000**
Group					
Net interest income					
– External	**46,368**	**62,989**	**13,485**	**–**	**122,842**
– Inter-segment	**14,282**	**(12,169)**	**(2,113)**	**–**	**–**
	60,650	**50,820**	**11,372**	**–**	**122,842**
Net non-interest income					
– External	**28,647**	**15,208**	**9,830**	**–**	**53,685**
– Inter-segment	**1,477**	**144**	**(1,621)**	**(339)**	**(339)**
	30,124	**15,352**	**8,209**	**(339)**	**53,346**
External employee compensation and benefits	**(35,601)**	**(12,453)**	**(2,669)**	**–**	**(50,723)**
General and administrative expenses					
– External	**(21,071)**	**(7,031)**	**(1,979)**	**–**	**(30,081)**
– Inter-segment	**(339)**	**–**	**–**	**339**	**–**
	(21,410)	**(7,031)**	**(1,979)**	**339**	**(30,081)**
External Depreciation	**(4,241)**	**(1,566)**	**(14)**	**–**	**(5,821)**
External Amortisation	**(668)**	**(247)**	**(65)**	**–**	**(980)**
External Net impairment	**(2,635)**	**(2,631)**	**(230)**	**–**	**(5,496)**
External Net provisions for liabilities and other charges	**20**	**–**	**(19)**	**–**	**1**
Profit before tax	**26,239**	**42,244**	**14,605**	**–**	**83,088**
Assets					
Segment total assets	**2,273,382**	**1,704,402**	**1,686,777**	**–**	**5,664,561**
Average total assets	**2,201,514**	**1,693,565**	**1,496,101**	**–**	**5,391,180**
Total Equity	**156,964**	**144,169**	**32,697**	**–**	**333,830**

47 Segmental information *(continued)*

a *Class of business*

	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Intersegment*	*Group Total*
	2009	2009	2009	2009	2009
	€000	€000	€000	€000	€000
Group					
Net interest income					
– External	30,821	60,493	13,656	–	104,970
– Inter-segment	24,041	(11,255)	(12,786)	–	–
	54,862	49,238	870	–	104,970
Net non-interest income					
– External	26,554	16,496	11,639	–	54,689
– Inter-segment	1,480	–	(1,480)	–	–
	28,034	16,496	10,159	–	54,689
External employee compensation and benefits	(32,475)	(14,254)	(2,523)	–	(49,252)
General and administrative expenses					
– External	(19,303)	(5,738)	(2,006)	–	(27,047)
	(19,303)	(5,738)	(2,006)	–	(27,047)
External Depreciation	(4,463)	(1,843)	(16)	–	(6,322)
External Amortisation	(755)	(330)	(63)	–	(1,148)
External Net impairment	(2,578)	(1,654)	(197)	–	(4,429)
External Net provisions for liabilities and other charges	(20)	(217)	(28)	–	(265)
Profit before tax	23,302	41,698	6,196	–	71,196
Assets					
Segment total assets	2,129,646	1,682,729	1,305,425	–	5,117,800
Average total assets	2,051,891	1,675,252	1,479,801	–	5,206,944
Total Equity	113,280	159,636	33,671	–	306,587

b *Geographical segments*

The group's activities are carried out within Malta. There are no identifiable geographical segments or other material concentrations.

48 Comparatives

Certain amounts have been reclassified to comply with the current year's presentation.

49 Related party transactions

During the course of banking operations, the group conducted business transactions with entities owned by the ultimate parent and its subsidiaries on an arm's length basis.

Executive Directors participate in the HSBC Group share option plans (refer to note 13).

a *Transactions, arrangements and agreements involving Directors and others*

Particulars of transactions, arrangements and agreements entered into with Directors, connected persons and companies controlled by them and with key management personnel of HSBC Bank Malta p.l.c.:

	Group		*Bank*	
	Balance at end of year	*Balance at end of year*	*Balance at end of year*	*Balance at end of year*
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Directors, connected persons and companies controlled by them				
Loans	**57,200**	119,777	**57,200**	119,777
Credit card transactions	**20**	27	**20**	27
Guarantees	**11,560**	5,968	**11,560**	5,968
Commitments to lend	**23,558**	55,297	**23,558**	55,297
Senior executive management				
Loans	**1,272**	2,053	**1,178**	1,942
Credit card transaction	**75**	54	**69**	49

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

b *Compensation to Directors and key management personnel*

	Group		*Bank*	
	2010	2009	**2010**	2009
	€000	€000	**€000**	€000
Short-term employee benefits	**4,148**	3,454	**3,589**	3,058
Post-employment benefits	**314**	238	**314**	238
Other long-term benefits	**2**	17	**2**	17
Termination benefits	**–**	348	**–**	348
Share-based payments	**281**	134	**256**	130
	4,745	4,191	**4,161**	3,791

Details of Directors' fees and emoluments are stated in note 15.

c *Transactions with other related parties*

Information relating both to transactions with HSBC Holdings plc and its subsidiaries as well as with subsidiary companies of HSBC Bank Malta p.l.c. are stated in the 'Notes on the Financial Statements' where the following are disclosed.

Note 6 – interest receivable and similar income
Note 7 – interest payable
Note 8 – net fee and commission income
Note 9 – dividend income
Note 13 – employee compensation and benefits
Note 19 – derivatives
Note 21 – financial investments
Note 22 – loans and advances to banks
Note 24 – shares in subsidiary companies

49 Related party transactions *(continued)*

c *Transactions with other related parties (continued)*

Note 27 – investment property
Note 29 – other assets
Note 30 – prepayments and accrued income
Note 31 – amounts owed to banks
Note 32 – amounts owed to customers
Note 37 – accruals and deferred income
Note 42 – contingent liabilities
Note 43 – commitments

Included in Interest receivable and similar income (refer to note 6) and in Interest payable (refer to note 7), the group recognised interest amounting to €2,832,000 and €199,000 respectively, on advances and deposits placed with an intermediate parent.

Included in Net fee and commission income (refer to note 8), the group recognised commission amounting to €898,000 (2009: €815,000) received from an intermediate parent.

Furthermore, expenditure relating to transactions with HSBC Holdings plc and its subsidiaries amounting to €3,249,000 (2009: €2,469,000) for the group and €2,618,000 (2009: €1,838,000) for the bank is included in Employee compensation and benefits and €7,952,000 (2009: €6,242,000) for the group and €7,071,000 (2009: €5,570,000) for the bank is included within General and administrative expenses.

50 Trust and custody activities

The group provides trust and custody services to individuals, trusts, retirement benefit plans and other institutions, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The group receives fee income for providing these services. Trust assets and assets held in custody are not assets of the group and are not recognised in the statements of financial position. The group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

At 31 December 2010, the total assets held by the group on behalf of customers were €2,588,033,000 (2009: €2,718,297,000).

51 Registered office and ultimate parent company

The addresses of the registered and principal offices of the bank and its subsidiary companies included in the consolidated financial statements can be found in a separate statement which is filed at the Registrar of Companies in accordance with the provisions of the Fourth Schedule to the Companies Act, 1995.

The ultimate parent company of HSBC Bank Malta p.l.c. is HSBC Holdings plc, which is incorporated and registered in England. The registered address is 8 Canada Square, London E14 5HQ, United Kingdom. Copies of the HSBC Holdings plc *Annual Review 2010* and *Annual Report and Accounts 2010* may be obtained from its registered office, from 30 March 2011 or viewed on www.hsbc.com from 28 February 2011.

52 Investor compensation scheme

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994, licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme.

HSBC Bank Malta p.l.c. and HSBC Stockbrokers (Malta) Limited have elected to pay the amount of the variable contribution directly to the Scheme.

53 Accounting estimates and judgements

In addition to disclosures set out in notes 4 and 25, the Directors considered the development, selection and disclosure of the group's critical accounting policies and estimates and the application of these policies and estimates. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting judgement in applying accounting policies

i Impairment losses on loans and advances

The group reviews its loan portfolio to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with groups of loans with similar risk characteristics (refer to note 3(g)(i)). As a result, the group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before the decrease is actually identified with an individual loan in that portfolio. The evidence may include observable data indicating that there has been an adverse change in the relative economic situation of an asset group or in the credit status of borrowers in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

ii Policyholder claims and benefits

The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the group. Estimates are made as to the expected number of deaths for each of the years in which the group is exposed to risk. The group bases these estimates on standard industry and national mortality tables that reflect recent historical mortality experience, adjusted where appropriate to reflect the group's own experience. The estimated number of deaths determines the value of the benefit payments and the value of the valuation premiums. The main source of uncertainty is that epidemics such as AIDS, SARS, pandemic flu and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the group has significant exposure to mortality risk.

Estimates are also made as to future investment income arising from the assets backing long-term insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments.

For long-term insurance contracts with fixed and guaranteed terms and with discretionary participation features, estimates of future deaths, voluntary terminations, investment returns and administrative expenses form the assumptions used for calculating the liabilities during the life of the contract. A margin for risk and uncertainty is added to these assumptions. New estimates are made each subsequent year to reflect the current long-term outlook.

iii Fair value of derivatives

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumption about these factors could affect reported fair value of financial instruments.

iv Impairment of available-for-sale equity instruments

The group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the group evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financial cash flows.

Independent Auditors' Report to the Members of HSBC Bank Malta p.l.c.

Report on the financial statements

We have audited the financial statements of HSBC Bank Malta p.l.c. (the "bank") and of the group of which the bank is the parent, as set out on pages 24 to 86, which comprise the statements of financial position as at 31 December 2010 and the income statements and statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

As explained more fully in the Directors' Responsibilities Statement set out on page 23, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU, the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act"), and the Banking Act, 1994 (Chapter 371, Laws of Malta), and, as regards the financial statements of the Group, Article 4 of the IAS Regulation, and for such internal control as the directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Article 179 of the Act, and Article 31 of the Banking Act, 1994 (Chapter 371, Laws of Malta), and may not be appropriate for any other purpose.

In addition, we read the other information contained in the Annual Report 2010 and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent material misstatements of fact or material inconsistencies with the financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion on financial statements

In our opinion, the financial statements:

- give a true and fair view of the group's and the bank's financial position as at 31 December 2010, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- have been properly prepared in accordance with the Companies Act, 1995 (Chapter 386, Laws of Malta), the Banking Act, 1994 (Chapter 371, Laws of Malta), and, as regards the financial statements of the group, Article 4 of the IAS Regulation.

Independent Auditors' Report to the Members of HSBC Bank Malta p.l.c. (continued)

Report on other legal and regulatory requirements

Matters on which we are required to report by the Banking Act, 1994 (Chapter 371, Laws of Malta)

In our opinion:

– we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purpose of our audit;

– proper books of account have been kept by the bank so far as appears from our examination thereof;

– the bank's financial statements are in agreement with the books of account; and

– to the best of our knowledge and belief and, on the basis of the explanations given to us, the financial statements give the information required by law in force in the manner so required.

Matters on which we are required to report by exception by the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act"), other than those reported upon above

We have nothing to report in respect of the following matters where the Act requires us to report to you if, in our opinion:

– the information given in the Report of the Directors for the financial year for which the financial statements are prepared is not consistent with the financial statements; or

– certain disclosures of directors' remuneration specified by the Act are not made.

Report required by Listing Rule 5.98 issued by the Listing Authority in Malta on the Directors' Statement of Compliance with the Code of Principles of Good Corporate Governance (the "Principles") outlined in Appendix 5.1 to Chapter 5 (Continuing Obligations) of the Listing Rules (the "Appendix")

Listing Rule 5.97 requires an Issuer whose securities are admitted to trading on a Regulated Market operating in Malta to prepare a corporate governance statement. In addition, as an Issuer registered in Malta, Listing Rule 5.94 requires that the Issuer endeavours to adopt the Principles and to prepare a report explaining how it has complied with the provisions of the Appendix.

Our responsibility as independent auditors of the bank, is laid down by Listing Rule 5.98, which requires us to issue a report on the Directors' Statement of Compliance with the Principles, which is set out on pages 18 to 21.

We review the Directors' Statement of Compliance, and report as to whether this Statement provides the disclosures required by Listing Rule 5.97. We are not required to, and we do not, consider whether the Board's statements on internal control and risk management systems cover all the risks and controls in relation to the financial reporting process, or form an opinion on the effectiveness of the group's corporate governance procedures or its risks and control procedures, nor on the ability of the group to continue in operational existence.

In our opinion, the Directors' Statement of Compliance set out on pages 18 to 21 provides the disclosures required by Listing Rule 5.97 issued by the Listing Authority of Malta.

Noel Mizzi (Partner) for and on behalf of

KPMG
Registered Auditors
Portico Building
Marina Street
Pietà PTA 9044
Malta

18 February 2011

Group Income Statements and Statements of Comprehensive Income: Five-Year Comparison

Group Income Statements

	2010	2009	2008	2007	2006
	€000	€000	€000	€000	€000
Interest receivable and similar income	**169,012**	169,038	245,510	237,580	188,388
Interest payable	**(46,170)**	(64,068)	(122,466)	(111,342)	(78,996)
Net interest income	**122,842**	104,970	123,044	126,238	109,392
Net non-interest income	**53,346**	54,689	65,257	72,453	66,634
Operating expenses	**(87,605)**	(83,769)	(90,409)	(83,672)	(80,007)
Net impairment	**(5,496)**	(4,429)	(1,907)	(42)	422
Net provisions for liabilities and other charges	**1**	(265)	102	(340)	(16)
Profit before tax	**83,088**	71,196	96,087	114,637	96,425
Tax expense	**(29,327)**	(25,329)	(32,972)	(38,322)	(33,944)
Profit for the year	**53,761**	45,867	63,115	76,315	62,481
Profit attributable to shareholders of the bank	**53,761**	45,867	63,115	76,315	62,451
Profit attributable to minority interest	**–**	–	–	–	30
Earnings per share	**18.4c**	15.7c	21.6c	26.1c	21.4c

Group Statements of Comprehensive Income

	2010	2009	2008	2007	2006
	€000	€000	€000	€000	€000
Profit attributable to shareholders	**53,761**	45,867	63,115	76,315	62,451
Other comprehensive income					
Available-for-sale investments:					
– change in fair value	**1,178**	17,496	(9,635)	(10,677)	(5,977)
– change in fair value transferred to profit or loss	**567**	(1,071)	(1,348)	(3,537)	(6,340)
Properties:					
– revaluation	**2,117**	–	–	9,789	–
Income taxes	**(699)**	(5,749)	3,844	3,800	4,325
Other comprehensive income for the year, net of tax	**3,163**	10,676	(7,139)	(625)	(7,992)
Total comprehensive income for the year, net of tax	**56,924**	56,543	55,976	75,690	54,459

Group Statements of Financial Position: Five-Year Comparison

	2010	2009	2008	2007	2006
	€000	€000	€000	€000	€000
Assets					
Balances with Central Bank of Malta, Treasury Bills and cash	**379,985**	172,671	130,682	472,136	304,144
Cheques in course of collection	**9,011**	10,764	9,308	3,103	24,540
Derivatives	**11,489**	11,746	11,823	15,980	24,216
Financial instruments designated at fair value through profit or loss	**306,299**	248,553	279,714	275,695	261,999
Financial investments	**690,606**	478,975	429,912	456,525	391,656
Loans and advances to banks	**714,901**	747,657	1,072,306	631,018	596,459
Loans and advances to customers	**3,303,835**	3,226,477	3,112,240	2,822,315	2,623,169
Intangible assets	**70,655**	60,691	64,256	36,110	25,388
Property and equipment	**65,487**	65,397	70,684	77,820	66,648
Investment property	**14,591**	14,588	14,050	12,885	7,959
Assets held for sale	**9,674**	10,604	9,168	11,922	9,266
Current tax assets	**4,712**	6,164	2,966	2,596	1,877
Deferred tax assets	**10,181**	9,053	15,916	11,553	–
Other assets	**34,425**	20,712	25,824	25,855	24,955
Prepayments and accrued income	**38,710**	33,748	47,239	39,576	33,983
Total assets	**5,664,561**	5,117,800	5,296,088	4,895,089	4,396,259
Liabilities					
Derivatives	**12,311**	11,044	11,381	15,043	24,792
Amounts owed to banks	**232,790**	168,771	462,185	87,142	294,264
Amounts owed to customers	**4,462,861**	4,086,669	4,016,632	4,039,492	3,436,873
Provision for current tax	**2,603**	207	688	11,043	–
Deferred tax liabilities	**19,604**	18,851	17,600	12,361	10,729
Liabilities to customers under investment contracts	**18,962**	16,853	15,122	18,947	21,321
Liabilities under insurance contracts issued	**410,461**	351,513	311,250	290,943	239,390
Other liabilities	**46,424**	35,479	36,734	32,303	32,183
Accruals and deferred income	**36,304**	33,422	53,930	53,147	42,271
Provisions for liabilities and other charges	**531**	577	312	414	75
Subordinated liabilities	**87,880**	87,827	87,777	57,962	–
Total liabilities	**5,330,731**	4,811,213	5,013,611	4,618,797	4,101,898
Total equity	**333,830**	306,587	282,477	276,292	294,361
Total liabilities and equity	**5,664,561**	5,117,800	5,296,088	4,895,089	4,396,259
Memorandum items					
Contingent liabilities	**128,478**	119,449	129,925	129,972	138,779
Commitments	**977,718**	923,900	1,110,572	1,148,034	1,064,288

Group Statements of Cash Flows: Five-Year Comparison

	2010	2009	2008	2007	2006
	€000	€000	€000	€000	€000
Net cash from/(used in) operating activities	**103,151**	293,498	(309,684)	343,005	(22,241)
Cash flows (used in)/from investing activities					
Dividends received	**281**	387	49	228	172
Interest received from financial investments	**25,575**	16,115	23,884	21,011	26,399
Purchase of financial investments	**(307,715)**	(218,285)	(83,733)	(278,768)	(88,169)
Proceeds from sale and maturity of financial investments	**94,246**	187,399	88,551	195,078	207,061
Purchase of property and equipment, investment property and intangible assets	**(11,038)**	(4,174)	(7,556)	(9,981)	(5,383)
Proceeds on sale of property and equipment and intangible assets	**453**	2,097	9,755	61	186
Proceeds on sale of shares in subsidiary company	**–**	–	–	–	1,048
Net cash (used in)/from investing activities	**(198,198)**	(16,461)	30,950	(72,371)	141,314
Cash flows used in financing activities					
Dividends paid	**(30,162)**	(32,817)	(50,649)	(93,677)	(67,827)
Maturity of debt securities in issue and subordinated loan stock	**–**	–	–	–	(28)
Issue of subordinated loan stock	**–**	–	30,000	58,234	–
Issue of units to minority interest	**–**	–	–	–	212
Subordinated loan stock issue costs	**–**	–	(226)	(302)	–
Net cash used in financing activities	**(30,162)**	(32,817)	(20,875)	(35,745)	(67,643)
(Decrease)/increase in cash and cash equivalents	**(125,209)**	244,220	(299,609)	234,889	51,430

Group Accounting Ratios: Five-Year Comparison

	2010	2009	2008	2007	2006
	%	%	%	%	%
Net interest income and other operating income to total assets	**3.1**	3.1	3.6	4.1	4.0
Operating expenses to total assets	**1.5**	1.6	1.7	1.7	1.8
Cost to income ratio	**49.7**	52.5	48.0	42.1	45.5
Profit before tax to total assets	**1.5**	1.4	1.8	2.3	2.2
Profit before tax on equity	**24.9**	23.2	34.0	41.5	32.8
Profit after tax to equity	**16.1**	15.0	22.3	27.6	21.2

	2010	2009	2008	2007	2006
Shares in issue (millions)	**291.8**	291.8	291.8	291.8	291.8
Net assets per 30 euro cent share (cents)	**114.4**	105.1	96.8	94.7	100.9
Earnings per 30 euro cent share (cents)	**18.4**	15.7	21.6	26.1	21.4
Dividend per 30 euro cent share (cents)					
– gross	**15.9**	17.3	26.7	49.4	35.9
– net	**10.3**	11.2	17.4	32.1	23.3
Dividend cover	**1.8**	1.4	1.2	0.8	0.9

Group Financial Highlights in US dollars

	2010	2009
	US$000	US$000
Income statements		
Net operating income	**235,634**	213,528
Operating expenses	**(117,163)**	(112,033)
Net impairment	**(7,350)**	(5,923)
Net provisions for liabilities and other charges	**1**	(354)
Profit before tax	**111,122**	95,218
Tax expense	**(39,222)**	(33,875)
Profit for the year	**71,900**	61,343
Profit attributable to shareholders	**71,900**	61,343
Statements of Financial Position		
Assets		
Balances with Central Bank of Malta, Treasury Bills and cash	**508,192**	230,930
Cheques in course of collection	**12,051**	14,396
Derivatives	**15,365**	15,709
Financial assets designated at fair value through profit or loss	**409,644**	332,415
Financial investments	**923,617**	640,581
Loans and advances to banks	**956,109**	999,916
Loans and advances to customers	**4,418,549**	4,315,090
Intangible assets	**94,494**	81,168
Property and equipment	**87,582**	87,462
Investment property	**19,514**	19,510
Assets held for sale	**12,938**	14,182
Current tax assets	**4,456**	8,244
Deferred tax assets	**13,616**	12,107
Other assets	**46,040**	27,700
Prepayments and accrued income	**51,771**	45,135
Total assets	**7,573,938**	6,844,545
Liabilities and equity		
Derivatives	**16,465**	14,770
Amounts owed to banks	**311,333**	225,714
Amounts owed to customers	**5,968,630**	5,465,511
Provision for current tax	**1,636**	277
Deferred tax liabilities	**26,218**	25,211
Liabilities to customers under investment contracts	**25,360**	22,539
Liabilities under insurance contracts issued	**548,950**	470,113
Other liabilities	**62,087**	47,450
Accruals and deferred income	**48,553**	44,699
Provisions for liabilities and other charges	**710**	772
Subordinated liabilities	**117,531**	117,460
Share capital	**117,092**	117,092
Revaluation reserve	**38,349**	34,538
Retained earnings	**291,024**	258,399
Total liabilities and equity	**7,573,938**	6,844,545

The US Dollar Exchange as at 31 December 2010 was €1 = US$1.33740. Comparative results have also been translated at these rates.

Branches and Offices

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Premier Centre
Wealth Management Office
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Commercial Banking
Business Banking Centre
80 Mill Street, Qormi QRM 3101
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International Banking Centre
Business Banking Centre
80 Mill Street Qormi
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Operations Centre
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Valletta VLT 1173
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32 Merchants Street, Valletta VLT 1173
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Inheritance Unit
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Valletta VLT 1173
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Airside Arrivals Area *(Automated Office)*

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Sliema ShareShop
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Żejtun
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Victoria ShareShop
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Xaghra *(Agency)*
8th September Avenue XRA 1011
(Corner with Victory Street)
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Business Banking Centre
Personal Financial Services
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HSBC Stockbrokers (Malta) Ltd
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