

**HSBC SECURITIES (USA) INC.**  
(An Indirect Wholly Owned Subsidiary of HSBC Holdings plc)

Statement of Financial Condition

June 30, 2011

**HSBC SECURITIES (USA) INC.**  
(An indirect wholly owned subsidiary of HSBC Holdings plc)

Statement of Financial Condition

(Unaudited)

June 30, 2011

(Dollars in thousands)

**Assets**

Assets:

Cash	\$ 33,223
Cash and securities segregated pursuant to federal and other regulations	525,526
Financial instruments, at market value	3,400,916
Financial instruments, at market value, pledged	15,866,895
Securities received as collateral	1,949,022
Securities purchased under agreements to resell	33,254,007
Receivable under securities borrowing arrangements	36,692,352
Receivable from brokers, dealers, clearing organizations, and customers	2,009,642
Goodwill	14,419
Other assets	<u>313,833</u>
Total assets	<u><u>\$ 94,059,835</u></u>

**Liabilities and Stockholders' Equity**

Liabilities:

Short-term borrowings	\$ 745,000
Financial instruments sold, not yet purchased, at market value	1,977,596
Financial instruments sold, not yet purchased, at market value, obligation to return collateral	12,584,673
Obligation to return securities received as collateral	1,949,022
Securities sold under agreements to repurchase	72,414,585
Payable under securities lending agreements	208,050
Payable to brokers, dealers, clearing organizations, and customers	2,191,818
Accounts payable and accrued liabilities	<u>399,786</u>
Total liabilities	<u>92,470,530</u>

Commitments and contingent liabilities:

Liabilities subordinated to claims of general creditors	<u>650,000</u>
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Stockholders' equity

	<u>939,305</u>
Total liabilities and stockholders' equity	<u><u>\$ 94,059,835</u></u>

See accompanying notes to the statement of financial condition.

**HSBC SECURITIES (USA) INC.**  
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**(1) Organization**

HSBC Securities (USA) Inc. (the Company) is a wholly owned subsidiary of HSBC Markets (USA) Inc. (the Parent) whose ultimate parent is HSBC Holdings plc (HSBC). The Company is an indirect wholly owned subsidiary of HSBC North America Holdings Inc. (HNAH), which is an indirect wholly owned subsidiary of HSBC.

The Company is a registered broker-dealer of securities under the Securities Exchange Act of 1934 and a registered Futures Commission Merchant (FCM) with the Commodity Futures Trading Commission (CFTC). In 1996, HSBC was granted the authority by the Federal Reserve Board to engage, through the Company, in limited underwriting and dealing activities under the Bank Holding Company Act of 1956, as amended. The Company is engaged in underwriting, dealing, and brokering a full range of debt and equity securities and futures contracts. The Company is also a primary dealer in U.S. Government and government agency securities.

The Company is a member of the Financial Industry Regulatory Authority (FINRA), New York Stock Exchange (NYSE), CME Group Inc. (CME), Intercontinental Exchange (ICE) and The Options Clearing Corporation (OCC).

The Company utilizes Pershing LLC (Pershing), a nonaffiliated broker-dealer, as its clearing agent for general securities brokerage transactions. Pershing carries the cash and margin accounts for the Company's retail brokerage customers as well as the Company's Private Banking customers (both domestic and international) on a fully disclosed basis. The Company is self-clearing for its businesses other than its retail brokerage and certain Private Banking businesses.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Presentation**

The Company's statement of financial condition is prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and prevailing industry practice, both of which require the use of estimates by management. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Such estimates, including the fair value measurements of certain financial assets and financial liabilities, by their nature, are based on judgment and available information and, therefore, may vary from actual results. Management evaluates its estimates and assumptions on an ongoing basis based on historical and existing environmental factors such as industry, political and economic data which management believes to be reasonable under the circumstances. Such estimates and assumptions are adjusted when facts and circumstances dictate. Although illiquid credit markets, volatile equity, foreign currency and energy markets, and declines in consumer spending combined have increased the uncertainty inherent in such estimates and assumptions, management does not believe that actual

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results will differ materially from these estimates. HNAH is committed to providing the necessary capital and liquidity to fund continuing operations.

Assets and liabilities denominated in foreign currencies are translated at June 30, 2011 exchange rates.

**(b) *Financial Instruments, Securities Sold, Not Yet Purchased***

Financial instruments, including proprietary securities, options, futures and other derivative transactions, are reflected in the statement of financial condition at fair value on a trade-date basis and are carried at fair value. Refer to note 4(c), *Fair Value Measurements and Hierarchy*, for further discussion on fair value measurements.

Securities, options, and futures transactions executed by the Company as agent for customers are reflected in the statement of financial condition on a settlement date basis. Receivables and payables relating to transactions that have not reached their contractual settlement date are reflected net on the statement of financial condition.

**(c) *Collateralized Financing Transactions***

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralized financing transactions and are recorded at fair value, plus accrued interest to date. Reverse repurchase and repurchase agreements with the same counterparty, same maturity date, and which are subject to master netting arrangements, are presented net in the statement of financial condition in accordance with the guidance issued by the Financial Accounting Standards Board (FASB). In connection with reverse repurchase agreements, it is the Company's policy to obtain possession of collateral with market value in excess of the principal amount loaned. Collateral is valued daily, and additional collateral is obtained when appropriate.

Securities borrowing and securities lending arrangements are financing agreements which are recorded at the amount of cash or other collateral advanced or received. Securities borrowed transactions require the Company to deposit cash or other collateral with the lender. With respect to securities loaned, the Company receives collateral in the form of cash or other collateral in an amount generally in excess of the market value of the securities loaned. The Company monitors the market value of securities borrowed and securities loaned on a daily basis with additional collateral obtained or refunded as necessary. The Company presents these transactions as receivable and payable under securities borrowing/lending arrangements in the statement of financial condition.

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During the normal course of business, the Company pledges its own assets as collateral pursuant to resale agreements and securities borrowing transactions. Trading inventory pledged as collateral, which can be sold or repledged by the creditor, is classified as securities received as collateral on the statement of financial condition. To the extent the Company sells collateral pledged to it, principally to settle short sale transactions, this amount is recorded as obligation to return securities received as collateral on the statement of financial condition.

**(d) *Income Taxes***

The Company is included in the consolidated federal income tax return filed by HNAH, and accounts for income taxes utilizing the asset and liability method. The Company's results of operations are included in the consolidated federal tax returns filed by HNAH and the unitary and combined state and local tax returns filed by HNAH and the Parent. In accordance with tax-sharing agreements, HNAH and the Parent allocate to the Company their proportionate share of the federal and state and local tax liabilities and benefits.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as the estimated future tax consequences attributable to net operating loss and tax credit carryforwards. A valuation allowance is established if, based on all available evidence, including the application of its tax sharing agreement with the Parent, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Foreign taxes paid are applied as credits to reduce federal income taxes payable.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

**(e) *Goodwill***

Goodwill is the excess of purchase price over the fair value of net identifiable assets acquired. Goodwill is not amortized, but is reviewed for impairment annually, or whenever events or circumstances give rise to losses that would make it more likely than not that a reduction of fair value of the reporting unit below its carrying amount has occurred. Determining whether an impairment has occurred requires valuation of the respective reporting unit, which is estimated using a discounted cash flow method. As of June 30, 2011, there were no impairment charges as a result of these tests.

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**(f) Principles of Consolidation**

The Company consolidates entities for which it has a controlling financial interest. The usual condition for a controlling financial interest is ownership of a majority voting interest. As a result, the Company generally consolidates entities it has ownership, directly or indirectly, of over 50% of the outstanding voting shares of another entity. Since a controlling financial interest may be achieved through arrangements that do not involve a voting interest, the Company also evaluates entities for consolidation under the “variable interest model” in accordance with FASB guidance. The Company consolidates variable interest entities (VIE) when it (a) has the power to direct the activities that most significantly impacts the entity’s economic performance and (b) has the obligation to absorb losses and/or the right to receive benefits of the entity that could potentially be significant to the variable interest entity. The Company conducts activities with an unconsolidated VIE. An affiliate of the Company currently consolidates this VIE. Information for the unconsolidated VIE is as follows:

The Company is the administrator of Bryant Park Funding LLC (Bryant Park), a multi-seller asset-backed commercial paper conduit, established in June 2001 to provide securitization financing solutions for HSBC clients. The Company, as administrator for Bryant Park, is responsible for originating and structuring conduit financings for clients and managing the day-to-day activities of the conduit including funding, transaction monitoring, and operations for a fee. The administrative fee is considered to be a variable interest because of other interests held by the Company’s affiliates. As of June 30, 2011, total assets and total liabilities for Bryant Park were \$3,007,548 and \$3,007,536, respectively.

**(g) New Accounting Pronouncements**

**Repurchase Agreements** In April 2011, the FASB issued a new Accounting Standards Update related to repurchase agreements. This new guidance removes the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and the related collateral maintenance guidance from the assessment of effective control. As a result, an entity is no longer required to consider the sufficiency of the collateral exchanged but will evaluate the transferor’s contractual rights and obligations to determine whether it maintains effective control over the transferred assets. The new guidance is required to be applied prospectively for all transactions that occur on or after January 1, 2012. Adoption is not expected to have a material impact on our financial position or results of operations.

**Fair Value Measurements and Disclosures** In May 2011, the FASB issued an Accounting Standards Update to converge with newly issued IFRS 13, Fair Value Measurement (“IFRS 13”). This new guidance primarily clarifies existing fair value measurement requirements but also makes some other amendments to align with the newly issued IFRS 13. The new guidance clarifies that the application of the highest and best use and valuation premise concepts are not relevant when measuring the fair value of financial assets or of liabilities, that is, an entity will not be able to group financial instruments for the purposes of measuring their fair value. However, an exception exists where a reporting entity manages its financial instruments on the basis of its net exposure. This

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Accounting Standards Update also requires new and enhanced disclosures on the quantification and valuation processes for significant unobservable inputs, transfers between Levels 1 and 2, and the categorization of all fair value measurements into the fair value hierarchy, even where those measurements are only for disclosure purposes. The guidance is effective prospectively from January 1, 2012. Adoption is not expected to have a material impact on our financial position or results of operations.

**(3) Cash and Securities Segregated under Federal and Other Regulations**

As of June 30, 2011, cash of \$267,234 and qualified securities with a market value of \$258,292 have been segregated in special reserve bank accounts for the exclusive benefit of customers in accordance with Regulations 1.32 and 30.7 of the Commodity Exchange Act and Rule 15c3-3 of the Securities Exchange Act of 1934, respectively.

In the normal course of business, the Company has deposited U.S. Government securities, with a market value of \$978,099 as of June 30, 2011, as collateral at various clearing organizations. These securities are included in financial instruments, at market value, pledged on the statement of financial condition.

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**(4) Financial Instruments, at Market Value and Financial Instruments Sold, Not Yet Purchased, at Market Value**

Financial instruments, at market value and financial instruments sold, not yet purchased, at market value at June 30, 2011, consisted of the following:

	<b>Financial instruments</b>	<b>Financial instruments sold, not yet purchased</b>
U.S. Government treasury bills	\$ 1,466,379	923,254
U.S. Government treasury notes, bonds, strips, and agencies	12,619,439	11,938,419
Total U.S. Government and government agency securities	14,085,818	12,861,673
Corporate debt	4,992,171	1,667,167
Auction rate securities	135,455	—
Municipal securities	1,740	71
Equities	25,518	15,162
Other securities	214	326
Derivative financial instruments	26,895	17,870
Total	19,267,811	14,562,269
Less:		
Financial instruments pledged	(15,866,895)	—
Obligation to return collateral	—	(12,584,673)
	\$ 3,400,916	1,977,596

As part of its financing activities, the Company has also accepted collateral that it is permitted to sell or repledge, the fair value of which was \$93,870,697 as of June 30, 2011. Collateral in the amount of \$82,746,568 has been sold or repledged. This is in excess of amounts recorded in the statement of financial condition due to various netting arrangements.

The Company has borrowed collateral and pledged collateral received in the amount of \$1,949,022 as of June 30, 2011. The market value of the collateral borrowed and pledged was \$1,912,178 and \$1,963,740, respectively.

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**(a) Derivative Financial Instruments**

In the normal course of its business, the Company enters into derivative transactions including financial futures contracts, exchange-traded options, securities purchased or sold on a delayed delivery or forward basis, credit default swaps, interest rate swaps, and total return swaps. These derivative instruments are held for trading purposes and as economic hedges to manage its exposure to market, credit, and interest rate risks. Derivative instruments are recorded at fair value.

A summary of the Company's derivative instruments, executed through regulated exchanges and over the counter markets, at contract or notional amounts, together with their fair values at June 30, 2011, is presented below. Although contract or notional amounts may reflect the extent of the Company's involvement in a particular class of financial instruments, they are not indicative of potential loss.

	Contractual/ notional amount	Derivative assets		Derivative liabilities	
		Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate derivatives:					
Futures	\$ 8,407,300	Financial instruments, at market value	\$ —	Financial instruments sold, not yet purchased, at market value	\$ —
Options	20,214,000	Financial instruments, at market value	839	Financial instruments sold, not yet purchased, at market value	102
Interest rate swaps	1,432,000	Financial instruments, at market value	3,127	Financial instruments sold, not yet purchased, at market value	7,030
Forwards	6,998,177	Financial instruments, at market value	12,798	Financial instruments sold, not yet purchased, at market value	8,759
Credit derivatives	380,000	Financial instruments, at market value	9,451	Financial instruments sold, not yet purchased, at market value	1,979
Total rate of return derivatives	918	Financial instruments, at market value	680	Financial instruments sold, not yet purchased, at market value	—
Total	\$ 37,432,395		\$ 26,895		\$ 17,870

**(b) Fair Value Option**

The FASB issued guidance which provides a fair value option that allows the Company to irrevocably elect fair value, on an instrument-by-instrument basis, as the initial and subsequent measurement attribute for most financial assets, financial liabilities, and unrecognized firm commitments, previously recognized at fair value. The Company elected to measure reverse repurchase and repurchase agreements at fair value effective January 1, 2008, as the positions are managed on a fair value basis. The guidance permits the Company to elect to measure certain

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eligible items at their initial recognition or upon occurrence of an event that give rise to a new basis of accounting for that eligible item.

(c) ***Fair Value Measurements and Hierarchy***

Accounting principles related to fair value measurements provide a framework for measuring fair value and focuses on an exit price in the principal (or alternatively, the most advantageous) market accessible in an orderly transaction between willing market participants (the Fair Value Framework). The Fair Value Framework establishes a three-tiered fair value hierarchy with Level 1 representing quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 1 measurements include most U.S. Government and government agency securities (noncallable), active exchange-traded equity securities, and exchange-traded derivatives.

Fair values determined by Level 2 inputs are inputs that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are disorderly, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 2 measurements include government agency securities (callable), corporate and municipal bonds, reverse repurchase and repurchase agreements, and most over-the-counter derivatives.

Level 3 inputs are unobservable inputs for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. Level 3 measurements include auction rate securities and certain credit default swaps.

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In determining the appropriate measurement levels, the Company performs analyses on the assets and liabilities at the end of each reporting period. Changes in the observability of significant valuation inputs during the reporting period may result in a reclassification of certain assets and liabilities within the fair value hierarchy upon review. The following table presents information about the Company's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis at June 30, 2011.

	<b>Fair value measurement on recurring basis as of June 30, 2011</b>					
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Gross balance</u>	<u>Netting</u>	<u>Net Balance</u>
Assets:						
Securities segregated under federal and other regulations	\$ 258,292	—	—	258,292	—	258,292
Securities purchased under agreements to resell and receivable under securities borrowing agreements	—	93,870,697	—	93,870,697	(23,924,339) (1)	69,946,358
Financial instruments owned:						
U.S. Government and government agency securities	13,339,377	746,441	—	14,085,818	—	14,085,818
Municipal securities	—	1,740	—	1,740	—	1,740
Corporate debt	—	4,970,251	—	4,970,251	—	4,970,251
Equities	23,079	2,439	—	25,518	—	25,518
Auction rate securities	—	55	135,400	135,455	—	135,455
Other securities	—	22,116	17	22,133	—	22,133
Financial instruments, excluding derivative assets	13,362,456	5,743,042	135,417	19,240,915	—	19,240,915
Derivative assets	839	29,074	8,801	38,714	(11,819) (2)	26,895
Total	<u>\$ 13,621,587</u>	<u>99,642,813</u>	<u>144,218</u>	<u>113,408,618</u>	<u>(23,936,158)</u>	<u>89,472,460</u>

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	<b>Fair value measurement on recurring basis as of June 30, 2011</b>					
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Gross balance</b>	<b>Netting</b>	<b>Net Balance</b>
<b>Liabilities:</b>						
Securities sold under agreements to repurchase and payable under securities lending arrangement	\$ —	96,546,974	—	96,546,974	(23,924,339) <sup>(1)</sup>	72,622,635
Financial instruments sold, not yet purchased:						
U.S. Government and government agency securities	12,730,874	130,799	—	12,861,673	—	12,861,673
Municipal securities	—	71	—	71	—	71
Corporate debt	—	1,667,167	—	1,667,167	—	1,667,167
Equities	14,296	866	—	15,162	—	15,162
Other securities	—	326	—	326	—	326
Financial instruments sold, not yet purchased, excluding derivative liabilities	12,745,170	1,799,229	—	14,544,399	—	14,544,399
Derivative liabilities	102	26,777	—	26,879	(9,009) <sup>(2)</sup>	17,870
<b>Total</b>	<b>\$ 12,745,272</b>	<b>98,372,980</b>	<b>—</b>	<b>111,118,252</b>	<b>(23,933,348)</b>	<b>87,184,904</b>

(1) Represents netting permitted on repurchase and reverse repurchase agreements when certain conditions are met.

(2) Represents counterparty and cash collateral netting which allow the offsetting of amounts relating to certain derivatives contracts when certain conditions are met.

**(d) Valuation Techniques for Major Assets and Liabilities**

**Debt and Equity Securities**

Where available, debt, preferred, and equity securities are valued based on quoted market prices. If a quoted market price for the identical security is not available, the security is valued based on quotes from similar securities where possible.

The fair value measurements for Level 2 are primarily determined or validated by inputs obtained from independent pricing sources taking into account differences in the characteristics and the performance of the underlying collateral. The Company determines whether adjustments to the observable inputs are necessary as a result of investigations and inquiries about the reasonableness of the inputs used and the methodologies employed by the independent pricing sources.

The valuation of Level 3 preferred securities is less transparent due to ongoing markets dislocation. For these securities, the Company applies valuation techniques that may include significant inputs that are unobservable from objective sources (which may include probability of default and loss

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severity based on the collateral types and the performance assumptions of the collateral). To ensure that the valuation presented is appropriate, the Company also compares the valuation output to the hypothetical estimates using the relevant market indices as inputs.

**Auction Rate Securities**

Auction Rate Securities (ARS) bear short-term variable interest rates reset regularly through Dutch auctions. Auctions for certain types of ARS have failed since February 2008 as investor demand has significantly decreased and the dealers were unable to provide liquidity. The Company uses internally developed valuation models that use both observable market data as well as unobservable inputs to value ARS for which auctions have failed. The primary inputs are coupon and maturity as well as current discount margin on instruments bearing comparable risks.

Additionally, where available, a limited number of broker quotes and secondary market trades were also sourced when valuing the ARS.

**Derivatives**

Level 2 measurements include OTC derivatives that are valued using a model based approach. Valuation models calculate the present value of expected future cash flows based on “no arbitrage” principles. The fair value for the majority of the Company’s derivative instruments is determined based on internally developed models that utilize independently sourced market parameters, including interest rate yield curves and option volatilities.

Where relevant, a liquidity adjustment is applied to determine the measurement of an asset or a liability that is required to be reported at fair value. Assessing the appropriate level of liquidity adjustment requires use of significant management judgments, which is often affected by, among other things, the product type, transaction-specific characteristics, and the level of liquidity for the product or in the market. Such adjustments generally result in Level 3 classification.

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**(5) Receivable from and Payable to Brokers, Dealers, Clearing Organizations, and Customers**

The balances shown as receivable from and payable to brokers, dealers, clearing organizations, and customers comprise the following:

Receivable from:	
Exchanges and clearing organizations	\$ 782,627
Fail to deliver	575,652
Customers	426,953
Securities transactions not yet settled, net	117,720
Other receivables from brokers and dealers	106,690
	\$ 2,009,642
Payable to:	
Customers	\$ 1,642,848
Fail to receive	407,122
Exchanges and clearing organizations	78,418
Other payables to brokers and dealers	63,430
	\$ 2,191,818

The Company considers certain customers to be affiliates. Refer to note 8, "Related Parties".

**(6) Other Assets**

The composition of other assets at June 30, 2011 was as follows:

Dividends and accrued interest receivable	\$ 183,754
Receivables from affiliates	46,140
Internally generated software, net	33,118
Current tax receivable	26,451
Deferred tax assets, net	12,018
Prepaid expenses	4,560
Exchange memberships, at cost (market value \$3,537)	316
Other	7,476
	\$ 313,833

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**(7) Short-Term Borrowings**

Short-term borrowings represent unsecured bank loans used to finance operations, including the securities settlement process.

The table below presents the breakdown of short-term borrowings at June 30, 2011:

	<u>Amount</u>	<u>Weighted average rate</u>
Overnight loan with affiliate	\$ 545,000	0.38%
Term loan with affiliate	200,000	1.76%
	<u>\$ 745,000</u>	

At June 30, 2011, an overnight loan of \$545,000 was outstanding under a committed unsecured credit line with an affiliate. This credit facility matures on May 25, 2012. Another term loan of \$200,000 was outstanding under an uncommitted unsecured credit line with an affiliate. This credit facility matures on September 16, 2011.

Committed facilities represent contractual lines of credit with annual renewal dates. The committed bank lines have various maturity dates through May 15, 2012. Uncommitted undrawn facilities represent lines of credit without a contractual obligation to fund that facility. These facilities are secured or unsecured and are used to fund the day-to-day operations of the Company. The Company had undrawn unsecured third-party bank credit facilities of \$1,675,000 at June 30, 2011.

Interest rates on bank loans are at market interest rates as of June 30, 2011.

In light of current market conditions, the Company has determined that a material adverse change has not occurred for line of credit arrangements that could require acceleration of repayment or termination of lines of credit.

**(8) Related Parties**

In the normal course of business, the Company's operations may include significant transactions conducted with affiliate entities. Such transactions are governed by contractual agreements between the Company and its affiliates.

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Balances and amounts resulting from transactions with related parties included in the statement of financial condition are presented below:

Assets:	
Cash	\$ 33,223
Financial instruments, at market value	207,796
Securities purchased under agreements to resell	13,260,365
Receivable from:	
Securities transactions not yet settled, net	823,670
Customers	100,340
Fail to deliver	15,337
Other receivables from brokers and dealers	81,935
Other assets	46,154
Liabilities:	
Short-term borrowings	\$ 745,000
Securities sold under agreements to repurchase	4,069,252
Financial instruments sold not yet purchased, at market value	86,044
Payable to:	
Customers	1,145,558
Fail to receive	33,700
Other payables to brokers and dealers	20,011
Accounts payable and accrued liabilities	39,174
Liabilities subordinated to the claims of general creditors:	
Floating rate revolving subordinated loan due June 15, 2015 at three-month LIBOR plus 225 basis points	\$ 650,000

Employees of the Company may participate in benefit plans sponsored by HNAH and equity compensation plans sponsored by HSBC. Refer to note 9, "Post Retirement Benefits", and note 10, "Stock Option Plans and Restricted Share Plan", for further information.

The Company has entered into revolving subordinated loan agreements with two affiliates. The Company has a revolving subordinated loan due June 15, 2015 with HNAH at three-month LIBOR plus 225 basis points. As of June 30, 2011, the Company has drawn \$650,000 from the total line of \$700,000. The Company also has a revolving subordinated loan due August 31, 2012 with HSBC USA Inc. at three-month LIBOR plus 150 basis points. As of June 30, 2011, no amount has been drawn from the total line of \$500,000.

The subordinated loans are covered by an agreement approved by FINRA and are, therefore, available in computing net capital under the Securities and Exchange Commission (SEC)'s Uniform Net Capital Rule. To the extent that such borrowings are required for the Company's continued compliance with minimum net capital requirements, they may not be repaid.

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At June 30, 2011, the Company has entered into interest rate swaps, credit default swaps, and total rate of return swaps, with affiliates for notional values of \$1,432,000, \$380,000, and \$918, respectively.

**(9) Post Retirement Benefits**

Employees of the Company are covered under HNAH's noncontributory defined benefit pension plan. In addition, certain employees of the Company are covered under HNAH's welfare benefit plan providing retiree medical benefits. These plans are subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). HNAH reserves the right to amend, suspend, or terminate the plans and the benefits provided to the extent permitted by law, in whole or in part, at any time and for any reason.

**(a) Pension Plan**

The HSBC – North America (U.S.) Pension Plan (Pension Plan) is a defined benefit pension plan sponsored by HNAH. The Pension Plan has both a final average pay formula, which uses base pay and years of credited service, and a cash balance formula. Participants become 100% vested after three years of service.

The final average pay formula covered all employees of the Company hired prior to January 1, 1997 who attained the age of 21 and completed one year of eligibility service, defined generally as a minimum of 1,000 hours in a 12-month period.

Employees hired on or after January 1, 1997 qualify for the cash balance formula, which provides employees who have attained the age of 21 and have completed one year of eligibility service with the Company paid retirement account credits equal to 2% of eligible pay plus interest credits. The definition of eligible pay includes base pay, bonus pay, commissions, and overtime.

In November 2009, the HNAH Board of Directors approved a plan to cease all future benefit accruals of final average pay formula participants effective January 1, 2011. Any service or pay earned by such participants after December 31, 2010 will not be used in benefit calculations under the final average pay formula. However, continued employment with a participating HSBC employer will maintain a participant's eligibility to reach age and service milestones for early retirement subsidies and features which may be available under the formula. Pension Plan accruals of all eligible participants beginning January 1, 2011, including participants who had accrued a benefit under the final average pay formula, will only be provided under the cash balance formula.

The costs of the Pension Plan have been actuarially determined. No separate determination has been made of the actuarial present value of accumulated benefits and the Pension Plan's net assets as they relate to the employees of the Company.

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**(b) Tax Reduction Investment Plan (TRIP)**

The TRIP is a defined contribution pension plan sponsored by HNAH. All employees of the Company who have completed 30 days of employment are eligible to participate in TRIP. Employees who are newly hired or rehired on or after January 1, 2007 are automatically enrolled in TRIP with deferral contributions set at 1% (if hired or rehired between January 1, 2007 and December 31, 2008) or 3% (if hired or rehired on or after January 1, 2009), unless they decline enrollment within 30 days of their hire/rehire date. Employees may elect to contribute up to 40% of their salaries, overtime, commissions, and bonuses up to the legal limitations. However, employees classified as highly-compensated under IRS regulations are not eligible to make after-tax contributions to TRIP. HNAH matches employee contributions \$3-for-\$1 on the first 1% contribution. In addition, HNAH matches \$1-for-\$1 on the next 2% to 4% of earnings contributed. Company matching contributions are calculated each pay period, not on an annual basis.

Participants are 100% vested in the value of their personal contributions, the employer matching contributions, and earnings and/or losses on such contributions. Although employees are eligible to contribute to the TRIP with respect to pay periods beginning after 30 days of employment, the employer matching contributions do not begin until pay periods beginning after completion of 12 months of service.

**(c) Retiree Medical**

The HSBC – North America (U.S.) Retiree Health Plan (Retiree Health Plan) is an employee welfare benefit plan sponsored by HNAH. Employees of the Company who were hired before January 1, 1993 (except certain former Republic National Bank employees) are generally eligible to participate in the retiree medical benefit component of the Retiree Health Plan provided that, at the time the employee retires, the employee is employed by the Company as a regular full-time employee, qualifies for an immediate pension benefit from the Pension Plan, and meets certain age and service requirements. Employees hired or rehired by the Company on or after January 1, 1993 are not eligible for retiree medical benefits.

The premium amount paid by retirees for retiree medical benefit coverage varies by type of coverage, retirement date and total years of credited service, although the Company generally pays the entire cost of coverage for individuals who retired before January 1, 1993, subject to a contribution limitation based on the cost of coverage in 1992. The coverage for retirees over age 65 is limited to a Medicare supplement plan with a lifetime maximum of \$20 per covered person.

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**(10) Stock Option Plans and Restricted Share Plan**

In 2011, equity awards of HSBC were granted to eligible employees under the restricted share plan:

**(a) *Group Share Option Plan***

The Group Share Option Plan was a discretionary long-term incentive compensation plan available prior to 2005 to certain employees based on performance criteria. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

Since 2004, no options have been granted under the Group Share Option Plan as the plan was terminated by HSBC in May 2005. Options outstanding and exercisable were for 1,523,708 shares at June 30, 2011. The weighted average exercise price for options outstanding was \$11.15. The range of exercise prices on options outstanding was between \$9.64 and \$11.72. The outstanding options were fully vested at June 30, 2011.

**(b) *HSBC Holdings Savings-Related Share Option Plan***

Options have been granted to employees of the Company under the HSBC Holdings Savings-Related Share Option Plan. Under the plan, employees have the choice to buy shares in HSBC at a discounted price fixed at the beginning of a one, three, or five-year contribution period. Employee contributions to the plan cannot exceed four hundred dollars per month. At the end of the one, three, or five-year period, employees have a six month period to exercise their option to buy HSBC shares or receive the cash equivalent of selling all or a portion of the shares back to the Company at the market price at the date of exercise.

Through June 30, 2011, 201,010 options were granted. Options outstanding at June 30, 2011 were 947,594. The weighted average price outstanding was \$6.70. The weighted average vesting period for options outstanding, at June 30, 2011, was 1.87 years.

There were no options exercisable at June 30, 2011.

**(c) *Restricted Share Plan***

In 2008 and prior, equity incentive awards were granted to eligible employees under a restricted share plan. The Company awarded eligible employees restricted share units (RSUs) for awards granted during 2009, 2010 and 2011. These RSUs are recorded as a liability over the relevant vesting period and the Company currently anticipates it will be required to deliver cash to HSBC when the shares vest to the employees.

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**(11) Income Taxes**

Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to be recovered or settled.

The deferred tax asset recoverability is calculated using a consistent approach that considers the relative impact of negative and positive evidence, including historical financial performance, projections of future taxable income, future reversals of existing taxable temporary differences, tax planning strategies and any carryback capacity. The realization of the deferred tax asset is projected based on management approved business plans, future capital requirements, and ongoing HNAH tax planning strategies, including capital support from HSBC necessary as part of such plans and strategies. This evaluation involves significant management judgment about assumptions that are subject to change from period to period.

At June 30, 2011, the Company had total net deferred tax assets consisting of federal and state and local tax assets as follows:

Net operating loss carryforward, federal and state	\$	188,195
Accrued expenses, deductible when paid		1,638
Restricted stock share awards, deductible when paid		25,116
Real Estate Mortgage Investment Conduit (REMIC) income		9,894
Original issue discount		822
Other net deferred tax assets		4,008
Total deferred tax assets		229,673
Less:		
Valuation allowance		195,565
Accrued bonus expense, net of Section 481(a) adjustment		14,153
Underwriting fees		7,937
Net deferred tax assets	\$	12,018

Deferred tax assets are reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. The Company is indirectly owned by HNAH and, since January 1, 2004, has been included in the HNAH consolidated federal income tax return. The Company has established a full valuation allowance for the New York State and City net deferred tax assets and for federal separate return limitation year (SRLY) net operating losses and alternative minimum tax credits.

Under the terms of the tax-sharing arrangement, the Company is allocated federal income taxes on a separate return basis. The Company is included in the combined New York State and City tax return filed with the Parent.

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The Company has federal SRLY net operating loss carryforwards of \$100,449 and New York State and City net operating loss carryforwards of \$1,779,514. These carryforwards expire as follows:

	<b>Federal</b>	<b>New York State and City</b>
Calendar year:		
2012	\$ 12,683	—
2018	7,569	—
2022	76,755	—
2023	3,442	—
2024	—	—
2025	—	26,233
2026	—	21,146
2027	—	559,875
2028	—	1,160,194
2031	—	12,066
	\$ 100,449	1,779,514

The Company is currently under audit by the Internal Revenue Service for tax years 2006 and 2007 as well as various state and local tax jurisdictions. Although one or more of these audits may be concluded within the next twelve months, it is not possible to reasonably estimate the impact on the uncertain tax positions at this time.

Major taxing jurisdictions for the Company and tax years for each that remain subject to examination, are as follows:

U.S. Federal	2004 and later
New York State	2007 and later
New York City	2007 and later

For 2011, the beginning and ending amount of unrecognized tax benefits was \$947. The total amount of unrecognized tax benefits at June 30, 2011 that, if recognized, would affect the effective tax rate is \$947.

**(12) Commitments and Contingent Liabilities**

**(a) Guarantees**

In the normal course of business, the Company provides guarantees to securities clearing organizations and exchanges. These guarantees are generally required under the standard

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membership agreements, such that members are required to guarantee the performance of other members. To mitigate these performance risks, the exchanges and clearing organizations often require members to post collateral. The Company's obligation under such guarantees could exceed the collateral amounts posted. However, the potential for the Company to be required to make payments under such agreements is deemed remote.

**(b) Commitments**

At June 30, 2011, the Company had entered into a forward start reverse repurchase agreements and repurchase agreements of \$7,797,867, and \$5,801,314, respectively. All contracts expire either before or on December 30, 2011.

**(c) Leases**

At June 30, 2011, the Company was obligated under various lease agreements with an affiliate entity relating to property used for office space and business purposes. These lease agreements expire on December 31, 2011.

The Company is also obligated to a third-party for a lease agreement for office space for one branch office which expires on April 30, 2015. The future minimum rental under the lease agreement for office space with a third-party, which provides for escalation based on property taxes and other operating costs, is as follows:

Period Ending		
<u>June 30,</u>		
2012	\$	25
2013		26
2014		27
2015		<u>22</u>
Aggregate minimum lease payments	\$	<u><u>100</u></u>

**(d) Litigation**

In the normal course of business, the Company is subject to pending and threatened legal actions. Due to uncertainties in litigation, management cannot be certain that the Company will ultimately prevail in each instance. However, based on current knowledge, management does not believe any of the outstanding litigation will have a material adverse effect on the Company's statement of financial condition.

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Participants in the U.S. mortgage securitization market have been the subject of lawsuits and governmental and regulatory investigations and inquiries, which have been directed at groups within the U.S. mortgage market, such as servicers, originators, underwriters, trustees or sponsors of securitizations, and at particular participants within these groups. The Company previously participated in residential loan securitization activities as an underwriter. From 2005 to 2007, the Company acted as underwriter for \$30 billion of securities issued by affiliates, the Company also acted as underwriter for \$37 billion of securities issued by third-parties. The Company is currently named as defendant in a limited number of actions in its role as underwriter in residential mortgage-backed securities (RMBS) offerings, which generally allege that the offering documents for securities issued by securitization trusts contained material misstatements and omissions, including statements regarding the underwriting standards governing the underlying mortgage loans. In addition, the Company and its affiliates have received three subpoenas from the SEC seeking production of documents and information related to its and their involvement as an issuer, sponsor, depositor, trustee, custodian, servicer and, in the case of the Company, underwriter in specified private-label RMBS transactions. As an underwriter, the Company's risks primarily relate to misrepresentations or omissions in the offering documents and other client communications that are part of the selling process and breaches of certain loan level representations and warranties. Based on the specifics of these transactions, the obligation to repurchase loans in the event of a breach of loan level representations and warranties resides predominantly with the organization that originated the loan. While certain of these originators are or may become financially impaired and, therefore, unable to fulfill their repurchase obligations, the Company does not believe it has significant exposure for repurchases on these loans. Additionally, as an underwriter, the Company generally received indemnification with respect to any losses suffered by the Company due to misrepresentations or omissions in the offering documents. While these indemnities were intended to protect the Company from exposure to liability, it is possible that the enforceability of these indemnities may be challenged, or that collection of indemnity payments may be impaired due to the financial condition of the indemnifying party.

**(13) Risk Management**

**(a) *Financial Instruments with Off-Balance-Sheet Risk***

In the normal course of business, the Company's customer and trading activities involve the execution, settlement, and financing of various securities and financial instrument transactions. These activities may expose the Company to off-balance-sheet risk in the event the customer or other broker is unable to fulfill its contracted obligations and the Company has to purchase or sell the financial instrument underlying the contract at a loss.

As part of the Company's financing and securities settlement activities, the Company uses securities as collateral to support various secured financing sources. In the event the counterparty is unable to meet its contractual obligation to return securities pledged as collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy its

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obligations. The Company controls this risk by monitoring the market value of financial instruments pledged on a daily basis and by requiring adjustments to collateral levels in the event of excess market exposure.

**(b) Concentrations of Market Risk**

In the normal course of its operations, the Company enters into various contractual commitments involving forward settlement. These include financial futures contracts, options contracts, and commitments to buy and sell securities. The potential for changes in the market value of our trading positions is referred to as market risk. Such positions result from market-making, proprietary trading, and investing activities. All of the Company's inventory positions are marked-to-market.

The Company monitors and manages its market risk exposure by setting market risk limits and by reviewing the effectiveness of economic hedging strategies. The Company's policy is to take possession of securities purchased under agreements to resell and securities borrowed and maintain these securities with its custodian. The Company monitors the market value of the assets acquired to ensure their adequacy as compared to the amount at which the securities will be subsequently resold, as specified in the respective agreements. The agreements provide that, where appropriate, the Company may require the delivery of additional collateral.

The Company records all contractual commitments involving future settlement at fair value. Futures contracts are exchange traded and cash settlement is made on a daily basis for market movements. Margin on futures contracts is included in receivable from and payable to brokers, dealers, and clearing organizations.

**(c) Concentrations of Credit Risk**

Credit risk is measured by the loss that the Company would record if its counterparties failed to perform pursuant to the terms of contractual commitments. Management of credit risk involves a number of considerations, such as the financial profile of the counterparty, specific terms, and duration of the contractual agreement, market fluctuations, and the value of collateral held, if any. The Company has established various procedures to manage credit exposure, including initial credit approval, credit limits, collateral requirements, rights of offset, and continuous oversight.

The Company regularly transacts business with, and owns securities issued by, a range of corporations, governments and agencies, and other financial institutions. The Company also enters into collateralized financing agreements in which it extends short-term credit, primarily to major financial institutions, including major U.S. and non-U.S. commercial banks, investment banks, and affiliates.

The Company generally controls access to the collateral pledged by the counterparties, which consists largely of securities issued by the U.S. Government and government agencies. The value and adequacy of the collateral are continually monitored. Consequently, management believes the

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risk of credit loss from counterparties' failure to perform in connection with collateralized lending activities is minimal.

Remaining concentrations arise principally from financial or contractual commitments involving future settlements, fixed income securities, and equity securities. Concentrations are diverse with respect to geographic locations and industries of counterparties.

Substantially all of the Company's cash and securities positions are either held as collateral by its clearing brokers and banks against various margin obligations of the Company or deposited with such clearing brokers and banks for safekeeping purposes.

**(14) Net Capital Requirements**

The Company is subject to the Uniform Net Capital Rule (15c3-1) of the SEC, Regulation 1.17 of the Commodity Futures Trading Commission (CFTC), and the capital rules of the Financial Industry Regulatory Authority (FINRA). The Company has elected to use the alternative method, permitted by Rule 15c3-1, which requires that it maintains a minimum net capital, as defined, equal to the greater of \$5,000 or 2% of aggregate debit balances arising from customer transactions, as defined. In addition, under the CFTC regulations, the Company is required to maintain a minimum net capital in an amount equal to the greater of \$1,000 or 8% of total risk margin in noncustomer accounts plus 8% of total risk margin in customer accounts, pursuant to the Commodity Exchange Act, exclusive of the market value of commodity options purchased by option customers. At June 30, 2011, the Company's net capital was \$1,097,609 which was 123.74% of aggregate debit balances, and \$1,000,262 in excess of its required net capital of \$97,347.