

# **HSBC SECURITIES (USA) INC.**

*(An Indirect Wholly Owned Subsidiary of HSBC Holdings plc)*

## **Statement of Financial Condition**

**June 30, 2009**

**HSBC SECURITIES (USA) INC.**

(An indirect wholly owned subsidiary of HSBC Holdings plc)

**STATEMENT OF FINANCIAL CONDITION****Unaudited****June 30, 2009****(Dollars in thousands)****ASSETS**

Cash	\$	60,293
Cash and securities segregated pursuant to federal and other regulations		269,559
Financial instruments, at market value		3,219,668
Financial instruments, at market value, pledged		11,357,917
Securities received as collateral		191,038
Securities purchased under agreements to resell		10,180,037
Receivable under securities borrowing arrangements		25,664,892
Receivable from brokers, dealers, clearing organizations, and customers		3,339,669
Goodwill		14,419
Other assets		<u>238,030</u>
Total assets	\$	<u><u>54,535,522</u></u>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

## Liabilities:

Short-term borrowings	\$	153,272
Securities sold under agreements to repurchase		36,632,594
Financial instruments sold, not yet purchased, at market value		1,494,402
Financial instruments sold, not yet purchased, at market value, obligation to return collateral		9,047,119
Obligation to return securities received as collateral		191,038
Payable under securities lending arrangements		9
Payable to brokers, dealers, clearing organizations, and customers		4,790,753
Accounts payable and accrued liabilities		<u>409,683</u>
Total liabilities		52,718,870

## Commitments and contingent liabilities:

Liabilities subordinated to claims of general creditors		975,000
Stockholders' equity		<u>841,652</u>
Total liabilities and stockholders' equity	\$	<u><u>54,535,522</u></u>

*The accompanying notes are an integral part of the statement of financial condition.*

**HSBC SECURITIES (USA) INC.**

(An indirect wholly owned subsidiary of HSBC Holdings plc)

**NOTES TO THE STATEMENT OF FINANCIAL CONDITION**  
**Unaudited**  
**June 30, 2009**  
**(Dollars in thousands, except share data)**

**NOTE 1 – ORGANIZATION**

HSBC Securities (USA) Inc. (the Company or HCSU) 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 National Association of Securities Dealers, Inc. (NASD), New York Stock Exchange (NYSE), CME Group Inc., and The Options Clearing Corporation (OCC).

The Company utilizes Pershing LLC (Pershing), a non-affiliated 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 on a fully disclosed basis.

**NOTE 2 – SUMMARY OF SIGNIFICANT**  
**ACCOUNTING POLICIES**

(a) ***Basis of Presentation***

The Company's statement of financial condition is prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and prevailing industry practice, both of which require the use of management's best judgment of estimates. 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 of instruments, 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 using historical experience and other factors, including the current economic environment, 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 have combined to increase the uncertainty inherent in such estimates and assumptions, management does not believe that actual results will differ materially from these estimates. HSBC continues to be committed to providing the necessary capital and liquidity to fund continuing operations.

Assets and liabilities denominated in foreign currencies are translated at June 30, 2009 exchange rates.

**(b) *Recently Adopted Accounting Standards***

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP FAS 140-3). Under FSP FAS 140-3, the initial transfer of a financial asset and a repurchase financing involving the same asset that is entered into contemporaneously with, or in contemplation of, the initial transfer, is presumptively linked and are considered part of the same arrangement under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (FAS 140). The initial transfer and subsequent financing transaction will be considered separate transactions under FAS 140 if certain conditions are met. FSP FAS 140-3 is effective for new transactions entered into in fiscal years beginning after November 15, 2008. The adoption of FSP FAS 140-3 did not have a material impact on the Company's statement of financial condition.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (FAS 161). FAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and improves transparency in financial reporting. SFAS 161 requires entities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. It is effective for fiscal years beginning after November 15, 2008 with early adoption encouraged. SFAS 161 was adopted effective January 1, 2009.

In April 2009, the FASB amended SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, and APB Opinion No. 28, *Interim Financial Reporting*, by issuing FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instrument* (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 require entities to disclose fair value of financial instruments for all interim reporting periods ending after June 15, 2009 with earlier application permitted. The disclosure requirements of FSP FAS 107-1 were adopted immediately upon issuance.

In April 2009, the FASB issued FASB FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, (FSP FAS 157-4) to provide additional guidance for estimating fair value in accordance with FAS No. 157, *Fair Value Measurements* (FAS 157). FSP FAS 157-4 provides additional guidance in determining fair value when the volume and level of activity for the asset and liability have significantly decreased and also on identifying circumstances that indicate a transaction is not orderly. It also amends FAS 157 to require enhanced disclosures about the inputs and valuation techniques for measuring fair value along with changes in the valuation methodologies and related inputs and to present further disclosures for debt and equity securities. FSP FAS 157-4 is effective for reporting periods ending after June 15, 2009 with earlier adoption permitted. FSP FAS 157-4 was adopted immediately upon issuance.

In May 2009, the FASB issued SFAS No. 165 (FAS 165), *Subsequent Events*. It provides guidance for the recognition and disclosure of subsequent events not addressed in other applicable generally accepted accounting principles. This Statement is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The adoption of FAS 165 did not have an impact on the Company's statement of financial condition.

(c) ***Recently Issued Accounting Standards***

In December 2008, the FASB issued FSP FAS No. 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1). FSP FAS 132(R)-1 applies to an employer that is subject to the disclosure requirements of FAS No. 132(R). It requires entities to provide disclosures about employer's defined benefit plans and other post retirement plans that would help users of the financial statements understand how investment allocation decisions are made, the major categories of plan assets, the inputs and the valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period, and significant concentrations of risk within plan assets. FSP FAS 132(R)-1 is applicable for the first fiscal year ending after December 15, 2009.

In June 2009, the FASB issued SFAS No.166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140* (FAS 166). This statement amends FAS 140 by removing the concept of a qualifying special-purpose entity (QSPE). It also modifies the financial-components approach and limits the circumstances in which a transferor derecognizes a portion or component of a financial asset, establishes conditions for reporting a transfer of a portion(s) of financial asset as a sale, defines "participating interest" and removes the special provisions for guaranteed mortgage securitizations and requires them to be treated in the same way as the transfer of other financial assets within the scope of FAS 140. It also requires enhanced disclosures about the transfers of financial assets and transferor's continuing involvement with transfers of financial assets accounted for as sales. The statement is effective for all interim and annual periods

beginning after November 15, 2009. Earlier application is prohibited. The recognition and measurement provisions of this statement shall be applied to transfers that occur on or after January 1, 2010. The impact of adoption of FAS 166 to the Company's statement of financial condition is currently being evaluated.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (FAS 167). This standard changes the requirement from using quantitative analysis to qualitative analysis when determining if an enterprise has a controlling financial interest in a variable interest entity (VIE) for the purpose of determining the primary beneficiary. It also changes the timing of assessment to determine if an enterprise is the primary beneficiary of a VIE from "when specific events occur" to "ongoing reassessment." The standard eliminates the exception related to troubled debt restructuring which is now considered to be an event that requires reconsideration of whether an entity is a VIE. In addition, it requires enhanced disclosures and nullifies FSP FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*. The statement is effective for all interim and annual periods beginning after November 15, 2009. Earlier application is prohibited. On the effective date, certain VIEs which are not consolidated currently may be required to be consolidated. The impact of adoption of FAS 167 to the Company's statement of financial condition is currently being evaluated.

In July 2009, the FASB, in an effort to codify all authoritative accounting guidance related to a particular topic in a single place, issued SFAS No.168 (FAS 168), *The FASB Accounting Standard Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*. It replaces the U.S. GAAP hierarchy created by SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, by establishing only two levels of generally accepted accounting principles: authoritative and non-authoritative. All authoritative guidance will carry the same level of authority. The statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of FAS 168 will not have an impact on the Company's statement of financial condition.

**(d) *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 on a trade-date basis and are carried at fair value. Refer to note 10 – Fair Value Measurements for further discussion of fair value measurement.

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.

(e) ***Collateralized Financing Transactions***

Securities purchased under agreement to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralized financing transactions and are recorded at the amounts at which they will be subsequently resold or reacquired, as specified in the respective agreements, 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 FIN 41, *Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*. In connection with securities purchased under agreements to resell, it is the policy of the Company 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 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.

During the normal course of business, the Company pledges its own assets as collateral pursuant to resale agreements and securities borrowing transactions. Financial instruments pledged as collateral, which can be sold or repledged by the creditor, is classified as an encumbered asset. To the extent the Company sells collateral pledged by counterparties, principally to settle short sale transactions, the obligation to return the collateral is recorded.

(f) ***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. 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 on a separate company basis.

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 HNAH, 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.

Beginning with the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) as of January 1, 2007, 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 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.

(g) ***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, at the minimum, 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. Due to the subjectivity and sensitivity of these impairment test estimates, coupled with further declines in market conditions beyond the levels already reflected in the cash flow forecasts, a future goodwill impairment charge could occur. As of June 2009, there were no impairment charges as a result of these tests.

(h) ***Principles of Consolidation***

In accordance with the FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51* (FIN 46(R)), the Company also consolidates any variable interest entities (VIEs) of which it is the primary beneficiary, as defined. When the Company does not have a controlling interest in an entity, but exerts a significant influence over the entity, the Company applies the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

**NOTE 3 – CASH AND SECURITIES SEGREGATED  
PURSUANT TO FEDERAL AND OTHER  
REGULATIONS**

As of June 30, 2009, cash of \$258,294 and qualified securities with a market value of \$11,265 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.

In the normal course of business, the Company has deposited U.S. Government securities, with a market value of \$441,567 as of June 30, 2009, as collateral at various clearing organizations. These securities are included in financial instruments, at market value, pledged, on the statement of financial condition.

**NOTE 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, 2009, consisted of the following:

	<b><u>Financial instruments, at market value</u></b>	<b><u>Financial instruments sold, not yet purchased, at market value</u></b>
U.S. Government Treasury bills	\$ 3,268,321	743,650
U.S. Government Treasury notes, bonds, strips, and government agency securities	8,985,020	8,904,365
Total	<u>12,253,341</u>	<u>9,648,015</u>
Corporate debt	1,672,428	887,206
Auction rate and preferred securities	568,554	—
Equities	2,998	251
Mortgage-backed securities	51,403	—
Municipal securities	5,193	—
Asset-backed securities	24	—
Other securities	1,249	92
Derivative contracts	22,395	5,957
Total	<u>14,577,585</u>	<u>10,541,521</u>
Less:		
Financial instruments pledged	(11,357,917)	—
Obligation to return collateral	—	(9,047,119)
	<u>\$ 3,219,668</u>	<u>1,494,402</u>

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 \$53,387,884 as of June 30, 2009. Collateral in the amount of \$52,305,986 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 \$191,038 as of June 30, 2009. The market value of the collateral borrowed and pledged was \$187,055 and \$194,861, respectively.

**NOTE 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:

Customers	\$ 1,760,295
Exchanges and clearing organizations	1,162,405
Fail to deliver	154,182
Other receivables from brokers and dealers	262,787
	<u>\$ 3,339,669</u>

Payable:

Customers	\$ 1,944,876
Fail to receive	1,760,540
Exchanges and clearing organizations	71,058
Securities transactions not yet settled, net	997,420
Other payables to brokers and dealers	16,859
	<u>\$ 4,790,753</u>

The Company considers certain customers to be affiliates. Refer to note 7 – Related Parties.

**NOTE 6 – SHORT-TERM BORROWINGS**

Short-term borrowings include both secured and unsecured bank loans used to finance operations, including the securities settlement process.

The table below exhibits the breakdown for short-term borrowings as of June 30, 2009:

	<u>Amount</u>	<u>Rate</u>
Term loan with affiliate	\$ 150,000	2.294%
Overnight third-party bank loans	3,272	2.000%
	<u>\$ 153,272</u>	

At June 30, 2009, a term loan of \$150,000 was outstanding under an uncommitted unsecured credit line with an affiliate. This credit facility matures on September 19, 2009.

Committed facilities represent contractual lines of credit with annual renewal dates. The committed bank lines have various maturity dates through December 4, 2009. 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 \$1,775,000 as of June 30, 2009.

Interest rates on bank loans approximate market interest rates as of June 30, 2009.

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.

**NOTE 7 – 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.

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

Assets:

Cash	\$	20,293
Cash and securities segregated pursuant to federal and other regulations		—
Financial instruments, at market value (including pledged)		35,524
Securities purchased under agreements to resell		23,771
Receivable from:		
Customers		245,417
Fail to deliver		14,024
Clearing organizations		—
Other receivables from brokers and dealers		212,274
Securities transactions not yet settled, net		1,567,720 <sup>(1)</sup>
Other assets		19,738

Liabilities:

Short-term borrowings	\$	150,000
Securities sold under agreements to repurchase		4,170,681
Financial instruments sold not yet purchased, at market value (including pledged)		19,796
Payable under securities lending arrangements		—
Payable to:		
Customers		1,568,664
Fail to receive		13,229
Clearing organizations		—
Other payables to brokers and dealers		2,536
Accounts payable and accrued liabilities		143,922

Liabilities subordinated to the claims of general creditors:

Floating rate revolving subordinated loan due July 31, 2013, at three-month LIBOR plus 175 basis points	\$	475,000
Floating rate revolving subordinated loan due August 31, 2012, at three-month LIBOR plus 150 basis points		500,000

(1) Reported net with third-parties in payable to brokers, dealers, clearing organizations, and customers on the statement of financial condition.

At June 30, 2009, the Company had an undrawn revolving note with an affiliate of \$225,000 at three-month LIBOR plus 175 basis points, which matures on July 31, 2013.

The subordinated loans are covered by an agreement approved by the Financial Industry Regulatory Authority (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.

At June 30, 2009, the Company has entered into credit default swaps, and total return swaps with an affiliate for notional values of \$130,000, and \$5,000, respectively.

## NOTE 8 – 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.

At June 30, 2009, the Company had total deferred assets (liabilities) consisting of federal and state and local tax assets (liabilities) as follows:

Net operating loss carryforward, federal and state	\$	221,033
Accrued expenses, deductible when paid		3,937
Restricted stock awards, deductible when paid		25,921
Real Estate Mortgage Investment Conduit (REMIC) income		12,767
Original issue discount		38
Other net deferred tax assets		13,114
Total deferred tax asset		<u>276,810</u>
Less:		
Valuation allowance		(236,114)
Underwriting fees		<u>(18,338)</u>
Net deferred tax asset	\$	<u><u>22,358</u></u>

SFAS No. 109, *Accounting for Income Taxes* (SFAS 109), requires that deferred tax assets be 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 asset and for federal separate return limitation year (SRLY) net operating losses and prior periods foreign tax credits. In addition, the Company has established a partial valuation allowance of \$770 on current foreign tax credits.

The Company is included in the consolidated federal income tax return filed by HNAH. 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.

The Company has federal SRLY net operating loss carryforwards of \$100,449 and New York State and City net operating loss carryforwards of \$2,160,519. These carryforwards expire as follows:

<b>Calendar year:</b>	<b><u>Federal amount</u></b>	<b><u>New York amount</u></b>
2012	\$ 12,683	12,683
2018	7,569	7,569
2022	76,755	76,755
2023	3,442	3,442
2024	—	98,805
2025	—	144,513
2026	—	21,146
2027	—	559,875
2028	—	1,456,916
Utilized at June 30, 2009	—	(221,185)
	<u>\$ 100,449</u>	<u><u>2,160,519</u></u>

The Company adopted FIN 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. The Internal Revenue Service's audit of the 2004 and 2005 federal income tax returns was effectively settled during the first quarter of 2009, resulting in a \$2,660 release of the FIN 48 reserve. The Company is currently under audit by state and local tax jurisdictions, and 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. The Internal Revenue Service began its audit of the 2006 and 2007 returns in the second quarter of 2009.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2009	\$	3,607
Additions based on tax positions related to the current year		—
Additions for tax positions of prior years		—
Release based on completion of IRS Audit, reserve of \$2,041 and interest of \$619		(2,660)
Balance at June 30, 2009	<u>\$</u>	<u>947</u>

The total amount of unrecognized tax benefits at June 30, 2009 that, if recognized, would affect the effective tax rate is \$947.

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

U.S. Federal:	2006 and later
New York State:	2003 and later
New York City:	2004 and later

#### **NOTE 9 – OTHER ASSETS**

The components of other assets at June 30, 2009 were as follows:

Exchange memberships, at cost (market value \$7,982)	\$	967
Dividends and accrued interest receivable		143,652
Deferred tax assets, net		22,358
Prepaid expenses		6,171
Employee deferred compensation		8,008
Other		56,874
	<u>\$</u>	<u>238,030</u>

Shares of HSBC purchased for future issuance for deferred compensation are recorded above as employee deferred compensation as of June 30, 2009. The shares purchased are held in custody by a third-party.

#### **NOTE 10 – FAIR VALUE MEASUREMENTS**

SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands the disclosures requirement for fair value measurements. The standard establishes a three-level fair value hierarchy based on the transparency of inputs to the fair value measurement of an asset or liability. In addition, SFAS 157

eliminates large position discounts for financial instruments held and requires the Company to consider its own credit risk when measuring the fair value of liabilities.

(a) ***Fair Value Hierarchy***

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure an asset or a liability fall to different levels within the hierarchy, the classification of the entire asset or liability will be based on the lowest level input that is significant to the overall fair value measurement of the asset or liability. The Company categorizes assets and liabilities based on the inputs to the valuation techniques used to measure fair value as follows:

**Level 1:** Unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date. Level 1 measurements include most U.S. Government and government agency securities, active exchange-traded equity securities, and exchange-traded derivatives.

**Level 2:** Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. Level 2 measurements include government agency securities, corporate and municipal bonds, preferred securities, mortgage-backed securities, resale and repurchase agreements, and most over-the-counter derivatives. Level 2 mortgage-backed securities have credit ratings of AAA- or above.

**Level 3:** Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. Level 3 inputs are estimates or assumptions that management expects market participants would use in determining the fair value of the asset or liability. Level 3 measurements include auction rate securities (ARS), mortgage-backed securities with credit ratings of AA+ or below, and certain preferred securities and credit default swaps.

In determining the appropriate measurement levels, the Company performs analyses on the assets and liabilities subject to SFAS 157 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.

The following table summarizes each of the Company's fair value hierarchy for those assets and liabilities measured at fair value,

including those pledged as collateral, on a recurring basis at June 30, 2009.

	Fair value measurement on recurring basis as of June 30, 2009					
	Level 1	Level 2	Level 3	Gross balance	Netting	Total
<b>Assets:</b>						
Securities segregated pursuant to federal and other regulations	\$ 11,265	—	—	11,265	—	11,265
Securities purchased under agreements to resell and receivable under securities borrowing arrangements	—	53,387,884	—	53,387,884	(17,542,955) <sup>(1)</sup>	35,844,929
<b>Financial instruments owned:</b>						
U.S. Government and government agency securities	11,261,827	991,514	—	12,253,341	—	12,253,341
Corporate debt	1,887	1,670,541	—	1,672,428	—	1,672,428
Auction rate and preferred securities	—	9,490	559,064	568,554	—	568,554
Equities	2,998	—	—	2,998	—	2,998
Mortgage-backed securities	36	20,217	31,150	51,403	—	51,403
Municipal securities	—	5,193	—	5,193	—	5,193
Asset-backed securities	—	—	24	24	—	24
Other securities	—	1,249	—	1,249	—	1,249
Financial instruments, excluding derivative assets	11,266,748	2,698,204	590,238	14,555,190	—	14,555,190
Derivative assets	1,981	52,215	15,829	70,025	(47,630) <sup>(2)</sup>	22,395
Total	\$ 11,279,994	56,138,303	606,067	68,024,364	(17,590,585)	50,433,779
<b>Liabilities:</b>						
Securities sold under agreements to repurchase and payable under securities lending agreements	\$ —	54,175,558	—	54,175,558	(17,542,955) <sup>(1)</sup>	36,632,603
<b>Financial instruments sold, not yet purchased:</b>						
U.S. Government and government agency securities	9,644,764	3,251	—	9,648,015	—	9,648,015
Corporate debt	—	887,206	—	887,206	—	887,206
Auction rate and preferred securities	—	—	—	—	—	—
Equities	251	—	—	251	—	251
Mortgage-backed securities	—	—	—	—	—	—
Municipal securities	—	—	—	—	—	—
Asset-backed securities	—	—	—	—	—	—
Other securities	36	56	—	92	—	92
Financial instruments sold, not yet purchased, excluding derivative liabilities	9,645,051	890,513	—	10,535,564	—	10,535,564
Derivative liabilities	1,035	16,252	—	17,287	(11,330) <sup>(2)</sup>	5,957
Total	\$ 9,646,086	55,082,323	—	64,728,409	(17,554,285)	47,174,124

(1) Represents netting permitted under FIN 41, *Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*.

(2) Represents counterparty and cash collateral netting permitted under FIN 39, *Offsetting of Amounts Related to Certain Contracts as amended by FSP FIN 39-1*.

## (b) *Valuation Techniques for Major Classifications of Financial Instruments*

### **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 mortgage-backed securities 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.

During the credit crisis, the valuation of Level 3 mortgage-backed and preferred securities has become less transparent. For these securities, the Company used internally developed valuation techniques to validate the pricing information obtained from independent pricing sources. The internal valuations use model inputs derived from observable market data as well as unobservable inputs (which may include probability of default and loss 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 based on the relevant market indices as inputs.

### **Auction Rate Securities**

The Company has classified all ARS as Level 3 assets. ARS bear short-term variable interest rates reset regularly through Dutch auctions. Auctions for certain types of ARS have continued to fail since February 2008 as investors' demands have 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. The primary inputs are coupon and maturity as well as spreads on instruments bearing comparable risks.

### **Derivatives**

Exchange-traded derivatives are valued using quoted prices. OTC derivatives are valued using a models-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.

## **NOTE 11 – FAIR VALUE OPTION**

SFAS 159 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, unrecognized firm commitments, and written loan commitments not previously recognized at fair value. The new standard permits the Company to elect the fair value option at the initial recognition of the asset or liability or upon occurrence of an event that gives rise to a new basis of accounting for that asset or liability.

The Company elected to apply the fair value option for all collateralized financing transactions to eliminate the accounting effect that arises from the difference between U.S. GAAP and International Financial Reporting Standards (IFRSs). HSBC complies with IFRSs for financial reporting purposes.

## **NOTE 12 – FINANCIAL INSTRUMENTS**

### ***Derivatives***

In the normal course of its business, the Company enters into derivative transactions including financial futures contracts, exchange-traded options, securities purchased and sold on a delayed delivery or forward basis, and credit default 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 OTC, at contract or notional amounts, together with their fair values at June 30, 2009, 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:					
Futures	\$ 3,620,400	Financial instruments, at market value	—	Financial instruments sold, not yet purchased, at market value	—
Forwards	7,822,623	Financial instruments, at market value	15,753	Financial instruments sold, not yet purchased, at market value	4,922
Options - listed	10,910,000	Financial instruments, at market value	1,981	Financial instruments sold, not yet purchased, at market value	1,035
Credit derivatives	<u>135,000</u>	Financial instruments, at market value	<u>52,291</u>	Financial instruments sold, not yet purchased, at market value	<u>11,330</u>
Total	<u>\$ 22,488,023</u>		<u>70,025</u>		<u>17,287</u>

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

### ***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 and foreign currencies. The potential for changes in the market value of the Company's trading positions is referred to as market risk. Such positions result from market-making, proprietary trading, and investing activities. All of the Company's financial instruments 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.

### ***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 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.

### **NOTE 13 – COMMITMENTS AND CONTINGENT LIABILITIES**

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

At June 30, 2009, 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 expired on December 31, 2008; however, were automatically renewed until December 31, 2009.

The Company is also obligated to a third-party for a lease agreement for office space for one branch office. This lease agreement expires on April 30, 2010, for which a minimum rental of \$30 is required.

In the normal course of business, the Company is subject to pending and threatened legal actions. After reviewing the pending and threatened litigation with counsel, management believes that the outcome of such actions will not have a material adverse effect on the Company's statement of financial condition.

### **NOTE 14 – POST RETIREMENT BENEFITS**

Employees of the Company are covered under an affiliate's non-contributory defined benefit pension plan and defined contribution pension plan. In addition, certain employees of the Company are covered under an affiliate'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).

#### **(a) *Pension Plan***

The HSBC - North America (U.S.) Retirement Income Plan (RIP) is a defined benefit pension plan sponsored by an affiliate. RIP has both a final average pay formula, which uses base pay and years of credited service, and a cash balance formula known as RIP 2000. Participants become 100% vested after three years of service.

The final average pay formula covers 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 RIP 2000 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.

The strategy has been to maintain RIP assets sufficient to provide not only for benefits based on service to date, but also for those expected to be earned in the future. The costs of RIP have been actuarially determined. No separate determination has been made of the actuarial present value of accumulated benefits and RIP's net assets as they relate to the employees of the Company.

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

The TRIP is a defined contribution pension plan sponsored by an affiliate. All employees of the Company who have completed 30 days of employment are eligible to participate in TRIP. Employees may elect to contribute up to 40% of their salaries, overtime, commissions, and bonuses up to the legal limitations. 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.

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.) Flexible Benefits Plan (Flexible Benefits Plan) is an employee welfare benefit plan sponsored by an affiliate. 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 Flexible Benefits 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 RIP, and meets certain age and service requirements. Employees hired 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.

**NOTE 15 – STOCK OPTION AND RESTRICTED  
SHARE PLANS**

The Company had the following stock option and restricted share plans:

(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 1,763,275 shares, respectively, at June 30, 2009. The weighted average exercise price for options outstanding was \$12.41. The range of exercise prices on options outstanding was between \$10.31 and \$14.73. The outstanding options were fully vested as of June 30, 2009.

(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 the USD equivalent of GBP 250 per month. At the end of the one, three, or five-year period, employees will 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.

During 2009, no options were granted and options outstanding as of June 30, 2009 were 537,139. The weighted average price outstanding was \$13.46. The weighted average vesting period for options outstanding, as of June 30, 2009, was 1.36 years.

There were no options exercisable as of June 30, 2009.

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

In 2008 and prior, equity incentive awards were granted to eligible employees under the restricted share plan. In 2009, the Company awarded eligible employees restricted share units (RSUs) for awards granted during 2009. These RSUs are recorded as a liability to a third-party.

**NOTE 16 – VARIABLE INTEREST ENTITIES (VIEs)**

The Company has involvement in certain VIEs that are unconsolidated because the Company is not considered the primary beneficiary, nor bears the greatest risk of loss, of the VIE. Information for the unconsolidated VIEs is described as follows:

### ***Commercial Paper Conduits***

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 is also the administrator of Abington Square Funding LLC (Abington), a multi-seller extendible asset-backed commercial paper conduit, which was established in October 2006 and commenced operations in April 2007. Abington also provides financing solutions for HSBC clients. The Company, as administrator for Bryant Park and Abington, is responsible for originating and structuring conduit financings for clients and managing the day-to-day activities of the conduits including funding, transaction monitoring, and operations.

As of June 30, 2009, total assets for Bryant Park and Abington were \$5,147,160 and \$11, respectively. An affiliate provides program-wide credit enhancement and therefore consolidates Bryant Park as of June 30, 2009.

### **NOTE 17 – 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 \$500 or 4% of total risk margin in non-customer 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, 2009, the Company's net capital was \$1,331,966, which was 59.17% of aggregate debit balances, and \$1,256,476 in excess of its required net capital of \$75,490.

# HSBC Securities (USA) Inc.

452 Fifth Avenue  
New York, NY 10018  
(212) 525-5000

## BRANCH OFFICES

CHICAGO  
123 North Wacker Drive  
Suite 2050  
Chicago, IL 60606  
(312) 429-3700

DES MOINES  
400 Locust Street  
Suite 360  
Des Moines, Iowa 50309  
(515) 280-1477

SAN FRANCISCO  
601 Montgomery Street  
10<sup>th</sup> Floor  
San Francisco, CA 94111  
(415) 442-0400

HONG KONG  
1 Queen's Road Central L16  
Hong Kong  
+852-2822-3036

LONDON  
8 Canada Square  
London, E14 5HQ  
United Kingdom  
+44-207-488-3922

For additional retail offices please call 1-800-662-3343