



# Annual Report 2011

HSBC  Trinkaus

# Financial Highlights of the HSBC Trinkaus Group

	2011	2010	Change in %
<b>Results in €m</b>			
Operating revenues	668.4	667.3	0.2
Net loan impairment and other credit risk provisions	-12.7	7.7	-
Administrative expenses	474.3	439.3	8.0
Operating profit	206.8	220.3	-6.1
Pre-tax profit	203.1	210.0	-3.3
Tax expenses	71.0	70.6	0.6
Net profit for the year	132.1	139.4	-5.2
<b>Balance sheet figures in €m</b>			
Total assets	20,634.4	18,584.0	11.0
Shareholders' equity	1,310.5	1,289.7	1.6
<b>Ratios</b>			
Cost efficiency ratio of usual business activity in %	71.4	66.9	-
Return on equity before tax in %	16.5	19.6	-
Net fee income in % of operating revenues	57.7	60.5	-
Funds under management and administration in €bn	125.5	115.3	8.8
Employees	2,577	2,440	5.6
<b>Share information</b>			
Number of shares issued in million	28.1	28.1	0.0
Dividend per share in €	2.50	2.50	0.0
Earnings per share in €	4.70	5.14	-8.6
Share price as at 31.12. in €	92.0	89.0	3.4
Market capitalisation in €m	2,585.9	2,501.6	3.4
<b>Regulatory ratios*</b>			
Tier 1 in €m	1,100.2	1,058.0	4.0
Regulatory capital in €m	1,438.8	1,397.0	2.8
Risk-weighted assets in €m	9,600.0	8,113.0	18.3
Tier 1 ratio in %	11.5	13.0	-
Regulatory capital ratio in %	15.0	17.2	-

\* following confirmation of the balance sheet



# Annual Report 2011

**HSBC Trinkaus & Burkhardt**

Date of issue: April 2012

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## Ladies and Gentlemen,

The financial and sovereign debt crisis continued to dominate events on the financial markets and economic activity last year. Germany gave a favourable economic performance overall, although growth forces weakened significantly at the end of 2011. Nevertheless, the domestic financial industry remains under pressure: low revenue growth, hardly measurable in part, is meeting with significant cost increases and higher capital requirements.

HSBC Trinkaus' results almost reached the record prior-year level despite the crisis affecting the financial markets. Pre-tax profit stood at € 203.1 million and was therefore just 3.3 % lower than the figure for 2010. Net profit of € 132.1 million was only 5.2 % down on the previous year. At € 206.8 million operating profit was one of the best in the Bank's history, a result with which we are very satisfied given the distortions on the financial markets.

The Bank's capital ratio remains high at 15.0 % and the Tier 1 capital ratio stands at 11.5 %. HSBC Trinkaus therefore already fulfils the future requirements under Basel III and also has sufficient capital for planned business expansion.

In the light of the good result, the Management Board and the Supervisory Board will propose to the Annual General Meeting the payment of an unchanged dividend of € 2.50 per share.

In the latest financial year HSBC Trinkaus proved again that the Bank's business model is still convincing. It is characterised by its clear orientation towards the target groups of corporate clients, institutional clients and high net worth private clients and is supported by risk-aware trading. This approach enabled us to acquire a large number of new clients last year since we are perceived as a safe haven in turbulent market conditions.

All customer groups were able to make a significant profit contribution. The Corporate Banking and Private Banking segments were able to further improve on their good prior-year results. We have proven to be a reliable banking partner in the Corporate Banking business and acquired many new clients. There were also inflows of funds in the Private Banking segment, highlighting the major confidence placed in the Bank by our clients. These positive

developments confirm the success of our growth strategy which we started to implement in 2010. The Global Markets segment managed to almost repeat its high prior-year result. This is to be regarded as a particular success given the unfavourable general setting and underlines the significance of client-driven trading for the Bank. The Institutional Clients segment fell short of its prior-year result on account of extraordinary income from a capital increase in 2010, but continued to make a very significant profit contribution.

More than four fifths of its profit comes from commercial banking business as HSBC Trinkaus is an integral part of one of the world's largest banking groups. Our particular strengths lie in our detailed knowledge of the international markets, in particular the emerging markets and their global networks, making it easy for our clients to use the opportunities arising from them. But what also continues to make us stand out compared to many other commercial banks is our individual and sustainable servicing approach, which is more akin to that of a private bank. For our clients and those set to become our clients we are increasingly their personal banking partner in Germany who can accompany them throughout the world.

Thanks to our international and client-oriented approach, conservative risk management as well as a strong capital base we are in the position to gain market shares in all business segments in a difficult environment in 2012 as well. The focus remains on the significant expansion of the business with internationally operating companies. The global expertise of local specialists throughout the HSBC Group as well as their skills in product development are available to the Bank's clients in the Institutional Clients business. For example, HSBC Trinkaus has direct access to the Group's global trading books which also enable large-volume transactions and risk assumption. In the Private Banking segment the Bank will work even more closely with the HSBC Group in future in particular in the area of investment solutions.

Not least our employees are paramount to HSBC Trinkaus' success. The continuity within our workforce in particular is a major advantage as only on this basis can lasting client relationships actually be built up and maintained. We want to further promote the particular commitment and outstanding performance of our employees and plan to make comprehensive investments in training and advanced training measures again this year, including inter-

national placements within the HSBC Group. Our staff members benefit not only from professional training, but also from the Bank's cultural diversity. The global Diversity & Inclusion programme, which supports diversity and equal opportunities in the company and promotes the integration and appreciation of the employees, is expected to further enhance this advantage.

Finally, we would like to thank our clients and shareholders for the trust they have placed in us, our business partners for their support and our employees for their constructive cooperation and commitment.

Yours sincerely,

The Management Board







# Executive Bodies

**10 Management Board**

**12 Supervisory Board**

**14 Advisory Board**

# Executive Bodies of HSBC Trinkaus & Burkhardt AG

## Management Board



Andreas Schmitz, Chairman  
Carola Gräfin v. Schmettow  
Paul Hagen  
Dr. Olaf Huth  
Manfred Krause

**Düsseldorf** **Baden-Baden** **Berlin**  
**Cologne** **Frankfurt am Main**  
**Hamburg** **Munich** **Stuttgart**

HSBC Trinkaus is an internationally-positioned, client-oriented commercial bank. We are in a unique position among the German banks: in a global network as HSBC in Germany and therefore part of one of the world's largest banking groups – and at the same time offering an individual and highly-personalised customer service with the values of our 227-year history. Our business model as a Bank clearly oriented towards the target groups of corporate clients, institutional clients and high net worth private clients has proven itself as viable for the future. At "AA" HSBC Trinkaus still has the best Fitch rating of a private commercial bank in Germany.

We accompany our clients throughout the world. Thanks to around 7,200 HSBC branches in over 80 countries and territories our strengths lie in the detailed knowledge of international markets, in particular the emerging markets. Through us our clients gain access to sophisticated financial services, exclusive market information and first-class contacts. We are one of only very few banks in Germany to offer global overall portfolio management by

## Executive Committee



Dr. Christiane Lindenschmidt  
Dr. Rudolf Apenbrink  
Florian Fautz

only one advisor who brings together the local expertise available world wide and thus makes it accessible to the customer.

For our corporate and institutional clients, both large corporations and larger mid-size corporates, we are the gateway to the world for your financial transactions. Thanks to our integration into the HSBC Group, this enables large-volume transactions and risk assumption. As the quality of our offer in the traditional banking business is recognised, we are increasingly acting as core bank for our clients. Our private clients – who appreciate our “Trusted Advisor” approach in particular – benefit from the internationality we are able to offer like no other bank in Germany at present.

You can rely on HSBC Trinkaus. This is borne out by our excellent, conservative risk management which functions according to few, but fundamental rules. The Bank only assumes risk in accordance with its risk-bearing capacity. We want to grow with our clients, not with our risks. This business policy provides our clients with security; we are re-

garded as a safe haven. The foundation for this is created by our employees who, thanks to their long-term commitment to the Bank, stand for lasting client relationships and add personality to our client orientation.

Firmly anchored values have always been an integral part of our corporate culture as is expressed in our Corporate Sustainability. We are aware of our responsibility to society and to the environment. Sustainability criteria corresponding to standards applicable worldwide have been incorporated into our business processes. We also support the commitment of our employees to social and environmental projects.

The trust our clients place in us is based not least on our claim that we were, are and will be there for them.

## Supervisory Board

Herbert H. Jacobi, Düsseldorf

Honorary Chairman

former Managing Partner,

HSBC Trinkaus & Burkhardt KGaA

Dr. Sieghardt Rometsch, Düsseldorf

Chairman

former Managing Partner,

HSBC Trinkaus & Burkhardt KGaA

Friedrich-Karl Goßmann\*, Essen

Deputy Chairman (from 7 June 2011)

Bank employee

Stuart Gulliver (to 7 June 2011)

Deputy Chairman

Group Chief Executive,

HSBC Holdings plc, London

Samir Assaf (from 7 June 2011)

Group Managing Director,

Chief Executive Officer Global Banking and Markets

HSBC Holdings plc, London

Sigrid Betzen\*, Meerbusch (from 29 September 2011)

Managing Director,

German Association of Bank Employees

Peter Boyles

Chief Executive Officer Continental Europe,

Deputy Chairman France,

HSBC France, Paris

Professor Dr. h. c. Ludwig Georg Braun, Melsungen

(to 7 June 2011)

Chairman of the Supervisory Board,

B. Braun Melsungen AG

Deniz Erkman\*, Krefeld

Bank employee

Monika Frank\*, Düsseldorf

(from 7 June 2011 to 8 September 2011)

German Association of Bank Employees

Stefan Fuchs\*, Düsseldorf (from 7 June 2011)

Employee of HSBC Transaction Services GmbH

Dr. Hans Michael Gaul, Düsseldorf

Timo Grütter\*, Wesel (to 7 June 2011)

Bank employee

Birgit Hasenbeck\*, Düsseldorf

Bank employee

Wolfgang Haupt, Düsseldorf

former Managing Partner,

HSBC Trinkaus & Burkhardt KGaA

Harold Hörauf, Eggstätt

former Managing Partner,

HSBC Trinkaus & Burkhardt KGaA

Oliver Honée\*, Essen (to 7 June 2011)

Bank employee

Professor Dr. Ulrich Lehner, Düsseldorf (to 7 June 2011)

Member of the Shareholders' Committee,

Henkel AG & Co. KGaA

Friedrich Merz, Arnsberg

Partner,

Mayer Brown LLP

Oliver Popp\*, Frankfurt (from 7 June 2011)

Press Spokesman,

German Association of Bank Employees

Ralf Rochus\*, Essen (from 7 June 2011)

Bank employee

Carsten Thiem\*, Düsseldorf (from 7 June 2011)

Bank employee

Hans-Jörg Vetter

Chairman of the Management Board,

Landesbank Baden-Württemberg, Stuttgart

\* elected by the employees

Situation as at 31 December 2011

## **Supervisory Board Committees**

### **Nominations Committee**

Dr. Sieghardt Rometsch, Düsseldorf  
Chairman  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Peter Boyles  
Chief Executive Officer Continental Europe,  
Deputy Chairman France,  
HSBC France, Paris

Harold Hörauf, Eggstätt  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

### **Personnel Committee**

Dr. Sieghardt Rometsch, Düsseldorf  
Chairman  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Peter Boyles  
Chief Executive Officer Continental Europe,  
Deputy Chairman France,  
HSBC France, Paris

Friedrich-Karl Goßmann\*, Essen  
Bank employee

Birgit Hasenbeck\*, Düsseldorf  
Bank employee

Harold Hörauf, Eggstätt  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

### **Audit and Risk Committee**

Wolfgang Haupt, Düsseldorf  
Chairman  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Deniz Erkman\*, Krefeld  
Bank employee

Dr. Hans Michael Gaul, Düsseldorf

Harold Hörauf, Eggstätt  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Deputies:

Stefan Fuchs\*, Düsseldorf  
Employee of HSBC Transaction Services GmbH

Friedrich Merz, Arnsberg  
Partner,  
Mayer Brown LLP

Dr. Sieghardt Rometsch, Düsseldorf  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

### **Mediation Committee**

Dr. Sieghardt Rometsch, Düsseldorf  
Chairman  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Peter Boyles  
Chief Executive Officer Continental Europe,  
Deputy Chairman France,  
HSBC France, Paris

Friedrich-Karl Goßmann\*, Essen  
Bank employee

Birgit Hasenbeck\*, Düsseldorf  
Bank employee

\* elected by the employees

## Advisory Board

Friedrich Merz  
Chairman  
Partner,  
Mayer Brown LLP

Professor Dr. Gerd Assmann, FRCP  
(to 31 December 2011)  
Chairman of the Management Board,  
Assmann-Stiftung für Prävention

Dr. Simone Bagel-Trah  
Chairwoman of the Supervisory Board  
and of the Shareholders' Committee,  
Henkel AG & Co. KGaA

Dr. Olaf Berlien  
Member of the Management Board,  
ThyssenKrupp AG

Christian Brand  
Chairman of the Management Board,  
Landeskreditbank Baden-Württemberg

Professor Dr. h. c. Ludwig Georg Braun (from July 2011)  
Chairman of the Supervisory Board,  
B. Braun Melsungen AG

Baron Wolf von Buchholtz

Albert H. K. Büll  
Entrepreneur and shareholder,  
B&L Gruppe

Heinrich Deichmann (from February 2011)  
Chairman of the Board of Directors,  
Chairman of the Managing Directors,  
Deichmann SE

Walter P. J. Droege  
Droege International Group AG

Dr. Thomas Enders (from January 2012)  
President & Chief Executive Officer,  
AIRBUS S.A.S.

Heinrich Johann Essing  
Managing Director,  
HEC Vermögensverwaltung GmbH

Henning von der Forst  
Member of the Management Board,  
Nürnberger Versicherungsgruppe

Robert Friedmann (from March 2012)  
Chairman of the Board of Directors,  
Würth-Gruppe

Dipl.-Kfm. Bruno Gantenbrink  
Managing Partner,  
BEGA Gantenbrink-Leuchten KG

Professor Dr. Michael Hoffmann-Becking, Lawyer  
Rechtsanwälte Hengeler Mueller

Hartmut Jenner  
Chairman of the Managing Committee,  
Alfred Kärcher GmbH & Co. KG

Professor Dr. Dr. h. c. Anton Kathrein  
Councillor of Commerce  
Managing Partner,  
KATHREIN-Werke KG

Dipl.-Kfm. Sigmund Kiener  
Owner,  
S. K. Management- und Beteiligungs GmbH

Dr. Karl-Ludwig Kley  
Managing Partner,  
Chairman of the Managing Committee,  
Merck KGaA

Professor Dr. Renate Köcher  
Executive Director,  
Institut für Demoskopie Allensbach

Professor Dr. Ulrich Lehner (from July 2011)  
Member of the Shareholders' Committee,  
Henkel AG & Co. KGaA

Professor Dr.-Ing. E. h. Dipl.-Ing. Berthold Leibinger  
(to March 2011)  
Chairman of the Supervisory Board,  
Trumpf GmbH + Co. KG



Professor Dr. Dirk Lepelmeier  
Managing Director,  
Nordrheinische Ärzteversorgung,  
Einrichtung der Ärztekammer Nordrhein

Professor Dr. Jörg-Andreas Lohr  
Managing Partner,  
Lohr + Company GmbH Wirtschaftsprüfungsgesellschaft

Udo van Meeteren

Dr. Claus Meier,  
Dipl.-Volkswirt, Oberkirchenrat  
Member of the Ecclesiastical Council,  
Evangelical Lutheran Church of Bavaria

Jürgen Meisch  
Member of the Management Board,  
Gothaer Finanzholding AG

Ludwig Merckle  
Managing Director,  
Merckle Service GmbH

Dr. Markus Michalke  
Managing Director,  
MIC Asset Management GmbH

Hildegard Müller  
Member of the Presidium,  
Chairman of the Executive Board,  
BDEW Bundesverband  
der Energie- und Wasserwirtschaft e. V.

Karsten Müller-Uthoff  
Managing Director,  
Ärzteversorgung Niedersachsen

Werner Nicoll  
Member of the Management Board,  
ARAG SE

Dr. Christoph Niemann  
former Managing Partner,  
HSBC Trinkaus & Burkhardt KGaA

Hartmut Retzlaff  
Chairman of the Management Board,  
STADA Arzneimittel AG

Petra Schadeberg-Herrmann  
Shareholder of Krombacher Brauerei  
Bernhard Schadeberg GmbH & Co. KG

Dr. Marcus Schenck  
Member of the Management Board,  
E.ON AG

Dr. Ulrich Schröder  
Chairman of the Management Board,  
KfW Bankengruppe

Dr. Botho von Schwarzkopf  
Managing Partner,  
Pfeifer & Langen IHKG

Professor Dr. Klaus Schweinsberg  
Centrum für Strategie und Höhere Führung

Professor Dennis J. Snower, Ph. D.  
President of the Kiel Institute for the World Economy

Helmut Späth  
Deputy Chairman of the Management Board,  
Versicherungskammer Bayern

Norbert Steiner  
Chairman of the Management Board,  
K+S Aktiengesellschaft

Thomas Unger (to January 2011)  
Chief Executive Officer,  
Constantia Flexibles Holding GmbH

Professor Dr.-Ing. Dieter H. Vogel  
Managing Partner,  
Lindsay Goldberg Vogel GmbH

Hartmuth Wiesemann

Situation as at March 2012



# Group Management Report

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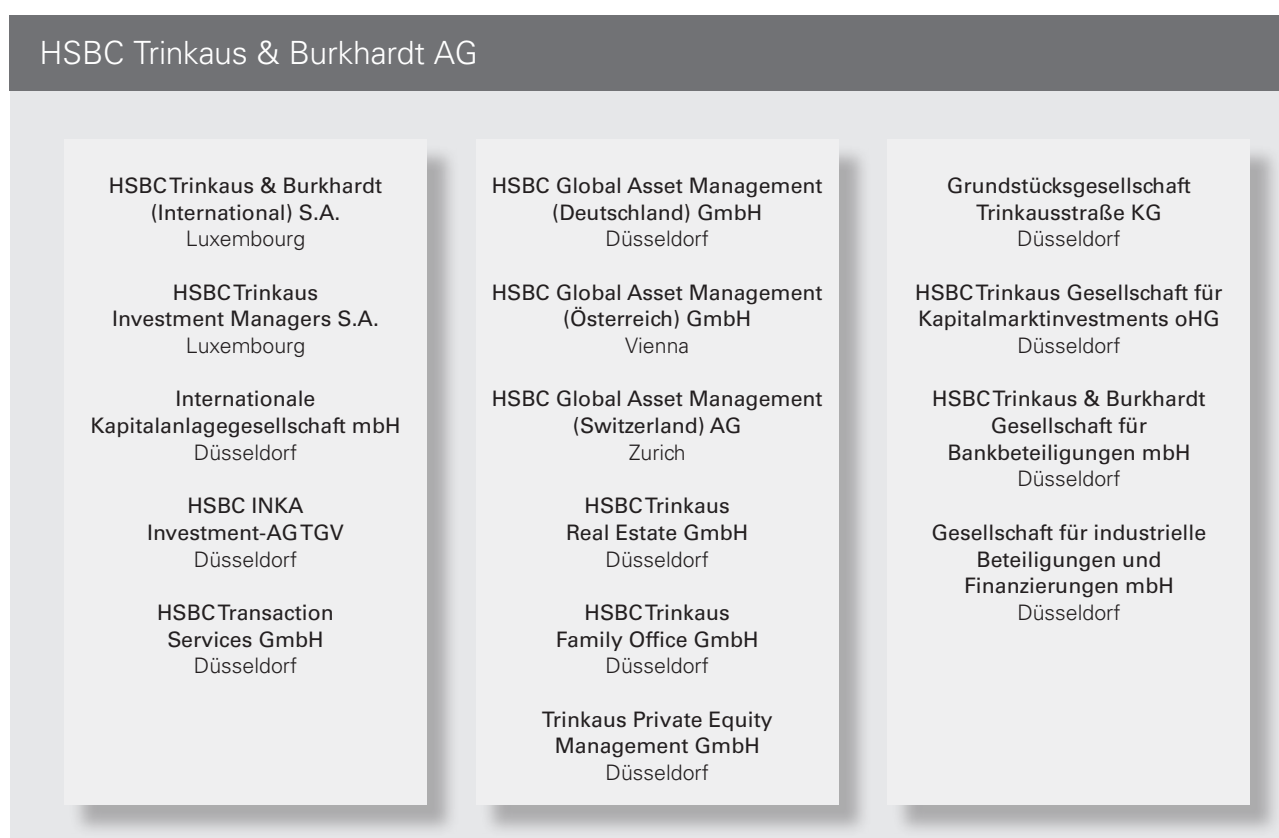
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# Structure and Management

## The Group

The HSBC Trinkaus Group comprises a group of 16 active companies. The parent company is HSBC Trinkaus & Burkhardt AG.



A number of other companies belong to the Group, but they are not engaged in any significant business activity at present. Finally, companies acting as the managing partners of closed-end property funds and of private equity funds also form part of the Group.

The Group is managed as a single entity by the Management Board of HSBC Trinkaus & Burkhardt AG. Supervision of executives managing Group subsidiaries is carried out as a rule by the relevant Supervisory Board, Board of Directors, and Advisory Board. Notwithstanding their independent legal status, all companies are managed within the framework of an overall strategy.

## Constitution of the Company

In accordance with the Articles of Association, the Management Board of the Bank must consist of at least two members. However, the Supervisory Board may appoint additional members of the Management Board in excess of this number. The Management Board currently consists of five persons.

The members of the Management Board are appointed and dismissed in accordance with the legal provisions of Section 84 German Stock Corporation Act (AktG).

Resolutions to amend the Articles of Association are passed by the Annual General Meeting with two thirds of the share capital represented upon adoption of the resolution, provided no greater majority is required by law. The Supervisory Board is authorised to amend the Articles of Association insofar as such amendments merely relate to the wording.

The Annual General Meeting can decide upon capital procurement measures only in accordance with the statutory provision in Section 119 German Stock Corporation Act (AktG). Please see Note 40 "Shareholders' Equity" in our Consolidated Financial Statements in respect of the Management Board's current authorisation to issue shares.

In accordance with the resolution passed by the Annual General Meeting on 8 June 2010, the Management Board has the right to buy and sell its own shares for the purpose of securities trading at prices which exceed or fall below the average closing price for the shares on the Düsseldorf stock exchange (or if this cannot be determined, on the Baden-Württemberg securities exchange, Stuttgart) on the ten preceding trading sessions by no more than 10 %. The number of shares bought for this purpose may not amount to more than 5 % of the company's share capital at the end of each day. This authorisation is valid until 07 June 2015.

The company has entered into no significant agreements which are subject to a change in the control of the company as a result of a takeover bid. The company has also not concluded any compensation agreements with employees or members of the Management Board in the event of a takeover bid.

### **Basic features of the compensation system for the Executive Bodies**

The compensation of the members of the Management Board is laid down in contracts of employment which the Bank, represented by the Chairman of the Supervisory Board, concludes individually with the various Management Board members.

The compensation of members of the Management Board comprises a fixed salary element plus a variable compensation component. Each member of the Management Board is also given an individual pension commitment. The extent of the annual variable compensation is determined

on a discretionary basis by the Supervisory Board and can be paid in cash, as an allocation of shares in HSBC Holdings plc or a combination of both. The members of the Management Board refrained from applying the contractual ruling valid until 31 December 2011 according to which the cash component amounts to at least 50 % of the variable compensation. Such an agreement is no longer included in the Management Board members' contracts currently valid.

The share of the cash component, the minimum waiting period until the allocation of the long-term share of the compensation as well as its distribution beyond the waiting period is geared towards the HSBC Group's provisions applicable throughout the Group and can vary from year to year. The details of this are published in the Annual Report for the respective year. For the 2011 financial year the long-term share of the compensation for two Management Board members consists exclusively of allocated shares in HSBC Holdings plc. A third of these shares will be transferred in each of the next three financial years, in other words from 2013 to 2015. For three members of the Management Board half of the long-term share of the compensation consists of a cash payment and half of an allocation of shares in HSBC Holdings plc. A third of both elements will be transferred in each of the next three financial years, from 2013 to 2015, whereby a further holding period of six months from transfer is stipulated for the shares of HSBC Holdings plc.

Price risks and opportunities arising from the shares allocated in the period up until transfer lie exclusively with the respective Management Board members.

Individual information on the extent and composition of the payments made to the members of the Management Board during the 2011 financial year can be found in Note 68 "Business Relationships with Companies and Persons Defined as Related Parties".

The Annual General Meeting decided with the required three-quarters majority on 5 June 2007 that the individual emoluments of the members of the Management Board are not to be published.

The compensation for members of the Supervisory Board is governed in the Articles of Association. Each Supervisory Board member is thereby entitled to receive fixed compensation of € 25,000 plus variable compensation of

€ 100.00 for every 1 cent of dividend distributed per share. The Chairman receives two-and-a-half times and the Deputy Chairman double these amounts. The Chairman of a Supervisory Board committee receives double and members of a committee one-and-a-half times the aforementioned compensation of a Supervisory Board member, provided the respective committee has met at least once in the financial year. If a member of the Supervisory Board holds several offices, he/she is only compensated for the office with the highest compensation. Should a member of the Supervisory Board or of a committee not be in office for the full financial year, the compensation is reduced proportionately to the period.

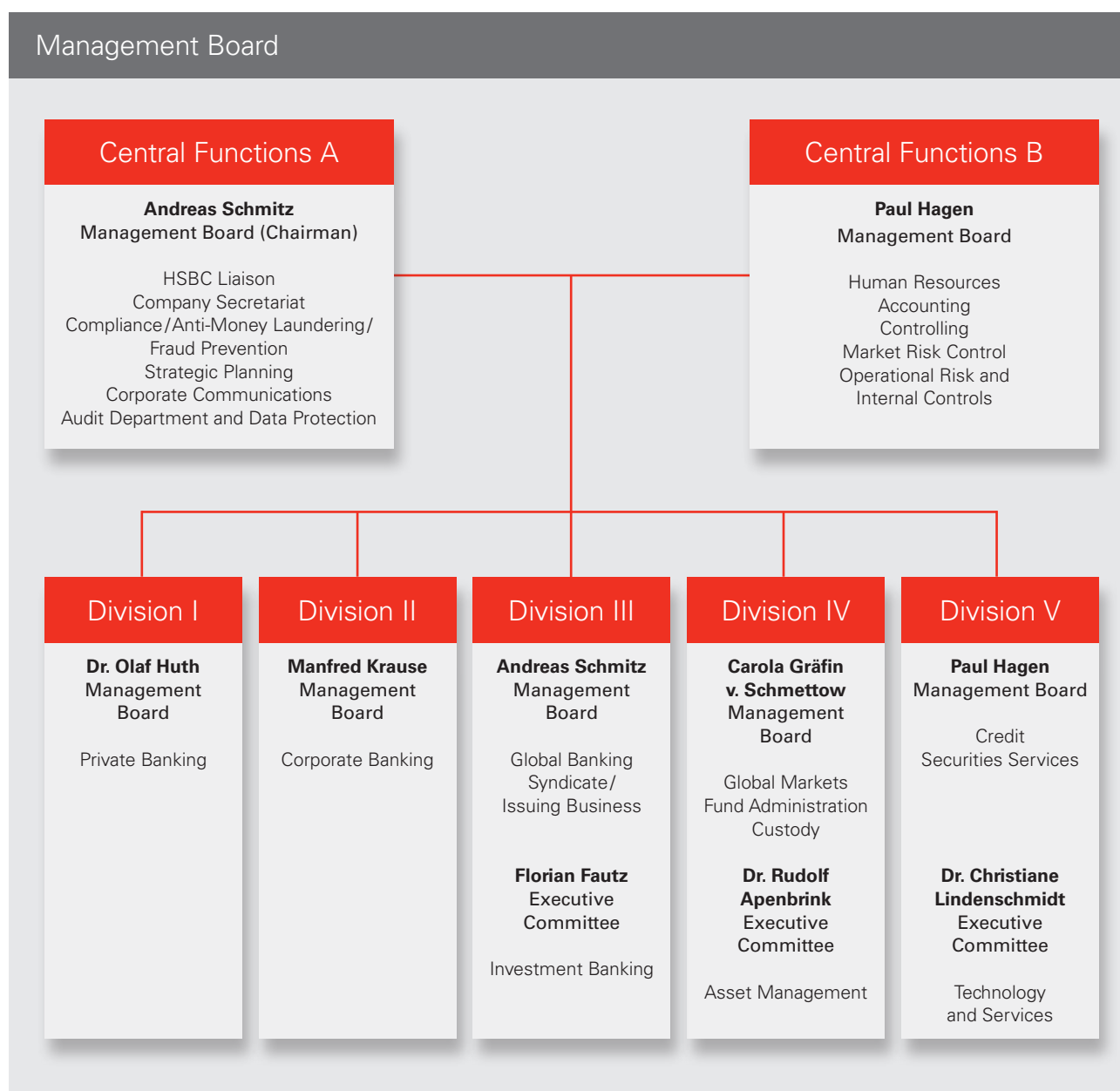
The compensation of members of the Supervisory Board in the 2011 financial year – including fees paid for advisory services – is reported under Note 68 of our consolidated accounts "Business Relationships with Companies and Persons Defined as Related Parties".



# The Business Divisions

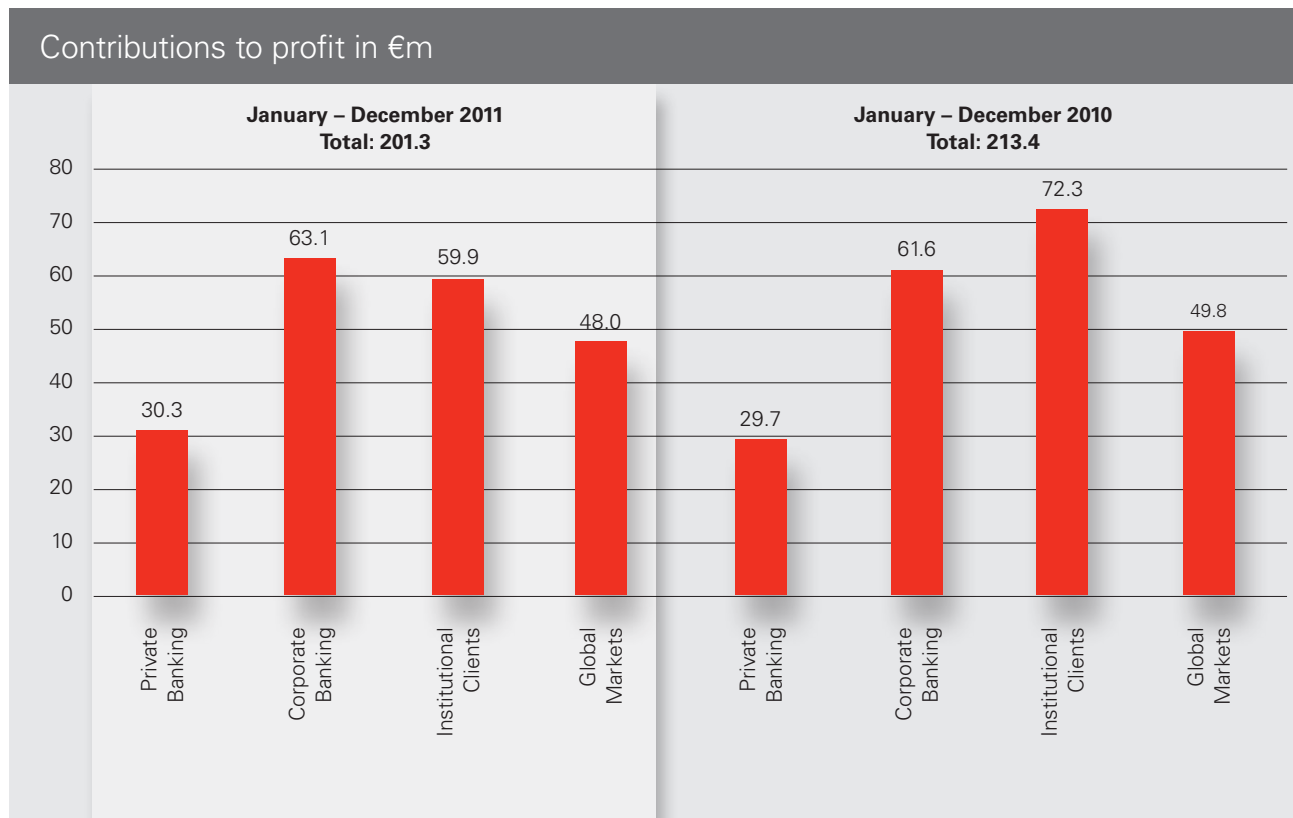
Notwithstanding their joint overall responsibility, all Management Board members are also assigned individual responsibility for specific business areas and central functions. The Management Board members are assisted by Dr. Christiane Lindenschmidt, Dr. Rudolf Apenbrink and

Mr. Florian Fautz as members of the Executive Committee. The assignment of responsibilities applies not only to the parent company and its branches, but also to the operations of its subsidiaries.



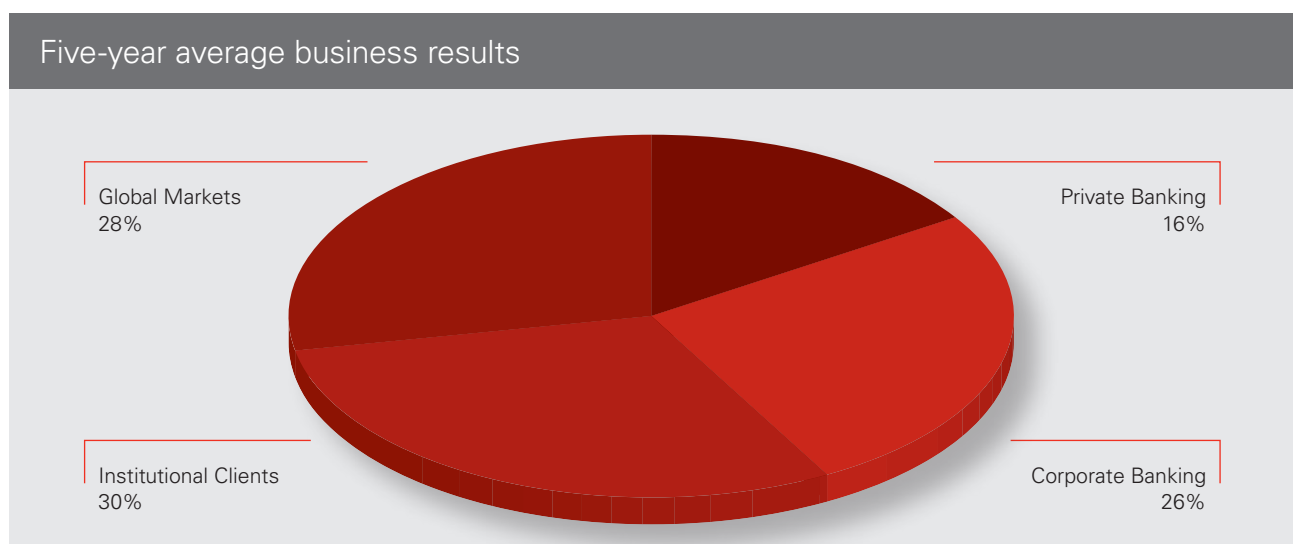
Within the business divisions, individual departments are defined as either profit centres or cost centres. The costs of Division V are mainly apportioned as unit costs to Divi-

sions I – IV. Divisional profits are calculated on the basis of partial cost allocation.



After allowing for a total of € 5.5 million for head office functions during 2011, as against € 6.9 million for 2010, the 2011 operating profit was € 206.8 million (2010:

€ 220.3 million). The mean contributions to profits over the last five years reveal a balanced picture:



# Strategic Direction

## General economic setting

Events on the financial markets and economic activity were again dominated by the financial and sovereign debt crisis last year. What started as a subprime crisis went on to force several banks to file for bankruptcy; even three years after the collapse of Lehman Brothers the situation in the lending industry is anything but resolved. The crisis affecting financial markets has turned into a sovereign debt crisis which will present a major challenge in 2012 as well.

The crisis revolves around government debt and the doubts on the financial markets as to whether this debt can be serviced. Only if violations of the debt criteria are punished and economic imbalances in the Eurozone are removed by means of a corresponding structural reform can the crisis be overcome. This will all be associated with costs, but it is worth investing in the euro and in Europe. In this environment the economic trend in Germany appears to be like a "German miracle" – even though the country is facing future challenges and risks.

The clearing-up operation in the financial sector continued last year. After the major loss of confidence accompanying the financial crisis, regaining the confidence of its customers and shareholders, but also of the political system and the regulatory authorities, is decisive for the sector. The population's response, vented in activities such as the "Occupy" movement, shows that our industry may have learned the right lessons, but that they have not yet been implemented. The financial market crisis has revealed fundamental weaknesses in the financial system that have to be removed by introducing better regulatory standards and clearer playing rules for the financial markets. However necessary it is to make significant adjustments to the rules, balanced regulation with a sense of proportion is required to help avoid a situation in which overregulation of the financial markets impedes a sector recovery. Above all, the ability to create equity capital must not be burdened. A decline in lending is to be avoided as this would obstruct the development of the real economy.

However, beyond the necessary government regulation and independent measures taken by the banks, the following still applies: the key to the success of a bank and a functioning financial market overall lies in consistent business models which focus on the customers and enable long-term economic success based on proven values. The financial crisis has revealed quite clearly here market participants without a sustainable business model which have in the end become a burden for the financial system and for the taxpayer. The end to the distortion of normal trading conditions, which the European Commission and other players are pushing for, will lead to a significant change in the German banking landscape.

## Orientation of HSBC Trinkaus in the current environment

HSBC Trinkaus proved again in the latest financial year that the unique combination of our business model is still convincing. Our strategic orientation is characterised by diversification, sustainability and risk awareness. This approach enabled us to acquire a large number of new clients again last year since we are perceived as a safe haven, avoiding many pitfalls.

Even against the backdrop of the bank stress tests HSBC Trinkaus is in an excellent position: our capital ratio remains high at 15.0 % and the Tier 1 capital ratio stands at 11.5 %. The Bank therefore already fulfils the future requirements under Basel III and also has enough scope for future business expansion. With a view to the intense discussions over the capital adequacy of banks and the possible consequences for lending to German corporate clients (keyword "credit crunch"), these ratios represent an important statement for the Bank's client business and at the same time a key feature differentiating us from the competition.

Despite the numerous global adjustments to bank ratings over the past year, we have had an unchanged "AA" Fitch rating since the end of 2007. HSBC Trinkaus therefore still has the best Fitch rating of a private commercial bank in Germany. This underlines the Bank's stability and security and its strong positioning within the sector, in particular given the general sector revaluation by the rating agencies.

We want to remain successful in the challenging market environment through consistent orientation to clearly defined target groups and pronounced risk awareness in 2012 as well. Our success remains based on:

- Our stable base of values such as trust, honesty, sense of duty and responsibility
- Our strong capital base, also with respect to future regulatory requirements
- Our earnings power, which has been above average for years in relation to the competition
- Our long-standing and motivated staff
- Our products and services which meet with our customers' satisfaction
- Our close cooperation with the HSBC Group

The fact that we can rely on a stable and reliable shareholder, HSBC, contributes to our unique position in the market. The close cooperation with the HSBC Group means that we are one of the few competent addresses for international business in the German market for more and more clients. HSBC Trinkaus takes a particular interest in using the global network of the HSBC Group to the benefit of our customers, seeing ourselves as a pioneer in global exchange in view of Germany's status as a leading export nation.

The growing significance of the German market for the HSBC Group was reaffirmed by Stuart Gulliver, the new Group Chief Executive, at the Investor Day last year. Alongside China, the USA, India, France and Great Britain, Germany is a key country for the strategic growth of the HSBC Group, an assessment which is based on the strong long-term export power forecast for Germany. The HSBC

Group expects a further increase in the German contribution to its pre-tax profit in the medium term. In addition to our "Growing on strength" organic growth strategy, which led to very favourable results in particular in our business with German corporate clients last year as well, we also want to realise this by buying in assets. We regularly examine opportunities that arise in the market to strengthen our business on a selective basis, but are very careful to ensure that we adhere to our internal profitability and risk criteria. The discussions over WestLB AG's corporate banking business up for sale are also to be seen against this backdrop. We regarded its value-added chain with medium-sized clients as a good addition to our own corporate client portfolio which would have provided our organic growth efforts with significant support. The fact that this could have been combined with securing jobs in our domestic banking market in Düsseldorf encouraged us in our efforts to find a constructive solution. However, we had to break off the talks last October as a competitor close to WestLB AG's shareholders, the "Verbundbank," entered into the negotiations. This significantly restricted the opportunity to acquire a portfolio corresponding to our goals. Our strict requirements of sustainable and profitable investments could therefore not be fulfilled and consequently we did not continue to participate in the bidding process.

In addition to the future strategy of the HSBC Group, Stuart Gulliver also emphasised features of the Bank's corporate culture at the Investor Day. The targeted return to the experience and expertise ("Capability") and responsible action of all employees ("Courageous Integrity") is already largely present at HSBC Trinkaus. We relish a traditionally open corporate culture and a working environment in which willingness to perform is rewarded. Part of our catalogue of values is promoting cultural diversity, which is also a fundamental component of HSBC as "the leading international bank." HSBC's Diversity & Inclusion programme, which supports diversity and equal opportunities in the company and promotes the integration and appreciation of the employees, is expected to expand this advantage further. HSBC Trinkaus is energetically supporting this programme as an expression of contemporary company management and a humane working environment. Our commitment with respect to the compatibility of family and working life, for example by setting up two company nurseries as well as promoting flexible working hours, are just two of the numerous facets in this area.

## Overview of our strategy

Our strategy is characterised by continuity and is based on the following six points:

- We concentrate on the target groups of corporate clients, institutional clients and wealthy private clients and would like to expand our activities with existing and new clients in these segments, provided there is a balanced risk/earnings profile.
- We continuously analyse our activities as to whether they are geared towards optimally meeting the national and international needs of our existing and new clients from our target groups. Our decisions are made with the focus on our clients and we attach the greatest importance to personnel continuity in servicing our clients.
- Our trading activities serve primarily to support the client segments and provide a comprehensive product offer. When determining risk limits and trading strategies, the focus is always on the Bank's risk-bearing capacity.
- Innovative and client-related solutions are our strength, because the application of wide-ranging expertise is the only way to realise value-added for our clients and for the Bank. The basis of every good client relationship is nonetheless the careful, flexible and service-oriented execution of standard transactions and is therefore of major importance for us.
- We are constantly expanding our service offer in the securities business for clients and for other financial institutions. With our two securities settlement and fund administration subsidiaries – HSBC Transaction Services GmbH and Internationale Kapitalanlage-gesellschaft mbH (HSBC INKA) – we offer highly-qualified services at competitive prices. Furthermore, the Bank has been able to position itself successfully in recent years as an important provider of depositary bank services and global custody services as well as in asset management with HSBC Global Asset Management.
- We draw on the resources of one of the largest and strongest banking groups in the world, the HSBC Group. This applies to both the range of powerful products and the respective regional networks in over 80 countries.

The success of this strategy depends on whether we will manage to satisfy the following conditions in future as well:

- We must offer our clients unlimited access to the global HSBC network, without having to make compromises in terms of their requirement of individualised servicing on private bank level.
- We must continue to focus the business relationship with our clients on trust and sustainability. Only on this basis can client and advisor work together to find optimum solutions against the backdrop of a growing variety of products.
- We must provide a cutting-edge systems technology infrastructure to meet the most demanding requirements throughout the entire value-added chain so that we can offer our services at a competitive price and in a client-friendly manner.
- We must invest in the qualification of our employees through targeted training and advanced training measures in order to do justice to the growing complexity and internationalisation of our business.
- We must use a precise management information system to record data on the performance of our employees as individuals and as team members, so that they receive fair compensation which is in line with the market.

The long-standing and successful business relationships with our clients as well as their positive feedback have strengthened our conviction that we are on the right track. In the spirit of our long-standing tradition, we remain committed to our values; future needs tradition.





# The 2011 Financial Year

## General economic setting

The global economy was driven by the continuing expansion of the emerging markets in 2011, but was not quite able to follow on from the previous year's growth momentum. Alongside the increase in commodity prices which lasted into the first half of 2011, the sovereign debt crisis in the developed national economies acted as a drag in particular. The German economy did well in this environment and is likely to have grown by around 3 % after an increase in gross domestic product of 3.6 % the previous year. However, growth forces weakened significantly as the year came to a close. The momentum provided by exports especially weakened while the domestic economy, driven among other things by a flourishing labour market, remained solid. Overall in 2011 the German economy therefore again grew at a faster pace than the Eurozone, but also than the USA.

The strong increase in commodity prices led to inflationary fears flaring up again in the first half of 2011 which in turn prompted the European Central Bank (ECB) to raise interest rates twice in April and June in each case by 25 basis points to 1.5 %. At 2.5 % price inflation in 2011 turned out to be twice as high as in the previous year. In the wake of the risks to growth which materialised in the second half of the year, the ECB lowered the key interest rate to 1.0 % again. The ECB also continued to provide the Eurozone banks with unlimited liquidity – even for a period of three years for the first time. In addition, the ECB purchased government bonds on the secondary market, although the volume purchased remained well below the programmes of the British and US central banks. The latter announced in August that it was leaving the Federal Funds Rate, which is currently between 0.00 % and 0.25 %, on this low level until at least mid-2013 owing to the prevailing risks to growth.

Despite the expansionary policy pursued by the central banks, there were significant losses on the stock markets; the economic concerns led to sharply falling share prices in particular at the start of the second half of the year. The DAX lost around 15 % over the course of the year. The decline in the broad European indices was not quite as strong and in the USA the S&P 500 was even spared losses. Bundesanleihen again benefited from their role as a safe haven in 2011. Yields on ten-year Bundesanleihen marked new historical lows at times with levels

below 1.7 %. However, refinancing costs in a number of other countries of the Eurozone rose significantly in the course of the debt crisis. Investors' mistrust of the stability of government finances in individual countries and the turnaround in the ECB's monetary policy were responsible for the euro losing the gains it had achieved versus the US dollar at the beginning of the year again and falling back below the \$ 1.30 mark at the end of the year.

## Profitability

In 2011, in which the break-up of the Eurozone became a possible scenario on the capital markets, HSBC Trinkaus was able to generate one of the best results in the Bank's history with pre-tax profit of € 203.1 million, even though the record prior-year figure could not quite be repeated. This means a decline of 3.3 % or € 6.9 million versus 2010 (€ 210.0 million). Net profit for the year came to € 132.1 million and is therefore 5.2 % or € 7.3 million below the prior-year figure of € 139.4 million. In view of the distortions observed on the financial markets in the second half of the year, we are highly satisfied with this result.

Our business model has proven itself again. We have therefore expanded and strengthened it on a targeted basis, although one project which envisaged external growth could not be realised. By focusing on our clearly defined target client groups and their requirements, we were able to make further advances in both the Private Banking and the Corporate Banking segments. On the other hand, we were not able to repeat the high prior-year result in the Institutional Clients segment as expected as we benefited more than proportionately from several larger capital measures the previous year. Operating trading income almost reached the prior-year level which we regard as a particular success. The continuing speculation over the credit standing of individual Eurozone member states put hardly any pressure on our result as we are exposed to these countries – if at all – only with very manageable bond holdings in the bank book.

The individual items of the income statement developed as follows:

Net interest income was up significantly by € 20.2 million or 15.7 % to € 148.9 million. The main developments were as follows:

- Interest income from the deposit-taking business improved substantially thanks to increased volumes and slightly better margins to begin with. We see the high level of deposits by our clients as evidence of the confidence they place in the Bank. Thanks not least to our integration into the HSBC Group, we are perceived as a safe haven, especially in this difficult operating environment for banks.
- Interest income in the lending business also grew further, although the trend towards lower margins in the lending business which already began the previous year continued in 2011. The consequential decline in interest income was more than compensated by further growth in lending volumes. Our readiness to extend the credit portfolio significantly in the wake of our growth strategy means that we can expand the business with larger mid-size corporate customers in particular as providing loans is still the mainstay of the entire business relationship for this client group. We do not have to or want to make concessions with respect to the financial standing of our clients, but can also expand our market share significantly with the traditionally high requirements we make of our clients' credit standing.
- Interest income from financial assets also rose significantly as the Bank has steadily been expanding financial assets as surplus liquidity for years. We have maintained strict rules for the quality of the assets and thus remained more or less unscathed by the escalation of the sovereign debt crisis, even foregoing higher margins.
- Net loan impairment and other credit risk provisions were partially released on both an individually-assessed and collectively-assessed basis in 2011. Only isolated and smaller additions were required on an individually-assessed basis while the positive developments in the year under report led to substantial reversals for individual larger exposures. Despite increased lending volumes the further improvement in the average credit ratings of our credit portfolio was the decisive factor for a modest reversal of collectively assessed impairments.
- At € 385.5 million net fee income was notably lower by € 18.5 million or 4.6 % than the record figure recorded the previous year of € 404.0 million. The uncertainties prevailing on the capital markets, which led to the postponement of capital market transactions and also impaired the willingness of private and institutional clients to invest, led to declining business volumes. The main developments were as follows:
  - The clear restraint shown by the Bank's clients in respect of the capital markets was felt in the traditional securities business as well as in Investment Banking and the issuing and structuring business. We recorded the strongest decline in Investment Banking where we were able to generate a record result the previous year. Our fee-based business remains focused on all services in the traditional securities business. Contrary to the decline in transaction figures in the Bank's securities business, we were able to record substantial volume and revenue growth at our subsidiary Internationale Kapitalanlagegesellschaft mbH (HSBC INKA). This – and also future – growth is made possible by its positioning as master capital investment company and the corresponding long-standing investments in the systems required for this. Fee income in Asset Management was also increased across all client segments. We recorded volume growth in particular in the asset category Emerging Markets Debts.
  - In the fee-based business with foreign exchange and derivatives we continue to benefit from the very close cooperation with various companies of the HSBC Group, which largely enter the risks of these transactions directly in their own books and thus contribute to extremely competitive pricing. In the foreign exchange business we were able to increase the already very good prior-year result significantly again, although margins in traditional forex trading remain very narrow on account of the electronic trading platforms. We were also able to offer foreign exchange transactions in offshore renminbi for the first time in the year under review. There was also significant growth in net fee income from interest rate derivatives while net fee income from derivatives on equities declined owing to the restraint shown by our clients.
  - We were also able to improve our results significantly in the traditional foreign and lending business and therefore continue with our profitable growth in the Corporate Banking segment in the fee-based business as well.
  - Alternative investments have increasingly established themselves as their own asset category for our sophisticated clients. Above all institutional investors, but also

to a lesser extent corporate clients and high net worth private clients appreciate the diversification effect of these products. We were again able to organise access to selected products in this asset category with new offers for our clients in 2011 and therefore repeat the prior-year result.

Net trading income was down slightly by € 3.6 million or 3.0 % to € 116.8 million. We therefore only just failed to reach the extremely good prior-year level in trading with equities and bonds. In view of the at times difficult situation on the capital markets in the latest financial year, this success is owed to our highly experienced trading teams and to our risk management which has proven itself over many years. Our performance in trading with equities and equity index-linked derivatives is based primarily on the issue and market making of retail products such as warrants, certificates and convertible bonds. We continue to attach major importance in this market to transparency and customer satisfaction as a guarantee for sustained business. Thanks to our still very good liquidity position the treasury result remained on a high level in the year under report. We were able to successfully master the comparatively high volatility of credit spreads with respect to our bond positions in interest rate trading. The foreign exchange business also grew by more than 10 % from € 8.6 million the previous year to € 10.1 million. Valuation losses on derivatives in the bank book of € 4.3 million were reported in the year under review compared to valuation losses of € 4.2 million the previous year.

Administrative expenses were up € 35.0 million or 8.0 % to € 474.3 million. This increase is due essentially to our growth strategy which led above all to a higher average workforce and therefore higher personnel expenses in 2011. Performance-related remuneration was lower than in the previous year in keeping with the slight decline in the Bank's overall result. Despite the growth strategy there was a comparatively moderate increase in other administrative expenses of 4.4 % to € 166.8 million. This includes the bank levy payable for the first time in Germany from the year under report. In addition, the costs of a banking operation have been rising more than proportionately for years as a result of growing regulatory control as well as the constant transfer of new tasks stipulated by the government to the banks – relating in particular to tax collection.

Income from financial assets showed a loss of € 4.8 million on balance, largely the result of individual impairments on equities and bonds in the bank book in accordance

with our strict valuation guidelines. This was set against realised net gains on disposals during the year under report which did not quite compensate the valuation loss from impairments, though.

Other operating income/expenses were up significantly by € 2.6 million or 27.1 % to € 12.2 million. This figure essentially includes rental income from our real estate project in Australia as well as changes to other provisions. We also generated net income of € 5.4 million in other net income compared to net expenses of € 5.5 million the previous year. This includes a gain of € 5.2 million in the year under report from the sale of a property so far used for banking operations.

Tax expenses rose by € 0.4 million or 0.6 % to € 71.0 million, despite a slight decline in net profit for the year. This gives a tax rate of 35.0 % after 33.6 % the previous year. Most of the taxes are paid in Germany.

### **The asset situation**

Total assets increased moderately by 11.0 % to € 20.6 billion as at the balance sheet date after € 18.6 billion the previous year. There were no major changes to the structure of our balance sheet. This shows that we did not have to adjust our business model, despite the financial market crisis, as it proved itself again in the balanced nature of the client segments combined with risk-aware proprietary trading. Instead, in 2012 we can continue to dedicate ourselves fully to implementing our growth strategy, in particular in the corporate banking business.

Customer deposits remain our most important source of refinancing. At € 12.4 billion they accounted for more than 60 % of total liabilities on the balance sheet date. Thanks to our high credit standing and still excellent liquidity position we recorded further inflows, although we completely refrained from offers with deposit interest above the market. We show further growth in the deposit base in all business segments.

On the other hand, there was a significant decline in deposits by banks. This development is mainly reporting-date-related and largely concerns money market transactions with other HSBC units.

In addition, we also refinance our business, in particular our trading assets, from promissory note loans, warrants, certificates and convertible bonds, which we report under trading liabilities. On the balance sheet date they amounted to just less than € 2.4 billion versus € 2.9 billion the previous year. Trading liabilities also include the negative market value of the derivatives and are almost unchanged versus the previous year overall at € 5.4 billion or 26.3 % of the balance sheet total. We refer to the section on our financial position for the increase in shareholders' equity.

Both the cash reserve and loans and advances to banks, which are extremely short-term and therefore highly liquid items, increased significantly amounting together to € 2.5 billion or 12.3 % of the balance sheet total after € 1.7 billion or 9.4 % of the balance sheet total the previous year.

The € 0.6 billion increase in loans and advances to customers to € 3.7 billion corresponds to our growth strategy and the general guideline that we want to grow with our clients, and not by entering into risks in proprietary holdings. We still see a great deal of growth potential here in particular. Firstly, the credit lines granted to our clients were underused despite the occasionally quoted credit squeeze and secondly, we are also planning significant new lending business within the scope of our growth strategy for 2012.

Trading assets declined slightly to € 9.9 billion as at the balance sheet date after € 10.1 billion the previous year. With a share of around 47.7 % and 54.5 % the previous year they still represent the largest item on the assets side of our balance sheet. Bonds, which are mostly exchange traded and also eligible, account for almost half of trading assets. They are used among other things to provide collateral for derivatives vis-à-vis the corresponding exchanges.

There was a further substantial increase in financial assets of € 0.9 billion or 26.0 % to € 4.2 billion. Financial assets also consist mainly of exchange-traded and eligible bonds serving as a liquidity cushion which we have continuously expanded in recent years. We have further reduced our exposure to the peripheral states in the Eurozone in both trading and in financial assets, which was limited even before.

## The financial position

No capital increases were carried out in the HSBC Trinkaus Group in 2011, not even for supplementary capital. HSBC Trinkaus & Burkhardt AG transferred € 70.0 million from the previous year's profit available for distribution to retained earnings in accordance with the resolution passed by the Annual General Meeting on 7 June 2011. Primarily as a result of this the Group's Tier 1 capital grew by almost € 100 million to over € 1 billion for the first time. At this year's Annual General Meeting on 5 June 2012 we will propose the payment of an unchanged dividend of € 2.50 per share enabling a further allocation to retained earnings of € 35.0 million from profit available for distribution.

As one of the consequences of the financial market crisis, the supervisory authorities worldwide are still working to significantly tighten the capital requirements for banks. Firstly, more restrictive requirements for the recognition of liable equity capital are being defined and higher minimum capital ratios in relation to the risks involved with the banking business are being introduced step by step. Secondly, the capital requirements for positions in the trading portfolio have been increased drastically. Capital backing for the stress value at risk was required for the first time with effect from 31 December 2011 involving a considerable additional burden for the Bank. On the other hand, the increase in risk-weighted assets as a result of the stricter capital requirements for the securitisation positions in the trading portfolio turned out to be rather moderate for the Bank. As our core capital already today consists exclusively of subscribed capital and reserves, we already fully meet the future requirements regarding the composition of core capital (core Tier I capital). In addition, with our long-term capital planning we have made sure that we already exceed by far the higher capital ratios applicable in future. This means that we are very well equipped for the coming supervisory changes with respect to the capital requirements for banks and also still have scope for business expansion or acquisitions.

Our risk-weighted assets in the lending business rose significantly within the scope of the planned growth in our credit book. Owing to a relatively low prior-year figure, there even was a reporting-date-related increase of more

than 20 % to around € 7.1 billion after € 5.9 billion the previous year. As a result of the good economic trend in Germany, the average rating of our corporate clients and therefore the quality of the entire portfolio improved slightly over the course of the year. The market risk equivalent rose only moderately by 11.9 % to almost € 1.2 billion despite the changes for the trading portfolio mentioned above. The broadening of our revenue base is reflected in a 9.5 % higher obligation to provide capital backing for operational risk. Overall the regulatory risk position amounts to € 9.6 billion and is therefore around € 1.5 billion or 18.3 % higher compared to the previous year.

Following approval of the accounts, this gives a Tier 1 capital ratio of 11.5 % and a total capital ratio of 15.0 % for the HSBC Trinkaus Group. This outstanding capitalisation will continue to provide our growth strategy with lasting support.

As a further lesson drawn from the financial market crisis, the regulatory authorities worldwide have drastically tightened the requirements for banks with respect to liquidity and the management of liquidity risk. We are already in a good position today in this regard as well. Firstly, our liquidity risk management fully meets the Minimum Requirements for Risk Management (MaRisk). Secondly, the substantial strategic liquidity cushion we have already had for some time has been continuously expanded in recent years. In 2011 we therefore continued to show growth in our liquidity cushion against the backdrop of a general shortage of liquidity. Further details of our management of risk in general and liquidity risk in particular can be found in the chapter "Risk Management".

# Outlook for 2012

The global economy is likely to cool down further in 2012 compared to the previous year. The emerging markets, where there is still scope for governments and central banks to generate growth impetus with the risk of inflation having subsided, will continue to support growth. However, economic forces in the developed national economies are at risk of becoming almost completely paralysed. The Eurozone economy is even likely to decline by around 1 % in 2012 owing to the austerity programmes introduced in many countries; the heavyweights Italy and Spain are likely to suffer particularly hefty declines. Given this weakness, we expect the ECB to lower interest rates further. In order to prevent the debt crisis from spreading further, the central banks will extend the volume of their bond purchases further.

As a result of the low level of interest rates, the real estate sector and private consumption in Germany should benefit. The latter will also benefit from the low unemployment figure which has fallen to the lowest level since reunification. However, these positive effects will be overshadowed by the slump in demand from the other countries in the Eurozone, which is likely to affect the German economy in particular at the start of the year. Although we expect the German economy to stabilise over the course of the year, we are expecting economic output for the full year to stagnate. The inflation rate is likely to ease to around 2 %. A turnaround at the long end of the yield curve is not to be anticipated in this environment. However, in light of the extent of inflation and the risks for the Federal budget resulting from the German guarantees for the European bail-out programmes, we are expecting a slight increase in yields overall.

As a result of the European Central Bank flooding the Eurozone with liquidity in December 2011, the significant tensions on the euro money market could be eased and the emerging systemic risks avoided. In an unprecedented operation the ECB provided the European banking system with liquidity via a three-year tender with full allocation at an interest rate of 1 % and announced a further tender of this kind for the beginning of February. This liquidity can now be used by the banks to buy government bonds, the placement opportunities of which caused major worries. These effects are already clearly visible from the decline in yields on Italian and Spanish government bonds this January.

For HSBC Trinkaus this new measure introduced by the ECB means the clear deterioration of its relative positioning in the banking competition. The Bank's strong liabilities side, which is based mainly on refinancing through customer deposits, will be devalued by the flood of liquidity at least for the next two years. At the same time earning "easy money" by buying large amounts of government bonds issued by peripheral euro states contradicts our conservative business policy. The situation is too unstable for this given that we are expecting insolvency in Greece, even though insolvency has been warded off in the Eurozone so far through political will and the considerable use of taxpayers' money since early 2010. Such a credit event could have an adverse impact on sentiment and therefore on the economic trend in Germany as well.

The Bank is also being burdened by more extensive regulation. These changes will have a far-reaching impact on the business models of several banks. HSBC Trinkaus will be affected by this to a lesser extent as we concentrate on business with three clearly-defined client target groups, supplemented by trading activities which are geared primarily to their requirements. This business model comes far closer to the objective of the global regulators than that of banks which have strong investment banking activities, are dependent on proprietary trading and refinance themselves via the capital markets. Furthermore, the capital increase we carried out in summer 2010 has created scope for the expansion of our business even in the new regulatory environment. We see our business strategy as confirmed by the current discussion. Since our overall client-focused orientation is not being questioned, HSBC Trinkaus' fundamental strategy will not be affected by the adjustments to the new regulations.

Nevertheless, the implementation of the new capital adequacy requirements through the introduction of the stress value at risk with effect from 30 December 2011 has considerable repercussions. As a result, HSBC Trinkaus has an additional capital adequacy requirement limiting lending capacity by more than € 1 billion in good loans to larger mid-size corporates.

Only thanks to its very strong starting base is the Bank in the position to continue along the path set out in its medium-term planning and also use 2012 and the years ahead to gain market shares in all business segments. The focus is on the significant expansion of business with larger mid-size corporate clients. But we will by no means neglect market



opportunities presented to us in the Global Banking segment (institutional clients and internationally operating corporations), in Private Banking as well as in the business with warrants and certificates for independently operating private investors.

This expansion strategy is based on:

- qualified and committed employees who live the Bank's values and take the clients' requirements as the starting point for their activities
- the integration into the HSBC Group as one of the world's most globally efficient banking groups

An expansion strategy means higher risks, but also greater opportunities. This applies in particular to the expansion of the lending portfolio with larger mid-size corporate clients. However, these risks appear to be manageable in the light of the positive trend in the German economy as compared to the European situation, even though we are expecting this growth momentum to slow down, not least due to the sovereign debt problem. Credit margins are falling below the level of adequate risk premiums again at present as a result of the surplus supply of liquidity. Nevertheless, we are prepared to expand lending should other banks tend to restrain themselves in the credit business owing to higher capital adequacy requirements.

The continuing low interest-rate policy and surplus liquidity will put the Bank's net interest income under pressure in 2012. There will be no growth in the volume of bank revenues in the client business in Germany in 2012. We can therefore only increase our revenues in the years ahead by realising the targeted gain in market shares. With net interest income under pressure as a result of external market intervention and only modest prospects for net fee income, the revenue forecast for 2012 is dampened.

Strict cost management is decisive in this situation. The increase in our administrative expenses is expected to slow down in the years ahead after rising significantly in 2010 and 2011. We will make sure that the Bank's infrastructure remains strong in the long term by making sufficient investments. We will examine the need for all personnel and material cost items in order to avoid a further increase in the cost efficiency ratio and bring it

down to below the 70 % mark. Growing regulatory costs will have an increasingly counterproductive effect. We will continue to concentrate more strongly on target clients and reconsider activities which are of no strategic importance for us.

The aim is to realise a pre-tax profit which is oriented more or less towards that generated in 2011. However, the forecast for 2012 involves far greater uncertainties than in the previous years making a more concrete statement for 2012 and 2013 appear as speculation.

The precondition for this is that there is no major slump in share prices, perhaps as a result of distortions on account of insolvency in Greece or a continuing sovereign debt crisis in several Eurozone countries with speculation over the break-up of the Eurozone. In addition, the pressure arising from credit risks is not likely to grow beyond the moderate projected figure which is based on past default rates. We anticipate that the average credit rating of our portfolio will remain more or less constant in 2012 after the significant improvements in 2010 and 2011. However, as our portfolio is characterised by differing levels of concentration, a small number of problem cases can already lead to significant individual impairments, which could depress the result contrary to what was planned. Furthermore, the possible introduction of a financial market transaction tax is not included in our forecasts for 2012 and 2013. The introduction of this tax could lead to a significant slump in revenues depending on its configuration.

Our exposure to the euro states with particularly high debt levels is limited. We are therefore not expecting this to exert any notable direct pressure, but cannot rule out indirect effects in crisis situations, for example through spread widening also with respect to domestic securities.

HSBC Trinkaus' collaboration with the globally operating HSBC Group puts the Bank in a unique position in the upper midsize corporate banking business and with international corporations. In recent years HSBC Trinkaus has proven itself a reliable partner in the corporate banking business and has thus been able to acquire new clients. Our growth strategy, which includes an extended service and product offer, such as factoring, as well as enhancements in the area of payments and cash management,

will further increase our credibility as a reliable partner. The growth in our client base in recent years gives us reason to believe that we will be able to further increase earnings in the corporate banking business.

We have only dampened expectations for the institutional clients business for this year. The ECB returning to the crisis-induced low interest rate policy will lead to a level of interest rates that no longer fulfils the returns on investment required by many institutional clients. Targeted advice and the development of solutions will therefore become more important. We only stand out as a trusted advisor for our institutional clients if we provide them with individual solutions and products which are tailor-made to their requirements and which exemplify the targeted risk-return profile. The product development competence of the entire HSBC Group is available to our clients. For example, we have direct access to the Group's global trading books which enable large-volume transactions and the assumption of risk and can thus offer added value.

Thanks to our integration into the HSBC Group, we can gear our interest-rate and foreign exchange trading activities exclusively to our clients' requirements. In addition, we benefit from the liquidity and risk-bearing capacity of the HSBC Group's trading books. In return, we have major expertise at the Bank in the equity derivatives business as part of the division of labour. A broad product range is expected to further increase our market share in certificates and warrants trading. Our excellent rating and the continuous tradability of the products are increasingly important differentiators for private investors. However, the demand for investment certificates is still far below the high vol-

ume seen in previous years and is limiting the earnings opportunities. Our goal is to at least come close to the once again favourable earnings contribution generated in 2011. The same applies to treasury business.

In the Private Banking business we will continue to support our clients as "Trusted Advisor" and take over responsibility for the assets entrusted to us. Our business model, which is based on trust and geared towards the long term, proves itself in particular in a highly volatile market environment, such as we have at present. We are determined to use our position as leading asset manager in the German market to win over new clients and intensify business with existing clients in the year ahead as well. For this purpose we are working together even more closely with the HSBC Group in particular in the area of investment solutions to generate added value for our clients. Our aim is to improve our performance despite the difficult environment in 2012. In addition to tapping new potential revenues, we will also keep a close eye on the development of costs which will also come under pressure as a result among other things of more extensive regulation.

We will carefully examine opportunities to make acquisitions if they offer synergies with our existing lines of business. We do not rule out the acquisition of interesting client portfolios either if it serves to expand the Bank's client base.

The state intervention in the banking market must not lastingly distort competition and put pressure on market participants who responsibly carry out their business without government assistance. We therefore hope we will be able to pay our shareholders an appropriate dividend and strengthen the Bank's capitalisation in the years ahead as well.

# Risik Management

## Definition

In accordance with German Accounting Standard No. 5 (DRS 5), we understand by the Risk Management System “a comprehensive set of control procedures covering all activities of an enterprise; these procedures are based on a defined risk strategy applying a systematic and consistent approach with the following components: identification, analysis, measurement, control, documentation and communication as well as the monitoring of these activities”.

## Principles of risk management policy

One of the key functions of a bank is to consciously accept risk, actively controlling it and systematically transforming it. We regard counterparty, market and liquidity risk, as well as operative and strategic risks, as the principal risks of our banking business. Active risk control entails identifying the nature, amount and extent of any risk and structuring the risk in such a way that it not only conforms to the Group's risk-bearing capacity, but also offers corresponding risk premium and return.

In accordance with these risk principles we are ready to actively enter into market and counterparty risk. We want to minimise operational risk if there is a reasonable balance between risk avoidance and the related costs. Furthermore, adequate insurance has been taken out. Avoiding risks to our reputation is one of the basic approaches with respect to our business policy. We avoid liquidity risk as far as possible and are also prepared to accept significantly lower profits as a consequence.

The extent of the Bank's overall risk is limited by the Management Board in consultation with the Supervisory Board. The appropriateness of taking on a given risk is also assessed in particular against the backdrop of the Group's risk-bearing capacity on the one hand and the special risk management expertise in our core lines of business on the other. These principles continue to apply.

Since the beginning of the banking crisis and the collapse of the US investment bank Lehman Brothers, the old principle of “liquidity before profitability” has proven to be extremely valid in a market environment which has undergone drastic change. Issues relating to the Bank's liquidity position continue to be of the greatest priority for us. We have maintained our strong liquidity reserves and paid strict attention

when investing the funds accruing in the money and capital market to maintaining liquidity as best as possible, even though other forms of investment would have brought significantly higher returns in part. We are aware at HSBC Trinkaus that we work with money deposited by our investors who entrust us with their funds. The new banking supervisory liquidity provisions confirm our cautious stance and we are making adequate provision in accordance with the new requirements.

The second central challenge facing our risk management was and is managing counterparty risk. The international sovereign debt crisis deteriorated dramatically in the year under report and for some countries in the Eurozone insolvency and problems with refinancing on the capital market, respectively, could only be avoided through as yet unknown measures by the ECB and the creation of new bailout institutions. Many opinions expressed and statements made by leading politicians and central bankers in Europe had to be corrected and withdrawn, respectively, severely damaging confidence in the political processes in Europe. The need for the EU to set up a bailout programme for euro states already prompted us in 2010 to monitor and control our exposure to Eurozone states with a weak credit standing even more intensively. Our exposure to these states and the banks located there is therefore narrowly limited.

The continuation of the economic recovery in Germany which could be observed in 2011 took pressure off our lending portfolio. Given the favourable situation there was a net release of individually assessed impairments. However, as the prospects for growth have clouded over significantly as a result of the sovereign debt crisis, the positive trend will not continue.

HSBC Trinkaus' market risk management was again faced with a major challenge in the year under report after 2009 and 2010. While the stock market recovered relatively quickly from the sharp slump as a result of the earthquake in Japan, the heavy fall in prices from mid-2011 represented a particular challenge. In trading with derivative products we were able to reliably quote tradable prices for our warrants and certificates at all times thanks to our risk management and the experience of our traders. The trading books for managing the overall bank balance sheet suffered from credit spreads widening without the Bank's risk-bearing capacity being exceeded.

## Risk management – organisational structure

The following three committees play a central role within the Group's risk management organisation:

- the Credit Committee for counterparty risk
- the Asset and Liability Management Committee for market and liquidity risk
- the Operational Risks and Internal Controls Committee for operational risk including legal and reputational risks.

The internal audit department plays a major role in early risk detection. In its reports it highlights significant risks through the classification of its audit findings. In addition, it reports to the Management Board and the Audit and Risk Committee of the Supervisory Board based on follow-up examinations on the progress made with removing deficiencies ascertained.

This organisational structure ensures that risks are promptly identified and that suitable measures are taken in good time – also taking the Bank's size and degree of specialisation into consideration. It should be noted nonetheless that unforeseen risks arise and can never be ruled out completely.

This is why short routes to the management, a clear awareness on all hierarchical levels of the risks entered into and the constant further development of risk management are decisive.

With the capital increase concluded in July 2010 as well as the adequate retention of profit available for distribution in recent years we have taken account of the higher future capital requirements, opening up additional scope for growth for our client business. We are preparing ourselves actively for the new requirements relating to liquidity management.

## Strategic risk

By strategic risk we mean possible changes in the market environment and in the Group's efficiency which could have a detrimental effect on earning power in the medium term. It arises from the changed environment in which banks now have to operate. The new provisions relating to capital adequacy and refinancing of the banking business will lower the profitability of our client-oriented business irrespective of the adjustment measures we will carry out. However, the trend, which will be strengthened by increased costs resulting from other regulatory provisions, will not only apply to HSBC Trinkaus. Secondly, strategic risk arises from our strategic orientation with its very selective client focus as there is strong competition for our clients owing to their significance in the market.

HSBC Trinkaus' strategic position includes the risk arising from the fact that a large proportion of our revenues are dependent upon our clients' activities on the equity, bond, forex and derivatives markets and also on the capital markets' capacity to absorb new issues of interest-rate and equity products. The diversification of our business activities, for instance through our active corporate client business dealings and the broadening of our offer for wealthy private clients in regional and product terms, can only counteract this risk to a limited extent. To a certain extent, we can also counteract this risk in a targeted way thanks to our strong integration into the HSBC Group through the large range of products available to the Bank as well as the global service offer we can rely on for our clients.

We are confident that HSBC Trinkaus' strategic position in Germany will not deteriorate as we have been able to improve our market position in all client segments in recent years. The risk premiums for counterparty risk have increased in the market in general and are at present allowing more risk-adequate pricing than before the financial crisis, even though individual banks with low return on equity requirements are exercising a certain amount of pressure on prices and the trend towards risk-adjusted margins is already starting to wane again. This trend is being strengthened significantly in particular by the ECB providing the euro money market with excess liquidity.

We have begun to systematically work off the accumulated demand with respect to the further modernisation of our IT architecture which arose on account of capacities being tied

up for the implementation of the flat-rate withholding tax and the requirements of additional regulatory controls. The adjustment to new technologies and to the changed environment will require the use of significant personnel and financial resources in future as well. These investments will be accompanied by increased expenses for licence and maintenance fees for third-party software and write-downs on software and hardware leading to a further significant increase in costs for the Bank. We are therefore cooperating actively in the HSBC Group's projects the aim of which is to increase the efficiency of the Bank's operating processes and streamline the organisation overall.

The Bank is preparing itself for comprehensive new regulatory controls as a consequence of the financial market crisis. We doubt whether the slogan already repeated many times that not more, but more effective regulation is required, will be implemented. The transfer of tasks stipulated by the government to the banks, such as money laundering control and tax collection, will lead to a permanent increase in regulatory costs. We are extremely concerned about this as it will lead to a substantial increase in fixed costs for the Bank irrespective of its earnings opportunities. In addition, the income statement was burdened by the bank levy for the first time in 2011. The regulatory costs have taken on a dimension which exerts a significant influence on the minimum cost-efficient operating size of the Bank. Nevertheless, we admit that the trend towards greater regulatory control has also been brought about by a few banks acting irresponsibly. The structural and lasting decline in the return on equity associated with the process of transformation in the banking sector will have a fundamental effect on all banks. HSBC Trinkaus is already actively preparing for the coming changes.

As a general principle, the continuous improvement of our efficiency is absolutely vital in order not to endanger the Bank's competitive situation.

On a positive note, the Bank's strategic orientation has proven itself in the crisis and we are confident that we will be able to gain market shares thanks to our consistent client orientation.

## Counterparty risk

### a) Organisation of the credit processes

Counterparty risk may be subdivided into credit and counterparty risk on the one hand and sovereign risk on the other. By counterparty risk we mean the risk of the partial or complete default by a business partner on a contractually defined performance. Where this risk relates to circumstances resulting from government action it is known as sovereign risk.

The organisation of our credit department has been tailored to the size of the Bank's lending business and its target groups, thus enabling us to process and evaluate all counterparty risk in a professional and timely way.

Based on our clients' needs, before a loan is approved we examine the various options available for structuring a credit facility. These include, for example, syndications and loan securitisation using promissory note loans, or the issue of bonds.

We are guided by the principle of risk diversification: on the one hand we are careful to ensure that the borrower's risk of default is in proportion to its size and is shared with other banking institutions. On the other, we spread our credit risks widely across different industry sectors and counterparties.

We comply consistently with the minimum requirements for the credit business of financial institutions laid down by the Federal Financial Supervisory Authority (BaFin). In accordance with the statutory provisions, the Management Board has duly delegated loan approval authority relating to large and intra-entity loans. Qualifications and credit experience are the yardsticks used to determine the extent of an employee's credit approval authority.

An authority ruling passed by the Management Board, which differentiates according to size and credit standing, regulates the authorisation process for loan commitments. The credit risk strategy coordinated with the Audit and Risk Committee of the Supervisory Board provides a framework for decisions in this area. It is examined and adjusted to the current requirements on a regular basis.

The Bank uses a ten-stage rating system to classify the credit quality of its clients in the private banking business. The ten-stage internal ratings for high net worth private clients are based exclusively on a qualitative credit assessment by the analyst. However, the lending business in this client segment is of minor importance and is carried out on a collateralised basis as a rule.

The Bank uses a 23-stage internal rating system to classify the credit quality of its corporate and institutional clients in the lending business. We use four different rating systems which cover the customer groups international corporations, larger mid-size German corporates, banks and financial service providers. These systems are constantly being improved in detail. The internal rating, the expert knowledge of the analysts and – where available – the collateral provided form the basis for the loan decision.

The rating system for the German upper mid-size corporates segment was developed independently by the Bank. It is based on a statistical component for assessing the borrower's financial situation from its financial data. We developed this component with the help of internal client data. This is supplemented by an expert system which gives a qualitative evaluation of the customer and its economic environment. The rating system is completed by a set of rules for recognising liabilities within corporations. The selectivity of this statistical model has been proven on the basis of a large external database of German companies with very good results.

The rating systems for large international corporations, banks and financial service providers were adopted by the Bank from the HSBC Group after an internal inspection of their suitability. We therefore indirectly use the extensive data history and the additional expertise of the specialists within the HSBC Group for the internationally-oriented portfolios. All HSBC rating systems also include a qualitative evaluation of the company and its economic environment which is drawn up by the relationship manager in Germany in collaboration with local credit experts. This evaluation is supplemented by the statistical analysis of financial data and analysis of the sector and country risk.

The expected probability of default for each borrower can be derived from the rating categories. On this basis, we estimate the expected loss for the individual loan exposures taking security and other agreements into account. We set up net loan impairment and other credit risk provisions for

loan exposures with a high risk of default. In order to calculate this provision, the future payments from the loan and if necessary from the realization of security are estimated throughout the term of the loan. We can thus compare the cash value of these payments with the book value of the loan exposure. Net loan impairment and other credit risk provisions fully cover the shortfall calculated in this way.

Each credit risk must be assessed and classified annually, or more frequently where the credit rating is lower, and subjected to the approvals procedure. It is assessed whether the profitability of the client relationship is adequate in proportion to the risk assumed. We examine this also on a global basis for clients with relationships to other HSBC units.

Credit risk monitoring is conducted with the help of a risk limit system. It includes daily monitoring to make sure that approved lines of credit are not being exceeded.

In the case of non-performing, doubtful or problematic debts, strategies and solutions are worked out by teams consisting of employees from the client relationship, credit and legal departments.

Credit business is subject at regular intervals to internal auditing, both of counterparty risk and of working practices and methods.

Loans involving sovereign risk can only be granted within the framework of approved country limits. Loans to foreign borrowers always involve sovereign risk unless fully covered by domestic collateral. Loans to domestic borrowers may also involve sovereign risk if they are granted on the strength of foreign security, or if the borrower is largely dependent on a foreign shareholder.

The sovereign risks associated with counterparty risk are limited and monitored separately. Country limits are approved by the Management Board and the Audit and Risk Committee of the Supervisory Board and reviewed at least annually on the basis of political and economic analyses of the countries in question. In this context, the Bank makes use of the high-quality expertise available to it through HSBC's worldwide office network.

The adherence to country limits is monitored on a daily basis with the help of IT programmes. They also take risk transfers to or from other countries into consideration.

The Bank is deliberately reticent about direct foreign lending, except where the purpose is to assist its own local clients in their business dealings throughout the world. We are then in the position here to offer comprehensive solutions with the help of the local HSBC units.

#### **b) Maximum default risk**

Above all loans and advances, trading assets, financial assets as well as contingent liabilities and lending commitments can be affected by default risk. The risk of non-delivery can also arise in the settlement of payments

transactions, foreign exchange trading as well as the securities services business. We pay greater attention to this risk despite the extremely short settlement periods.

The following table shows the Bank's theoretical maximum default risk as at the balance sheet date disregarding collateral received and other risk-reducing techniques. The maximum default risk can be quantified best by means of the gross book value of the financial assets including OTC derivatives. The netting provisions under IAS 32 as well as the impairments for financial investments under IAS 39 are taken into consideration in the gross book value. Exchange-traded derivatives are not subject to default risk on account of the margin system.



As regards the furnishing of financial guarantees, the maximum default risk corresponds to the highest amount the Bank would have to pay in the event of a claim under the guarantee. The maximum default risk in respect of issued lending commitments, which cannot be revoked during their term or only in the event of a significant negative market change, is the full amount committed.

HSBC Trinkaus' maximum default risk according to this definition breaks down as follows as at the balance sheet date:

	31.12.2011		31.12.2010	
	in €m	in %	in €m	in %
<b>Loans and advances</b>	<b>5,574.8</b>	<b>21.3</b>	<b>4,492.5</b>	<b>19.9</b>
to banks	1,857.6	7.1	1,402.9	6.2
to customers	3,717.2	14.2	3,089.6	13.7
<b>Trading assets</b>	<b>9,481.2</b>	<b>36.3</b>	<b>9,737.9</b>	<b>43.1</b>
Bonds and other fixed-income securities	4,312.0	16.5	4,590.7	20.3
Equities and other non-fixed-income securities	561.1	2.1	1,004.4	4.4
Tradable receivables	1,892.5	7.2	2,334.8	10.3
OTC derivatives	1,952.0	7.5	1,439.5	6.4
Reverse repos/securities lending	119.4	0.5	72.3	0.3
Cash deposits	644.2	2.5	296.2	1.3
<b>Financial assets</b>	<b>4,164.7</b>	<b>16.0</b>	<b>3,305.9</b>	<b>14.6</b>
Bonds and other fixed-income securities	3,768.9	14.4	2,776.3	12.3
Equities	40.2	0.2	24.3	0.1
Investment certificates	73.9	0.3	100.1	0.4
Promissory note loans	180.9	0.7	293.6	1.3
Investments	100.8	0.4	111.6	0.5
<b>Contingent liabilities</b>	<b>1,746.1</b>	<b>6.7</b>	<b>1,305.4</b>	<b>5.8</b>
<b>Loan commitments</b>	<b>5,156.4</b>	<b>19.7</b>	<b>3,751.9</b>	<b>16.6</b>
<b>Total</b>	<b>26,123.2</b>	<b>100.0</b>	<b>22,593.6</b>	<b>100.0</b>



### (c) Collateral and other risk-reducing techniques

The provision of collateral is agreed in principle where necessary, for example with long-term financing or pure loans against securities. Netting agreements, where offsetting contracts with one customer can be netted against each other under certain conditions, are also concluded specifically in the derivatives business or agreements over guar-

antees for market values in the form of specific collateral. These agreements substantially reduce the theoretical maximum default risk represented above.

The following tables show the correlation between the maximum default risk in the credit portfolio and the financial collateral (excluding guarantees):

in €m		31.12.2011			
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments <sup>1)</sup>	Total
<b>Total</b>	<b>1,857.6</b>	<b>3,717.2</b>	<b>1,746.1</b>	<b>5,156.4</b>	<b>12,477.3</b>
of which uncollateralised	1,808.6	3,173.3	1,655.5	5,156.4	11,793.8
of which fully collateralised	49.0	349.5	84.1	0.0	482.6
of which partly collateralised	0.0	194.4	6.6	0.0	201.0
Amount of partial collateralisation	0.0	35.6	1.1	0.0	36.7

in €m		31.12.2010			
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments <sup>1)</sup>	Total
<b>Total</b>	<b>1,402.9</b>	<b>3,089.6</b>	<b>1,305.4</b>	<b>3,751.9</b>	<b>9,549.8</b>
of which uncollateralised	1,402.9	2,730.5	1,225.9	3,751.9	9,111.2
of which fully collateralised	0.0	178.9	62.5	0.0	241.4
of which partly collateralised	0.0	180.2	17.0	0.0	197.2
Amount of partial collateralisation	0.0	46.5	2.0	0.0	48.5

<sup>1)</sup> Collateral is only considered upon utilisation.

HSBC Trinkaus uses internally-developed IT systems to record and monitor loan collateral. The allocation of the collateral to a credit line is carried out in the line system.

Where financial guarantees are provided, the accounts and securities accounts pledged are recorded and valued daily using a programme which links the key data of the guarantees to the account and securities account data. Standard loan-to-value ratios for various financial guarantees are predetermined for the valuation, from which the person responsible can deviate if necessary by making decisions in individual cases (e.g. to avoid cluster risks). If no valuation is available for certain securities, an individual decision is made with the help of a credit analyst as to whether they can be recognised as collateral.

Financial guarantees in the form of pledged accounts and securities accounts at third-party banks are accepted only in exceptional cases. A valuation is carried out only if we receive account statements regularly and promptly from the third-party bank. Our aim is always that the financial guarantees are transferred to us.

Warranties and guarantees are valued on the basis of the amount of the guarantee specified in the contract and the credit standing/rating of the guarantor. In contrast, physical collateral (assigned receivables and rights and transfers of title to objects as security) is not valued according to fixed rules owing to its special features in each individual case. Instead, all of the relevant risk parameters are taken into consideration. For example, when carrying out the valuation, the legal status of the collateral agreement and the credit quality of the receivables assigned are taken into account. With transfers of title as security the location, the realisability of the tangible assets as well as the volatility of the market values are taken into consideration in the valuation. Depending on the result of this analysis, an individual valuation mark-down is determined for each collateral provided.

Land charges should be within a loan-to-value ratio of 50 % (mainly commercial use) or 60 % (mainly residential use) of the lastingly achievable market value determined on the basis of recognised expert methods. For real estate, the market value is based on the net income value as a rule. If residential properties are used mainly privately, the real value can also be applied.

Government and private loan insurance and bank guarantees in particular are considered as collateral in the international business. They are valued at the amount guaranteed.

The collateral provided is examined at regular intervals. With charges on property, the property serving as security is to be revalued after 5 years at the latest. However, if the loan secured by a charge on property exceeds the normal lending framework of 50 % or 60 % of the value of the property serving as collateral, an annual revaluation is required. As regards assignments and transfers of title as security, it is to be determined by the persons responsible how often and to what degree of detail corresponding proof of collateral is to be submitted by the customer.

The collateral value, if necessary allowing for upper limits (to avoid cluster risks), is automatically taken into consideration in the risk statement in respect of valued collateral.

If the collateral requirement for a credit line has not been fulfilled, i.e. either no collateral has been allocated to the credit line in the system or the value of the collateral falls below the minimum value kept in the system, the line system reports that the credit line has been exceeded.

#### (d) Information on credit quality

##### Loans and advances as well as contingent liabilities and loan commitments

in €m	31.12.2011				
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments	Total
Neither overdue, nor impaired	1,857.6	3,666.5	1,740.8	5,144.9	12,409.8
Overdue, but not impaired	0.0	0.8	0.0	0.0	0.8
Individually impaired *	0.0	49.9	5.3	11.5	66.7
<b>Total</b>	<b>1,857.6</b>	<b>3,717.2</b>	<b>1,746.1</b>	<b>5,156.4</b>	<b>12,477.3</b>

in €m	31.12.2010				
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments	Total
Neither overdue, nor impaired	1,402.9	3,001.3	1,299.0	3,741.7	9,444.9
Overdue, but not impaired	0.0	2.9	0.1	0.0	3.0
Individually impaired *	0.0	85.4	6.3	10.2	101.9
<b>Total</b>	<b>1,402.9</b>	<b>3,089.6</b>	<b>1,305.4</b>	<b>3,751.9</b>	<b>9,549.8</b>

\* including the setting-up of credit risk provisions

##### Trading assets and financial assets (exclusively bonds)

The following overviews are based on the results of external rating agencies (as a rule Standard and Poor's). It is taken into consideration that external issue ratings are

available on a regular basis only for bonds and other fixed-interest securities. Should different rating agencies arrive at differing valuations of the same financial assets, the lower value is reported.

in €m	31.12.2011			31.12.2010		
	Trading assets	Financial assets	Total	Trading assets	Financial assets	Total
AAA	1,898.4	1,705.1	3,603.5	2,136.7	1,209.0	3,345.7
AA+ to AA-	2,151.1	1,546.2	3,697.3	1,854.3	1,182.0	3,036.3
A+ to A-	70.9	148.4	219.3	403.3	193.4	596.7
BBB+ to BBB-	42.4	180.9	223.3	29.2	142.1	171.3
Lower than BBB-	12.1	43.6	55.7	14.8	26.0	40.8
No rating	137.1	144.8	281.9	152.4	23.8	176.2
<b>Total</b>	<b>4,312.0</b>	<b>3,768.9</b>	<b>8,080.9</b>	<b>4,590.7</b>	<b>2,776.3</b>	<b>7,367.0</b>

## OTC derivatives

For an assessment of the credit quality of OTC derivatives, their market values are classified by counterparty below:

		31.12.2011		31.12.2010	
		in €m	in %	in €m	in %
OECD	Banks	1,357.0	69.5	1,077.8	74.8
	Financial institutions	312.0	16.0	135.1	9.4
	Other	282.3	14.5	222.5	15.5
Non-OECD	Banks	0.7	0.0	3.8	0.3
	Financial institutions	0.0	0.0	0.0	0.0
	Other	0.0	0.0	0.3	0.0
<b>Total</b>		<b>1,952.0</b>	<b>100.0</b>	<b>1,439.5</b>	<b>100.0</b>

### (e) Information on exposures which are neither overdue nor impaired

We determine the quality of the loans and advances including contingent liabilities and loan commitments which are neither overdue nor impaired by means of an internal rating procedure (see section Counterparty risk (a) Organi-

sation of the credit processes). Allowing for risk-reducing elements, such as collateral, the loan exposures can be mapped onto 7 credit categories. As a rule, credit categories 1 to 5 comprise exposures which are neither overdue nor impaired. The credit quality as at the balance sheet date was as follows:

in €m	31.12.2011				
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments	Total
Credit categories 1–2	1,784.1	1,681.9	940.1	2,993.2	7,399.3
Credit categories 3–4	73.5	1,969.2	791.0	2,108.8	4,942.5
Credit category 5	0.0	15.4	9.7	42.9	68.0
<b>Total</b>	<b>1,857.6</b>	<b>3,666.5</b>	<b>1,740.8</b>	<b>5,144.9</b>	<b>12,409.8</b>

in €m	31.12.2010				
	Loans and advances to banks	Loans and advances to customers	Contingent liabilities	Loan commitments	Total
Credit categories 1–2	1,327.3	971.5	608.2	1,404.5	4,311.5
Credit categories 3–4	75.6	1,946.9	683.4	2,335.8	5,041.7
Credit category 5	0.0	82.9	7.4	1.4	91.7
<b>Total</b>	<b>1,402.9</b>	<b>3,001.3</b>	<b>1,299.0</b>	<b>3,741.7</b>	<b>9,444.9</b>

As in the previous year, no restructuring of individual loan agreements was carried out.

**(f) Information on loans and advances which are overdue, but not impaired**

The Bank's loans and advances which have not been impaired although overdue amounted to € 0.8 million in the year under report (2010: € 2.9 million) and are exclusively to customers. € 0.5 million (2010: € 2.4 million) is the result of the purchase of credit-insured foreign accounts receivable outside the European Union. The fair value of the collateral stood at € 0.1 million in the year under report (2010: € 0.5 million). We have not carried out a corresponding impairment as we assume that the loans can be repaid in full.

There are also overdue, but not impaired claims resulting from excess interest of € 0.3 million (2010: € 0.5 million) for which adequate collateral is also available in the form of charges on property. The fair value of this collateral was € 0.3 million (2010: € 0.5 million).

**(g) Information on exposures for which credit risk provisions have been set up**

HSBC Trinkaus sets up a net loan impairment provision as soon as there are objective, substantial indications suggesting the reduction in value of a financial asset. Such in-

dications include the following: substantial payment difficulties on the part of the debtor as well as the associated concessions we make in respect of the borrowers, breaches of contract such as default or arrears in respect of interest and redemption payments, the risk of insolvency proceedings or other capital restructuring requirements, the disappearance of an active market for this financial asset, other indications suggesting that the recoverable sum is below the book value for this type of loan as well as the substantial reduction in value of the loan collateral if the loan is to be based essentially on the collateral. If one of these indications exists, we correct the probable recoverable sum. If no statistically reliable comparative data are available, the probable recoverable sum is to be estimated on the basis of a competent, experienced assessment by the person responsible. Problematic exposures, for which net loan impairment and other credit risk provisions have been set up, are classified as being in default in terms of their credit rating and are therefore automatically shown in the credit ratings 6 and 7. In order to allow for country risks, net loan impairment and other credit risk provisions can also be set up for exposures with higher credit ratings. These stood at € 1.3 million in the year under report (2010: € 2.4 million).

The following table shows the individually impaired financial assets as at the balance sheet date:

in €m	31.12.2011			31.12.2010		
	Loans and advances to banks	Loans and advances to customers	Total	Loans and advances to banks	Loans and advances to customers	Total
<b>Book value before IAI*</b>						
Credit category 6	0.0	44.9	44.9	0.0	65.9	65.9
Credit category 7	0.0	5.0	5.0	0.0	19.5	19.5
<b>Total</b>	<b>0.0</b>	<b>49.9</b>	<b>49.9</b>	<b>0.0</b>	<b>85.4</b>	<b>85.4</b>
<b>IAI*</b>						
Credit category 6	0.0	15.1	15.1	0.0	23.5	23.5
Credit category 7	0.0	1.5	1.5	0.0	14.7	14.7
<b>Total</b>	<b>0.0</b>	<b>16.6</b>	<b>16.6</b>	<b>0.0</b>	<b>38.2</b>	<b>38.2</b>
<b>Book value after IAI*</b>	<b>0.0</b>	<b>33.3</b>	<b>33.3</b>	<b>0.0</b>	<b>47.2</b>	<b>47.2</b>

\* IAI: Individually assessed impairments

Within the scope of credit risk provisions HSBC Trinkaus also makes credit provisions for individual contingent liabilities and loan commitments as a rule. In the year under report, however, there was no need to make such credit provisions, which amounted to € 2.1 million the previous year.

In addition to individually assessed impairments, the Bank also carries out collectively assessed impairments. These stood at € 10.5 million (2010: € 10.9 million) for loans and advances and € 3.2 million (2010: € 3.6 million) for contingent liabilities and loan commitments.

Impairments on financial assets came to € 35.9 million (2010: € 34.8 million) as at the balance sheet date.

#### (h) Information on collateral received

For loans and advances which have been individually impaired, the Bank holds collateral and other credit improvements especially in the form of securities and land charges, the value of which totalled € 18.7 million (2010: € 21.4 million) in the year under report.

#### (i) Realisation of collateral received and drawing on other credit improvements

As was already the case the previous year, no collateral received and other credit improvements were realised and drawn on, respectively, in the 2011 financial year.

#### (j) Information on credit risk concentration

There can be a concentration in the area of credit risks if a large number of debtors pursue similar activities or operate in the same geographical region. The ability of all of these debtors to fulfil their financial obligations to HSBC Trinkaus is then influenced strongly by individual changes in the economic situation, political framework or other conditions. The Bank therefore monitors its credit risk concentrations by sector and region. Furthermore, there can also be a concentration of the credit risk if a disproportionately large share of the credit risk is concentrated on individual borrowers. The Bank therefore also monitors the concentration on individual addresses in order to achieve the greatest possible distribution of the risk in the lending business.

As at the balance sheet date the Bank's theoretical maximum default risk breaks down as follows:

	31.12.2011		31.12.2010	
	in €m	in %	in €m	in %
<b>Risk concentration by sector</b>				
Banks and financial institutions	10,334.2	39.5	9,401.4	41.6
Companies and self-employed professionals	10,191.0	39.0	8,352.7	37.0
Public sector	5,245.1	20.1	4,456.6	19.7
Employed private individuals	352.9	1.4	382.9	1.7
<b>Total</b>	<b>26,123.2</b>	<b>100.0</b>	<b>22,593.6</b>	<b>100.0</b>

	31.12.2011		31.12.2010	
	in €m	in %	in €m	in %
<b>Risk concentration by region</b>				
Domestic	16,606.3	63.5	14,806.3	65.6
Other EU (including Norway and Switzerland)	7,436.7	28.4	6,514.8	28.8
Asia	719.7	2.8	449.0	2.0
North America	676.3	2.6	616.1	2.7
Rest of Europe	520.8	2.0	28.3	0.1
South America	123.3	0.5	118.7	0.5
Africa	23.4	0.1	43.5	0.2
Oceania	16.7	0.1	16.9	0.1
<b>Total</b>	<b>26,123.2</b>	<b>100.0</b>	<b>22,593.6</b>	<b>100.0</b>

The breakdown by sector shows that the maximum default risk exists vis-à-vis banking organisations on the one hand and companies and self-employed professionals on the other. Other units of the HSBC Group account for € 3,874.1 million (2010: € 1,633.2 million) of the default risk vis-à-vis banking organisations.

It can be seen from the breakdown by region that a substantial part of the loans and advances is concentrated in Germany as well as in EU countries including Norway and Switzerland.

There was no exposure to Greece, Ireland, Portugal, Spain, Italy and Hungary as at 31 December 2011. There was exclusively covered bond exposure vis-à-vis banks in Spain and Ireland amounting to € 82 million and € 31 million, respectively, while there was no exposure vis-à-vis banks in the other states mentioned. In Spain, Italy, Ireland and Hungary there was exposure vis-à-vis non-banks of € 33 million, € 25 million, € 18 million and € 3 million, respectively, while there was no exposure vis-à-vis non-banks in the other states mentioned. It can be summarised that our credit risks vis-à-vis and in the states mentioned are kept within very narrow limits.

#### **(k) Counterparty risk monitoring as required by the supervisory authority**

The Credit Risk Control department acts as the counterparty risk monitoring unit on portfolio level and is responsible for the maintenance, monitoring and further development of the credit risks measurement systems used at HSBC Trinkaus, in particular the Bank's own larger mid-size corporates rating system.

#### **(l) Credit portfolio management**

The Credit Risk Control department is responsible for preparing the internal risk-sensitive assessments of the credit positions (economic RWA) as well as the analysis of the credit risks on portfolio level. For this purpose the Bank applies a simplified portfolio model which uses the credit risk measurement systems established by the Bank within the scope of the IRBA report as input parameters. Parallel to this, the RiskFrontier portfolio model used on HSBC level is applied in order to monitor credit risk concentration. The results of the risk-sensitive analysis of the credit portfolio are included as a credit risk share in the institution-wide Internal Capital Adequacy Assessment Process (ICAAP).

#### **(m) Stress tests**

Both the internal and the external risk-sensitive assessment of the credit portfolio are subjected to various stress test scenarios on a quarterly basis. The stress tests are conceived and the calculation and analysis of the results carried out by the Credit Risk Control department involving the credit department and the corporate banking segment. There is extremely close cooperation with respect to both methods and scenarios with the HSBC Group here as well.

#### **Operational risk**

We define operational risk as the risk of losses caused by fraud, unauthorised activities, errors, negligence, inefficiency or system faults, as well as those caused by external events. Operational risks exist in any area of an organisation and embrace a broad spectrum. Legal risks are also regarded as operational risks.

HSBC Trinkaus has always attached major importance to the reduction of operational risk to a level which is acceptable from the point of view of the costs involved. The Operational Risks and Internal Controls Committee is the central body responsible for the control of operational risks as well as reputational risks across the board within the Bank. The Committee meets every two months and is chaired by the Management Board member responsible for risk controlling. The Committee represents an important element in the Bank's risk management organisational structure and enables the integrated cross-divisional control of operational risks in the Bank and the entire HSBC Trinkaus Group.

The Committee's task is to identify operational risk across the Group, to evaluate and monitor it and to take steps for its control and future avoidance. The business procedures and processes in all of the Bank's divisions and subsidiaries are analysed in collaboration with the respective divisional heads and managing directors as well as the decentralised coordinators for operational risks in order to identify potential risk. The Committee monitors via these and other measures the effectiveness of the internal control environment.

Identified operational risks are evaluated with respect to their loss potential; the probability of these risks occurring is also examined. On this basis the risks are assigned to one of four risk categories. If the Committee identifies major operational risks which it believes are not being monitored, or inadequately so, it decides upon the measures to be taken. For example, the Committee can require the implementation of appropriate supervision measures, or may stipulate that certain products or business procedures and processes should not be undertaken or should be discontinued.

The risks, including their valuation, supervision implemented, measures introduced as well as losses incurred, are formally documented in a system developed by the HSBC Group. The individual business divisions and subsidiaries are responsible for the information recorded reflecting the current risk profile at all times.

As the Group-wide coordinator, the secretary of the Operational Risk and Internal Controls Committee in the Support Function Operational Risk and Internal Controls initiates and monitors the implementation of the Committee's decisions in the Bank including its subsidiaries. The methods, concepts and instruments of operational risk management are constantly refined and developed further in close collaboration with the HSBC Group.

The minutes of the Committee meetings are approved and particularly important points discussed in the Management Board meetings. This ensures that all Management Board members are constantly informed about current developments and the Bank's risk profile.

The reporting system for incidents is a further important instrument for identifying and observing operational risks. All HSBC Trinkaus subsidiaries and branches are also included in the system. All operational problems that lead to significant loss of profit, or which could have done so under unfavourable conditions, must be reported to the Committee's office. This ensures that each incident, including each potential incident, is analysed to establish whether the error was an isolated occurrence or is likely to recur. The Committee then decides how this risk can be reduced if necessary. All operational incidents above a certain pre-set reporting threshold as well as the total of the losses below the reporting threshold are centrally recorded in an incidents database.

The Supervisory Board is informed once a year about the activities of the Operational Risks and Internal Controls Committee. This also includes a statement of overall losses including an explanation of particular occurrences.

In addition to the reporting system for incidents, all staff are asked to report problems connected with operational risk to the Committee's office.

The Management Board attaches major importance to establishing a risk culture in the Group whereby risks are not only identified at an early stage, but are also reported directly and openly. The work carried out by the Committee in recent years has significantly increased the awareness of operational risk among all employees. As a formal organisational unit within the Bank, the Committee provides a central contact point for all issues relating to operational risk as well as reputational risks. In the light of this, regular training is carried out in the various business areas of the Bank. In addition, every new employee has to take part in obligatory training on the topic of operational risk.

HSBC Trinkaus minimises operational risk by the constant control of working processes, security measures and not least by the employment of highly qualified staff. Operational risk is also partly covered by insurance. The processes in the Bank are regularly analysed and improved on an on-going basis. In particular, the Support Function Operational Risk and Internal Controls is also involved in the conception and approval of new products and services in order to ensure that operational risks are identified early on and minimised via suitable measures. Flat hierarchies and direct communication mean that problems can be quickly removed and risk therefore reduced.

Workflow descriptions of the individual business processes stipulate in detail which controls are built into the processes in question. We attach particular importance to the principle of dual control. Workflow descriptions are revised on a regular basis and managed centrally.

HSBC Trinkaus has installed three safeguarding levels to secure the effectiveness of risk management: The first level comprises those responsible for risk and controlling in the business segments and at the subsidiaries which ensure that the key controls are carried out in accordance with the working process descriptions applicable in each case and that the risk is reduced to the degree required



from the cost-benefit point of view. For this purpose all important controls are examined in detail and the results of these examinations formally documented in order to introduce on this basis the necessary improvement measures if required. The Operational Risks and Internal Controls Committee and the Support Function Operational Risk and Internal Controls as executing body monitor the valuation of risks and the execution of the controls in the second level. The third level is covered by the Bank's internal audit department within the scope of carrying out audit reports.

Information risks are managed within the scope of the Business Information Risk Officer (BIRO) programme which is controlled by a central committee, the Group's Information Security Risk Committee. The Committee meets on a quarterly basis to discuss relevant issues, stipulate key points of emphasis and decide upon corresponding measures.

The specialist management of the BIRO programme is carried out by the Information Security team. So-called Business Information Risk Officers have been appointed in all business segments and at all subsidiaries. This guarantees that information risks are observed from an integral perspective and that alongside technological, also specialist, legal and conceptional issues are taken into consideration. The Chief Information Security Officer is responsible for drawing up and implementing a strategy and corresponding programmes which ensure that the Group's data and information are adequately protected.

The observance of the HSBC Group's guidelines is guaranteed by the integration of the head of the BIRO programme into the corresponding activities of the HSBC Group.

## Market risk

Market risk is understood as the extent to which the market value of a financial instrument can rise or fall to the Bank's disadvantage based on changes to market price parameters. Market risk includes the following three types of risk: exchange-rate risk, interest-rate risk (including credit spread risks) as well as equity and other price risks. Market risks arise at HSBC Trinkaus primarily from interest-rate, equity and foreign exchange trading activities as well as to a lesser extent from commodities where there is no physical delivery.

To measure market risks under normal market conditions we have been using for many years a value-at-risk approach. We understand value-at-risk to be the potential loss which will, with 99 % probability, not be exceeded within one trading day, assuming unaltered trading positions. Our value-at-risk model is based on an historical simulation of risk factors over a period of 500 equally-weighted trading days and covers interest-rate, equity, foreign-exchange and volatility risk (see also Note 5 of the consolidated financial statements "Financial Instruments" for the valuation of the financial instruments included in the model). The complete revaluation of all positions is carried out to reflect changes in the market parameters. With respect to interest-rate risk we consider both general interest-rate risk resulting from a change in the level of market rates and also spread risk between different issuers and issuer categories.

The following are included as risk factors in particular:

- Cash stock prices and stock indices
- Spot exchange rates including gold prices
- Commodity prices (various types of oil, silver)
- Zero interest rates for typical maturities from swap curves
- Credit spreads for various categories, such as Pfandbriefe, federal state bonds and bank bonds with further differentiation by creditworthiness and/or maturity
- Equity and equity index option volatilities for typical maturities
- Foreign-exchange options volatilities for typical maturities
- Volatilities of options on Bundesanleihen for typical maturities
- Cap/floor volatilities for typical maturities
- Swaption volatilities for typical maturities

Issuer-specific, idiosyncratic interest-rate risks are still covered outside the risk model through the credit risk process and controlled via issuer risk limits. They are also covered via the regulatory standard approach in the parent company's trading book.

For the purposes of assuring risk assessment quality, we conduct daily back-testing of the model. This involves comparing the evaluated result for the previous day's trading position with the value-at-risk calculated for that position. Back-testing anomalies were found throughout the Bank for the first time since 2008 in 2011. This continues to suggest that the modelling employed is probably on the conservative side.

The model is basically used for all of the Group's units. These include the trading and investment books of the parent company and the Luxembourg subsidiary as well as the special assets liable to consolidation in the investment book. The following table shows the main sources of market risk: the aggregated trading books of the parent company and the Luxembourg subsidiary.

The total market risk from these two sources is as follows:

in €m	2011			
	31.12.	Average	Minimum	Maximum
Interest-rate risk	1.0	1.4	0.7	2.6
Currency risk	0.1	0.2	0.0	0.8
Equity/index risk	0.8	1.3	0.5	5.7
Credit spread risk	2.7	2.4	1.5	3.7
Commodities risk	0.0	0.0	0.0	0.2
<b>Total potential market risk in the trading book</b>	<b>2.7</b>	<b>3.1</b>	<b>1.7</b>	<b>7.5</b>

in €m	2010			
	31.12.	Average	Minimum	Maximum
Interest-rate risk	2.6	2.4	1.6	3.2
Currency risk	0.3	0.4	0.1	1.2
Equity/index risk	1.8	3.8	1.2	7.9
Credit spread risk	3.7	3.8	3.1	4.3
Commodities risk	0.2	0.0	0.0	0.2
<b>Total potential market risk in the trading book</b>	<b>4.9</b>	<b>8.1</b>	<b>4.9</b>	<b>10.9</b>

Risks relating to interest rates (including general credit spread risks) and equities still represent the Bank's greatest market risks. A 500-day history is used to simulate the risks. There was an increase in the value-at-risk figures in the second half of 2011 owing to the strong market movements as a result of the Eurozone sovereign debt crisis.

The average market risk potential in the regulatory investment book (99 % confidence interval/99-day holding period) came to € 7.3 million (2010: € 7.2 million).

We also use our internal value-at-risk model to quantify the market risks inherent in the special assets managed by our subsidiaries.

The so-called crisis risk amount was also reported for the first time as at 31 December 2011. The underlying period of particular stress on the markets was identified as March 2008 to February 2009. The model used to calculate the crisis risk amount is largely the same as that used to determine the normal value-at-risk. Owing to the major distortions on the stock markets within the stress period, the crisis risk amount is far higher in part than the normal value-at-risk. On average over twelve weeks the mark-up for the trading book of the parent company comes to around 83 % as at 31 December 2011.

Outside the model we continue to employ a number of additional sensitivity, volume and maturity limits in order to avoid concentration risks and also account for those risks which cannot be entirely incorporated into the model. We counteract high levels of uncertainty in the valuation of positions in illiquid markets not only by using limits, but also by making adequate valuation adjustments.

Value-at-risk approaches are unsuitable for calculating losses likely in extreme market situations or in the case of previously unobserved occurrences. To cater for this, we supplement our full risk identification system with daily stress testing in order to assess the impact of extreme market movements on the value of positions. The stress testing results form part of the daily risk reporting process and provide us with valuable additional information. Separate limits are defined for the losses arising from the stress tests and the scenarios we use are regularly checked and adjusted.

Compliance with all risk limits is monitored every day by Market Risk Control on the basis of overnight positions. The limits used here are assigned to the trading divisions once a year by the Asset and Liability Management Committee on the basis of their capacity to assume risk and are adjusted, if necessary, during the course of the year. Market Risk Control also monitors the limits prescribed by HSBC and reports risk figures in relation to the Group-wide aggregation of market risk to HSBC.

### **Liquidity risk**

We understand liquidity risk as the danger of insolvency which arises if long-term assets are financed on a short-term basis or unexpected outflows of funds cannot be compensated. We also understand it as possible losses which could arise as the result of active measures against impending insolvency.

We reduce the risk of insolvency by maintaining high surplus liquidity and by the responsible structuring of assets and liabilities. We have stipulated our risk tolerance with respect to liquidity risks based on quantitative and qualitative criteria in our liquidity risk strategy, predetermining stringent standards as regards liquidity and funding ratios in order to remain solvent at all times, even in the case of extreme events. In order to detect liquidity risk early on, threshold values are defined for the various observation parameters which lead to escalation procedures if they are exceeded. These are specifically defined in our three-stage emergency liquidity plan which can be activated at short notice.

While operating liquidity management is carried out by the treasury team, the Asset and Liability Management Committee (ALCO) is responsible for the Bank's structural liquidity risk within the scope of limits agreed with HSBC. ALCO's duties include monitoring liquidity and funding ratios as well as the regular adjustment of the liquidity risk strategy including the emergency liquidity plan and transfer pricing for liquidity within the Bank.

Our liquidity risk strategy envisages that the Bank can finance itself without recourse to HSBC at any time and can also fulfil its payment obligations in an emergency without HSBC's support. Central bank liquidity is not to be used as a lasting source of financing. The constant raising of funds from institutional investors on the capital market (whole-sale funding) is of no significance for our liquidity management. We therefore have no medium-term note or commercial paper programme and do not issue certificates of deposit either.

Our subsidiary in Luxembourg is included in liquidity risk management on Group level according to the procedures and parameters used throughout the Group. In addition, as an individual institution it controls its liquidity independently, thereby fulfilling all the regulatory requirements in Luxembourg.

The following overview shows the Bank's key liquidity ratio in accordance with the Liquidity Ordinance (LiqV), which by far exceeds the statutory requirements:

in %	Liquidity ratio in accordance with LiqV	
	2011	2010
31.12.	2.13	2.13
Minimum	1.68	1.75
Maximum	2.27	2.63
Average	2.03	2.13
Reference value in accordance with Section 2 LiqV	1.00	1.00

Standardised worldwide methods are used for strategic liquidity management within the HSBC Group. Liquidity forecasts which are derived from six different stress scenarios are the central control instrument. The scenarios differ in terms of the various assumptions with respect to outflows of liquidity and changes in the value of securities which can be linked with institute-specific or market-wide results. In each scenario we forecast the cumulative change in the cumulative inflows and outflows from the commercial business across several maturity bands. In the institution-specific scenarios, the full deduction of the customer deposits not qualified as core deposits within three months and the drawing on uncalled loan commitments of up to 35 % in the same period is assumed. Resulting cash deficits have to be balanced out by the liquidation of the liquidity cushion of marketable assets.

The minimum amount of the cushion required for this in an institution-critical scenario therefore also secures the Bank's ability to pay at all times even given unexpected

outflows of funds. The institution-critical scenario is based on an annual risk valuation in cooperation with HSBC on the basis of internal and external factors and is supplemented by an in-house scenario which is meant to show the effect of a rating downgrade of up to three rating notches.

The cumulative net balance of the liquid funds after three months and after liquidation of the liquidity cushion in the institution-critical scenario is the most important internal liquidity ratio. It must be clearly positive.

Large parts of the liquidity cushion consist of public sector bonds, Pfandbriefe and other eligible assets which are not used otherwise as collateral and for which we carry out different valuation mark-downs depending on the scenario. Securities or cash collateral transferred to third parties for collateral or margin obligations are not included in the liquidity cushion. As at 31 December 2011 we had deposited most of these assets with a collateral value of € 4.74

billion at the Bundesbank (2010: € 4.34 billion) giving us potential access to central bank loans to this extent. We did not participate in any new ECB main refinancing transactions in 2011.

In order to determine the extent of the losses which could arise from emergency measures to prevent insolvency, we take possible cash outflows in the institution-critical stress scenario as a base and look at various alternative courses of action and market situations. The result is part of the institute-wide Internal Capacity Adequacy Assessment Process (ICAAP) where it reduces the available risk cover assets.

The advances/core funding ratio represents the most important funding ratio. Owing to a different method of calculation, this ratio is higher than the ratio of loans and advances to customers/customer deposits, which can be derived from the balance sheet. This ratio stood at 29.9 % (2010: 30.4 %) at the end of the year versus an advances/core funding ratio of 56.1 % (2010: 52.1 %).

We monitor the maturity matching of the financing structure based on regular liquidity outflow analysis in which the liquidity commitment is broken down into contractual and expected terms. The dependence on individual creditors is also measured based on concentration ratios for the 20 largest creditors. There is no material concentration with respect to assets and financing sources or in respect of foreign currencies.

We issue no funding tools which provide for accelerated repayment depending on the deterioration of credit quality or which can be settled by the delivery of treasury shares instead of in cash. Obligations to provide collateral in cash or in securities can arise unilaterally in connection with stock exchange transactions which are settled via central counterparties or bilaterally with OTC transactions which are concluded under outline agreements with collateral riders. The individual transactions are usually subject to netting agreements. As of 31 December 2011 the Bank had received € 107.4 million (2010: € 57.0 million) and provided € 644.2 million (2010: € 296.2 million) in cash collateral under such collateral riders.

In order to show the Bank's liquidity risk, an overview of the residual terms of the financial liabilities is given in the table below. The cash flows agreed by contract including future interest payments are reported on an undiscounted basis. Such undiscounted cash flows can deviate from the book value shown in the balance sheet.

in €m		31.12.2011					
			Gross outflow (not discounted)				
	Book value	Σ	< 1mon.	1–3mon.	3–12mon.	12mon.–4y.	> 4y.
Financial liabilities within the balance sheet:							
Deposits by banks	749.6	750.0	729.9	1.3	2.4	16.4	0.0
Customer accounts	12,413.3	12,422.3	10,763.7	924.4	441.8	250.3	42.1
Certificated liabilities	10.0	12.4	0.4	0.0	0.0	1.2	10.8
Trading liabilities (excluding derivatives*)	2,614.6	2,910.8	456.2	146.0	700.8	739.9	867.9
Derivatives in hedging relationships	39.5	49.6	0.0	0.0	0.0	10.6	39.0
Provisions**	103.4	116.0	86.5	0.0	0.0	0.0	29.5
Other liabilities	212.5	213.6	56.4	10.3	112.9	31.9	2.1
Subordinated capital	353.4	563.6	5.7	0.0	0.0	110.3	447.6
Sub-total	16,496.3	17,038.3	12,098.8	1,082.0	1,257.9	1,160.6	1,439.0
Financial liabilities outside the balance sheet:							
Financial guarantees	1,175.7	1,175.7	1,175.7	0.0	0.0	0.0	0.0
Loan commitments	5,156.4	5,156.4	5,156.4	0.0	0.0	0.0	0.0
Total	22,828.4	23,370.4	18,430.9	1,082.0	1,257.9	1,160.6	1,439.0

in €m		31.12.2010					
			Gross outflow (not discounted)				
	Book value	Σ	< 1mon.	1–3mon.	3–12mon.	12mon.–4y.	> 4y.
Financial liabilities within the balance sheet:							
Deposits by banks	1,180.4	1,181.4	1,084.4	3.1	75.4	18.5	0.0
Customer accounts	10,148.0	10,158.6	8,782.4	779.2	345.5	96.6	154.9
Certificated liabilities	10.0	12.8	0.4	0.0	0.0	1.2	11.2
Trading liabilities (excluding derivatives*)	2,997.9	3,289.8	586.4	170.2	888.2	879.5	765.5
Derivatives in hedging relationships	5.7	5.6	0.3	–0.2	2.1	4.2	–0.8
Provisions**	96.5	106.4	84.0	0.0	0.0	0.0	22.4
Other liabilities	214.1	215.3	57.5	29.2	99.0	22.3	7.3
Subordinated capital	378.4	616.4	16.5	0.1	0.0	72.7	527.1
Sub-total	15,031.0	15,586.3	10,611.9	981.6	1,410.2	1,095.0	1,487.6
Financial liabilities outside the balance sheet:							
Financial guarantees	842.3	842.3	842.3	0.0	0.0	0.0	0.0
Loan commitments	3,751.9	3,751.9	3,751.9	0.0	0.0	0.0	0.0
Total	19,625.2	20,180.5	15,206.0	981.6	1,410.2	1,095.0	1,487.6

\* In accordance with the changes to IFRS 7 in March 2009, no derivatives in trading liabilities are included in the liquidity analysis by contractual residual term which do not serve to hedge the Bank's long-term positions.

\*\* Net obligations pursuant to IAS 19 are recognised with their average term.

Analysis of the residual terms shows that most of the financial instruments are due by contract within the first three months of the balance sheet date. However, it is to be taken into consideration that liabilities do not necessarily have to be repaid at the earliest possible point in time and that uncalled loan commitments are not drawn on in full.

IFRS 7 requires that gross outflows are shown by contractual residual term. The informative value of such a table showing the Bank's liquidity is only limited as the expected

cash flows are used above all for effective management. Internal liquidity management as well as the supervisory ratios give a far better insight into the liquidity position here.

Since the Bank's liquidity situation cannot be adequately reproduced by looking at liabilities alone, the book values of the main assets and liabilities by residual term which will lead to future cash outflows or inflows are set against each other in the table below:

in €m		< 1mon.	1–3mon.	3–12mon.	12mon.–4y.	> 4y.	No fixed term	Total
Loans and advances to banks	31.12.2011	1,522.3	127.9	207.4	0.0	0.0	0.0	1,857.6
	31.12.2010	1,199.2	191.2	12.5	0.0	0.0	0.0	1,402.9
Loans and advances to customers	31.12.2011	1,979.5	1,029.3	567.7	125.6	15.1	0.0	3,717.2
	31.12.2010	1,642.2	863.5	400.6	165.1	18.2	0.0	3,089.6
Trading assets* / **	31.12.2011	9,852.3	0.0	0.0	0.0	0.0	0.0	9,852.3
	31.12.2010	10,129.7	0.0	0.0	0.0	0.0	0.0	10,129.7
Financial assets	31.12.2011	147.3	191.2	275.7	1,791.0	1,544.6	214.9	4,164.7
	31.12.2010	291.3	32.7	609.5	1,267.7	868.6	236.1	3,305.9
Other assets	31.12.2011	4.1	0.0	6.2	0.0	0.0	202.8	213.1
	31.12.2010	0.4	0.0	9.7	0.0	0.0	193.6	203.7
Total	31.12.2011	13,505.5	1,348.4	1,057.0	1,916.6	1,559.7	417.7	19,804.9
	31.12.2010	13,262.8	1,087.4	1,032.3	1,432.8	886.8	429.7	18,131.8

in €m		< 1mon.	1–3mon.	3–12mon.	12mon.–4y.	> 4y.	No fixed term	Total
Deposits by banks	31.12.2011	729.8	1.3	2.4	16.1	0.0	0.0	749.6
	31.12.2010	1,084.1	3.1	75.1	18.1	0.0	0.0	1,180.4
Customer accounts	31.12.2011	10,763.2	923.3	440.4	246.1	40.3	0.0	12,413.3
	31.12.2010	8,781.8	778.3	344.4	95.0	148.5	0.0	10,148.0
Certificated liabilities	31.12.2011	0.0	0.0	0.0	0.0	10.0	0.0	10.0
	31.12.2010	0.0	0.0	0.0	0.0	10.0	0.0	10.0
Trading liabilities* / **	31.12.2011	5,386.5	0.0	0.0	0.0	0.0	0.0	5,386.5
	31.12.2010	5,194.3	0.0	0.0	0.0	0.0	0.0	5,194.3
Provisions***	31.12.2011	86.5	0.0	0.0	0.0	16.9	0.0	103.4
	31.12.2010	83.7	0.0	0.0	0.0	12.8	0.0	96.5
Other liabilities	31.12.2011	56.4	10.3	112.4	31.4	2.0	0.0	212.5
	31.12.2010	214.1	0.0	0.0	0.0	0.0	0.0	214.1
Subordinated capital	31.12.2011	5.7	0.0	0.0	91.9	255.8	0.0	353.4
	31.12.2010	16.5	0.1	0.0	60.6	301.2	0.0	378.4
Total	31.12.2011	17,028.1	934.9	555.2	385.5	325.0	0.0	19,228.7
	31.12.2010	15,374.5	781.5	419.5	173.7	472.5	0.0	17,221.7

\* Trading assets and liabilities are reported in accordance with the intended holding period in the shortest maturity band, irrespective of the actual maturity. A breakdown by residual term for derivatives pursuant to their legal maturities can be found in Note 59.

\*\* excluding derivatives which are part of a hedging relationship

\*\*\* Net obligations pursuant to IAS 19 are recognised with their average term.

# The ICS in the Accounting Process

## General

The Internal Control System (ICS) is an integral part of our risk management system. The requirements pursuant to section 289 para. 5 and section 315 para. 2 German Commercial Code (HGB) relating to the explanation of the main features of the internal control and risk management system with regard to the accounting process are to be fulfilled here.

The ICS with regard to the accounting process takes into account the principles, procedures and measures to guarantee the observance of all the statutory requirements and the provisions of the Articles of Association to this effect. It ensures that a true and fair view of the company's assets and liabilities, along with its financial position and earnings situation, determined in accordance with generally accepted accounting principles is presented. The controls implemented shall guarantee with reasonable assurance that the individual and consolidated financial statements are drawn up in compliance with the provisions.

Through the establishment and further development of our internal control system, adequate, but not absolute certainty with respect to the fulfilment of the control targets can be achieved. This means on the one hand that the establishment of internal controls is determined by their cost:benefit ratio. On the other, the implementation of the ICS by our employees entails the risk of human error when executing activities. Furthermore, errors can arise with respect to estimates or the exercise of discretionary powers. Misstatements in the annual financial statements cannot therefore be uncovered or prevented with absolute certainty.

We define an issue as material if the assessment of the annual financial statements by the reader of the financial report and the quality of the accounting information were to be impaired by the absence of this information and if the picture given of the company's assets and liabilities, along with its financial position and earnings situation, were incorrect.

The Internal Control System on company level is documented comprehensively and examined and updated annually within the scope of the requirements under the US Sarbanes Oxley Act (SOX), which is indirectly applicable to us as well through the listing of the HSBC shares in New York. HSBC Trinkaus follows the principles of responsible

company management and company monitoring as laid down in the German Corporate Governance Code. Pursuant to section 161 German Stock Corporation Act (AktG) the Management Board and Supervisory Board declare on an annual basis that the recommendations of the "Government Commission on the German Corporate Governance Code" were and are complied with and which recommendations were or are not applied and for what reason. This declaration is part of the corporate governance statement pursuant to section 289a German Commercial Code (HGB) which is published on our homepage ([www.hsbctrinkaus.de](http://www.hsbctrinkaus.de)).

In addition, we have formulated a code of conduct in writing which expresses our understanding of values and our behavioural standards. The Management Board and all employees have committed themselves to this in writing. We have also laid down a detailed compliance concept in writing.

## Organisational structure

The organisational structure of the Bank including the Support Functions and the responsibilities within the Management Board are presented in the chapter entitled "The Business Divisions". Accounting at the Bank is primarily the responsibility of the Support Functions Accounting and Controlling.

The Support Function Accounting is responsible for accounting according to HGB (individual financial statements of the parent company) and according to IFRS (consolidated financial statements of the HSBC Trinkaus Group and subgroup financial statements for HSBC Bank plc, London). The tax department, the accounting of the main German subsidiaries as well as regulatory reporting are also assigned to the Support Function Accounting.

The Support Function Controlling is responsible for the internal Management Information System (MIS) which consists essentially of profit contribution accounting, cost centre accounting, customer costing as well as planning and budgeting.

The Support Function Market Risk Control (MRC) is responsible for determining the market and fair values of financial instruments. Where available, market prices publicly quoted on an active market are taken as a base, otherwise the values are determined on the basis of rec-



ognised valuation methods. The prices determined in this way are included in the back office and accounting systems via automated interfaces on a same-day basis. The selection of the data sources used as well as the assignment of the valuation parameters used and the valuation methods to be applied are carried out by Market Risk Control independently of trading. Essential matters relating to the valuation are discussed in the monthly Valuation Committee meetings. The Chairman of the Committee is the Management Board member responsible for Accounting. Further members include the heads of MRC and Accounting as well as the Chief Operating Officer Markets as the representative of the trading departments.

The company's annual financial statements and management report as well as the consolidated financial statements and group management report are drawn up by Accounting and the Management Board. The key figures of the annual financial statements and the consolidated financial statements are discussed in the February meeting of the Supervisory Board. In a second meeting the annual financial statements and the management report as well as the consolidated financial statements and the group management report are approved by the Supervisory Board and hence adopted. On the basis of the adopted annual financial statements the Annual General Meeting makes the resolution over the appropriation of profit available for distribution.

The annual financial statements including the management report as well as the consolidated financial statements including the group management report and the interim reports are published electronically in the Federal Gazette (Bundesanzeiger).

The Supervisory Board has formed an Audit and Risk Committee from its members. According to the rules of procedure, its responsibilities include examining the independence of the proposed external auditors, mandating the external auditors to audit the annual financial statements and consolidated accounts, determining the focus of the audit and arranging the fee contract with the external auditors, taking measures to monitor the independence of the external auditors, preparing for the examination of the annual financial statements and consolidated accounts by the Supervisory Board as well as key accounting and basic risk-management issues. Further responsibilities are laid down in the Terms of Reference and comprise in particular

the discussion of the findings of the internal audit department, of compliance-relevant matters and other issues relevant for the Internal Control System. Wolfgang Haupt, Düsseldorf, was Chairman of the Audit and Risk Committee until 31 December 2011. Further members at this time were Deniz Erkman, Krefeld, Dr. Hans Michael Gaul, Düsseldorf, and Harold Hörauf, Eggstätt.

The external auditors are elected at the Annual General Meeting for the current financial year. The external auditors are appointed by the Audit and Risk Committee of the Supervisory Board observing the provisions of section 318 ff. German Commercial Code (HGB). In addition, the external auditors explain their audit programme together with the main points of the audit and prove their independence in an Audit and Risk Committee meeting. In a further Audit and Risk Committee meeting the external auditors explain their main audit procedures and findings. At the meeting of the Supervisory Board at which the annual financial statements are adopted, the external auditors explain their main audit procedures and findings to the entire Supervisory Board.

In accordance with the provisions of the Minimum Requirements for Risk Management (MaRisk) published by the Federal Financial Supervisory Authority (BaFin), the internal audit department examines the effectiveness and appropriateness of the Risk Management and Internal Control System on a risk-oriented and process-independent basis. In order to carry out its duties, the internal audit department has the right to full and unlimited information regarding all processes and IT systems used.

## IT systems

The financial statements of HSBC Trinkaus & Burkhardt AG according to HGB as well as the MIS are based substantially on integrated accounting. This involves a self-developed mainframe programme package which essentially provides data and interim results for the daily, monthly and annual financial statements including the income statement as well as for cost centre accounting and customer costing. Integrated accounting guarantees that there is a close connection between accounting and the MIS. Accounting according to IFRS for HSBC Trinkaus & Burkhardt AG is also featured in integrated accounting via separate company codes.

Various input systems for settling the different business transactions automatically transfer the accounting records for these business transactions (machine registers) to integrated accounting. The settlement of the business transactions and therefore the utilisation of the input systems is carried out in the various specialised back office areas on a decentralised basis (for example securities transactions in GEOS by HSBC Transaction Services GmbH, exchange-traded derivatives in Rolfe & Nolan by Treasury and Derivatives Operations, etc.). Manual registers are required only in exceptional cases.

Both external standard software and accounting entry programmes developed by the Bank itself as well as individual data processing programmes (Microsoft Excel and Access) are used to complement integrated accounting. The programmes are used to determine accounting data which are then transferred to integrated accounting. They consist essentially of systems for entering and recording provisions, entering and paying incoming invoices, drawing up outgoing invoices and entering simple booking records as well as applications for account reconciliation, investment accounting and the presentation of the development of fixed assets and summary of movements in provisions.

Accounting for the subsidiaries is carried out in each case in a standard software solution provided by an external software supplier and serves primarily the preparation of the individual financial statements of the respective subsidiary according to commercial law.

Consolidation is based substantially on TuBKons, an access programme package developed by the Bank itself, and the data stored in a DB2 system. Debt, expense and income as well as capital consolidation and the elimination of inter-company gains is carried out in TuBKons based on the import from integrated accounting, the various import systems with the required transaction details as well as the accounting carried out for all main subsidiaries (including the special funds liable to consolidation). Reconciliation from HGB to IFRS figures is also carried out for the subsidiaries and all group valuation measures presented.

## **General structure of the ICS**

The main principles for the structure of the ICS with regard to the accounting process are:

### **(a) Functional separation**

Customer contact and business transactions are clearly separated from all downstream processes in operational terms up to Management Board level. In addition to the internal audit department, HSBC Transaction Services GmbH is of particular importance with regard to the accounting process. It is responsible among other things for the reconciliation of all loro and nostro accounts, reconciling the front office systems with the back office systems as well as reconciling all trade confirmations received with the trade confirmations of the various back office areas. The results of reconciliation are reported to the Management Board member responsible for accounting on a monthly basis.

### **(b) Principle of dual control and authority rules**

Each entry must be verified by a second person. The permissions for this are geared towards the experience and specialist knowledge of the individual employees and regularly updated in the IT systems. They are examined by the respective divisional heads on a regular basis.

### **(c) Professional skills of the employees**

The quantitative and qualitative staffing in Accounting and Controlling is appropriate. The employees have the required knowledge and experience depending on their area of responsibility. This is examined within the scope of the annual planning process and considered accordingly in both the staff appointment scheme and the training budget.

### **(d) Access authorisations**

Differentiated system access authorisations have been established for integrated accounting as well as all other main systems in accounting to protect against unauthorised access.

## **Specific components of the ICS**

In addition to the general principles, specific measures and controls have also been established with respect to the requirements of the accounting process.

### **(a) Accounting guidelines**

The statutory requirements and relevant accounting standards are specifically defined in accounting guidelines and workflow descriptions which are examined regularly and

updated if required. These also include detailed guidelines of the HSBC Group which are laid down in writing in several manuals and updated regularly. By way of standard, the observance of the workflow descriptions is part of the examination of the division responsible in each case by the internal audit department.

#### **(b) Plausibility checks for all registers**

During the processing of a register, various plausibility checks are carried out by the system. The plausibility checks lead either to the entry being rejected or to entries with default settings or to an error log which is processed the next day.

#### **(c) Reconciliation of the back office systems**

All derivatives and securities transactions as well as all money market transactions are reconciled between the front and back office systems by a separate department of HSBC Transaction Services GmbH on a daily basis. Any differences are clarified the next day.

#### **(d) Depositary reconciliation**

Reconciliation with all depositaries is carried out on a monthly basis for all securities portfolios. In addition, daily reconciliation is carried out between the securities nostro system and the corresponding general ledgers for proprietary holdings. The results of reconciliation are reported to the Management Board member responsible for accounting on a monthly basis.

#### **(e) Internal accounts and securities accounts**

All balances and holdings on internal accounts and securities accounts are broken down in detail and confirmed by the responsible divisions on a monthly basis. Particular attention is paid to the settlement and clearing accounts which are also subject to unannounced examinations. The results of reconciliation are reported to the Management Board member responsible for accounting on a monthly basis.

#### **(f) Reconciliation with affiliated companies**

All transactions within the HSBC Trinkaus Group are consolidated on a monthly basis. Any differences arising are recorded and clarified. Transactions with other companies from the HSBC group are presented separately in the monthly report to HSBC and automatically consolidated by HSBC. Any substantial differences arising are reported to both companies concerned on a quarterly basis and are to be promptly clarified.

#### **(g) Account statements and confirmations of open transactions**

HSBC Transaction Services GmbH sends out annual account statements for all customer accounts. For open transactions, in particular OTC derivatives (including foreign exchange transactions), the internal audit department separately reconciles all outstanding transactions with a random sample of counterparties on an annual basis.

#### **(h) Reconciliation between Accounting and Controlling**

As the preparation of the financial statements and the MIS are collectively based on integrated accounting, the monthly reconciliation between Controlling and Accounting is a central component of the ICS with regard to the accounting process. This ensures that all substantial errors are quickly recognised and corrected.

As part of the cost centre accounting, the administrative expenses according to the income statement are allocated in the MIS to the divisions incurring the costs and compared with the budgeted figures. Larger deviations are to be explained by the responsible divisional heads at least on a quarterly basis.

Net interest and net fee income according to the income statement are also reconciled with customer costing. Customer costing is made available to the customer service officers and the divisional heads of the divisions servicing customers on a monthly basis. It is the main control instrument for all divisions servicing customers. Implausible and conspicuous features are promptly clarified between Controlling and the customer division.

#### **(i) Reconciliation between Market Risk Control und Accounting**

Market Risk Control determines the trading result per trading desk on a daily basis. The results are reconciled in Accounting each month with the revenues of the trading departments in accordance with profit contribution accounting. All differences are analysed down to instrument level, the main differences being promptly discovered and corrected.

#### **(j) Analysis of special business transactions**

The customer-servicing divisions report all special business transactions to Accounting and Controlling on a monthly basis in order to ensure that they have been entered correctly and promptly in accounting. Accounting

also analyses all main items under net other operating income and expenses and income from financial assets on a monthly basis.

**(k) Plausibility checks**

All general ledgers of the income statement are checked for plausibility in an initial step on a monthly basis by comparing them with prior periods and with the budgeted figures. Any irregularities and discrepancies are clarified immediately in cooperation with Accounting and Controlling.

**(l) Overall reconciliation of the income statement**

The preliminary monthly result is discussed between the responsible Management Board member and the heads of Accounting and Controlling before the accounts are closed. Direct contact between all the main decision-makers is an important element of the internal control process in a Bank of our proportions. Any implausibilities are promptly discussed and clarified. All points still open are also discussed and the responsibility and timeframe for clarifying and dealing with them agreed.

**(m) Discussion of the monthly results by the Management Board**

Immediately after completion of the monthly income statement the results are sent to the Management Board member responsible for accounting. He forwards the key data of the monthly statement together with his comments to the other Management Board members for discussion in the next Management Board meeting. The discussion by the Management Board guarantees the initial monthly plausibility check of the group figures by the overall Management Board. In addition, all Management Board members receive a detailed monthly report drawn up and commented on by Controlling which includes the trend in revenues and costs for both the Group as a whole and the main subsidiaries. The revenues and costs are also shown broken down by product and business segment. An additional quarterly report is drawn up by Controlling in the quarterly results, which makes the revenues and costs of all subsidiaries broken down into private and corporate banking business as well as the revenues and costs of all product specialists in the individual client groups transparent for all Management Board members.

# Staff

## Number of employees and persons receiving pensions

We had a total of 2,577 employees at the end of 2011, compared to 2,440 at the end of the previous year. This represents an increase of 5.6 %. At the end of 2011 we were also paying retirement, widow's and orphan's pensions to 571 recipients, compared to 554 at the end of 2010.

## Training activities

A total of 41 highly-motivated apprentices are currently working at the Bank towards professional qualifications in banking, IT and office communication. Four of the banking apprentices are attending a parallel part-time Bachelor of Arts study course in "Business Administration" at the Hochschule für Oekonomie & Management. In addition, four apprentices are working towards investment fund specialist qualifications at our subsidiary Internationale Kapitalanlagegesellschaft mbH, and a further six towards professional office communication qualifications at HSBC Transaction Services GmbH. We are proud to report that a total of 20 trainees in the HSBC Trinkaus Group successfully completed their training in 2011 as well, four with the grade of "very good". We as an employer also received an award from the Düsseldorf Chamber of Commerce and Industry and were therefore honoured for the fifth year in succession for special services in our professional training. We will remain strongly committed to the qualified training of our employees.

## Advanced training

We see the professional and social skills as well as the special commitment of our employees as a decisive competitive advantage. Thanks to targeted personnel development we are in the position to constantly offer our clients major expertise and high quality with respect to our advisory service. The individual advanced training measures we offer our employees are tailored to meet their respective concrete requirements and are developed in advance based on detailed analysis. We work together with selected trainers who are familiar with the Bank's requirements and whose excellent qualifications guarantee the successful implementation as well as the needs-oriented preparation and fine-tuning of the measures. We help our employees to advance by providing individual product- and subject-specific training as well as various measures for

the further development of interdisciplinary expertise. We also offer acquisition training, coaching measures as well as communication and presentation training. We pay particular attention to training, promoting and supporting our senior management members in their special management functions by means of individual development programmes and coaching.

As part of our personnel development we also still give high priority to promoting Bachelor and Master occupational study courses as well as selected specialised training courses. The Frankfurt School of Finance & Management, Deutsche Vereinigung für Finanzanalyse und Asset Management (DVFA), the CFA Institute as well as specialist providers, independent trainers and universities have been our competent partners for these training measures for many years. A broad range of PC and IT seminars as well as foreign language courses (also in preparation for secondments abroad) round off our advanced training activities.

## Performance-related compensation

Performance-related compensation which is in line with the market remains of major importance for motivating our staff regardless of whether they are tariff or non-tariff employees. In this context, long-term compensation components which are in keeping with the Bank's goals and strategies play an important role for our managerial staff.

## Thanks

The Bank continues to owe its success to the special commitment and outstanding performance of our employees, and we would like to take this opportunity to thank them all. We would also like to thank the Employees' Council and the staff representatives on the Supervisory Board for their constructive and trusting cooperation once again over the past financial year.

# Shareholders and Shares

## Capital

At 31 December 2011 the Bank's issued share capital was € 75.4 million divided into 28.1 million no-par value shares as in the previous year. 55.2 % of the share capital was listed on the Düsseldorf and Stuttgart stock exchanges.

All shares have uniform rights and are bearer shares. Each no-par value share carries one vote. The Management Board knows of no limitations affecting voting rights or the transfer of shares.

HSBC Holdings plc, London, indirectly held 80.4 % of the share capital as at the balance sheet date as in the previous year. Landesbank Baden-Württemberg, Stuttgart, still holds a direct share of 18.7 %.

## Share Price and Market Value

During 2011 our share price rose by 1.3 % to € 90.20. The lowest fixing price of the year was € 83.00 and the highest € 96.00. From the initial issue price of DM 190 per DM 50 nominal share (25 October 1985) the exchange price and market capitalisation have developed as follows:

Date	Number of shares	Share price* in €	Market capitalisation in €m
31.12.1985	18,000,000	17.64	317.52
31.12.1990	22,000,000	19.79	435.38
31.12.1995	23,500,000	30.58	718.63
31.12.2000	26,100,000	110.00	2,871.00
31.12.2005	26,100,000	87.50	2,283.75
31.12.2010	28,107,693	89.00	2,501.58
31.12.2011	28,107,693	90.20	2,535.31

\* Adjusted for 1 for 10 stock split on 27 July 1998.

## Dividends

For the 2011 financial year we propose paying a dividend of € 2.50 per share (2010: € 2.50 per share). With a dividend total of € 70.3 million (2010: € 70.3 million) we wish to ensure

that our shareholders participate suitably in the profits we generated in 2011.



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# Consolidated Balance Sheet

## HSBC Trinkaus & Burkhardt

Assets in €m	(Note)	31.12.2011	31.12.2010	Change	
				in €m	in %
Cash reserve	(20)	672.2	336.1	336.1	100.0
Loans and advances to banks	(5, 21)	1,857.6	1,402.9	454.7	32.4
Loans and advances to customers	(5, 22)	3,717.2	3,089.6	627.6	20.3
Net loan impairment provision	(7, 23)	-27.1	-49.1	22.0	-44.8
Trading assets	(5, 24)	9,852.3	10,130.6	-278.3	-2.7
Financial assets	(5, 25)	4,164.7	3,305.9	858.8	26.0
Interests in associates	(26)	65.2	38.0	27.2	71.6
Property, plant and equipment	(10, 27)	79.3	83.1	-3.8	-4.6
Intangible assets	(11, 27)	31.3	38.9	-7.6	-19.5
Taxation recoverable	(15, 28)	8.6	4.3	4.3	100.0
Current		8.6	4.3	4.3	100.0
Deferred		0.0	0.0	0.0	0.0
Other assets	(29)	213.1	203.7	9.4	4.6
<b>Total assets</b>		<b>20,634.4</b>	<b>18,584.0</b>	<b>2,050.4</b>	<b>11.0</b>

Liabilities in €m	(Note)	31.12.2011	31.12.2010	Change	
				in €m	in %
Deposits by banks	(5, 32)	749.6	1,180.4	-430.8	-36.5
Customer accounts	(5, 33)	12,413.3	10,148.0	2,265.3	22.3
Certificated liabilities	(34)	10.0	10.0	0.0	0.0
Trading liabilities	(5, 35)	5,426.0	5,200.1	225.9	4.3
Provisions	(14, 36)	103.4	96.5	6.9	7.2
Taxation	(15, 37)	55.6	66.7	-11.1	-16.6
Current		48.3	52.6	-4.3	-8.2
Deferred		7.3	14.1	-6.8	-48.2
Other liabilities	(38)	212.5	214.1	-1.6	-0.7
Subordinated capital	(39)	353.4	378.4	-25.0	-6.6
Shareholders' equity	(40)	1,310.5	1,289.7	20.8	1.6
Share capital		75.4	75.4	0.0	0.0
Capital reserve		360.0	354.0	6.0	1.7
Retained earnings		695.8	627.2	68.6	10.9
Valuation reserve for financial instruments		88.5	125.3	-36.8	-29.4
Valuation reserve for actuarial profits and losses		-38.5	-29.8	-8.7	29.2
Valuation reserve from currency conversion		-2.8	-1.8	-1.0	55.6
Consolidated profit available for distribution		132.1	139.4	-7.3	-5.2
Minority interests	(41)	0.1	0.1	0.0	0.0
<b>Total equity and liabilities</b>		<b>20,634.4</b>	<b>18,584.0</b>	<b>2,050.4</b>	<b>11.0</b>



# Consolidated Statement of Comprehensive Income

## HSBC Trinkaus & Burkhardt

### Consolidated Income Statement

Income statement in €m	(Note)	2011	2010	Change	
				in €m	in %
Interest income		238.0	198.5	39.5	19.9
Interest expense		89.1	69.8	19.3	27.7
Net interest income	(42)	148.9	128.7	20.2	15.7
Net loan impairment and other credit risk provisions	(7, 44)	-12.7	7.7	-20.4	-
Share of profit in associates	(43)	0.7	0.4	0.3	75.0
Fee income		681.5	683.9	-2.4	-0.4
Fee expenses		296.0	279.9	16.1	5.8
Net fee income	(45)	385.5	404.0	-18.5	-4.6
Net trading income	(46)	116.8	120.4	-3.6	-3.0
Administrative expenses	(47)	474.3	439.3	35.0	8.0
Income from financial assets	(48)	-4.8	-0.6	-4.2	> 100.0
Net other income/expenses	(49)	17.6	4.1	13.5	> 100.0
<b>Pre-tax profit</b>		<b>203.1</b>	<b>210.0</b>	<b>-6.9</b>	<b>-3.3</b>
Tax expenses	(50)	71.0	70.6	0.4	0.6
<b>Net profit for the year</b>		<b>132.1</b>	<b>139.4</b>	<b>-7.3</b>	<b>-5.2</b>
Consolidated profit/loss attributable to minority shareholders		0.0	0.0	0.0	0.0
Consolidated profit/loss attributable to HSBC Trinkaus shareholders		132.1	139.4	-7.3	-5.2

### Reconciliation from Net Income to Comprehensive Income

in €m	2011	2010
Net profit for the year	132.1	139.4
Gains/losses not recognised in the income statement	-46.5	8.6
of which from financial instruments	-36.8	16.7
of which from actuarial results	-8.7	-6.5
of which from currency conversion	-1.0	-1.6
<b>Comprehensive income</b>	<b>85.6</b>	<b>148.0</b>
Attributable to:		
Minority interests	0.0	0.0
HSBC Trinkaus shareholders	85.6	148.0

Cf. Note 40 on the development of unrealised gains/losses from financial instruments.

## Earnings per share

	2011	2010
Net income after tax in €m	132.1	139.4
Minority interests in €m	0.0	0.0
Net profit after tax and minority interests in €m	132.1	139.4
Average number of shares in circulation in million	28.1	27.1
<b>Earnings per share in €</b>	<b>4.70</b>	<b>5.14</b>
<b>Undiluted earnings per share in €</b>	<b>4.70</b>	<b>5.14</b>

As at the end of 2010, no subscription rights were outstanding at the end of the 2011 financial year. There was therefore no calculable dilution effect.

No modification to any accounting methods, assessment methods or consolidation methods (cf. Note 18) had a material impact on earnings per share. The Management Board proposes to the Annual General Meeting the distribution of a dividend of € 2.50 per share (2010: € 2.50 per share).

# Consolidated Statement of Changes in Capital HSBC Trinkaus & Burkhardt

in €m	Share capital	Capital reserve	Retained earnings	Valuation reserve for financial instruments	Valuation reserve for actuarial profits and losses	Valuation reserve from currency conversion	Consolidated profit available for distribution	Shareholders' equity	Minority interests	Total including minority interests
At 31.12.2009	70.0	216.9	569.6	108.6	-23.3	-0.2	120.9	1,062.5	0.1	1,062.6
Dividend distribution							-65.3	-65.3		-65.3
Retention from 2009 profit available for distribution			55.6				-55.6			
Addition from net profit for the year							139.4	139.4		139.4
Changes on account of the capital increase	5.4	145.2						150.6		150.6
Share-based payments		-8.1	2.2					-5.9		-5.9
Other changes			-0.2	16.7	-6.5	-1.6		8.4		8.4
At 31.12.2010	75.4	354.0	627.2	125.3	-29.8	-1.8	139.4	1,289.7	0.1	1,289.8
Dividend distribution							-70.3	-70.3		-70.3
Retention from 2010 profit available for distribution			69.1				-69.1	0.0		0.0
Addition from net profit for the year							132.1	132.1		132.1
Share-based payments		6.0	-0.5					5.5		5.5
Other changes				-36.8	-8.7	-1.0		-46.5		-46.5
At 31.12.2011	75.4	360.0	695.8	88.5	-38.5	-2.8	132.1	1,310.5	0.1	1,310.6

# Consolidated Cash Flow Statement

## HSBC Trinkaus & Burkhardt

In €m	2011	2010
Net profit for the year	132.1	139.4
Non-cash items in net profit and adjustments to reconcile net profit with net cash from operating activities:		
Write-downs, depreciations, write-backs and changes to provisions	67.2	-32.8
Net profit from the sale of investments and property, plant and equipment	-8.0	0.7
Other adjustments (net)	-100.1	-63.7
Sub-total	91.2	43.6
Changes to assets and liabilities from operating activities after adjustment for non-cash components		
Loans and advances to banks	-454.7	1,026.5
Loans and advances to customers	-627.6	-404.7
Securities held for trading	504.2	-121.5
Other assets	-943.3	-177.6
Liabilities	1,834.5	-440.7
Other liabilities	-42.5	91.0
Total adjustments	283.2	-27.0
Interest receipts	236.3	196.7
Dividend receipts	2.2	2.3
Interest payments	-89.1	-69.8
Income taxes paid	-81.7	-51.5
<b>Cash flow from operating activities</b>	<b>429.5</b>	<b>94.3</b>
Proceeds from the sale of		
Financial assets	0.7	0.1
Property, plant and equipment	13.8	1.4
Payments for the acquisition of		
Financial assets	-0.7	-0.3
Property, plant and equipment	-11.9	-15.8
<b>Cash flow from investing activities</b>	<b>1.9</b>	<b>-14.6</b>
Dividends paid to HSBC Trinkaus shareholders	-70.3	-65.3
Dividends paid to minority shareholders	0.0	0.0
Adjustments to subordinated capital	-25.0	-6.0
Net cash provided by the capital increase	0.0	150.6
<b>Cash flow from financing activities</b>	<b>-95.3</b>	<b>79.3</b>

Cash and cash equivalents at beginning of period	336.1	177.0
Cash flow from operating activities	429.5	94.3
Cash flow from investing activities	1.9	-14.6
Cash flow from financing activities	-95.3	79.3
<b>Cash and cash equivalents at end of period</b>	<b>672.2</b>	<b>336.1</b>

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# Notes to the Consolidated Financial Statements

## Fundamental accounting policies

The consolidated financial statements of HSBC Trinkaus & Burkhardt AG, Düsseldorf, for the 2011 financial year have been prepared in accordance with International Financial Reporting Standards (IFRS) as they are to be applied in the European Union (EU). Additional provisions pursuant to section 315a (1) of the German Commercial Code (HGB) have also been taken into consideration.

Confirmation of the financial statements is carried out in accordance with the legal provisions and – based on a proposal by the Management Board – is on principle the function of the Supervisory Board. Following approval, the Annual General Meeting passes the resolution on the appropriation of distributable profit.

For greater clarity we basically report all amounts in € million. The figures have been rounded commercially, which may result in marginal deviations in the consolidated financial statements to hand with respect to generating figures and calculating percentages.

The consolidated financial statements were prepared and valued on a going concern basis.

The consolidated financial statements include the balance sheet, the consolidated statement of comprehensive income, the statement of changes in equity, cash flow statement and the notes.

At the end of 2011, HSBC Holdings plc had an indirect interest of 80.4% (2010: 80.4%) in the share capital of HSBC Trinkaus & Burkhardt AG via HSBC Germany Holdings GmbH. As a result, the consolidated financial statements of HSBC Trinkaus & Burkhardt AG are included in the consolidated financial statements of HSBC Holdings plc, 8 Canada Square, London E14 5HQ, United Kingdom, registration number 617987.

## Information on accounting, valuation and consolidation methods

### 1 Scope of Consolidation

The consolidated financial statements include as subsidiaries all affiliated companies in which the parent company, HSBC Trinkaus & Burkhardt AG, directly or indirectly holds the majority of the voting rights or over which it can exercise a controlling influence.

DPT Deutscher Pension Trust GmbH, with registered offices in Düsseldorf, was disposed of during the financial year and is therefore no longer included within the scope of consolidation.

In addition, we have fully consolidated two special funds and one closed-end real estate fund in accordance with SIC 12. A detailed list of the consolidated companies in addition to these funds can be found in Note 63.

### 2 Consolidation Principles

In accordance with IAS 27.24, the accounting policies were applied consistently throughout the Group.

Differences arising from the consolidation of investments are calculated on the basis of the value of the new companies on the date of acquisition.

Intra-group claims and liabilities, income and expenses have been offset against each other; inter-company profits have been eliminated.

### 3 Foreign Currency Translation

For the purposes of foreign currency translation, pursuant to IAS 39 in conjunction with IAS 21, we distinguish between monetary and non-monetary financial instruments. Revaluations resulting from currency translation of monetary items are always recognised in the income statement. In the case of non-monetary items, the treatment of currency results depends on the way in which the other market price-related revaluation results of the corresponding instrument are treated.

Income and expenses resulting from the translation of foreign currencies are entered under the same item in the income statement as the corresponding income and expenses from the respective underlying transaction.

Foreign exchange forwards are translated at the relevant forward rate on the balance sheet date. Spot foreign exchange trades, and assets and liabilities denominated in foreign currencies, are translated at the official reference rate of the European Central Bank or at other suitable spot rates on the last trading day of the year.

Transactions carried out by foreign subsidiaries are translated in accordance with the modified reporting date method; balance sheet items are translated using the exchange rate applicable at the reporting date (closing rate), while income and expenditure are translated at the relevant average rate. The equity capital available (subscribed capital, profit, capital, revaluation surplus) at the time of initial consolidation must be converted at the reporting rate (closing rate) on the date of initial consolidation and maintained at a constant level. Additions to retained earnings must be converted at the conversion rate of the respective year in which the corresponding net income was generated. Translation gains or losses arising from capital consolidation are presented separately under equity.

Translation differences with no effect on the income statement amounted to € –2.8 million (2010: € –1.8 million) and relate to a closed-end real estate fund in Australia as well as to a subsidiary in Hong Kong (cf. Note 63).

### 4 Business Combinations

IFRS 3 defines the application of the acquisition method for business combinations in which the buyer takes control of the company acquired. After the buyer's procurement costs are calculated, the assets and liabilities acquired through the business combination must be valued at their fair value at the time of acquisition.

The extensive recognition and measurement provisions of IFRS 3 for tangible and intangible assets purchased, as well as for contingent liabilities and other items on the balance sheet, are applied. This also includes assets (such as client contracts) that did not qualify previously for recognition in the financial statements.

If goodwill is to be recognised, because the purchase costs exceed the fair value of the net assets acquired, it must be reviewed for impairment at least once a year (impairment test) in accordance with IAS 36.

## 5 Financial Instruments

### Recognition

HSBC Trinkaus recognises financial instruments in the balance sheet for the first time when the Group becomes a contractual party to the corresponding agreement, in accordance with IAS 39. Recognition for spot transactions (regular way contracts) is uniform on the trade date (trade date accounting), otherwise on the settlement date.

Financial instruments are derecognised fully provided the Group has transferred the contractual rights to receipt of the cash flows from the financial instrument, plus all material risks and opportunities under such assets. If not all opportunities and risks are transferred, recognition is at

the amount of the residual risk position, if we continue to exercise control over the financial instrument (continuing investment).

Transferred financial instruments which do not qualify for derecognition comprise mainly interest-bearing securities pledged as collateral under repurchase transactions or shares borrowed under securities lending transactions. Owing to the legal obligation to retransfer securities, all opportunities and risks incurred in relation to the genuine repurchase transactions remain with the transferor. The corresponding risks are: counterparty risk, foreign exchange risk and market risk. The same principle applies to securities lending transactions.

### Reporting

Reporting, as well as the corresponding measurement classes and measurement categories, are included in the following overview.

Measurement classes (IFRS 7)	Balance sheet item	Measurement category (IAS 39)
Measurement at amortised costs	Cash reserve	
	Loans and advances to banks	Loans and receivables
	Loans and advances to customers	Loans and receivables
	Deposits by banks	Other liabilities
	Customer accounts	Other liabilities
	Certificated liabilities	Other liabilities
	Subordinated capital	Other liabilities
Measurement at fair value	Financial assets	Available for sale
	Trading assets/liabilities	Held for trading
Derivatives in hedging relationships	Trading assets/liabilities	
Off-balance sheet business (IAS 37)	Contingent liabilities	
	Other liabilities	

IFRS 7 redefines the disclosure of financial instruments and groups the reporting rules together in one standard. Furthermore, the standard contains disclosure requirements of risk reporting, which we will deal with within the Risk Report as part of the audited consolidated Financial Statements.

### Measurement

All financial instruments are measured at fair value at acquisition. This generally equates to the transaction price initially; in other words, the fair value of the consideration including transaction costs. In addition, we allocate all fi-

nancial instruments at initial recognition to the categories as defined in IAS 39, which are decisive for subsequent measurement. We have implemented the rules as follows at the HSBC Trinkaus Group:



#### **(a) Financial assets or liabilities at fair value through profit or loss**

This category differentiates between financial instruments that are either classified irrevocably as held-for-trading (HfT) or at fair value through profit or loss upon initial recognition (fair value option). As in the previous year, we did not exercise the fair value option, so that the corresponding sub-category is not filled at present.

Besides all derivatives – including embedded derivatives which are required to be separated – financial instruments in the held-for-trading category include all positions which have been acquired for the purpose of generating short-term gains from changes in market price.

As a rule, subsequent measurement is at fair value, where publicly traded market prices, if available, are based on the assumption of an active market; measurement is otherwise determined using recognised measurement methods. For the most part, standard measurement models are used, such as those implemented by external software providers in the respective software. These are mainly present value methods and option price models. We have cooperated closely with HSBC to develop in-house valuation routines for specific complex products. Owing to the broad product spectrum, the measurement parameters imposed are as differentiated as possible – for example, according to lifetimes, strike prices, etc. The choice of data sources used plus the allocation of measurement parameters and applicable measurement method for the financial instruments in question are independent of trading. Provided all material measurement parameters cannot be observed for specific products, the measurement results from new transactions (day-1 profit or loss) in these products are not recognised in the income statement until maturity or when the position is closed out. There is no distribution over the transaction term. All realised gains and losses as well as the unrealised measurement results are reported under net trading income.

#### **(b) Held-to-maturity investments**

As in the previous year, no financial instruments were allocated to the held-to-maturity category.

#### **(c) Loans and receivables**

The “loans and receivables” category comprises all those non-derivative financial assets with fixed or determinable payments that are not quoted in an active market or that were not classified as available-for-sale financial assets

when the agreement was concluded. Financial instruments are the exception here which, owing to the short-term intention of the category to resell the assets, are allocated to the held-for-trading category. The corresponding loans and receivables are measured at amortised cost. Discounts and premiums are recorded proportionately within interest income. Impairments on loans and receivables are reported under net loan impairment provision.

#### **(d) Financial assets available-for-sale**

The “available-for-sale” category includes on the one hand all financial instruments and is on the other the residual variable of the financial assets; in other words, it also includes the financial instruments that were not allocated to any of the three other measurement categories of IAS 39. These consist of securities (including registered bonds), acquired loans and advances and investments.

Subsequent measurement of financial instruments in this category is at fair value. The measurement methods are identical to those used for the measurement of held-for-trading financial instruments. Changes in the value vis-à-vis the net acquisition costs are reported under shareholders’ equity with no effect on the income statement.

There are no sufficient measurement parameters for holdings in partnerships and specific unlisted public limited companies: on the one hand, no price is quoted for these financial instruments in an active market. On the other, it is impossible to reliably determine the market value, since the volatility of possible securities is too great or no probability of event can be attributable to the individual securities. These holdings are measured at amortised cost.

In the event of a reduction in value due to counterparty or sovereign risk – impairments – (direct) write-downs to the lower fair value are made. The impairment test is carried out on the occasion of every interim report. The impairments are reported in income from financial assets. Objective evidence of impairment on debt instruments is included as income immediately. Write-ups affecting the income statement up to maximum amortised cost are recognised as soon as the reason for the write-down no longer applies. Equity instruments are written down if the fair value is significantly or permanently below original cost. A decline in the fair value of at least 20% below the original cost is considered significant. If the fair value has fallen permanently below original cost in the nine months prior to the balance sheet date, this is seen as permanent im-

pairment. Impairment is made to the fair value in both cases. If the reasons for impairment cease to exist for equity instruments – unlike debt instruments – no write-up with an effect on the income statement is made. Rather, the corresponding write-ups are recognised directly in retained earnings.

#### **(e) Other liabilities**

The “other liabilities” category includes all financial liabilities that were not allocated to the “fair value” category. They are therefore not measured at fair value through profit and loss, but at amortised cost: as a rule, other liabilities are carried at their settlement amount. Discounts and premiums are recognised proportionately within interest expense. Non-interest-bearing liabilities, such as zero coupon bonds, are measured at their interest rate as at the balance sheet date.

#### **(f) Reclassification**

As in the previous year, the option to reclassify financial instruments, pursuant to IAS 39, was not exercised.

## **6 Hedge Accounting**

In order to hedge the market risk of fixed-income bonds held in the available-for-sale portfolio, HSBC Trinkaus applies the provisions for the reporting of hedge relationships in accordance with IAS 39 (hedge accounting). The fair value of the fixed-income bonds (hedged item) depends on changes in the market interest rate (e.g. five-year rate) on the one hand and on liquidity and risk premiums for the issuer (so-called spreads) on the other. HSBC Trinkaus hedges against market interest rate-induced volatility (designated portion of the hedged item) by concluding interest rate swaps with other banks (hedging instrument), which largely compensates for the fluctuations in the fair value of the bonds. This hedging of fair value fluctuations (so-called fair value hedges), the interest rate-induced volatility plus the interest rate swaps of the fixed-income bonds are recognised in the income statement in accordance with IAS 39. The spread-related fair value fluctuations of the bonds are not hedged (unhedged portion of the hedged item). These are transferred to retained earnings in line with the subsequent measurement of available-for-sale securities, without effect on the income statement.

The reporting of hedging relationships in the balance sheet in accordance with IFRS is linked to a series of requirements that are largely related to the documentation of the hedging relationships and effectiveness of the hedging measures. The following data in particular must be documented at the time of entering into a hedging relationship (inception of a hedge): the identification of the hedge and the underlying transaction, flagging the hedged risk and the procedure for reviewing the effectiveness of the hedge transaction.

HSBC Trinkaus uses a linear regression model to assess the effectiveness of the hedge transaction. The model examines the linear correlation between the cumulative changes in value in the underlying transaction and the cumulative changes in value of the hedge transaction. The so-called coefficient of determination (R-square) provides information about the direction of the correlation through the quality of the regression and the steepness of the regression straight line (slope).

The proof of effectiveness requires higher expected effectiveness for a hedging relationship in the future (prospective effectiveness) on the one hand. Proof of the high effectiveness of the hedging relationship during the reporting period must be submitted regularly (retrospective effectiveness) on the other. Sufficient effectiveness within the scope of the prospective test requires an R-square of greater than 0.9 and a slope of between –0.9 and –1.1. An R-square of greater than 0.8 and a slope of between –0.8 and –1.2 is adequate for the retrospective effectiveness test.

## **7 Net Loan Impairment and Other Credit Risk Provision**

We show net loan impairment and other credit risk provisions on the one hand as net loan impairment provision on the assets side and on the other as provisions for credit risks on the liabilities side. The item net loan impairment provision differentiates between individually assessed impairments/provisions on the one hand and collectively assessed impairments/provisions on the other.

Individually assessed impairments in relation to receivables recognised in the balance sheet and off-balance-sheet transactions are determined individually for each borrower. The Credit Department classifies all borrowers in one of 23 rating categories using a Group-wide, standardised internal credit rating procedure. The debtor's country of domicile is also relevant. Please refer to the chapter on counterparty risk in the consolidated financial statements for further explanations – especially on calculating impairments/provisions.

Furthermore, write-downs/provisions are created on a portfolio basis: provided there is no substantial objective evidence of impairment of individual assets or of individual contingent losses, these assets will be aggregated collectively into a group with comparable default risks (portfolio). A general impairment/provision will then be calculated on the basis of the respective default probabilities and economic indicators.

Where it is determined that a loan cannot be repaid, the uncollectible amount is first written off against any existing individually assessed impairments, and/or directly recognised as expense in the income statement.

## 8 Repurchase Agreements and Securities Lending Transactions

The securities sold under repurchase agreements (genuine repurchase agreements) are still reported and valued as securities stock in the consolidated balance sheet. The inflow of liquidity is generally reported under the balance sheet item trading liabilities (cf. Note 35).

Similarly, the outflow of liquidity arising from reverse repos is reported under the balance sheet item trading assets (cf. Note 24). This facilitates more appropriate reporting. Securities purchased under agreements to resell are not reported.

The Bank does not enter into non-genuine repurchase transactions.

Securities lending transactions are reported in the balance sheet in the same way as genuine repurchase transactions. Liquidity inflows/outflows from collateral pledged

for securities lending transactions are reported under the balance sheet item trading assets or trading liabilities (cf. Notes 24 and 35).

## 9 Share of Profit in Associates

As associated enterprises and joint ventures, all companies where HSBC Trinkaus & Burkhardt AG has a significant influence – either directly or indirectly – or has joint control with the other company, are carried on the balance sheet. A significant influence or joint control is assumed for voting interests of between 20% and 50%. Shares in associated companies and joint ventures are consolidated at equity.

## 10 Property, Plant and Equipment

The property, plant and equipment balance sheet item comprises property and buildings, hardware and other operational and business equipment.

Hardware and other operational and business equipment are valued at cost less regular depreciation. The prospective useful life of an asset is calculated applying factors such as physical life expectancy and technological progress, as well as contractual and legal restrictions. Scheduled amortisation is on a straight-line basis over the expected useful life of the asset and is based on the following useful lives throughout the Group:

	Useful life in years
Hardware	3
Motor vehicles	6
Fixtures/operating facilities	10
Furniture	13
Buildings	50

Depreciation that exceeds wear- and tear-related erosion is taken into consideration under impairments. Where the reasons cease, corresponding write-ups are made.

## 11 Intangible Assets

Items disclosed under intangible assets include standard software. In-house development work carried out within the scope of software projects is capitalised in accordance with IAS 38. Intangible assets are valued at purchase or production cost less regular depreciation on a straight-line basis over the expected useful life of the asset of three to ten years. In addition to regular depreciation, impairment tests are also carried out to value fixed assets (cf. Note 10).

Intangible assets also include the goodwill resulting from company acquisitions. The goodwill is not subject to any scheduled amortisation. An impairment test is carried out instead at least once a year, in accordance with IAS 36. The enterprise value is calculated using a discounted cash flow method, where the future cash flows are estimated and discounted by an interest rate that adequately reflects the risks involved.

## 12 Leasing

Group companies are involved in the leasing business exclusively as lessees. All leasing contracts signed are operating lease agreements. In operating lease agreements, all risks and benefits attendant upon ownership remain with the lessor, which also carries the leased item on its balance sheet. For this reason, the Group treats lease payments as rental payments reported under administrative expenses.

## 13 Treasury Bonds and Shares

The Bank holds its treasury bonds only to a limited extent and, in accordance with IFRS requirements, offsets them against the liability items arising from the issuance of bonds.

As at the end of 2011, the Bank held no shares in HSBC Trinkaus & Burkhardt AG. During the latest financial year 6,799 treasury shares were bought at an average price of € 89.73 (2010: € 98.27) and sold at an average price of € 90.28 (2010: € 90.63). As in the previous year, the results of this trading in treasury shares had no material effect. The maximum holding of treasury shares was 0.02% (2010: 0.16%) of the subscribed capital.

## 14 Provisions

Provisions for pensions and similar obligations, for credit risks and uncertain liabilities are reported under provisions.

Provisions for pensions and similar obligations are created on the basis of actuarial reports in the amount of the DBO (defined benefit obligation). The calculation is performed using the projected unit credit method. Within the scope of a Contractual Trust Arrangement (CTA) certain assets were transferred into a trust corporation as collateral for pension obligations and therefore qualified as plan assets within the meaning of IAS 19.7. The expected income from the plan assets is offset against the expected pension expenses in the income statement. Actuarial profits and losses from the performance of the plan assets and the pensions are reported under shareholders' equity with no effect on the income statement after the deduction of deferred taxes.

Provisions for uncertain liabilities are created in amounts equal to the present value of the expected expenditure. We report provisions for credit risks under net loan impairment provision.

## 15 Taxation Recoverable and Taxation

Current tax expenses are calculated in accordance with the tax rates applicable for each individual company. Current taxation recoverable is offset against current taxation provided the offsetting requirements specified in IAS 12 are fulfilled.

Deferred tax expenses are calculated by comparing the balance sheet valuations of the assets and liabilities with the valuations that are used for the taxation of the Group company in question. Deferred taxation recoverable or deferred taxation must be taken into consideration regardless of when realignment of the valuations occurs. The deferred taxation is calculated according to the tax rates which, to the best of our current knowledge and based on existing and anticipated tax legislation, will be used for the adjustment of the valuation methods. Should actual tax rates differ from these estimates, the balance sheet entries for deferred taxation recoverable and deferred taxation will be adjusted accordingly (cf. Note 50).

## 16 Share-Based Payments

Group employees have the opportunity to participate in a share option scheme offered by HSBC Holdings plc. The share option scheme is graduated according to different blocking periods (one, three and five years) and allows staff to save up to the equivalent of £ 250 per month. In accordance with IFRS 2, this option scheme is reported as share-based payments settled in the form of equity instruments. The share options are recognised at fair value. The personnel expenses (service costs) derived from this – apportioned to the respective blocking period (vesting period) – are recognised in the income statement. If employment is terminated within the vesting period, the total service costs must be recognised as an expense immediately (so-called acceleration of vesting). If an existing bonus programme is modified, a distinction must be made as to whether the fair value of the approval at the time of the modification exceeds or falls short of the original fair value.

If the modified fair value exceeds the original fair value of the approval, the excess amount must be recognised in the income statement, in addition to the previous service

costs over the vesting period. If the fair value is lower, the previous service costs remain unchanged; in other words, the modification is ignored.

In addition, the performance-related remuneration components for employees and the Management Board are, over a certain volume, paid partly in cash and partly in the form of an allocation of shares in HSBC Holdings plc. The share component will be paid in different tranches within or at the end of the vesting period and is generally subject to their continued service for the Bank. It is reported as a share-based payment settled in the form of equity instruments in accordance with IFRS 2; personnel expenses are spread over the vesting period. The resulting transfer obligation is revalued every month, whereby the valuation result is recognised directly in the capital reserves.

## 17 Reporting of Income and Expenses

Interest income and expenses are recognised on an accrual basis. Interest income includes income from loans and advances to banks and customers, and income from financial assets. Interest expenses include expenses arising from deposits by banks and customers as well as liabilities in certificate form and subordinated capital. The Bank recognises dividends at the time of the legal creation of the dividend entitlement with an effect on the income statement.

Net fee income includes above all income from securities, foreign exchange and derivatives business, as well as from special advisory services (e.g. Investment Banking). Fee income and expenses are recognised in the income statement whenever the service is performed.

All unrealised and realised trading results are reported in net trading income. This also includes interest and dividend income alongside price gains/losses as well as the proportional refinancing costs of the trading activities.

The results from derivatives held in the banking book are also reported in net trading income.

## 18 IFRS Treatment Applied

The IASB has published the Standard IFRS 9, Financial Instruments, step by step. The aim of the standard is to completely revise the accounting of financial instruments and thus replace the standard IAS 39 applicable to date. The adoption of the standard is mandatory for financial years starting on or after 1 January 2015 and will have a material effect on HSBC Trinkaus' accounting.

The IASB published IFRS Standards 10 to 12 in May 2011. These standards deal among other things with the issue as to when a company is to be consolidated and enhances the corresponding disclosure requirements. The Board also published at the same time IFRS Standard 13. This standard specifies in detail the term "fair value". This rule could have a substantial effect on HSBC Trinkaus' accounting and is mandatory for financial years starting on or after 1 January 2013.

The Board passed the final version of the amendments to IAS 19 in June 2011. These new regulations on the reporting of employee benefits will impact on the accounting

and valuation of pension and other benefits, the application of which is expected to be mandatory in reporting periods that start on or after 1 January 2013.

Earlier application of the aforementioned standards is not yet possible in the EU, since the EU has not yet concluded the endorsement process for these standards.

All changes to standards and interpretations, the early application of which we have dispensed with, are of no or only minor significance for our consolidated financial statements.

## 19 Material Events Occurring after the Balance Sheet Date

No transactions materially affecting the assets, financial position and profitability of the company took place during the period between the balance sheet date and the date on which these accounts were prepared.

# Notes to the Consolidated Balance Sheet

## 20 Cash Reserve

in €m	31.12.2011	31.12.2010
Cash in hand	3.3	3.3
Balances held with central banks	668.9	332.8
<b>Total</b>	<b>672.2</b>	<b>336.1</b>

Balances held with central banks are held mainly with the Deutsche Bundesbank and continue to be almost exclusively in euros.

The balances are managed on a daily basis within the scope of liquidity management observing the minimum reserve requirements.

## 21 Loans and Advances to Banks

in €m	31.12.2011	31.12.2010
Current accounts	409.9	328.3
Money market transactions	1,230.8	955.8
of which overnight money	76.6	78.6
of which term deposits	1,154.2	877.2
Other loans and advances	216.9	118.8
<b>Total</b>	<b>1,857.6</b>	<b>1,402.9</b>
of which to domestic banks	375.7	398.4
of which to foreign banks	1,481.9	1,004.5

Loans and advances to banks also include our deposits within the HSBC Group. The increase is largely attributable to other HSBC companies.

## 22 Loans and Advances to Customers

in €m	31.12.2011	31.12.2010
Current accounts	1,153.6	1,024.2
Money market transactions	742.1	631.9
of which overnight money	124.1	67.2
of which term deposits	618.0	564.7
Loan accounts	1,803.0	1,412.4
Other loans and advances	18.5	21.1
<b>Total</b>	<b>3,717.2</b>	<b>3,089.6</b>
of which domestic customers	2,331.2	1,811.1
of which foreign customers	1,386.0	1,278.5

The increase in the number of loan accounts is primarily due to the higher volume in the syndicated lending business. We also further expanded our factoring business,

which was offered for the first time in 2010, during the year under report. The increase in the volume held on the current accounts is largely attributable to the reporting date.

## 23 Net Loan Impairment and Other Credit Risk Provisions

Net loan impairment and other credit risk provisions are made up as follows:

in €m	31.12.2011	31.12.2010
Net loan impairment provision	27.1	49.1
Provisions for credit risks	3.2	5.7
<b>Net loan impairment and other credit risk provisions</b>	<b>30.3</b>	<b>54.8</b>

Net loan impairment provision relates exclusively to adjustments on loans and advances to customers. The decline is almost exclusively attributable to the reduction in individually assessed impairments, whereas collectively

assessed impairments were almost at the previous year's level. This not only reflects the largely positive economic trend during the year under report, but also our prudent assessment vis-à-vis future developments.

Net loan impairment provision developed as follows:

in €m	Impairments				Total	
	Individually assessed		Collectively assessed			
	2011	2010	2011	2010	2011	2010
As at 01.01.	38.2	29.5	10.9	13.4	49.1	42.9
Reversals	12.9	3.4	0.4	2.5	13.3	5.9
Utilisation	11.4	3.1	0.0	0.0	11.4	3.1
Additions	3.0	13.8	0.0	0.0	3.0	13.8
Direct write-offs	0.3	1.4	0.0	0.0	0.3	1.4
Currency translation effects/transfers	0.0	0.0	0.0	0.0	0.0	0.0
<b>As at 31.12.</b>	<b>16.6</b>	<b>38.2</b>	<b>10.5</b>	<b>10.9</b>	<b>27.1</b>	<b>49.1</b>



Provisions for credit risks developed as follows:

in €m	Provisions				Total	
	Individually assessed		Collectively assessed			
	2011	2010	2011	2010	2011	2010
As at 01.01.	2.1	3.2	3.6	3.6	5.7	6.8
Reversals	2.1	1.1	0.4	0.0	2.5	1.1
Utilisation	0.0	0.0	0.0	0.0	0.0	0.0
Additions	0.0	0.0	0.0	0.0	0.0	0.0
Currency translation effects/transfers	0.0	0.0	0.0	0.0	0.0	0.0
As at 31.12.	0.0	2.1	3.2	3.6	3.2	5.7

## 24 Trading Assets

in €m	31.12.2011	31.12.2010
Bonds and other fixed-income securities	4,312.0	4,590.7
of which:		
public-sector issuers	2,743.3	2,334.0
other issuers	1,568.7	2,256.7
of which:		
listed	4,274.8	4,441.7
unlisted	372	149.0
Equities and other non-fixed-income securities	561.1	1,004.4
of which:		
listed	561.1	1,003.9
unlisted	0.0	0.5
Tradable receivables	1,892.5	2,334.8
Positive market value of derivatives	2,321.0	1,828.7
of which:		
OTC derivatives	1,949.9	1,436.0
exchange-traded derivatives	371.1	392.7
Reverse repos	118.5	72.3
Securities lending	0.9	0.0
Security in the derivatives business	644.2	296.2
Derivatives in hedging relationships	0.0	0.9
Derivatives held in the banking book	2.1	2.6
<b>Total</b>	<b>9,852.3</b>	<b>10,130.6</b>

Tradable receivables are recognised mainly as promissory note loans and registered bonds. The rise in the positive market value of the derivatives corresponds with the rise in the negative market values of the derivatives (cf. Note 35).

The securities lending and collateral items in the derivatives trading business comprise funds that we pledged as collateral (cf. Notes 31 and 61). The slight fall in trading assets is largely attributable to the reporting date.

## 25 Financial Assets

Financial assets comprise the Bank's strategic positions, which are broken down as follows:

in €m	31.12.2011	31.12.2010
Bonds and other fixed-income securities	3,768.9	2,776.3
of which:		
public-sector issuers	1,389.2	714.6
other issuers	2,379.7	2,061.7
of which:		
listed	3,712.3	2,727.5
unlisted	56.6	48.8
Equities	40.2	24.3
Investment certificates	73.9	100.1
Promissory note loans	180.9	293.6
Investments	100.8	111.6
<b>Total</b>	<b>4,164.7</b>	<b>3,305.9</b>

All financial assets are assigned to the available-for-sale category in accordance with IAS 39.

The difference between the fair value and amortised cost price is as follows:

in €m	31.12.2011	31.12.2010
Bonds and other fixed-income securities	54.9	78.3
Equities	3.0	9.3
Investment certificates	3.6	11.0
Promissory note loans	23.2	19.3
Investments	29.0	39.4
<b>Total</b>	<b>113.7</b>	<b>157.3</b>

## 26 Share of Profit in Associates

The following table provides information on the development of share of profit in associates:

in €m	2011	2010
<b>Book value as at 01.01.</b>	<b>38.0</b>	<b>10.6</b>
Additions	26.9	27.5
Share of results of financial year	0.7	0.4
Elimination of interim result	0.0	0.0
Dividend distribution	-0.4	-0.5
Disposals	0.0	0.0
<b>Book value as at 31.12.</b>	<b>65.2</b>	<b>38.0</b>

On the one hand, we reported the associated company sino AG, Dusseldorf, under the share of profit in associates. Owing to sino AG's different financial year, the figures published for the previous quarter are used in the accounting process. On the other hand, HSBC Global Asset Management (Switzerland) AG, Zurich, which was managed as a joint venture with HSBC Global Asset Management (France), Paris and HSBC Trinkaus Gesellschaft für Kapitalmarktinvestments oHG, Düsseldorf, which is a joint venture with Société Financière et Mobilière, Paris, are taken into consideration here.

The proportional market value of the listed sino AG shares amounted to € 2.5 million as at the balance sheet date (2010: € 3.9 million). All in all, the assets and liabilities of the companies consolidated at equity amount to € 555.7 million (2010: € 283.7 million) and € 2.4 million (2010: € 1.9 million) respectively on profit before taxes of € 9.7 million (2010: € 3.9 million).

## 27 Investment Overview

in €m	Land and property	Operating and office equipment	Fixed assets (aggregate)	Intangible assets
Acquisition costs as at 01.01.2011	92.0	75.4	167.4	104.1
Increases	0.4	14.7	15.1	3.4
Disposals	12.7	6.7	19.4	0.5
Acquisition costs as at 31.12.2011	79.7	83.4	163.1	107.0
Depreciation as at 01.01.2011	36.9	47.4	84.3	65.2
Scheduled depreciation	1.1	9.2	10.3	10.8
Non-scheduled depreciation	0.0	0.0	0.0	0.0
Depreciation of reversals	5.4	5.4	10.8	0.3
Depreciation as at 31.12.2011	32.6	51.2	83.8	75.7
Carrying amount as at 31.12.2011	47.1	32.2	79.3	31.3
Carrying amount as at 31.12.2010	55.1	28.0	83.1	38.9

As in the previous year, foreign currency translation did not affect property, plant and equipment values.

## 28 Taxation Recoverable

in €m	31.12.2011	31.12.2010
Current taxation recoverable	8.6	4.3
Deferred taxation recoverable	0.0	0.0
<b>Total</b>	<b>8.6</b>	<b>4.3</b>

Current taxation recoverable relates predominately to receivables from German tax authorities.

## 29 Other Assets

As in 2010, other assets of € 213.1 million (2010: € 203.7 million) include one building with a book value totalling € 166.2 million (2010: € 158.0 million), which is marketed within the framework of a closed-end real estate fund. As in the previous year, no interest on borrowing was activat-

ed in the current year. Additionally, this item predominately includes excess cover from our CTAs of € 1.0 million (2010: € 10.5 million) and other taxes of € 0.9 million (2010: € 1.2 million).

## 30 Subordinated Assets

The following overview shows the composition of our subordinated assets:

in €m	31.12.2011	31.12.2010
Bonds and other fixed-income securities	135.0	137.5
Profit-participation certificates	7.8	6.7
<b>Total</b>	<b>142.8</b>	<b>144.2</b>

## 31 Repurchase Agreements and Securities Lending

The following overview shows the securities we pledged and which cannot be written off in accordance with IAS 39 as well as the associated financial liabilities.

In addition to treasury securities, we also pledged securities that we had previously received within the scope of securities lending transactions and repurchase agreements. All of the transferred securities are reported under trading assets.

in €m	31.12.2011		31.12.2010	
	Market value of the transferred financial assets	Book value of the associated financial liabilities	Market value of the transferred financial assets	Book value of the associated financial liabilities
Repurchase agreements	0.0	0.0	0.0	0.0
Securities lending transactions	24.6	9.0	66.0	4.1
<b>Total</b>	<b>24.6</b>	<b>9.0</b>	<b>66.0</b>	<b>4.1</b>

The following table provides an overview of the securities received:

in €m	31.12.2011		31.12.2010	
Type of transaction	Fair value of the transferred financial assets	Book value of the associated receivable	Fair value of the transferred financial assets	Book value of the associated receivable
Repurchase agreements	131.8	118.5	88.9	72.3
of which may be sold or pledged	131.8	0.0	88.9	0.0
of which are already sold or pledged	0.0	0.0	0.0	0.0
Securities lending transactions	112.4	0.9	136.5	0.0
of which may be sold or pledged	87.5	0.0	114.2	0.0
of which are already sold or pledged	24.9	0.0	22.3	0.0
<b>Total</b>	<b>244.2</b>	<b>119.4</b>	<b>225.4</b>	<b>72.3</b>

The overview includes the financial instruments that cannot be reported in accordance with IAS 39, as well as the associated receivables.

The Bank acts as protection purchaser as well as protection provider within the scope of repurchase agreements and securities lending transactions (cf. Note 61). The transactions were carried out at normal market conditions.

## 32 Deposits by Banks

in €m	31.12.2011	31.12.2010
Current accounts	598.8	394.4
Money market transactions	66.2	583.5
of which overnight money	0.0	3.0
of which term deposits	66.2	580.5
Other liabilities	84.6	202.5
<b>Total</b>	<b>749.6</b>	<b>1.180.4</b>
of which domestic banks	200.3	352.7
of which foreign banks	549.3	827.7

As at 31 December 2011, deposits by banks secured by charges on real property amounted to € 72.9 million (2010: € 71.1 million). In addition to the balances on our accounts held with our correspondent banks, the depos-

its by banks comprise mainly deposits from other banks of the HSBC Group. The decline in these was attributable to the reporting date.

### 33 Customer Accounts

in €m	31.12.2011	31.12.2010
Current accounts	7,671.7	6,488.3
Money market transactions	4,385.1	3,332.0
of which overnight money	817.2	439.0
of which term deposits	3,567.9	2,893.0
Savings deposits	40.8	43.0
Other liabilities	315.7	284.7
<b>Total</b>	<b>12,413.3</b>	<b>10,148.0</b>
of which domestic customers	9,152.3	7,167.0
of which foreign customers	3,261.0	2,981.0

Customer accounts continue to represent our main refinancing source and are at an extremely high level. The increase in overnight and term deposits is largely attributable to the reporting date. As we see it, the high level of

and further increase in customer deposits demonstrates the clear commitment of our customers to our solid business policy.

### 34 Certificated Liabilities

Certificated liabilities relate to bond issues in the amount of € 10 million (2010: € 10 million).

### 35 Trading Liabilities

in €m	31.12.2011	31.12.2010
Negative market value of derivatives	2,769.4	2,196.4
Discount certificates, promissory note loans, bonds and warrants	2,425.1	2,852.7
Delivery obligations arising from securities sold short	73.1	84.1
Securities lending	9.0	4.1
Security in the derivatives business	107.4	57.0
Derivatives held in the banking book	2.5	0.0
Derivatives in hedging relationships	39.5	5.8
<b>Total</b>	<b>5,426.0</b>	<b>5,200.1</b>

The issue and placement of certificates and warrants, as well as of structured promissory note loans and bonds is the direct responsibility of the trading divisions. These issues are recognised accordingly as trading liabilities pursuant to IAS 39 and are valued at fair value. The rise in the negative market value of the derivatives corresponds

with the rising positive market value of the derivatives (cf. Note 24).

The securities lending and collateral items in the derivatives trading business include funds that we have received as collateral.

## 36 Provisions

in €m	At 01.01.2011	Utilisation	Reversals	Additions / compound- ing	Transfers	Actuarial result	At 31.12.2011
Provisions for pensions and similar obligations	12.8	3.4	0.0	4.3	–9.5	12.7	16.9
Provisions related to human resources	2.0	0.7	0.0	0.1	–1.3	0.0	0.1
Provisions for credit risks	5.7	0.0	2.5	0.0	0.0	0.0	3.2
Provisions for other taxes	2.7	0.0	0.0	0.0	0.0	0.0	2.7
Other provisions	73.3	15.1	6.7	35.7	–6.7	0.0	80.5
<b>Provisions</b>	<b>96.5</b>	<b>19.2</b>	<b>9.2</b>	<b>40.1</b>	<b>–17.5</b>	<b>12.7</b>	<b>103.4</b>

Provisions for credit risks include provisions for impending losses in connection with sureties, acceptances and credit commitments. They are a part of net loan impairment and other credit risk provisions (cf. Note 23).

The provisions for other taxes essentially include expected payment obligations resulting from auditing for taxes on commercial capital, turnover and capital from the previous years.

Other provisions include above all provisions for contingent liabilities, especially in connection with risks in the property business, with interest rate risks from tax audits, as well as from IT agreements and goodwill provisions.

## Provisions for pensions and similar obligations

Various pension payment and benefit regulations exist for employees depending on the date the employee joined the Group, as well as on the country of incorporation of the respective Group company.

Old-age, early retirement, invalidity as well as surviving dependent's pensions are granted within the framework of all plans. The amount of the pension is geared substantially to the employee's pensionable length of service and basic salary. In addition, for part of the benefit claims, the amount paid depends on the contribution assessment ceiling in the statutory pension scheme.

Alongside the general pension and benefit plans for all employees, individual agreements were concluded by way of exception. Furthermore, there are two endowments that bear 6.0 % and 7.5 % interest, respectively.

In addition, several Group companies pay contributions to BVV Versicherungsverein des Bankgewerbes a. G. and to BVV Versorgungskasse des Bankgewerbes e.V. These defined contribution plans cost € 5.2 million in the year under report (2010: € 4.8 million).

Provisions for pensions and similar obligations are computed in accordance with actuarial principles using the projected unit credit method. These calculations are performed annually, and are currently based on the following parameters:

in %	31.12.2011	31.12.2010
Long-term base rate of interest	5.0	5.0
Estimated salary increases	3.0	3.0
Estimated pension indexation	2.0	2.0
Estimated rate of inflation	2.0	2.0
Expected increase in the contribution ceiling for social insurance	2.5	2.5
<b>Estimated return on plan assets</b>	<b>6.0</b>	<b>6.0</b>

The base interest rate is calculated on the basis of the average yield on long-term and first-class bonds. At 5.0 %, it is in line with the figure for the previous year.

The expected returns for the plan assets were determined on the basis of the historical average performance of the fund in which the plan assets are invested. These estimates will be maintained for 2012.

The provision for pensions and similar obligations also includes the obligations for semi-retirement, early retirement and anniversary payments.

In addition, this item includes for the first time the obligations arising from the lifetime working account model. This model has been offered to our staff since January 2011 and was already very popular in the first year.



## Development of pension obligations

in €m	2011	2010
<b>Pension obligations as at 01.01.</b>	<b>206.0</b>	<b>190.8</b>
Service costs	6.5	6.8
Interest expense	10.2	10.5
Pensions paid	–9.7	–11.4
Transfers and others	3.1	0.0
Change in actuarial gains and losses	–3.3	9.3
<b>Pension obligations as at 31.12.</b>	<b>212.8</b>	<b>206.0</b>

Within the scope of the calculation of pension obligations, parameters that are naturally characterised by uncertainties are estimated on a regular basis. A decrease in the long-term base interest rate to 4.50 % would increase the pen-

sion obligations to € 227.3 million. On the other hand, if the long-term base interest rate were to increase to 5.50 %, pension obligations would fall to € 200.1 million.

## Breakdown of pension obligations

in €m	2011	2010	2009	2008	2007
<b>Non-funded pension obligations</b>	<b>10.5</b>	<b>9.9</b>	<b>8.1</b>	<b>6.7</b>	<b>4.3</b>
<b>Funded pension obligations</b>					
Present value of pension obligations	202.3	196.1	182.7	173.3	172.6
Fair value of plan assets	196.9	203.8	197.4	185.3	201.7
<b>Balance</b>	<b>5.4</b>	<b>–7.7</b>	<b>–14.7</b>	<b>–12.0</b>	<b>–29.1</b>
of which plan shortfall	6.4	2.8	4.0	4.5	2.8
of which plan excess	1.0	10.5	18.7	16.5	31.9
<b>Total pension obligations</b>	<b>16.9</b>	<b>12.8</b>	<b>12.1</b>	<b>11.2</b>	<b>7.1</b>
of which actuarial gains and losses					
from plan assets	–32.8	–16.8	–16.6	–24.4	–1.1
from plan obligations	–23.6	–26.9	–17.6	–11.4	–16.2

The change in the plan excess is shown in the provisions in the transfers column.

The cumulative actuarial losses, which are recorded in shareholders' equity with no effect on the income statement, amounted to € 38.5 million after taxes (2010: € 29.8 million). The actuarial losses in the year under report were created from the plan assets.

### Development of the fair value of plan assets

in €m	2011	2010
Fair value of plan assets as at 01.01.	203.8	197.4
Additions/withdrawals	-2.8	-5.3
Reversals	0.0	0.0
Estimated income from plan assets	11.9	11.9
Change in actuarial gains and losses	-16.0	-0.2
Fair value of plan assets as at 31.12.	196.9	203.8

The actual loss from plan assets in the year under report amounted to € 4.1 million (2010: € 11.7 million). A reduction to 5.75 % in the planned return on plan assets would

have increased the actuarial result by € 0.5 million. An increase in the planned return to 6.25 % would have reduced the actuarial result by € 0.5 million.

### Breakdown of the fair value of plan assets

in €m	2011	2010
Bonds and other fixed-income securities	62.1	89.3
Equities	19.5	22.1
Discount/index certificates	34.8	32.7
Re-insurance claims from life insurance	17.0	16.2
Investment funds	23.2	26.9
Closed-end property funds	4.0	4.0
Other	36.3	12.6
Fair value of plan assets as at 31.12.	196.9	203.8

### 37 Taxation

in €m	31.12.2011	31.12.2010
Current taxation	48.3	52.6
Deferred taxation	7.3	14.1
<b>Total</b>	<b>55.6</b>	<b>66.7</b>

Current income tax liabilities include provisions for income taxes that are likely to be paid on the basis of the tax accounts of the fully-consolidated Group companies, less previous tax prepayments; our obligations arising from any taxation to be paid as a result of current and future audits are also reported under this item.

The deferred taxation is our future tax burden or relief, formed for the differences between the taxation valuation and the amounts stated in the balance sheet (cf. Note 50).

As in the previous year, deferred taxation recoverable is offset against deferred taxation if the prerequisites for off-setting exist.

Deferred taxation recoverable and deferred taxation are attributable to the following items:

in €m	31.12.2011	31.12.2010	Change
	As shown in the balance sheet	As shown in the balance sheet	
Trading portfolio*	6.3	16.6	-10.3
Share-based payments	9.8	5.0	4.8
Intangible assets	2.2	2.2	0.0
Loss carried forward	0.0	0.0	0.0
Derivatives held in the banking book	0.0	-1.9	1.9
Buildings	-0.1	-0.9	0.8
Net loan impairment and other credit risk provisions	-1.8	-1.4	-0.4
Pensions	-0.7	-3.1	2.4
Financial assets	-2.0	-8.6	6.6
Provisions	-12.3	-11.1	-1.2
<b>Recognised in the income statement</b>	<b>1.3</b>	<b>-3.2</b>	<b>4.5</b>
Financial Instruments	25.2	32.1	-6.9
Foreign Currency Translation	-1.3	-0.9	-0.4
Pensions	-17.9	-13.9	-4.0
<b>With effect on equity</b>	<b>6.0</b>	<b>17.3</b>	<b>-11.3</b>
<b>Deferred taxes</b>	<b>7.3</b>	<b>14.1</b>	<b>-6.8</b>
of which taxation recoverable	0.0	0.0	0.0
of which taxation	7.3	14.1	-6.8

\* Balance from measurement differences in all trading activities

### 38 Other Liabilities

in €m	31.12.2011	31.12.2010
Liabilities from other taxes	18.7	26.2
Deferred income	9.6	9.0
Accrued interest on		
Subordinated liabilities	6.8	6.9
Participatory capital	4.9	4.9
Other	172.5	167.1
<b>Total</b>	<b>212.5</b>	<b>214.1</b>

Liabilities from other taxes comprise turnover tax liabilities as well as capital gains tax from our business with clients.

Other liabilities include predominately trade payables and liabilities from performance-related remuneration.

### 39 Subordinated Capital

in €m	31.12.2011	31.12.2010
Subordinated liabilities (promissory note loans, bonds)	253.4	278.4
Participatory capital	100.0	100.0
<b>Total</b>	<b>353.4</b>	<b>378.4</b>

A resolution passed at the Annual General Meeting on 30 May 2006 authorised the Management Board to issue registered and/or bearer participation rights without a conversion or option right with the approval of the Supervisory Board on one or several occasions by 29 May 2011 up to a total amount of € 250 million. As in the previous year, no use was made of this facility in the last financial year.

In the event of liquidation, insolvency or other proceedings to avert insolvency, claims from subordinated liabilities will be settled only after all other claims against HSBC Trinkaus have been met. All subordinated claims have equal priority. No subordinated liabilities can be terminated prematurely by creditors. Profit-participation certificates can be terminated prematurely by HSBC Trinkaus if there is a change in the tax framework, subject to two years' notice of termination.

Subordinated capital of € 348.8 million (2010: € 363.4 million) – before discounts and market support deductions – is referred to for the calculation of liable equity capital according to section 10 (5a) of the German Banking Act (KWG).

For the 2011 financial year, interest payable amounts to € 12.7 million (2010: € 13.1 million) on subordinated liabilities and to € 4.9 million (2010: € 4.9 million) on participatory capital.

## Interest and repayment of subordinated liabilities

Interest rates	Nominal amount (€m) 31.12.2011	Nominal amount (€m) 31.12.2010
5 % or lower	100.2	100.2
Over 5 % up to 8 %	153.2	153.2
Fixed rates	253.4	253.4
Variable rates	0.0	25.0
<b>Total</b>	<b>253.4</b>	<b>278.4</b>

Repayment	Nominal amount (€m) 31.12.2011	Nominal amount (€m) 31.12.2010
Up to 1 year	0.0	25.0
Over 1 year up to 5 years	75.4	55.2
Over 5 years	178.0	198.2
<b>Total</b>	<b>253.4</b>	<b>278.4</b>

## 40 Shareholders' Equity

HSBC Trinkaus & Burkhardt AG's subscribed capital as at 31 December 2011 amounted to € 75.4 million (2010: € 75.4 million) and is divided into 28,107,693 no-par value shares. This is unchanged from the previous year.

The Management Board is authorised to increase the share capital by up to € 37.7 million on or before 31 May 2016, with the Supervisory Board's approval, through one or more issues of new bearer shares against cash contributions or contributions in kind (authorised capital).

The share capital is also subject to a conditional capital increase of up to € 37.7 million by means of issuing no-par value bearer shares. The contingent capital increase may only be carried out to the extent that the holders of convertible and option rights make use of the conversion and option rights under the convertible bonds or bonds cum warrants, or profit participation rights to be issued on or before 31 May 2016 (conditional capital).

## Valuation reserve for financial instruments

The change in the valuation reserve for financial instruments is as follows:

in €m	2011	2010
<b>Net valuation reserve as at 01.01.</b>	<b>125.3</b>	<b>108.6</b>
Disposals (gross)	-34.7	0.7
Market fluctuations (gross)	-21.0	20.9
Impairments (gross)	12.0	0.4
Deferred taxes	6.9	-5.3
<b>Net valuation reserve as at 31.12.</b>	<b>88.5</b>	<b>125.3</b>

## Shareholders' equity pursuant to German Banking Act (KWG)

A bank's regulatory capital is divided into three tiers – core capital (Tier I capital), supplementary capital (Tier II capital) and ancillary capital (Tier III capital). Core capital comprises primarily share capital plus the capital reserve and retained earnings, less intangible assets (largely software). Supplementary capital consists predominantly of profit-participation certificates, long-term subordinated liabilities and unrealised profits from listed securities.

According to the regulatory requirements, banks are obliged to quantify their counterparty, market and operational risks and to cover them with eligible capital. Mar-

ket risks result from the interest rate and share price risk on the trading portfolio, as well as foreign exchange risk, commodity risk and other positions exposed to market risk. Counterparty risk may be covered only by core and supplementary capital, while market risk can also be covered by Tier III capital. The minimum mandatory total capital ratio is 8 %. At the same time, at least 4 % of the risk-weighted assets must be backed by core capital (core capital ratio). The requirements of adequate capitalisation must be met by the banks, on a daily basis at the close of trading. The banking supervisory authority is reported to on a quarterly basis. The regulatory ratios following confirmation of the balance sheet are as follows:

in €m	2011	2010
<b>Core capital (Tier I)</b>		
Consolidated core capital as disclosed on the balance sheet	1,128	1,093
Intangible assets	-28	-35
<b>Total core capital</b>	<b>1,100</b>	<b>1,058</b>
<b>Supplementary capital (Tier II)</b>		
Subordinated liabilities	247	261
Participatory capital	100	100
Unrealised gains on listed securities	32	36
Consolidation/equal deduction	-40	-15
<b>Total supplementary capital</b>	<b>339</b>	<b>382</b>
Adjustment items	0	-43
<b>Regulatory capital excluding Tier III capital</b>	<b>1,439</b>	<b>1,397</b>
<b>Available Tier III capital</b>	<b>0</b>	<b>0</b>
<b>Total regulatory capital</b>	<b>1,439</b>	<b>1,397</b>
Risk-weighted assets	7,112	5,862
Market risk equivalent	1,188	1,063
Operational risk	1,300	1,188
<b>Risk position</b>	<b>9,600</b>	<b>8,113</b>
<b>Tier 1 ratio* in %</b>	<b>11.5</b>	<b>13.0</b>
<b>Capital ratio in %</b>	<b>15.0</b>	<b>17.2</b>

\* before taking half the adjustment item into account

The Bank's core capital consists exclusively of share capital plus the capital reserve and retained earnings and therefore already meets the future regulatory requirements of hard core capital.

Our above-average capital resources enable us to continue along the planned growth strategy within the scope of our successful business model.

The availability of adequate shareholders' equity is fundamental to the management of the Bank, in order to adequately cover the risks inherent in banking. We have deliberately exceeded the regulatory requirements quite considerably in order to be prepared to achieve organic growth and deal with fluctuations in the course of business, whilst creating scope for appropriate strategic acquisitions. All in all, we want to maintain a minimum total capital ratio of 10.5 %. Please refer also to the comments on the Bank's financial position in the Group Management Report.

Analysis of the economic capital requirement complements our management of shareholders' equity, which is focused on the regulatory requirements. Although the introduction of the Basel II Accord considerably improved the risk measurement framework in the credit business in particular, there is still some discrepancy between the regulatory and economic approaches. The primary objective of our analysis of economic capital is to identify all risks and the available risk cushions in our

business, in conjunction with the issue of the Bank's risk-bearing capacity even in extreme stress scenarios. We have also developed a reverse stress test for the Bank pursuant to the revised MaRisk. The theoretical methods for quantifying risk have developed to varying degrees in the risk categories, and the statistical databases feature different qualities, so that an aggregation of all risks is not quite without its problems. We continue to adjust the calculation of economic capital requirements to meet the growing challenges we face.

Ultimately it can be said that the Bank's risk-bearing capacity is unchanged and its capitalisation adequate.

HSBC Trinkaus meets its disclosure obligation pursuant to Pillar 3 through the disclosure made at the Group level by HSBC Holdings plc, London (section 319 para. 3 SolvV). We refer in this respect to HSBC's publications under the heading Investor Relations on its website ([www.hsbc.com](http://www.hsbc.com)).

## **41 Minority Interests**

As in the previous year, minority interests comprise investments in one closed-end property fund that is fully-consolidated in the consolidated financial statements.

# Notes to the Consolidated Income Statement

## 42 Net Interest Income

in €m	2011	2010
<b>Interest income</b>	<b>238.0</b>	<b>198.5</b>
From loans and advances to banks	26.1	19.6
Money market transactions	20.7	15.7
Other interest-bearing receivables	4.4	3.7
Reverse repos	1.0	0.2
From loans and advances to customers	92.4	75.3
Money market transactions	16.9	14.5
Other interest-bearing receivables	75.5	60.8
From financial assets	119.5	103.6
Interest income	116.3	100.4
Dividend income	1.7	1.8
Income from subsidiaries	1.5	1.4
<b>Interest expense</b>	<b>89.1</b>	<b>69.8</b>
From deposits by banks	21.2	16.3
Money market transactions	12.6	8.9
Other interest-bearing deposits	8.6	7.4
From customer accounts	49.9	32.5
Money market transactions	19.2	7.4
Other interest-bearing deposits	30.7	25.1
From securitised liabilities	0.4	0.4
From subordinated capital	17.5	17.9
Other	0.1	2.7
<b>Net interest income</b>	<b>148.9</b>	<b>128.7</b>

We achieved positive net interest income of € 148.9 million during the year under report, thus exceeding the figure reported in the previous year by 15.7 %. This increase is largely due to higher volumes and margins in the lending business. Furthermore, remarkable growth in volume was recorded in the lending business on lower margins.

We continued to invest a considerable portion of our liquidity in bonds that are eligible for use in Eurosystem credit operations. Income from financial assets improved significantly over the previous year.

During the period under report, interest income from

financial assets subject to impairment was recognised in the amount of € 1.7 million (2010: € 2.0 million).

## 43 Share of Profit in Associates

The share of profit in associates resulted mainly from our interest in sino AG and Trinkaus Gesellschaft für Kapitalmarktinvestments oHG (cf. Note 26).



#### 44 Net Loan Impairment and Other Credit Risk Provisions

in €m	2011	2010
Additions	3.0	13.8
Reversals	15.8	7.0
Direct write-offs	0.3	1.4
Recoveries on loans and advances previously written off	0.2	0.5
<b>Total</b>	<b>-12.7</b>	<b>7.7</b>

We were able to reduce net loan impairment in the year under report by € 12.7 million, compared with a net addition of € 7.7 million in 2010. This is largely due to the improvement in the global economic situation that benefits our export-oriented customers in particular.

Notwithstanding the positive overall economic development, we had to allocate € 3.0 million to individually-assessed impairments, while reversing impairments in the

amount of € 15.0 million at the same time. The net reversal of collectively assessed impairments was € 0.8 million compared with € 2.5 million the year before, thus reflecting the improvement in our customers' credit quality in our loan book.

Our conservative stance is unchanged and we continue to apply stringent standards of provisioning in relation to the assessment of default risks.

#### 45 Net Fee Income

in €m	2011	2010
Securities transactions	245.3	257.3
Foreign exchange transactions and derivatives	67.6	58.4
Investment Banking	18.2	34.2
Foreign business	14.8	13.6
Lending	12.5	11.5
Issuing and structuring business	8.0	11.0
Payments	6.6	6.6
Alternative investments*	5.3	5.2
Other fee-based business	7.2	6.2
<b>Total</b>	<b>385.5</b>	<b>404.0</b>

\* The alternative investments division offers alternative investment products to our customers; these include hedge funds, private equity or infrastructure investments that are based on a sustained and broadly diversified footing.

The fee-based business, which accounted for 57.7 % of operating profit (2010: 60.5 %), remains a crucial factor to the Bank's success. At € 385.5 million (2010: € 404.0 million), net fee income for the year under report is only slightly lower than the previous year.

The moderate decline is attributable mainly to the remarkably strong result achieved the year before in Investment Banking, which came about largely by supporting several capital adjustment measures for large exchange-listed companies.

Lower fee income from the securities business was mainly due to the cautious stance adopted by our customers because of tensions on money and capital markets.

We achieved a moderate increase in the result in our international and lending business within the scope of our growth initiative. We must emphasise the development in net fee income generated from the intermediation of our customers' foreign exchange and derivatives business to

other companies in the HSBC Group. The hedging requirements of our clients were increased on account of volatile exchange rates in particular.

Trust activities performed by the Group in its own name, but for the account of third parties, are not recognised in the balance sheet. As in the previous year, net fee income includes practically no income or expense from trust activities.

## 46 Net Trading Income

in €m	2011	2010
Equities and equity/index derivatives	65.4	68.1
Bonds and interest rate derivatives	45.6	47.9
Foreign exchange	10.1	8.6
Derivatives held in the banking book	-4.3	-4.2
<b>Total</b>	<b>116.8</b>	<b>120.4</b>

At € 116.8 million, net trading income is down slightly on last year's result (2010: € 120.4 million).

Despite the major turbulence on equity markets, we achieved a remarkable result in trading in equities and equity index-linked derivatives, our strongest contributor in the trading division. At € 65.4 million (2010: € 68.1 million), the result was only marginally lower than the prior-year figure. This development is largely attributable to trading activities with retail products. We achieved a particularly favourable result in the business with trading-oriented certificates, as well as with discount certificates and plain-vanilla products in a still competitive market.

At € 45.6 million (2010: € 47.9 million), the results achieved on trading bonds and interest rate derivatives are defined by credit spread volatility on the bond markets. On the other hand, our treasury services benefited strongly from our excellent liquidity situation.

At € 10.1 million, the result from the foreign exchange business is significantly higher than the prior-year figure of € 8.6 million.

We incurred valuation losses again on derivatives held in the banking book.

Strong net trading income overall is convincing evidence of our prudent trading activities that take into consideration the risks involved.

## 47 Administrative Expenses

in €m	2011	2010
Staff expenses	286.4	259.1
Wages and salaries	247.6	222.6
Social security costs	28.4	26.0
Expenses for retirement pensions and other employee benefits	10.4	10.5
Other administrative expenses	166.8	159.8
Depreciation of property, plant and equipment and of intangible assets	21.1	20.4
<b>Total</b>	<b>474.3</b>	<b>439.3</b>

Administrative expenses climbed in the year under report, by € 35.0 million or 8.0 %, to € 474.3 million (2010: € 439.3 million). This increase is attributable above all to the rise in staff numbers associated with our growth strategy, which creates the basis for securing additional market share and for expanding our revenue base.

The moderate rise in other administrative expenses is due among other things to expenses incurred in improving workflows. We accepted these expenses knowingly in order to secure the long-term success of our growth strategy. Other administrative expenses include € 32.2 million (2010: € 31.8 million) in expenses arising from rental and lease payments.

Rates in the HSBC Group also increased in the year under report, since we availed increasingly of the services offered by the HSBC Group.

Finally, the bank levy payable for the first time this year also led to higher administrative expenses.

Within the scope of the lifetime working account model (cf. Note 36), which was offered for the first time in 2011, € 3.1 million including social insurance contributions was transferred to a trustee.

The breakdown of expenses for retirement pensions and other employee benefits is as follows:

in €m	2011	2010
Expenses for defined benefit plans	4.7	5.4
of which current service costs	6.5	6.8
of which interest expense	10.2	10.5
of which estimated income from the plan assets	–12.0	–11.9
Expenses for defined contribution plans	5.2	4.8
Other expenses for retirement provisions	0.5	0.3
<b>Total</b>	<b>10.4</b>	<b>10.5</b>

## 48 Income from Financial Assets

A loss of € 4.8 million from financial assets was reported in the year under report compared with a loss of € 0.6 million the year before. This development was largely owing

to necessary impairments on individual non-trading portfolios. Overall, we recognised impairment in the amount of € 12 million (2010: € 0.4 million).

On balance, the sale of financial assets measured at fair value generated a profit of € 2.1 million (2010: € –3.0 million). The Bank has very limited exposure to the Eurozone periphery states, and the price performance of existing

holdings is shown in the fair value measurement for financial assets. We also reported profits of € 4.6 million (2010: € 2.3 million) in conjunction with the share-based payments made to our staff in accordance with IFRS 2.

The following table highlights the composition of the realisation gains from financial assets measured at fair value from the performance of previous years and of the year under report:

in €m	2011	2010
<b>Income statement</b>		
Net gain/loss from disposal	6.7	–0.7
Tax expenses	0.2	1.3
<b>Net realisation gain in the income statement</b>	<b>6.9</b>	<b>0.6</b>
<b>Performance of the gross valuation reserve for financial instruments</b>		
Change from disposals (derecognition)	–6.7	0.7
of which volatility in the year under report	0.5	2.3
of which volatility in previous years	–7.2	–1.6
<b>Performance of corresponding tax expenses</b>		
Change from disposals (derecognition)	–0.2	–1.3
of which volatility in the year under report	–1.2	1.5
of which volatility in previous years	1.0	–2.8

The following table shows how the impairments or write-ups on financial assets are attributable to the performance of previous years and of the year of impairment/write-back:

in €m	2011	2010
<b>Income statement</b>		
Impairments/write-ups on financial instruments	–12.0	–0.4
<b>Performance of the valuation reserve for financial instruments</b>		
Changes from impairments/write-ups	12.0	0.4
of which volatility in the year under report	12.3	–0.9
of which volatility in previous years	–0.3	1.3
<b>Performance of corresponding tax expenses</b>		
Changes from impairments/write-ups	–1.5	–0.1
of which volatility in the year under report	–1.6	0.3
of which volatility in previous years	0.1	–0.4

## 49 Net Other Income

in €m	2011	2010
Other operating income	57.7	26.6
Other operating expenses	45.5	17.0
<b>Other operating income</b>	<b>12.2</b>	<b>9.6</b>
Other income	5.6	0.7
Other expenses	0.2	6.2
<b>Other net income</b>	<b>5.4</b>	<b>-5.5</b>
<b>Net other income</b>	<b>17.6</b>	<b>4.1</b>

The significant increase in other operating income and expenses is essentially due to changes in market values of financial instruments in hedging relationships. In the case of effective hedging relationships, considerable price increases on hedged underlying transactions are offset against the substantial discounts on the valuation of the hedging instruments. On balance, the hedge result of € 0.1 million in the year under report is virtually unchanged from the previous year's figure of € 0.2 million (cf. Notes 6 and 59).

Other operating income essentially includes € 11.1 million (2010: € 11.5 million) in rental income and € 8.4 million (2010: € 8.2 million) from the reversal of other provisions. Other operating expenses include for the most part additions of € 12.4 million (2010: € 9.9 million) to provisions and expenses of € 2.2 million incurred in renting (2010: € 2.6 million).

Other income of € 5.6 million was mainly from the sale of a property in Germany.

## 50 Tax Expenses

in €m	2011	2010
Current taxes	63.6	64.6
of which off-period	2.3	-0.5
Deferred taxes from change in limited valuation differences	7.4	6.8
Deferred taxes from changes to the tax rates	0.0	-0.8
<b>Total</b>	<b>71.0</b>	<b>70.6</b>

As in the previous year, the effective corporation tax in Germany is 15.8 %. Taking trade income tax into account, the combined tax rate remains at approximately 31.4 %.

The rate also forms the basis for calculating deferred taxes.

The following table shows the relationship between tax expenses derived from profit before taxes and the actual tax expenses reported.

in €m	2011	2010
Pre-tax profit	203.1	210.0
Tax rate (%)	31.4	31.4
Tax expenses derived from pre-tax profit	63.8	65.9
Tax rate differential on income proportions subject to taxation outside of Germany	-0.5	-0.5
Effect from unused losses carried forward	0.0	0.0
Taxes for previous years	2.3	-0.5
Non-deductible expenses from share-based payments	2.2	1.4
Corporation tax modification	-6.5	2.0
Trade tax modification	7.8	2.0
Miscellaneous	1.9	0.3
<b>Reported taxation</b>	<b>71.0</b>	<b>70.6</b>

## 51 Calculation of Operating Profit

in €m	2011	2010	Change	
			in €m	in %
Interest income	238.0	198.5	39.5	19.9
Interest expense	89.1	69.8	19.3	27.7
Net interest income	148.9	128.7	20.2	15.7
Net loan impairment and other credit risk provisions	-12.7	7.7	-20.4	> 100.0
Net interest income after net loan impairment and other credit risk provisions	161.6	121.0	40.6	33.6
Share of profit in associates	0.7	0.4	0.3	75.0
Fee income	681.5	683.9	-2.4	-0.4
Fee expenses	296.0	279.9	16.1	5.8
Net fee income	385.5	404.0	-18.5	-4.6
Operating trading income	121.1	124.6	-3.5	-2.8
Staff expenses	286.4	259.1	27.3	10.5
Other administrative expenses	187.8	180.2	7.6	4.2
Administrative expenses	474.3	439.3	35.0	8.0
Other operating income/expenses	12.2	9.6	2.6	27.1
<b>Operating profit</b>	<b>206.8</b>	<b>220.3</b>	<b>-13.5</b>	<b>-6.1</b>
Income from financial assets	-4.8	-0.6	-4.2	> 100.0
Income from derivatives in the bank book	-4.3	-4.2	-0.1	2.4
Other net income	5.4	-5.5	10.9	> 100.0
<b>Pre-tax profit</b>	<b>203.1</b>	<b>210.0</b>	<b>-6.9</b>	<b>-3.3</b>
Tax expenses	71.0	70.6	0.4	0.6
<b>Net profit for the year</b>	<b>132.1</b>	<b>139.4</b>	<b>-7.3</b>	<b>-5.2</b>

Operating profit includes the operating profit and operating expenses posted under Net Other Income (cf. Note 49). Operating trading income comprises net trading income from our trading desks but does not include results from

derivatives held in the banking book. A breakdown of operating profit by business segment is shown in Segment Reporting (cf. Note 54).

## 52 Income Statement by Measurement Category

The following overview includes on the one hand net profit or net loss for every IAS 39 measurement category of financial assets and financial liabilities. Net profits/losses are a net earnings indicator comprising changes in market value recognised in the income statement, disposals of

financial instruments, impairments and currency translation effects if necessary. On the other hand, interest income/expenses as well as fee income/expenses are included in every measurement category.

Measurement category	Loans and receivables	Other financial instruments	Held-for-trading	Derivates in hedging relationships	Available-for-sale	Other financial commitments	Other	Total
<b>31.12.2011</b> in €m								
Net interest income								
Interest income	114.5	4.0			119.5			238.0
Interest expense						-89.0	-0.1	-89.1
Net fee income								
Fee income	12.7		1.3				667.6	681.6
Fee expenses	-0.2		-3.5				-292.3	-296.0
Net trading income			116.8					116.8
Income from financial assets					7.2			7.2
Net other income/expenses				-28.3	28.4		17.6	17.7
Impairments								
Net impairment and other credit risk provisions	10.2						2.5	12.7
Income from financial assets					-12.0			-12.0
<b>Total</b>	<b>137.2</b>	<b>4.0</b>	<b>114.6</b>	<b>-28.3</b>	<b>143.1</b>	<b>-89.0</b>	<b>395.3</b>	<b>676.9</b>

Measurement category	Loans and receivables	Other financial instruments	Held-for-trading	Derivates in hedging relationships	Available-for-sale	Other financial commitments	Other	Total
<b>31.12.2010</b> in €m								
Net interest income								
Interest income	92.3	2.6			103.6			198.5
Interest expense						-67.1	-2.7	-69.8
Net fee income								
Fee income	11.7		5.9				666.3	683.9
Fee expenses	-0.2		-1.8				-277.9	-279.9
Net trading income			120.4					120.4
Income from financial assets					-0.2			-0.2
Net other income/expenses				-1.7	1.9		3.9	4.1
Impairments								
Net impairment and other credit risk provisions	-8.8						1.1	-7.7
Income from financial assets					-0.4			-0.4
<b>Total</b>	<b>95.0</b>	<b>2.6</b>	<b>124.5</b>	<b>-1.7</b>	<b>104.9</b>	<b>-67.1</b>	<b>390.7</b>	<b>648.9</b>



# Other Notes

## 53 Notes to the Cash Flow Statement

IAS 7 (Cash Flow Statements) requires all companies to draw up a cash flow statement. However, the value of the information it provides, as part of the annual accounts of financial institutions, is relatively limited. It shows movements in cash and cash equivalents arising from additions and disposals in the Group over the course of the financial year.

The payment transactions of the financial year are classified in three different categories: operating, investing and financing activities. The payment flows of the operating activities are classified according to the definition of operating profit. This comprises the sum of net interest income, net fee income, the at-equity result, operating trading income and the balance of other operating income and expenses, minus administrative expenses and net loan impairment and other credit risk provisions.

The summary item "Other adjustments (net)" in the cash flow statement essentially comprises net changes to deferred taxes, the change in taxation recoverable as well as tax expenses paid, interest and dividends received minus interest paid.

### Cash and cash equivalents

As in the previous year, cash and cash equivalents of € 672.2 million (2010: € 336.1 million) correspond to the cash reserve balance sheet item, which comprises cash in hand plus balances held with central banks. The cash and cash equivalents are denominated almost exclusively in euros. No major valuation effects resulting from exchange rates were to be taken into consideration.

### Cash flow from operating activities

Consolidated cash flows from operating activities for the Group are presented according to the indirect method, which derives them from net profit for the year.

Consolidated net profit for the year of € 132.1 million (2010: € 139.4 million) is the input figure for the cash flow statement. Gross cash flow of € 91.2 million (2010: € 43.6 million), which is reported as a sub-total, shows the cash surplus from operating activities. The cash flow from operating activities also takes into account changes in funds employed in operations.

### Cash flow from investing activities

Spending on the acquisition of property, plant and equipment totalled € 11.9 million (2010: € 15.8 million). The sale of property, plant and equipment realised € 13.8 million (2010: € 1.4 million) for the Group, a large portion of which resulted from the sale of a property in Germany. In the 2011 financial year, the sale and purchase of financial investments offset one another (2010: € 0.2 million outgoing payment).

### Cash flow from financing activities

Cash flow from financing activities includes the dividend of € 70.3 million for the 2010 financial year (2010: € 65.3 million) paid by HSBC Trinkaus & Burkhardt AG in the year under report. Bullet subordinated capital resulted in a payment of € 25.0 million (2010: € 6.0 million).

## 54 Customer Groups

The segment reporting prepared by HSBC Trinkaus in accordance with IFRS 8 provides readers of the statements with information on the sources of profit, growth and risk within individual segments and regions, and should help them gain a more differentiated picture of the economic performance of the Group.

The segment reporting of the HSBC Trinkaus Group is based on contribution to profits as a key component of the Management Information System (MIS). The MIS serves as one of the Bank's central management and controlling tools, reflecting the organisational structure of the HSBC Trinkaus Group on a divisional basis.

Hence, the segment reporting covers the following business areas, which are essentially structured to meet the needs of our clients:

### Private Banking

The Private Banking business division offers the clients of HSBC Trinkaus extensive advisory and management services for larger private portfolios. In addition to general portfolio management and advisory services, this involves special services such as advice on asset structuring, execution of wills, property advisory services as well as Family Office services. These services are provided at our head office, our branches and our subsidiary in Luxembourg.

### Corporate Banking

The Corporate Banking division of HSBC Trinkaus offers large and medium-sized companies a comprehensive spectrum of professional services tailored to meet individual needs. These include basic services for various lending and deposit products, as well as the comprehensive domestic and foreign payment transactions service (PCM = payments and cash management). In addition, we offer sophisticated specialised services such as interest-rate and currency management, international business, securities business, portfolio management and investment banking.

### Institutional Clients

In the Institutional Clients division HSBC Trinkaus offers its institutional clients, namely fund-gathering institutions with major investment needs such as insurance companies, pension and investment funds and also banks, the full range of traditional and modern investment and re-financing instruments, as well as solutions specifically tailored to individual clients, e.g. to guarantee the value of large investment portfolios.

### Global Markets

The Global Markets division deals with the transactions in securities, financial instruments, foreign exchange and derivatives that HSBC Trinkaus undertakes on its own account and in its own name. Through its trading activities, therefore, the Bank itself participates in the market, acting as a market-maker whilst seeking to generate additional profit by pursuing clearly defined trading goals.

### Central Divisions

In addition to overhead costs that cannot be unambiguously allocated to specific business divisions, Central Divisions/Consolidation includes profits from selected strategic asset and liability items that cannot be directly attributed to one particular division, as well as the results of asset liability management. As in the previous year, this segment also includes the earnings contributions from securities processing for financial services providers.

Segment income is broken down into net interest income, net fee income and net trading income. The difference between the standardised risk-related costs in the operating segments (credit rating-related add-ons to drawings and limits not utilised) and the risk costs reported in the income statement is reported under Consolidation/Reconciliation. Wherever possible, administrative expenses are charged to the segments according to the principle of causation, while unallocated overhead expenses are charged to the Central Divisions.

Segment reporting by business division for 2011 and 2010 is as follows:

in €m		Private Banking	Corporate Banking	Institu- tional Clients	Global Markets	Central Divisions	Eco- nomic Group result	Consoli- dation / Recon- ciliation	Total
Net interest income	2011	10.4	59.8	3.1	5.5	70.1	148.9	0.0	148.9
	2010	11.0	50.7	2.5	3.8	60.7	128.7	0.0	128.7
Net loan impairment and other credit risk provisions	2011	0.7	8.3	1.1	0.2	0.5	10.8	-23.5	-12.7
	2010	1.1	10.6	1.5	0.1	0.1	13.4	-5.7	7.7
Net interest income after net loan impair- ment and other credit risk provisions	2011	9.7	51.5	2.0	5.3	69.6	138.1	23.5	161.6
	2010	9.9	40.1	1.0	3.7	60.6	115.3	5.7	121.0
Share of profit in associates	2011	0.0	0.0	0.0	0.0	0.7	0.7	0.0	0.7
	2010	0.0	0.0	0.0	0.0	0.4	0.4	0.0	0.4
Net fee income	2011	94.5	108.4	165.1	1.1	16.4	385.5	0.0	385.5
	2010	94.4	107.4	173.8	5.3	23.1	404.0	0.0	404.0
Operating trading income	2011	0.0	-0.2	5.7	92.2	23.4	121.1	0.0	121.1
	2010	0.0	-0.3	5.5	93.5	25.9	124.6	0.0	124.6
Income after loan impairment and other credit risk provisions	2011	104.2	159.7	172.8	98.6	110.1	645.4	23.5	668.9
	2010	104.3	147.2	180.3	102.5	110.0	644.3	5.7	650.0
Administrative expenses	2011	73.9	96.6	112.9	50.6	140.3	474.3	0.0	474.3
	2010	74.6	85.6	108.0	52.7	118.4	439.3	0.0	439.3
Of which deprecia- tion and amortisation	2011	1.7	1.3	0.7	0.6	16.8	21.1	0.0	21.1
	2010	1.7	1.2	0.9	0.5	16.1	20.4	0.0	20.4
Other operating income	2011	0.0	0.0	0.0	0.0	12.2	12.2	0.0	12.2
	2010	0.0	0.0	0.0	0.0	9.6	9.6	0.0	9.6
Operating profit	2011	30.3	63.1	59.9	48.0	-18.0	183.3	23.5	206.8
	2010	29.7	61.6	72.3	49.8	1.2	214.6	5.7	220.3
Income from financial assets	2011	0.0	0.0	0.0	0.0	-4.8	-4.8	0.0	-4.8
	2010	0.0	0.0	0.0	0.0	-0.6	-0.6	0.0	-0.6
Income from deriva- tives in the bank book	2011	0.0	0.0	0.0	0.0	-4.3	-4.3	0.0	-4.3
	2010	0.0	0.0	0.0	0.0	-4.2	-4.2	0.0	-4.2
Other net income	2011	0.0	0.0	0.0	0.0	5.4	5.4	0.0	5.4
	2010	0.0	0.0	0.0	0.0	-5.5	-5.5	0.0	-5.5
Profit before taxes	2011	30.3	63.1	59.9	48.0	-21.7	179.6	23.5	203.1
	2010	29.7	61.6	72.3	49.8	-9.1	204.3	5.7	210.0
Taxation	2011	9.2	19.8	18.8	15.1	0.7	63.6	7.4	71.0
	2010	9.2	19.3	22.8	15.5	2.0	68.8	1.8	70.6
Net profit for the year	2011	21.1	43.3	41.1	32.9	-22.4	116.0	16.1	132.1
	2010	20.5	42.3	49.5	34.3	-11.1	135.5	3.9	139.4
Change versus previous year in %		2.9	2.4	-17.0	-4.1	>100.0	-14.4	>100.0	-5.2

The prolonged debt crisis that deteriorated further in the course of the year in some European countries and in the US brought about growing uncertainty in 2011 as a whole. This reinforced uncertainty among players on the financial markets. Against the backdrop of this difficult market environment, the significant contributions to operating income made by HSBC Trinkaus' four core segments demonstrate the strategic balance and stability of our client-based business model. The Private Banking and Corporate Banking segments were able to further improve on their good prior-year results. These positive developments confirm the success of the Bank's growth strategy that was first implemented in 2010. Global Markets almost succeeded in replicating its strong result from the previous year. Given the unfavourable environment, this should be interpreted as a particular success as well as underlining the position of our Bank's client-based Global Markets segment. The Institutional Clients segment lagged behind the prior-year result due to extraordinary income generated from a capital increase in the fourth quarter of last year.

Corporate Banking recorded the highest contribution to results of all segments and succeeded in offsetting the loss of noteworthy revenues from capital measures last year, in which we played a leading role. This was achieved through growth in fee income from advisory mandates and from its asset management operations. Furthermore, the constant increase in volume in the lending business more than compensated for the decline in net interest income attributable to margins. The higher margins in the deposit-taking business due to the increase in the ECB's key rates also impacted net interest income to a greater extent than the significant increase in volume.

In the Private Banking segment, the decline in net interest income as a result of lower interest rates and utilisation of credit facilities was balanced by higher net fee income in traditional personalised wealth management and asset management. The inflow of funds from new and existing clients made a considerable contribution and emphasises the high degree of confidence our clients place in our investment strategies.

In the Institutional Clients segment, the sharp increase in revenues in the asset management and the transaction-led equities business, as well as in sales trading, once again failed to match the very high revenues from the previous year that were generated from a capital increase and the distribution of fixed-income products.

Global Markets posted strong revenue growth in treasury, which was overcompensated slightly by falling revenue in equity, equity derivative and foreign exchange trading.

Against the background of the continuing crisis in the Eurozone, measures for limiting cost increases were stepped up in all of the Bank's segments during the year. This could only ease the rise in administrative expenses over the previous year in the entire bank due to the increase in staff number to 2,577 as part of the growth strategy, higher IT investments to improve the Bank's competitive position and higher regulatory costs.

		Private Banking	Corporate Banking	Institutional Clients	Global Markets	Central Divisions	Total	Adjustments	Values as at balance sheet date
Cost-efficiency ratio in %	2011	70.4	57.5	64.9	51.2	0.0	71.4	0.0	71.4
	2010	70.8	54.2	59.4	51.4	0.0	66.9	0.0	66.9
Assets* in €m	2011	443.0	2,005.0	2,692.0	5,280.6	9,499.4	19,920.0	714.4	20,634.4
	2010	535.0	1,660.0	2,268.0	5,710.7	9,657.6	19,831.3	-1,247.3	18,584.0
Liabilities* in €m	2011	3,354.0	4,624.0	1,651.0	2,408.9	6,803.8	18,841.7	-30.2	18,811.5
	2010	3,259.0	3,773.0	1,515.1	2,920.6	5,467.0	16,934.6	-396.1	16,538.5
Items for mandatory inclusion* in €m	2011	465.4	2,841.7	940.7	479.7	3,725.2	8,452.6	1,147.4	9,600.0
	2010	518.5	2,821.8	922.7	785.9	2,782.5	7,831.4	281.6	8,113.0
Attributable shareholders' equity* in €m	2011	146.5	384.2	194.1	148.0	356.2	1,228.9	81.6	1,310.5
	2010	146.9	377.2	187.3	173.6	187.0	1,072.0	217.7	1,289.7
Employees	2011	228	266	256	85	1,742	2,577	0	2,577
	2010	239	217	246	99	1,639	2,440	0	2,440
Return on equity before taxes (%)	2011	20.7	16.4	30.9	32.4	0.0	16.5	0.0	0.0
	2010	20.2	16.3	38.6	28.7	0.0	19.6	0.0	0.0

\* Annual average

Assets, liabilities and items for mandatory inclusion are based on the average values of the Bank's management information system. The differences with respect to the values on the reporting date as at year-end are shown in the adjustments column.

The cost-efficiency ratio is a measure of the segments' cost efficiency and reveals the ratio of total administration expenses to income before net loan impairment and other credit risk provisions. Lower costs on virtually constant revenues contributed towards the slight improvement year-on-year in this indicator in the Private Banking and Global Markets segments. On the other hand, the cost-efficiency ratio increased in Corporate Banking and Institutional Clients, since their growth strategy remained intact despite the unfavourable environment, resulting in a disproportionate increase in administrative expenses. The

cost-efficiency ratio at Group level deteriorated sharply to 71.4 %.

The capital resources of the business segments are made up of a base amount, which is identical for each segment, plus a variable portion calculated according to the amount of risk-weighted assets in a given segment.

The assignment of assets, liabilities, risk assets and balance sheet equity follows the assignment of customers to each segment according to the Bank's management information system. The greatest increase in items for mandatory inclusion was reported in the Central Divisions segment, while risk assets in Corporate Banking and Institutional Clients remained virtually constant. Private Clients and Global Markets reported moderate and sharp declines, respectively.

The results of the various companies' activities, which are classified geographically, are illustrated below. Segment allocation is determined by the registered office of the respective Group company:

in €m		Germany	Luxembourg	Remainder	Total
Pre-tax profit	2011	196.1	7.1	-0.1	203.1
	2010	193.9	15.0	1.1	210.0

Long-term segment assets amounted to € 276.8 million (2010: € 280.0 million) during the year under report, with Germany accounting for € 269.3 million (2010: € 271.1 mil-

lion) thereof and the Luxembourg region for € 7.5 million (2010: € 8.3 million).

## 55 Measurement Classes

The following table provides an overview of the measurement classes underlying each balance sheet item:

Assets as at 31.12.2011 in €m					
Measurement class	At amortised cost		At fair value		Total
Measurement category	Loans and receivables	Other financial assets	Held-for-trading	Available-for-sale	
Cash reserve		672.2			672.2
Loans and advances to banks*	1,857.6				1,857.6
Loans and advances to customers*	3,690.1				3,690.1
Trading assets			9,852.3		9,852.3
Financial assets		52.2		4,112.5	4,164.7
Other financial assets	10.5	19.9			30.4
Total financial instruments	5,558.2	744.3	9,852.3	4,112.5	20,267.3
Other assets not included under IAS 39					367.1
Total assets					20,634.4

Liabilities as at 31.12.2011 in €m				
Measurement class	At amortised cost		At fair value	Total
Measurement category	Other financial commitments		Held-for-trading	
Deposits by banks	749.6			749.6
Customer accounts**	12,413.3			12,413.3
Certificated liabilities	10.0			10.0
Trading liabilities			5,426.0	5,426.0
Subordinated capital	353.3			353.3
Other financial instruments	93.0			93.0
Total financial instruments	13,619.2		5,426.0	19,045.2
Other liabilities not included under IAS 39				278.6
Shareholders' equity				1,310.5
Minority interests				0.1
Total assets				20,634.4

\* Net loan impairment provision is reported by means of direct deduction from loans and advances to banks or from loans and advances to customers.

\*\* Our customers' deposits are used in part internally to refinance our trading divisions.

Assets as at 31.12.2010 in €m					
Measurement class	At amortised cost		At fair value		Total
Measurement category	Loans and receivables	Other financial assets	Held-for-trading	Available-for-sale	
Cash reserve		336.1			336.1
Loans and advances to banks*	1,402.9				1,402.9
Loans and advances to customers*	3,040.5				3,040.5
Trading assets			10,130.6		10,130.6
Financial assets		51.7		3,254.2	3,305.9
Other financial instruments	14.1	4.3			18.4
<b>Total financial instruments</b>	<b>4,457.5</b>	<b>392.1</b>	<b>10,130.6</b>	<b>3,254.2</b>	<b>18,234.4</b>
Other assets not included under IAS 39					349.6
<b>Total assets</b>					<b>18,584.0</b>

Liabilities as at 31.12.2010 in €m				
Measurement class	At amortised cost		At fair value	Total
Measurement category	Other financial commitments		Held-for-trading	
Deposits by banks	1,180.4			1,180.4
Customer accounts**	10,148.0			10,148.0
Certificated liabilities	10.0			10.0
Trading liabilities			5,200.1	5,200.1
Subordinated capital	378.4			378.4
Other financial instruments	102.2			102.2
<b>Total financial instruments</b>	<b>11,819.0</b>		<b>5,200.1</b>	<b>17,019.1</b>
Other liabilities not included under IAS 39				275.1
Shareholders' equity				1,289.7
Minority interests				0.1
<b>Total assets</b>				<b>18,584.0</b>

\* Net loan impairment provision is reported by means of direct deduction from loans and advances to banks or from loans and advances to customers.

\*\* Our customers' deposits are used in part internally to refinance our trading divisions.

## 56 Fair Value of Financial Instruments

The fair value of a financial instrument is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing and independent parties. Details of the valuation can be found in Note 5.

Assets and liabilities held-for-trading as well as financial assets are reported in the balance sheet at fair value, i.e. book value equates to fair value. Cash reserves, interbank

funds, book-entry claims on customers and customer deposits are excluded from the valuation. Based on the short maturity of these transactions, the difference between fair value and book value is insignificant. For other items in the balance sheet, the following differences are noted between the fair value and reported book values:

in €m	31.12.2011		31.12.2010	
Assets	Book value	Fair value	Book value	Fair value
Other financial instruments	30.4	30.4	18.4	18.4

in €m	31.12.2011		31.12.2010	
Liabilities	Book value	Fair value	Book value	Fair value
Deposits by banks (from the measurement of long-term promissory note loans borrowed)	749.6	749.6	1,180.4	1,180.4
Customer accounts (from the measurement of long-term promissory note loans borrowed)	12,413.3	12,449.2	10,148.0	10,170.5
Certificated liabilities	10.0	9.2	10.0	9.5
Subordinated capital	353.3	393.7	378.4	401.1
Other financial instruments	93.0	93.0	102.2	102.2

The financial instruments whose fair value cannot be determined reliably are listed in the following table. These are mainly partnerships or unlisted public limited

companies for which there is no active market. Measurement is therefore at cost.

in €m	31.12.2011	31.12.2010
	Book value	Book value
Partnerships	15.8	15.9
Holdings in unlisted public limited companies	36.4	35.8
<b>Total</b>	<b>52.2</b>	<b>51.7</b>

Partnerships for which there is no active market were not disposed of during the year under report (2010: € 0.1 mil-

lion). The Bank has no intentions to dispose of further partnerships at this point in time.



The following overview shows which methods were applied to calculate the fair value of the items measured at fair value:

Measurement method	Active market	Internal model with		Measured at cost	Total
		observed parameters	unobservable parameters		
<b>31.12.2011</b>					
<b>in €m</b>					
Trading assets	2,108.7	7,726.9	16.7	0.0	9,852.3
of which derivatives in hedging relationships	0.0	0.0	0.0	0.0	0.0
Financial assets	1,090.5	3,016.0	6.0	52.2	4,164.7
Trading liabilities	116.5	5,260.6	48.9	0.0	5,426.0
of which derivatives in hedging relationships	0.0	39.5	0.0	0.0	39.5

Measurement method	Active market	Internal model with		Measured at cost	Total
		observed parameters	unobservable parameters		
<b>31.12.2010</b>					
<b>in €m</b>					
Trading assets	1,326.5	8,786.3	17.8	0.0	10,130.6
of which derivatives in hedging relationships	0.0	0.8	0.0	0.0	0.8
Financial assets	922.4	2,326.0	5.8	51.7	3,305.9
Trading liabilities	104.9	5,031.5	63.7	0.0	5,200.1
of which derivatives in hedging relationships	0.0	5.7	0.0	0.0	5.7

For some financial instruments, quoted prices are used as fair values (so-called level 1). The fair values of the financial instruments are measured using the Bank's own internal measurement models. These models allow all parameters included on the market to be observed (so-called level 2).

Equity instruments comprise for the most part plain vanilla options or single barrier options. The former are measured by means of a Black-Scholes approach (binomial process), while the latter are evaluated using an approximate valuation approach. The following observable market parameters – underlying spot, underlying volatility, underlying dividends and interest rate – are included in these models.

Level 2 transactions in interest rate instruments are generally valued using the discounted cash flow method or the Black-Scholes method. The parameters required here (swap rates and volatility) can also be observed on the market.

Financial instruments in the amount of € 101.4 million were transferred from level 1 to level 2 during the year under report (2010: € 0.0 million). Similarly, financial instruments in the amount of € 482.4 million were transferred from level 2 to level 1 (2010: € 0.0 million).

Additionally, the fair value of some financial instruments was calculated using valuation models, where at least one of the parameters used cannot be observed on the market (so-called level 3). These instruments include amongst other things equity certificates on two or more underlyings (multi underlying certificates) or currency-hedged certificates (quanto certificates), which can be measured in an analytical Black-Scholes approach. As a rule, the correlation between the individual underlyings or between the underlying and the foreign currency represent the parameters that are not observable on the market.

In the year under report, the volume of level 3 financial instruments amounted to € 71.6 million (2010: € 87.3 million). The portfolio of level 3 financial instruments developed as follows in the year under report:

in €m	Trading assets	Financial assets	Trading liabilities	Total
<b>01.01.2011</b>	<b>17.8</b>	<b>5.8</b>	<b>63.7</b>	<b>87.3</b>
Changes in the carrying amount				
recognised in the income statement	-1.1	0.2	-19.5	-20.4
recognised directly in equity	0.0	0.0	0.0	0.0
Purchases	0.0	0.0	0.0	0.0
Issuance	0.0	0.0	37.4	37.4
Sales	0.0	0.0	0.6	0.6
Maturities	0.0	0.0	28.3	28.3
Transfers to level 3	0.0	0.0	0.0	0.0
Transfers out of level 3	0.0	0.0	3.8	3.8
<b>31.12.2011</b>	<b>16.7</b>	<b>6.0</b>	<b>48.9</b>	<b>71.6</b>

in €m	Trading assets	Financial assets	Trading liabilities	Total
<b>01.01.2010</b>	<b>37.9</b>	<b>7.4</b>	<b>82.8</b>	<b>128.1</b>
Changes in the carrying amount				
recognised in the income statement	-8.0	-1.6	-3.3	-12.9
recognised directly in equity	0.0	0.0	0.0	0.0
Purchases	4.9	0.0	0.0	4.9
Issuance	0.0	0.0	42.6	42.6
Sales	0.0	0.0	0.0	0.0
Maturities	17.0	0.0	58.4	75.4
Transfers to level 3	0.0	0.0	0.0	0.0
Transfers out of level 3	0.0	0.0	0.0	0.0
<b>31.12.2010</b>	<b>17.8</b>	<b>5.8</b>	<b>63.7</b>	<b>87.3</b>

A 25 % change in the unobservable parameters would lead to a € 0.9 million (2010: € 1.5 million) change in the market value.

## 57 Day-1 Profit or Loss

Financial assets measured on the basis of an internal model, where at least one key measurement parameter is unobservable on the market, can be subject to a day-1

profit or loss. The day-1 profit or loss is determined as the difference between the theoretical price and the price actually traded.

The day-1 profit or loss developed as follows during the year under report:

in €m	2011	2010
As at 01.01.	2.3	1.8
New business	2.3	0.7
Day-1 profit or loss recognised in the income statement	-2.4	-0.2
of which positions closed out	-1.2	-0.1
of which matured transactions	-1.2	-0.1
of which observable market parameters	0.0	0.0
As at 31.12.	2.2	2.3

## 58 Holdings in Foreign Currency

As at 31 December 2011, assets denominated in a foreign currency were valued at € 1,585.7 million (2010: € 1,660.2 million) and the corresponding liabilities at € 2,785.3 million (2010: € 2,888.3 million). As in the previous year, the bulk of these assets and liabilities were in US dollars.

The market value of the derivatives is always reported in euros.

## 59 Derivatives Business

We chiefly employ derivative financial instruments in our business with clients. We assess the resultant open items individually in order to deploy them in such a way as to generate profits. Reporting on transactions with derivatives in accordance with section 36 of the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – RechKredV), the Bank follows the recommendations of the Accounting Committee of the German Federal Association of Banks (Bundesverband deutscher Banken e.V. – BdB). In accordance with the international standard, the market values stated reflect the replacement costs on trading activities in the event of counterparty default, regardless of their credit rating and any netting agreements. As there is no counterparty risk on exchange-traded derivatives, the table below does not include the market values of these derivatives.

## Breakdown of the derivatives business by nominal amount

in €m		Nominal amounts with a residual term of			Nominal amounts	
		up to 1 year	over 1 year up to 5 years	over 5 years	Total 2011	Total 2010
OTC products	FRA's	5	0	0	5	0
	Interest rate swaps	5,345	11,391	9,451	26,186	24,854
	Interest rate options	1,073	1,358	1,017	3,448	5,912
	Forward transactions	44	655	192	891	1,104
Exchange-listed	Interest rate futures	1,018	161	0	1,179	3,851
	Interest rate options	125	807	184	1,116	0
Interest rate transactions		7,610	14,372	10,844	32,826	35,721
OTC products	Foreign exchange forwards	27,119	1,345	312	28,775	27,207
	Cross currency swaps	557	204	175	936	436
	Foreign exchange options	2,628	196	0	2,824	2,792
Foreign exchange-based transactions*		30,304	1,744	487	32,535	30,435
OTC products	Forward transactions	1	1	0	2	2
	Equity/index options	58	76	0	134	232
	Equity swaps	63	57	21	141	193
Exchange-listed	Equity/index futures	356	75	0	431	846
	Equity/index options	3,727	1,428	923	6,078	5,435
Equity/index-based transactions		4,205	1,638	944	6,787	6,708
Total financial derivatives		42,119	17,754	12,275	72,148	72,864

\* including gold transactions

## Breakdown of the derivatives business by market value

in €m		Positive market values with a residual term of			Positive market values		Negative market values	
		up to 1 year	over 1 year up to 5 years	over 5 years	Total 2011	Total 2010	Total 2011	Total 2010
OTC products	FRAs	0	0	0	0	0	0	0
	Interest rate swaps	51	270	875	1,197	876	1,538	1,146
	Interest rate options	7	30	31	68	59	78	75
	Forward transactions	1	0	0	1	19	11	2
Interest rate transactions		59	300	907	1,266	954	1,627	1,223
OTC products	Foreign exchange forwards	550	48	4	602	401	579	372
	Cross currency swaps	15	2	0	17	17	1	13
	Foreign exchange options	26	8	0	34	32	35	34
Foreign exchange-based transactions*		590	58	4	652	450	615	419
OTC products	Forward transactions	0	0	0	0	0	0	0
	Equity/index options	16	13	0	30	31	48	83
	Equity swaps	1	3	0	4	4	5	20
Equity/index-based transactions		17	16	0	34	35	53	103
Total financial derivatives		667	374	911	1,952	1,439	2,296	1,745

\* including gold transactions

## Hedging instruments

HSBC Trinkaus uses specific derivatives (usually interest rate swaps) to hedge against market interest rate risk on financial assets (so-called fair value hedges; cf. Note 6). This

hedging relationship resulted in negative market values of € 39.5 million (2010: € 5.8 million) as at 31 December 2011 and no positive market values (2010: € 0.9 million).

The hedge result is specified in more detail in the following overview:

Profit and loss in €m	2011	2010
From hedging instruments	-28.3	-1.7
From underlying transactions	28.4	1.9

## 60 Contingent Liabilities and Other Obligations

in €m	31.12.2011	31.12.2010
Contingent liabilities on guarantees and indemnity agreements	1,746.1	1,305.4
Irrevocable loan commitments	5,156.4	3,751.9
<b>Total</b>	<b>6,902.5</b>	<b>5,057.3</b>

The 27.2 % increase in loan commitment is due to the growth strategy pursued by the Bank in the Corporate Banking segment.

The contingent liabilities arising from shares in cooperatives remained unchanged from the previous year, at € 0.2 million.

Our liability to make further contributions arising from our interest in Liquiditäts-Konsortialbank GmbH was also unchanged, at € 3.7 million. In addition, we are also contingently liable pro rata for fulfilment of the additional funding obligations of other partners belonging to the Association of German Banks (Bundesverband deutscher Banken e. V.).

Obligations from lease agreements (incl. rental and lease contracts) amounted to € 97.5 million (2010: € 78.5 million) as at the balance sheet date.

in €m	31.12.2011	31.12.2010
Up to 1 year	21.1	26.3
Over 1 year up to 5 years	41.4	25.1
Over 5 years	35.0	27.1
<b>Total commitments arising from leasing and rental contracts</b>	<b>97.5</b>	<b>78.5</b>

The Bank outsourced to external third parties the operation of the information centre for card payments and the establishment and operation of an account information

centre in accordance with section 24 c of the German Banking Act (KWG). The outsourced sections do not have any material impact on the Bank's financial situation.

## 61 Assets Pledged as Collateral

Securities with a nominal value of € 960.1 million (2010: € 898.9 million) were deposited as collateral for transactions on Eurex and for securities lending transactions (cf. Note 31).

Debt instruments with a nominal value of € 4,449.2 million (2010: € 3,873.7 million) were available for use as collateral for peak funding facilities on the balance sheet date.

## 62 Trust Activities

Trust activities may not be shown on a bank's balance sheet. As an indication of the extent of our potential liability, the following table shows the value of off-balance-sheet trust activities:

in €m	31.12.2011	31.12.2010
<b>Trust assets</b>	<b>337.6</b>	<b>373.7</b>
Loans and advances to banks	162.4	153.2
Loans and advances to customers	23.9	68.4
Investments	151.3	152.1
<b>Trust liabilities</b>	<b>337.6</b>	<b>373.7</b>
Deposits by banks	0.6	2.2
Customer accounts	337.0	371.5



## 63 Participating Interests

HSBC Trinkaus & Burkhardt AG's participating interests can be presented as follows:

Company	Registered office	Percentage share of issued share capital in %	Equity held in the company in € 000	Net income for 2011 in € 000
<b>Banks and near-bank entities</b>				
HSBC Trinkaus & Burkhardt Gesellschaft für Bankbeteiligungen mbH	Düsseldorf	100.0	117,485	0 *
HSBC Trinkaus & Burkhardt (International) S.A.	Luxembourg	100.0	112,803	11,853
HSBC Trinkaus Investment Management Ltd.	Hong Kong	100.0	641	144
Internationale Kapitalanlagegesellschaft mbH	Düsseldorf	100.0	24,000	0 *
HSBC Trinkaus Investment Managers S.A.	Luxembourg	100.0	4,267	347
HSBC INKA Investment-AG TGV**	Düsseldorf	100.0	1,963	6
HSBC Transaction Services GmbH	Düsseldorf	100.0	14,641	0 *
HSBC Trinkaus Family Office GmbH	Düsseldorf	100.0	25	0 *
HSBC Trinkaus Gesellschaft für Kapitalmarktinvestments OHG***	Düsseldorf	10.0	547,847	7,783
HSBC Global Asset Management (Deutschland) GmbH	Düsseldorf	100.0	5,001	0 *
HSBC Global Asset Management (Österreich) GmbH	Vienna	100.0	401	62
HSBC Global Asset Management (Switzerland) AG***	Zurich	50.0	1,036	79
<b>Companies with a special mission</b>				
HSBC Trinkaus Real Estate GmbH	Düsseldorf	100.0	167	0 *
HSBC Trinkaus Immobilien Beteiligungs-KG	Düsseldorf	100.0	3,010	0
Trinkaus Europa Immobilien-Fonds Nr. 3 GmbH	Düsseldorf	100.0	57	5
HSBC Trinkaus Europa Immobilien-Fonds Nr. 5 GmbH	Düsseldorf	100.0	31	5
Trinkaus Canada Immobilien-Fonds Nr. 1 Verwaltungs-GmbH	Düsseldorf	100.0	61	6
Trinkaus Canada 1 GP Ltd.****	Toronto	100.0	-19	-19
Trinkaus Australien Immobilien-Fonds Nr. 1 Treuhand GmbH	Düsseldorf	100.0	23	2
Trinkaus Immobilien-Fonds Verwaltungs-GmbH	Düsseldorf	100.0	45	16
Trinkaus Immobilien-Fonds Geschäftsführungs-GmbH	Düsseldorf	100.0	24	0
Gesellschaft für industrielle Beteiligungen und Finanzierungen mbH	Düsseldorf	100.0	500	0 *
Trinkaus Private Equity Management GmbH	Düsseldorf	100.0	1,973	1,902
HSBC Trinkaus Private Wealth GmbH	Düsseldorf	100.0	261	0 *

Company	Registered office	Percentage share of issued share capital in %	Equity held in the company in € 000	Net income for 2011 in € 000
<b>Real estate companies</b>				
Grundstücksgesellschaft Trinkausstraße KG	Düsseldorf	100.0	12,596	942
Joachim Hecker Grundbesitz KG	Düsseldorf	100.0	9,082	2,273
<b>Other companies</b>				
HSBC Trinkaus Consult GmbH****	Düsseldorf	100.0	6,134	449
Trinkaus Private Equity Verwaltungs GmbH	Düsseldorf	100.0	33	6
sino AG*****	Düsseldorf	26.6	4,450	289

\* Profit-transfer agreement

\*\* Equities issued by private companies

\*\*\* Consolidated at equity

\*\*\*\* Figures as at 31.12.10

\*\*\*\*\* Figures as at 30.06.11; consolidated at equity

## 64 Releasing Subsidiaries from the Disclosure Requirements of the German Commercial Code (HGB)

The following subsidiaries intend to make use of the exemption afforded by Section 264 (3) of the German Commercial Code (HGB) and will not publish their financial statements for the year 2011:

- HSBC Trinkaus & Burkhardt Gesellschaft für Bankbeteiligungen mbH, Düsseldorf
- HSBC Trinkaus Family Office GmbH, Düsseldorf
- HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf
- Internationale Kapitalanlagegesellschaft mbH, Düsseldorf
- HSBC Transaction Services GmbH, Düsseldorf
- HSBC Trinkaus Real Estate GmbH, Düsseldorf
- HSBC Trinkaus Private Wealth GmbH, Düsseldorf
- Gesellschaft für industrielle Beteiligungen und Finanzierungen mbH, Düsseldorf

## 65 Letter of Comfort

HSBC Trinkaus & Burkhardt AG undertakes to ensure that all fully-consolidated companies of the Group – HSBC Trinkaus & Burkhardt (International) S.A., Luxembourg, Internationale Kapitalanlagegesellschaft mbH, Düsseldorf, HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf and Gesellschaft für industrielle Beteiligungen und Finanzierungen mbH, Düsseldorf – are in a position to fulfil their contractual obligations.

Moreover, HSBC Trinkaus & Burkhardt AG regularly indemnifies the current general partners or managing partners of those fully consolidated companies having the legal form of a KG (limited partnership), as well as those of the Trinkaus property fund companies and Trinkaus private equity companies against all third-party claims that are made against them in their legal capacity or activities as general partners in the respective companies, provided they are natural persons.

## 66 Staff

Annual average	2011	2010
Staff employed abroad	219	218
Staff employed in Germany	2,316	2,120
<b>Total (including trainees)</b>	<b>2,535</b>	<b>2,338</b>
of which:		
female members of staff	1,104	1,025
male members of staff	1,431	1,313

## 67 Auditors' Fees

The following fees for the auditors of the consolidated accounts, KPMG AG Wirtschaftsprüfungsgesellschaft, including expenses and turnover tax, were reported as expense:

in €m	2011	2010
Audits	0.7	0.7
Other audit or valuation services	0.5	0.4
Tax advisory services	0.2	0.0
Other services	0.0	0.2
<b>Total</b>	<b>1.4</b>	<b>1.3</b>

## 68 Business Relationships with Companies and Persons Defined as Related Parties

We foster intensive business relationships with other HSBC companies. These business relationships relate firstly to normal bank transactions, which are carried out at market prices and are usually unsecured. Derivative transactions on the other hand are generally concluded under master agreements that allow netting and secured within the scope of CSAs (Credit Support Annex). Secondly, there

are cooperation and agency agreements with various companies of the HSBC Group. These are also concluded under normal market conditions. Overall, the consolidated income statement includes € 138.7 million (2010: € 120.2 million) in income and € 27.4 million (2010: € 21.3 million) in expenses for transactions with HSBC Holdings plc, London, and its affiliated companies. In the 2011 financial year interest income from other HSBC companies amounted to € 23.4 million (2010: € 13.6 million), while interest expense stood at € 9.6 million (2010: € 8.3 million).

Loans and advances to banks and customers include the following amounts:

in €m	Affiliated companies		Associated Companies	
	31.12.2011	31.12.2010	31.12.2011	31.12.2010
Loans and advances to banks	1,041.9	445.7	0.0	0.0
Loans and advances to customers	0.0	0.3	40.4	26.3
<b>Total</b>	<b>1,041.9</b>	<b>446.0</b>	<b>40.4</b>	<b>26.3</b>

Liabilities to banks and customers include the following amounts:

in €m	Affiliated companies		Associated Companies	
	31.12.2011	31.12.2010	31.12.2011	31.12.2010
Deposits by banks	321.2	643.5	0.0	0.0
Customer accounts	21.8	13.8	10.2	8.5
<b>Total</b>	<b>343.0</b>	<b>657.3</b>	<b>10.2</b>	<b>8.5</b>

Trading assets/liabilities include the following transactions concluded with affiliated enterprises:

in €m	Securities		Derivatives	
	31.12.2011	31.12.2010	31.12.2011	31.12.2010
Trading assets	0.0	171.0	892.6	734.7
Trading liabilities	0.0	0.0	1,468.3	999.8
Financial assets	733.2	474.5	0.0	0.0

### Compensation of the Executive Bodies

The main components of the compensation system are presented in the Consolidated Management Report (please refer to Chapter 1: Structure and Management). The following overview complies with the requirements of German Accounting Standard (GAS) No. 17. As resolved by the Annual General Meeting held on 5 June 2007, information is disclosed pursuant to section 314 sentence 1 No. 6 (a) sentences 5 to 9 of the German Commercial Code (HGB).

The remuneration of the members of the Management Board is comprised of both a fixed and a variable component. At €2,544.0 thousand, the fixed remuneration of all members of the Management Board for 2011 was higher than the previous year (€ 2,189.8 thousand) due to the expansion of the Management Board. The variable share of the remuneration is € 11,200.0 thousand (2010: € 12,355.9 thousand) and includes a long-term remuneration component of € 6,332.5 thousand (€ 6,512.0 thousand).

Other compensation in the amount of € 124.2 thousand (2010: € 86.9 thousand) comprises mainly remuneration paid for the use of a company car, insurance premiums plus other valuable benefits that must be taxed individually.

Provisions totalling € 15.7 million (2010: € 13.3 million) have been created to cover pension obligations to the members of the Management Board and their surviving dependents according to IFRS.

Subject to the approval of the proposed appropriation of profit by the Annual General Meeting on 5 June 2012, the compensation of the Supervisory Board will be € 1,226,1890.07 (2011: € 1,134,330.82). The members of the Advisory Board received remuneration totalling € 372,375.00 (2010: € 362,025.00). Furthermore, fees were paid to two (2010: two) members of the Supervisory Board for consultancy services provided over the course of the financial year. These totalled € 270,725.00 (2010: € 313,862.50). No separate pension obligations exist for Supervisory Board members. The general rules for employees and former Managing Partners apply for the pension obligations to the employees' representatives as well as for the former Managing Partners of the Bank.

Pension payments to retired Managing Partners of HSBC Trinkaus & Burkhardt KGaA and Trinkaus & Burkhardt KG,

the legal predecessors of HSBC Trinkaus & Burkhardt AG, and their surviving dependents totalled € 4.1 million (2010: € 4.4 million). Provisions totalling € 33.5 million (2010: € 36.3 million) have been created to cover pension obligations to the members of the Management Board and their surviving dependents according to IFRS.

None of the Management Board members acquired shares in HSBC Trinkaus & Burkhardt AG over the course of the financial year. No subscription rights or other share option schemes involving the Bank's own shares were offered. The employees' representatives on the Supervisory Board basically have the right to participate in the share option scheme for employees described under Note 69.

As in the previous year, advances and loans were not granted to members of the Management Board. As at the balance sheet date, two members of the Supervisory Board availed of current account overdrafts totalling € 4,000 (2010: € 0). Contingent liabilities with respect to third parties in favour of members of executive bodies occurred only within the scope of the structure shown in Note 65.

## 69 Share-Based Payments

### Breakdown of the share option scheme

Type	Day of granting	Fair value per option right on the day of granting in €	Exercise price in €	Number of option rights 31.12.2011	Number of option rights 31.12.2010
SAYE 2006 (5Y)	01.08.2006	2.67	9.59	–	3,502
SAYE 2007 (5Y)	01.08.2007	2.99	9.08	4,807	6,784
SAYE 2008 (3Y/5Y)	01.08.2008	2.66/2.77	7.55	10,030	47,269
SAYE 2009 (3Y/5Y)	01.08.2009	1.59/1.50	3.64	773,805	791,160
SAYE 2010 (1Y/3Y/5Y)	01.08.2010	1.75/1.90/2.01	6.07	74,288	172,951
SAYE 2011 (1Y/3Y/5Y)	01.08.2011	1.41/1.53/1.61	5.80	195,857	–
<b>Total</b>				<b>1,058,787</b>	<b>1,021,666</b>

The fair value of the options is calculated uniformly within the Group by HSBC Holdings plc. On the day on which the options are granted, the fair value is calculated using the Lattice model, which is based on the assumptions of the Black-Scholes model. The share options are generally exercised by staff on August 1 of a financial year. The options

held by staff that availed of the right to exercise the options at a later stage are of minor importance.

The HSBC share price used for the immediate exercise of the option rights on 1 August 2011 was € 6.84 (1 August 2010: € 7.74).

### Development of the share option scheme

	Type	Number of option rights	Weighted exercise price in €
Balance as at 01.01.2011	SAYE 2006-2010	1,021,666	4.29
Granted in the course of the year	SAYE 2011	195,857	5.80
Exercised in the course of the year	SAYE 2006 (5Y)/ SAYE 2008 (3Y)/ SAYE 2010 (1Y)	129,096	6.56
Forfeited in the course of the year	SAYE 2007-2011	29,640	7.04
Balance as at 31.12.2011		1,058,787	4.27
of which outstanding option rights		962,692	
of which exercisable option rights		96,095	

The staff expenses to be taken into account in the year under report are € 0.6 million (2010: € 0.7 million).

### Breakdown of the share participation scheme

As in the previous year, performance-related remuneration for employees and the Management Board was partially carried out by means of assigning shares of HSBC Holdings plc in 2011. It can be broken down as follows:

in €m	Performance-related remuneration in HSBC shares	
	For financial year 2011	For financial year 2010
Maturing in March 2012	0.0	3.8
Maturing in March 2013	5.3	3.8
Maturing in March 2014	5.3	3.8
Maturing in March 2015	5.2	0.0
<b>Total</b>	<b>15.8</b>	<b>11.3</b>

The total value of capital reserves for share-based payments at the end of the reporting period amounts to € –1.3 million (2010: € 6.6 million). The corresponding liability for share-based payments amounts to € 34.1 million (2010: € 20.9 million).

## 70 Statement on the German Corporate Governance Code Pursuant to Section 161 of the German Stock Corporation Act (AktG)

The Management Board and the Supervisory Board of the Bank have submitted their statement on the recommendations of the “Commission of the German Corporate Governance Code” and made this permanently available to the public on the HSBC Trinkaus & Burkhardt AG website under [www.hsbctrinkaus.de/global/display/wirueberuns/berichteundinvestorrelations/corporategovernance](http://www.hsbctrinkaus.de/global/display/wirueberuns/berichteundinvestorrelations/corporategovernance).

## 71 Offices held by Members of the Management Board

As at 31 December 2011, the members of the Management Board of HSBC Trinkaus & Burkhardt AG sit on the following statutory supervisory boards and comparable management bodies: Messrs Manfred Krause (member of the Management Board) and Florian Fautz (member of the Executive Committee) did not hold any offices subject to disclosure during the year under report.

<b>Andreas Schmitz (Chairman)</b>	
<b>Position</b>	<b>Company</b>
Chairman of the Supervisory Board	Börse Düsseldorf AG, Düsseldorf
Member of the Supervisory Board	HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf
Member of the Board of Directors	KfW-Bankengruppe, Frankfurt/Main
Member of the Board of Directors	Liquiditäts-Konsortialbank, Frankfurt/Main
Deputy member of the Board of Directors	L-Bank, Karlsruhe

<b>Paul Hagen</b>	
<b>Position</b>	<b>Company</b>
Chairman of the Supervisory Board	HFI Hansische Vermögensverwaltung AG, Hamburg
Deputy Chairman of the Board of Directors	Bankhaus Wölbern & Co. (AG & Co. KG), Hamburg
Deputy Chairman of the Supervisory Board	HSBC Transaction Services GmbH, Düsseldorf
Deputy Chairman of the Supervisory Board	HSBC Trinkaus & Burkhardt (International) S.A., Luxembourg
Member of the Supervisory Board	HSBC Trinkaus Investment Managers S.A., Luxembourg
Member of the Supervisory Board	RWE Supply & Trading GmbH, Essen
Member of the Advisory Board	SdB-Sicherungseinrichtungsgesellschaft deutscher Banken mbH, Berlin

<b>Dr. Olaf Huth</b>	
<b>Position</b>	<b>Company</b>
Chairman of the Supervisory Board	HSBC Trinkaus & Burkhardt (International) S.A., Luxembourg
Deputy Chairman of the Supervisory Board	HSBC Trinkaus Investment Managers S.A., Luxembourg
Deputy Chairman of the Supervisory Board	HSBC Trinkaus Real Estate GmbH, Düsseldorf
Member of the Supervisory Board	HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf
Member of the Supervisory Board	Internationale Kapitalanlagegesellschaft mbH, Düsseldorf

<b>Carola Gräfin v. Schmettow</b>	
<b>Position</b>	<b>Company</b>
Chairwoman of the Supervisory Board	HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf
Chairwoman of the Supervisory Board	HSBC Trinkaus & Burkhardt (International) S.A., Luxembourg
Chairwoman of the Supervisory Board	HSBC Trinkaus Investment Managers S.A., Luxembourg
Chairwoman of the Supervisory Board	Internationale Kapitalanlagegesellschaft mbH, Düsseldorf



<b>Dr. Rudolf Apenbrink</b>	
<b>Position</b>	<b>Company</b>
Chairman of the Board of Directors	HSBC Global Asset Management (Switzerland) AG, Zurich, Switzerland
Member of the Board of Directors	HSBC Global Asset Management (France), Paris, France
Member of the Supervisory Board	Internationale Kapitalanlagegesellschaft mbH, Düsseldorf

<b>Dr. Christiane Lindenschmidt</b>	
<b>Position</b>	<b>Company</b>
Chairwoman of the Supervisory Board	HSBC Transaction Services GmbH, Düsseldorf
Non-Executive Member of the Board of Directors	HSBC Securities Services S.A., Luxembourg
Member of the Supervisory Board	HSBC Trinkaus & Burkhardt (International) S.A., Luxembourg
Member of the Supervisory Board	HSBC Trinkaus Investment Managers S.A., Luxembourg
Member of the Supervisory Board	Internationale Kapitalanlagegesellschaft mbH, Düsseldorf

## 72 Offices Held by Other Members of Staff

As at 31 December 2011, the following employees sit on the following statutory supervisory boards or comparable control bodies of large corporations:

<b>Dr. Michael Böhm</b>	
<b>Position</b>	<b>Company</b>
Member of the Advisory Board	DPG Deutsche Performancemessungs-Gesellschaft für Wertpapierportfolios mbH, Frankfurt/Main

<b>Robert Demohn</b>	
<b>Position</b>	<b>Company</b>
Member of the Supervisory Board	HSBC Transaction Services GmbH, Düsseldorf

<b>Gerd Goetz</b>	
<b>Position</b>	<b>Company</b>
Member of the Supervisory Board	Kerdos Investment-AG TGV, Düsseldorf
Member of the Supervisory Board	sino AG, Düsseldorf
Member of the Supervisory Board	tick-TS AG, Düsseldorf

<b>Marcus Hollmann</b>	
<b>Position</b>	<b>Company</b>
Member of the Supervisory Board	HSBC Transaction Services GmbH, Düsseldorf

<b>Dr. Detlef Irmen</b>	
Position	Company
Member of the Supervisory Board	HSBC Transaction Services GmbH, Düsseldorf

<b>Wolfgang Jakobs</b>	
Position	Company
Member of the Supervisory Board	HSBC INKA Investment-AG TGV, Düsseldorf

<b>Marc Landvatter</b>	
Position	Company
Deputy Chairman of the Supervisory Board	Algopool InvAG, Cologne

<b>Dr. Manfred v. Oettingen</b>	
Position	Company
Member of the Supervisory Board	HSBC Global Asset Management (Deutschland) GmbH, Düsseldorf

<b>Heiko Schröder</b>	
Position	Company
Chairman of the Supervisory Board	HSBC INKA Investment-AG TGV, Düsseldorf

<b>Ulrich W. Schwittay</b>	
Position	Company
Deputy Chairman of the Supervisory Board	HSBC Trinkaus Real Estate GmbH, Düsseldorf

<b>Norbert Stabenow</b>	
Position	Company
Deputy Chairman of the Supervisory Board	HSBC INKA Investment-AG TGV, Düsseldorf

<b>Hans Jakob Zimmermann</b>	
Position	Company
Chairman of the Supervisory Board	Garant Schuh & Mode AG, Düsseldorf
Chairman of the Supervisory Board	Paragon AG, Delbrück
Chairman of the Supervisory Board	Schaltbau Holding AG, Munich
Member of the Supervisory Board	Merkur Bank KGaA, Munich
Member of the Board of Directors	Rheinzink GmbH & Co. KG, Datteln

### 73 Offices Held by Supervisory Board Members

The members of our Supervisory Board also sit on the statutory supervisory boards and the comparable control bodies listed below:

<b>Dr. Sieghardt Rometsch (Chairman)</b>	
<b>Position</b>	<b>Company</b>
Chairman of the Supervisory Board	Düsseldorfer Universitätsklinikum, Düsseldorf
Chairman of the Board of Directors	Management Partner GmbH, Stuttgart
Member of the Board of Directors	HSBC Private Banking Holdings (Suisse) S.A., Geneva, Switzerland

<b>Samir Assaf</b>	
<b>Position</b>	<b>Company</b>
Board Member	HSBC Bank Egypt S.A.E., Cairo, Egypt

<b>Peter W. Boyles</b>	
<b>Position</b>	<b>Company</b>
Chairman	HSBC Bank A.S., Istanbul, Turkey
Deputy Chairman	HSBC France S.A., Paris, France
Member of the Supervisory Board	S.A. des Galeries Lafayette, Paris, France
Director	HSBC Bank plc, London, Great Britain
Director	HSBC Bank Malta plc, Valletta, Malta

<b>Dr. Hans Michael Gaul</b>	
<b>Position</b>	<b>Company</b>
Member of the Supervisory Board	BDO AG, Hamburg
Member of the Supervisory Board	Evonik Industries AG, Essen
Member of the Supervisory Board	EWE Aktiengesellschaft, Oldenburg
Member of the Supervisory Board	Siemens AG, Munich
Member of the Supervisory Board	VNG – Verbundnetz Gas AG, Leipzig

**Wolfgang Haupt**

Position	Company
Chairman of the Supervisory Board	HSBC Trinkaus Real Estate GmbH, Düsseldorf
Chairman of the Supervisory Board	Trinkaus Private Equity M 3 GmbH & Co. KGaA, Düsseldorf
Chairman of the Supervisory Board	Trinkaus Private Equity Pool I GmbH & Co. KGaA, Düsseldorf
Chairman of the Supervisory Board	Trinkaus Secondary GmbH & Co. KGaA, Düsseldorf

**Harold Hörauf**

Position	Company
Chairman of the Supervisory Board	HSBC US Buy-Out GmbH & Co. KGaA, Düsseldorf
Chairman of the Supervisory Board	Trinkaus Secondary Zweitausendsechs GmbH & Co. KGaA, Düsseldorf
Member of the Supervisory Board	BVV Pensionsfonds des Bankgewerbes AG, Berlin
Member of the Supervisory Board	BVV Versicherungsverein des Bankgewerbes a.G., Berlin
Member of the Supervisory Board	BVV Versorgungskasse des Bankgewerbes e. V., Berlin

**Friedrich Merz**

Position	Company
Chairman of the Supervisory Board	WEPA Industrieholding SE, Arnshausen
Member of the Supervisory Board	AXA Konzern AG, Cologne
Member of the Supervisory Board	Borussia Dortmund GmbH & Co. KGaA, Dortmund
Member of the Supervisory Board	Deutsche Börse AG, Frankfurt/Main
Member of the Board of Directors	BASF Antwerpen N.V., Antwerp, Belgium
Member of the Board of Directors	Stadler Rail AG, Bussnang, Switzerland

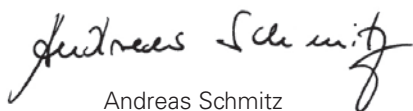
**Hans-Jörg Vetter**

Position	Company
Chairman of the Supervisory Board	BWK GmbH Unternehmensbeteiligungsgesellschaft, Stuttgart
Chairman of the Supervisory Board	LBBW Immobilien GmbH, Stuttgart
Chairman of the Supervisory Board	LHI Leasing GmbH, Pullach
Member of the Supervisory Board	Allgaier Werke GmbH, Uhingen
Member of the Supervisory Board	Deutscher Sparkassen Verlag GmbH, Stuttgart
Member of the Supervisory Board	Herrenknecht AG, Schwanau
Member of the Board of Directors	Schweizerische National-Versicherungs-Gesellschaft, Basel, Switzerland

## 74 Publication

The Annual Report will be released for publication on 18 April 2012. The release for publication was approved by the Management Board in its meeting on 20 March 2012.


Düsseldorf, 7 February 2012



Andreas Schmitz




Paul Hagen



Dr. Olaf Huth



Manfred Krause



Carola Gräfin v. Schmettow



# Auditor's Report

We have audited the consolidated financial statements, comprising the balance sheet, the statement of comprehensive income, the statement of changes in shareholders' equity and cash flows, notes to the financial statements as well as the group management report prepared by HSBC Trinkaus & Burkhardt AG for the business year from 1 January to 31 December 2011. The preparation of the consolidated financial statements and the group management report in accordance with IFRS, as they are to be applied in the EU, and the commercial law provisions to be applied additionally in accordance with Section 315a para. 1 German Commercial Code (HGB), is the responsibility of the Management Board. Our responsibility is to express an opinion on these consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Section 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the German Institute of Auditors (Institut der Wirtschaftsprüfer – IDW). Those standards require that we plan and perform the audit such that it can be recognized with reasonable assurance whether there are inaccuracies and irregularities which have a substantial impact on the view of the net assets, financial position and earnings situation given by the consolidated financial statements observing the accounting provisions to be applied and by the group management report. Knowledge of the Group's business activities and its economic and

legal environment and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system as well as evidence supporting the amounts and disclosures in the consolidated financial statements and the group management report are examined mainly on a test basis within the framework of the audit. The audit comprises assessing the annual financial statements of the companies included in the consolidated financial statements, the accounting and consolidation principles used and significant estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that the audit provides a sufficiently sure basis for our opinion.

Our audit has not led to any objections.

In our opinion, based on the findings of the audit, the consolidated financial statements are in accordance with IFRS as they are to be applied in the EU and the commercial law provisions to be applied additionally in accordance with Section 315a para. 1 HGB and give, observing these provisions, a true and fair view of the net assets, financial position and earnings situation of the Group. The group management report is in keeping with the consolidated financial statements, provides on the whole an accurate picture of the Group's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 17 February 2012

KPMG AG Wirtschaftsprüfungsgesellschaft

Signed by Dr. Hübner  
Auditor

Signed by Bormann  
Auditor

# Report of the Supervisory Board

## Management

At four meetings conducted during the 2011 financial year, the Supervisory Board received comprehensive reports from the Management Board on the development of business at the Bank, its major subsidiaries and individual business areas. During an additional meeting held after the Annual General Meeting, the newly-elected Supervisory Board constituted itself and appointed the members of its committees. New elections were necessary following the conclusion of proceedings pursuant to section 97 of the German Public Limited Companies Act (Aktiengesetz – “AktG”) initiated by the Management Board; as a result, the German Co-determination Act now applies to the Bank instead of the One-Third Employee Participation Act, which applied previously. Shareholders and employees are now represented on the Supervisory Board in equal proportions.

The reports given by the Management Board to the Supervisory Board addressed current business development against target figures and the figures of the corresponding period of the previous year, risk management aspects, external audit activities, and corporate governance issues. The Bank's investment securities (including the relevant valuation) and liquidity situation were also presented to the Supervisory Board. Reports given on material individual transactions included the progress made in implementing the Bank's growth strategy across all divisions, and particularly concerning business with larger medium-sized enterprises. Moreover, in one meeting the Management Board informed the Supervisory Board in detail about its deliberations concerning the potential purchase of parts of WestLB's business. In another meeting, the Management Board outlined its reasons for cancelling this project.



At one meeting, the Supervisory Board focused on the review and discussion of the strategic positioning of the Bank, its business policy contemplated for 2012 and its principles of corporate planning. The auditor took part in the Supervisory Board's meeting regarding the financial statements for the previous year. The Supervisory Board has delegated the appointment of the auditors for the audit of the annual financial statements and the consolidated financial statements to its Audit and Risk Committee. The auditor participated in the relevant committee meeting, presenting objectives, methods and focal points of the 2011 audit plan in great detail. As a result of this presentation, the auditor was mandated to perform the audit of the annual financial statements and the consolidated financial statements, on the basis of the appropriate fee structure agreed.

In April 2011, the Supervisory Board appointed Mr. Manfred Krause as a member of the Bank's Management Board, with effect from the date of the Annual General Meeting on 7 June 2011. The distribution of responsibilities amongst the Management Board members was amended accordingly, with the agreement of the Supervisory Board; it is shown in this Annual Report.

## Activities of the Supervisory Board's Committees

In order to permit the more efficient handling of selected management issues, the Supervisory Board set up four separate committees from amongst its members in its constituting meeting following the Annual General Meeting in June 2011. Specifically, the following committees were established:

- the Mediation Committee, whose task it is to submit a proposal to the Supervisory Board if the appointment of a member to the Management Board failed to achieve the required two-thirds majority;
- the Nomination Committee, which nominates candidates to be proposed by the Supervisory Board for election by the General Meeting;
- the Remuneration Committee, whose responsibilities include preparing Supervisory Board resolutions regarding personnel matters concerning the Management Board, the long-term successor planning in cooperation with the Management Board, the handling of conflicts of interests of Management Board or Supervisory



Board members, as well as the approval of loans from the Bank to its employees and their family members or to members of the Supervisory Board;

- the Audit and Risk Committee which, in addition to the issuing of the audit mandate to the auditor, is responsible for the determination of the focal points for the audit, monitoring the auditor's independence and concluding a fee agreement with the auditor. The Committee also handles accounting and fundamental risk-management issues, as well as regularly discussing the audit findings of Internal Audit and external auditors. The Supervisory Board has delegated to the Committee, inter alia, the power to express reservations of approval with regard to any loans that require Supervisory Board approval – either pursuant to the Bank's internal regulations or to the provisions of the German Banking Act (Kreditwesengesetz) – particularly with regard to connected-party loans to enterprises. The Audit and Risk Committee also discusses the risk management strategy with the Management Board, responsible for devising it.

The Mediation Committee has four members, the Nomination Committee has three, the Remuneration Committee five, and the Audit and Risk Committee four members. In line with legal requirements and the recommendations set out by the Corporate Governance Code, the chairperson of the Supervisory Board chairs the Mediation Committee, the Nomination Committee and the Remuneration Committee.

Until the internal rules of procedure were amended in the constituting meeting of the Supervisory Board in June 2011, the Supervisory Board had three committees: the Remuneration and Nomination Committee, the Audit Committee and the Credit and Risk Committee.

The Remuneration and Nomination Committee and the new Remuneration Committee each met twice during the period under review. The Credit and Risk Committee met twice, and the Audit Committee held three meetings, of which one meeting was held as a conference call. The new Audit and Risk Committee met four times (on two occasions in the form of a conference call).

The Remuneration and Nomination Committee submitted proposals concerning Management Board remuneration, and concerned itself with the Bank's remuneration system. The Committee proposed to the Supervisory Board that Mr. Manfred Krause be appointed to the Manage-

ment Board. The Committee also presented the candidates for election to the Supervisory Board by the Annual General Meeting held on 7 June 2011 to the Supervisory Board. Furthermore, the Committee approved various appointments of Managing Directors of subsidiaries.

The new Remuneration Committee also concerned itself with the Bank's remuneration system and approved various connected-party loans.

The Audit and Risk Committee assumed the tasks of its predecessor bodies, the Credit and Risk Committee and the Audit Committee. A key topic discussed by the Credit and Risk Committee and by the new Audit and Risk Committee (in its risk committee function) was allowance for credit losses. Related discussions covered both the overall credit risk strategy (which was also discussed by the plenary meeting of the Supervisory Board) and individual exposures. Moreover, the Credit and Risk Committee as well as the Audit and Risk Committee carried out all regular tasks delegated to it by the Supervisory Board in the course of all Committee meetings.

The Audit Committee and the Audit and Risk Committee (in its audit committee functions) duly noted and discussed reports submitted by Internal Audit, the Compliance Officer and the Money Laundering Prevention Officer during its plenary meetings; moreover, reports submitted by the external auditors were noted and discussed during two meetings. During three conference calls, the Audit Committee and subsequently the Audit and Risk Committee discussed the draft quarterly reports prior to publication.

## Corporate Governance

During its meeting in February, the Supervisory Board discussed the German Corporate Governance Code and its implementation by the Company. The 2011 Corporate Governance Report, which details and explains the deviations from the recommendations of the Government Commission "German Corporate Governance Code", is included in this Annual Report. Together with the Declaration of Compliance pursuant to section 161 of the AktG, the report is also available for download from the Bank's website.

In its efficiency examination, the Supervisory Board concluded that in view of the personal professional qualifications of individual members of its body, it had no concerns

whatsoever regarding their suitability. To assess and determine its efficiency, the Supervisory Board carried out a self-evaluation as recommended by the German Corporate Governance Code.

The information given to the Supervisory Board satisfied all legal requirements and, in particular with regard to the depth of information provided on risks and to the supplementary presentations on new products, services and the activities of selected business areas, exceeded the requirements of the AktG. The Supervisory Board therefore concluded that comprehensive information had been provided. The external auditors' report contained no findings which had not previously been reported on and examined at Supervisory Board meetings. The Supervisory Board therefore concluded that it had carried out its business efficiently.

During the 2011 financial year, no conflicts of interest were detected between the Bank and members of the Supervisory Board or others for whom a member of the Supervisory Board acted in an advisory or executive capacity. The Supervisory Board's Audit and Risk Committee satisfied itself of the independence of the external auditors and the individual persons acting on their behalf.

### **Annual financial statements**

The Supervisory Board examined the annual financial statements of the Bank for the year ending 31 December 2011, as well as the 2011 Management Report and the proposal of the Management Board for the appropriation of profit and gave approval in its meeting on 18 April 2012. The Annual General Meeting held on 7 June 2011 appointed KPMG AG Wirtschaftsprüfungsgesellschaft, Düsseldorf, as the auditors for the financial statements and consolidated financial statements. The Supervisory Board's Audit and Risk Committee commissioned the auditors to carry out the audit of the financial statements and the consolidated financial statements on 20 September 2011. KPMG have audited the Bank's books, its annual financial statements and the Management Report for the year ending 31 December 2011 and have issued their unqualified audit opinion. The audit report was submitted to the Supervisory Board; no objections were raised.

The consolidated financial statements for the year ended 31 December 2011 were prepared under International Financial Reporting Standards (IFRS) in a manner which also addressed the requirements of the German Commercial

Code (Handelsgesetzbuch – HGB). These financial statements were also audited by KPMG and given an unqualified opinion. Both the consolidated financial statements and the audit report were submitted to the Supervisory Board and approved by it in its meeting on 18 April 2012.

### **Relationships with affiliated enterprises**

In accordance with section 312 of the AktG, the Management Board has prepared a report on the Bank's relationships with affiliated enterprises for the 2011 financial year. Pursuant to section 313 of the AktG, the auditor provided this report with the following audit opinion: "Having duly examined and assessed this report in accordance with professional standards, we confirm that (1) the report is free from factual misrepresentations, and (2) that the company did not pay any excessive consideration with regard to the transactions identified in the report." The Supervisory Board duly noted and approved this report.

### **Personnel changes within the Supervisory Board**

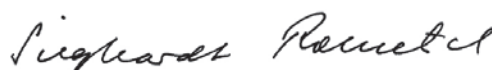
The Supervisory Board was re-elected by the Annual General Meeting on 7 June 2011, with Mr. Samir Assaf elected as a new shareholder representative. New employee/trade union representatives elected were Ms. Monika Frank (until 8 September 2011), Ms. Sigrid Betzen (since 29 September 2011), and Messrs. Stefan Fuchs, Oliver Popp, Ralf Rochus and Carsten Thiem.

### **Recognition**

The Supervisory Board thanks the members of the Management Board for their open and trustworthy cooperation. The Supervisory Board would also like to extend a special thank-you to the staff whose work in the past year has made an essential contribution to the Bank's success.

Düsseldorf, April 2012

The Supervisory Board



Dr. Sieghardt Rometsch  
Chairman

# Corporate Governance Report 2011

## Corporate Governance as an integral part of our corporate culture

The German Corporate Governance Principles, as we have adopted them in our Declaration pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – AktG) – as shown below, are integral to the corporate culture of HSBC Trinkaus. An open information policy toward our shareholders, clear management structures, transparency of financial accounting and the strict avoidance of conflicts of interest are all indispensable conditions for winning and retaining the trust of our investors and business partners on the national and international financial markets. Our Code of Conduct sets out our understanding of corporate values and behavioural standards. Our Management Board and staff have given a written commitment that they will comply with this Code of Conduct.

Both management and representation of the Bank are the responsibility of a Management Board, consisting of five members. At the end of 2011, the Management Board was assisted by three Divisional Board members responsible for the Investment Banking, Technology and Services, and Asset Management businesses. The Bank's organisational structure – including the responsibilities of the individual members of the Management Board for their specific business areas and central functions – is described in the chapter "Business areas" of the Annual Report.

## Composition of the Supervisory Board

The Management Board is subject to the supervision of a Supervisory Board, which is in turn subject to co-determination provisions. Until the Annual General Meeting 2011, the Supervisory Board comprised 15 members, including 5 employee representatives. At the time, the composition of the Supervisory Board was governed by the German One-Third Employee Participation Act (Drittelbeteiligungsgesetz). By virtue of a resolution passed on 25 November 2010, the Management Board initiated proceedings for change of status/transition proceedings (Statusverfahren/Überleitungsverfahren) under section 97 (1) of the German Public Limited Companies Act (AktG). These proceedings concluded with the Annual General Meeting on 7 June 2011. The Supervisory Board now comprises 16 members, shareholders and employees being represented by eight members each.

The Supervisory Board currently has three female members. As the largest shareholder (holding a stake exceeding 80 %), HSBC has two representatives on the Supervisory Board, neither of whom is a German national. LBBW, the second largest shareholder (holding a stake of just under 19 %), has one representative on the Supervisory Board. Of the eight shareholder representatives, six individuals hold professional experience obtained in senior positions in the banking sector; the two other individuals have each gained their experience in similar positions in other business sectors.

Against this background, the Supervisory Board has formulated the following objectives for its composition, as provided by the German Corporate Governance Code:

- The composition of the Supervisory Board shall be determined in the interest of the Company. The members of the Supervisory Board must be reliable, in line with the legal requirements applicable for credit institutions, and must have the professional aptitude necessary for carrying out their control functions, and also to assess and verify the Bank's business activities.
- One of the factors determining the Bank's business model is its close integration into the HSBC Group's global network. Accordingly, the Supervisory Board should always have at least two individuals holding senior positions at HSBC – with experience and expertise in the international business – as is the case now.
- Conflicts of interest affecting Supervisory Board members prevent them from giving independent and efficient advice to and supervising the Management Board. The Supervisory Board will decide on how to deal with any conflicts of interest which may arise on the merits of each individual case. In principle, any individual holding an office with one of the Bank's material competitors might be disqualified from election to the Bank's Supervisory Board. Since LBBW, the Bank's second-largest shareholder (holding a stake of just under 19 %), only competes with the Bank in certain business sub-segments, it should retain one representative on the Supervisory Board in the future.
- The Supervisory Board does not consider it sensible to impose any fixed age limit for membership of the Supervisory Board. A fixed age limit would oblige the

Bank to make a change in Supervisory Board membership even when a member, notwithstanding his or her age, was providing valuable contributions for the Bank. Also, such a limit would contradict the general trend of postponing the statutory retirement age. Therefore, the Bank will continue not to comply with this recommendation of the Code.

- In 2010, the Supervisory Board expressed its plans to raise the representation of women on the Supervisory Board from then two members by seeking the election of at least one more female member; at present, there are three female members. As in the past, when proposing candidates for election to shareholders, the Supervisory Board will solely consider the Company's best interests – without any regard to gender, age, family situation, race, religion or political views, ethnic and social origin.

## Supervisory Board Committees

The Supervisory Board has set up four separate committees from amongst its members:

- the Mediation Committee, whose task it is to submit a proposal to the Supervisory Board if the appointment of a member to the Management Board fails to achieve the required two-thirds majority;
- the Nomination Committee, which nominates candidates to be proposed by the Supervisory Board for election by the General Meeting;
- the Remuneration Committee, whose responsibilities include preparing Supervisory Board resolutions regarding personnel matters concerning the Management Board, the long-term successor planning in cooperation with the Management Board, the handling of conflicts of interests of Management Board or Supervisory Board members, as well as the approval of loans from the Bank to its employees and their family members or to members of the Supervisory Board;
- the Audit and Risk Committee which, in addition to the issuing of the audit mandate to the auditor, is responsible for the determination of the focal points for the audit, monitoring the auditor's independence and concluding a fee agreement with the auditor. The Committee

also handles accounting and fundamental risk management issues as well as regularly discussing the audit findings of Internal Audit and external auditors. The Supervisory Board has delegated to the Committee, inter alia, the power to express reservations of approval with regard to any loans that require Supervisory Board approval – either pursuant to the Bank's internal regulations or the provisions of the German Banking Act (Kreditwesengesetz) – particularly with regard to connected-party loans to enterprises. The Audit and Risk Committee also discusses the risk management strategy with the Management Board, responsible for devising it.

Resolutions of the Supervisory Board and its committees shall be adopted with a simple majority of votes cast, unless mandatory law provides otherwise. All the committees of the Supervisory Board consist of between three and five members. The chairperson of the Supervisory Board only chairs the Mediation, Nomination and Remuneration Committees. The members of the Management Board, Supervisory Board and of the Supervisory Board's committees are listed in the Annual Report, Chapter Boards and Committees. The Report of the Supervisory Board on its activities during the financial year under review, which has also been included in our Annual Report, describes in more detail the number of Supervisory Board and committee meetings as well as the specific items discussed during the financial year under review.

## Remuneration structures

As a bank, HSBC Trinkaus is subject to the provisions of German company law and the recommendation of the German Corporate Governance Code, and in particular to the provisions contained in the German Ordinance on Remuneration in Financial Institutions (Institutsvergütungsverordnung) promulgated by the German Ministry of Finance on 6 October 2010. Having carried out a detailed risk analysis, the Management Board expressed the belief that the Bank is not a "material institution" as defined in section 1 (2) of this Ordinance. The Management Board has reviewed and affirmed this view in the meantime.

The remuneration of the members of the Management Board is laid down in individual service contracts which the Bank, represented by the Chairman of the Supervisory Board, concludes with each individual member of the Management Board.

The remuneration of the members of the Management Board is comprised of both a fixed and a variable component. In addition, each Management Board member has received an individual pension commitment. The amount of the variable annual remuneration is determined by the Supervisory Board at its discretion and may be paid in cash, in shares of HSBC Holdings plc or a combination of both. The members of the Management Board have waived the contractual provision (which was in force until 31 December 2011) providing for a minimum cash portion of 50 % of variable remuneration. The currently valid contracts held by Management Board members no longer include such clauses. The share of the cash component, the minimum waiting period for vesting the long-term remuneration component, as well as its distribution across the waiting period are all governed by uniform rules throughout HSBC Group and may vary from year to year. Details are published in the annual report for the respective financial year. For two members of the Management Board, the long-term remuneration component for the 2011 financial year consists exclusively of HSBC Holdings plc shares allocated, which will be awarded in three equal tranches over the next three financial years (i.e. from 2013 to 2015). For three Management Board members, the long-term remuneration component consists of a cash amount and shares in HSBC Holdings plc, in equal proportions, with both elements awarded in three equal tranches over the next three financial years (2013 to 2015); in this case, an additional six-month holding period (starting from the date of transfer) applies for HSBC Holdings plc shares.

During the period until awarded shares are transferred, the respective Management Board members are fully exposed to potential price gains and losses on these shares. Moreover, details regarding the remuneration structure of the Management Board are disclosed in the Management Report, and in Note 68 to the consolidated financial statements of HSBC Trinkaus & Burkhardt AG.

The Company's General Meeting on 5 June 2007 passed a resolution, with the requisite three-quarters majority, that the compensation paid to members of the Management Board should not be disclosed individually.

The remuneration of the Supervisory Board members, including any consultancy fees, is also disclosed in Note 68 to the consolidated financial statements. The remuneration of the Supervisory Board members is governed by

the Articles of Association. Accordingly, each Supervisory Board member is entitled to receive a fixed remuneration of € 25,000 as well as an additional variable remuneration of € 100.00 for every 1 cent in dividends paid per share. The chairperson receives two and a half times this amount and the deputy chairperson two times this amount. The chairman of a Supervisory Board Committee shall receive twice, and each member of a committee one and a half times the amounts stipulated for Supervisory Board members above, provided that the respective committee has been active at least once during the financial year. Where a member of the Supervisory Board holds more than one office, such member is only remunerated for the office with the highest remuneration. Where membership in the Supervisory Board or a committee does not last the duration of an entire financial year, the remuneration is reduced on a pro rata basis.

The staff remuneration system for tariff employees is governed by collective wage agreements for private and public-sector banks; the remuneration structure for non-tariff employees is determined by the Management Board. In addition to a fixed salary, which is reviewed annually, non-tariff employees receive variable remuneration, as determined by the Management Board on a discretionary basis upon proposals made by heads of divisions. In line with the variable remuneration principles adopted by the HSBC Group, such remuneration is paid in cash or – as the case may be – partially in cash and in HSBC Holdings plc shares. According to HSBC Group's variable remuneration guidelines for the 2011 financial year, any variable remuneration not exceeding € 55,000 will be fully disbursed in cash, in March 2012. Any variable remuneration exceeding this amount will be made partially in HSBC shares, with a share portion of between 10 % and 50 %, depending on the overall amount. Cash remuneration components will be paid out in March 2012. Shares awarded as variable remuneration will be vested in three equal instalments during the three following years, i.e. in the years 2013, 2014 and 2015. For certain members of staff, the long-term remuneration component consists of a cash amount and shares in HSBC Holdings plc, in equal proportions, with both elements awarded in three equal tranches over the next three financial years (2013 to 2015); in this case, an additional six-month holding period (starting from the date of transfer) applies for HSBC Holdings plc shares.

The aggregate fixed remuneration paid by the HSBC Trinkaus & Burkhardt Group during 2011 (including the fixed remuneration paid to the Management Board), amounted to € 163.4 million. During 2012, 1,298 individuals received variable remuneration totalling € 63.1 million for the 2011 financial year. This figure includes variable remuneration paid to the Management Board.

### **Reporting duties regarding transactions in HSBC Trinkaus & Burkhardt shares as well as rights to those shares in accordance with Section 15a of the German Securities Trading Act ("WpHG")**

In 2011, no transactions in HSBC Trinkaus & Burkhardt shares or any rights to those shares which would require a disclosure under section 15 a of the WpHG and subsection 6.6 of the Corporate Governance Code were made by persons who are subject to a reporting requirement.

### **Continuous monitoring**

We have entrusted the Head of our Bank's company secretariat with the day-to-day monitoring of the strict observance of the Corporate Governance rules in our daily business. During the 2011 financial year, no infringements of the rules were identified, neither in terms of the form nor the content and spirit of the Corporate Governance Code.

### **Declaration pursuant to section 161 of the German Public Limited Companies Act (AktG) of the Management Board and the Supervisory Board regarding the German Corporate Governance Code**

The Management Board and the Supervisory Board of HSBC Trinkaus & Burkhardt AG declare that, subject to the exceptions and/or modifications as set out below, they have complied with the "Recommendations of the Government Commission for the German Corporate Governance Code" as published in the official section of the web-based Federal Gazette in the version of 26 May 2010, and that they will continue to comply with this Code in the future.

The Company does not implement the recommendation, in accordance with section 2.3.2 of the German Corporate Governance Code (the "Code"), of giving notice of convening the General Meeting, and disseminating related documents to financial services providers, shareholders,

and shareholders' associations by electronic means if the approval requirements have been fulfilled. Given that the Company's shares are bearer shares, to implement this recommendation in practice would incur material obstacles and is also likely to incur significant costs. Taking the Company's shareholder structure into account, there is no real need to propose the requisite resolution for approval to the General Meeting.

Section 5.4.1 is not implemented, to the extent that it provides for an age limit for Supervisory Board members. Such a limitation would needlessly restrict the Company's flexibility, since a fixed age limit would require a change in Supervisory Board membership even when a member, notwithstanding his or her age, was performing highly valuable services for the Bank.

The Company does not comply with the recommendation of Section 5.4.2, according to which the Supervisory Board should not include more than two former members of the Management Board. HSBC Trinkaus has preserved its special profile, whereby long-term and personal client relationships represent a key strategic element, even after the change in its legal form to a public limited company. Through the transition from the Bank's executive management to the Supervisory Board, in the past the Company has managed to avoid disruptions of client relations and ensured continuity, which the former Managing Partners or Management Board members ascertain as members of the Supervisory Board. A strict limitation to two former members of the Management Board does not support this concept.

The recommendation of the Government Commission in section 5.4.3 of the Corporate Governance Code has been implemented with the modification that elections to the Supervisory Board will only be made on an individual basis if a shareholder has presented a motion to this effect at the Annual General Meeting for which the election is scheduled. This regulation provides sufficient protection to shareholders whilst at the same time granting the necessary organisational flexibility.

Furthermore, the Company has refrained from adopting the recommendation of the Government Commission in sentence 3 of section 5.4.3 of the Code that the shareholders should be notified, in advance, of the candidates for an upcoming election of the chairperson of the Super-



visory Board. According to the Articles of Association of HSBC Trinkaus, the term of office for which members of the Supervisory Board are elected ends on the same date for all members, so that new elections at the end of a term are automatically new elections of the entire Supervisory Board. Upon such a complete new election, the newly-elected members convene immediately after the Annual General Meeting in which the election took place in order to appoint one of their number as the chairperson. An earlier announcement of the candidates for the chairmanship by the old Supervisory Board (as recommended by the Code) would pre-determine and limit the freedom of the new Supervisory Board to appoint its chairperson. Even though the newly elected Supervisory Board would not be bound by the announcements of candidates proposed by the old Supervisory Board, any deviation from such proposals would result in negative publicity detrimental to the Bank.

The recommendation in section 5.4.6 concerning disclosure of individualised details of the remuneration of Supervisory Board members (including fees for personal advisory or intermediation services rendered) in the Corporate Governance Report, has not been adopted. The details regarding the remuneration of Supervisory Board members are disclosed in the notes to the single-entity financial statements, as well as in Note 68 to HSBC Trinkaus & Burkhardt AG's consolidated financial statements, as prescribed by law. The Corporate Governance Report contains the provisions of the Articles of Association governing the remuneration of Supervisory Board members. Such disclosure would constitute a gross interference with Supervisory Board members' right of privacy – particu-

larly with respect to fees for personal services rendered, such as advisory services – without a strict necessity for such interference.

The Government Commission's Recommendation in section 6.3 is applied, with the clarifying note that parity of information between shareholders, financial analysts and comparable recipients is limited to information which may have an impact on the share price. For the purpose of clearly defining the scope of "passing on of information," expressions of opinion by members of the executive bodies in the press and other media, as well as background discussions with financial analysts and rating agencies do not constitute "new facts" within the meaning of section 6.3 of the Code.

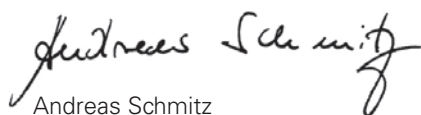
Published information about the company as defined in section 6.8 only comprises information that may affect the share price of HSBC Trinkaus & Burkhardt AG. The comments above regarding section 6.3 apply mutatis mutandis.

Varying from section 7.1.2, HSBC Trinkaus & Burkhardt AG will observe the statutory deadlines for the preparation of its consolidated financial statements and interim reports, to enhance its timing flexibility in preparing such statements and reports.

HSBC Trinkaus & Burkhardt AG will comply with the recommendation in section 7.1.4 subject to the legal disclosure thresholds being reached; this reference helps to avoid any interpretation issues.

Düsseldorf, February 2012

For the  
Management Board:



Andreas Schmitz  
– Speaker –

For the  
Supervisory Board:



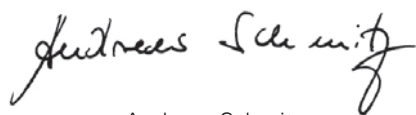
Dr. Sieghardt Rometsch  
– Chairman –

# Responsibility Statement by the Management Board

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair

review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Düsseldorf, 7 February 2012



Andreas Schmitz



Paul Hagen



Dr. Olaf Huth



Manfred Krause



Carola Gräfin v. Schmettow





# Locations

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## Interpretation and evaluation of statements about the future

This Annual Report provides information on the results of the HSBC Trinkaus & Burkhardt Group for the past financial year. The information is based on the consolidated figures at the close of the 2011 financial year in accordance with International Financial Reporting Standards and as audited by the auditors of our Consolidated Statements. To allow you to evaluate our consolidated financial statements, general economic data and data in relation to financial markets as they evolved during the past year have also been included. In addition, this publication contains statements of our expectations concerning our Group's progress during 2012. Such statements about the future can be found in particular in the Letter from the Management Board to our shareholders in the "Outlook for 2012" section, in the section on our company's strategy and also in many other places throughout this Annual Report. These

statements about the future are based on our expectations of future economic and political developments and on our assumptions about the effects these will have on business progress and our related business plans. All statements about the future in the form of assumptions, expectations and future plans represent our assessments and forecasts up to the date on which we formulated them. Any changes subsequent to that date in macroeconomic data, in the political or regulatory environment, or in the foreign exchange or capital markets, as well as unexpected losses in lending business or with counterparties in trading activities, or the occurrence of other events, may lead to our forecasts and expectations for the 2012 financial year becoming obsolete or outdated. We accept no obligation to adjust our forecasts, assumptions and expectations in the light of new information or in line with subsequent events to reflect the new level of knowledge, nor to update our Annual Report through subsequent publication of such changes.



# Key Dates

## **15 May 2012**

Interim Report as at 31 March 2012

## **5 June 2012**

Annual General Meeting

## **1 August 2012**

Press conference

Interim Report as at 30 June 2012

## **14 November 2012**

Interim Report as at 30 September 2012



# Five-year Comparison of Consolidated Figures in €m

IFRS consolidated financial statements in €m	2011	2010	2009	2008	2007
<b>Total assets</b>	<b>20,634.4</b>	<b>18,584.0</b>	<b>18,728.6</b>	<b>22,205.7</b>	<b>21,066.9</b>
<b>Assets</b>					
Cash reserve	672.2	336.1	177.0	139.5	332.3
Loans and advances to banks	1,857.6	1,402.9	2,429.4	2,979.7	4,117.0
Loans and advances to customers	3,717.2	3,089.6	2,687.5	4,082.6	4,272.9
Net loan impairment and other credit risk provisions	-27.1	-49.1	-42.9	-21.4	-16.2
Trading assets	9,852.3	10,130.6	10,005.7	12,482.6	10,436.8
Financial assets	4,164.7	3,305.9	3,126.1	2,118.8	1,568.2
Interests in associates	65.2	38.0	10.6	10.1	15.2
Property, plant and equipment	79.3	83.1	83.3	81.1	196.3
Intangible assets	31.3	38.9	44.1	56.0	12.3
Taxation recoverable	8.6	4.3	13.0	17.5	54.8
current	8.6	4.3	13.0	13.0	54.8
deferred	0.0	0.0	0.0	4.5	0.0
Other assets	213.1	203.7	194.8	259.2	77.3
<b>Liabilities</b>					
Deposits by banks	749.6	1,180.4	2,697.6	2,709.1	2,532.7
Customer accounts	12,413.3	10,148.0	9,062.1	11,592.8	10,283.2
Certificated liabilities	10.0	10.0	10.0	10.0	10.0
Trading liabilities	5,426.0	5,200.1	5,196.7	6,152.9	6,488.4
Provisions	103.4	96.5	152.2	117.4	112.4
Taxation*	55.6	66.7	67.7	85.1	106.0
current*	48.3	52.6	61.1	81.5	48.4
deferred	7.3	14.1	6.6	3.6	57.6
Other liabilities	212.5	214.1	95.3	108.2	106.8
Subordinated capital	353.4	378.4	384.4	458.7	458.7
Shareholders' equity*	1,310.5	1,289.7	1,062.5	955.0	968.7
Minority interests	0.1	0.1	0.1	16.5	0.0
<b>Income statement</b>					
Net interest income	148.9	128.7	143.3	139.5	110.0
Net loan impairment and other credit risk provisions	-12.7	7.7	22.4	4.5	-3.5
Share of profit in associates	0.7	0.4	0.6	0.5	6.4
Net fee income	385.5	404.0	346.2	347.6	318.1
Net trading income	121.1	124.6	117.9	98.2	100.1
Administrative expenses*	474.3	439.3	400.8	384.2	334.0
Other operating income	12.2	9.6	11.6	3.5	1.3
Operating profit	206.8	220.3	196.4	200.6	205.4
Income from financial assets	-4.8	-0.6	-24.0	-50.0	1.9
Income from derivatives in the bank book	-4.3	-4.2	5.1	-11.1	0.0
Other net income	5.4	-5.5	-13.8	-1.3	-0.1
Pre-tax profit	203.1	210.0	163.7	138.2	207.2
Tax expenses*	71.0	70.6	54.5	48.6	63.2
Net profit for the year	132.1	139.4	109.2	89.6	144.0

\* The prior-year figures were adjusted retrospectively in 2008 pursuant to IAS 8 as a result of the first-time application of IFRIC 11, Group and Treasury Share Transactions.

