2005

HSBC Bank Canada

Annual Report and Accounts

HSBC

The world's local bank

Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 170 offices. With around 9,500 offices in 76 countries and territories and assets of US$1,502 billion at 31 December 2005, the HSBC Group is one of the world's largest banking and financial services organizations.

Shareholder Information

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HSBC BANK CANADA SECURITIES LISTED ON THE TSX:

HSBC Bank Canada Class 1 Preferred Shares Series C and D (HSB.PR.C-TSX and HSB.PR.D-TSX)

HSBC Canada Asset Trust Securities Series 2010 (HSBC HaTS™) (HBH.M-TSX)

TRANSFER AGENT AND REGISTRAR:

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Shareholder Service Department
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SHAREHOLDER CONTACT:

For change of address, shareholders are requested to write to the bank's transfer agent, Computershare Investor Services Inc., at their mailing address.

Other shareholder inquiries may be directed to our Shareholder Relations Department by writing to:

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Shareholder Relations
885 West Georgia Street
Vancouver, British Columbia
Canada V6C 3E9
shareholder_relations@hsbc.ca

Shareholder Relations:
Chris Young (604) 641-1976
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Message from the President and Chief Executive Officer

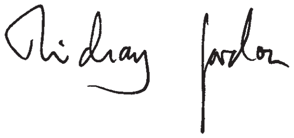
The past year was once again a busy and exciting one for HSBC Bank Canada. Results in 2005 were good and reflected a robust Canadian economy and the strength of our customers. We exceeded all our growth targets, and enjoyed strong credit performance and revenue growth.

During 2005 we introduced a number of new investment products and made other changes to prepare for future growth. For example, we relocated and expanded branches in key regions and implemented surcharge-free access to BMO Bank of Montreal ABMs for our customers. To bring HSBC Bank Canada in line with our competitors, our parent company, HSBC Holdings plc, discontinued its unlimited guarantee of our deposits. This historical arrangement was removed in recognition of our significant growth since the guarantee was instituted. Finally, in November 2005 we launched a new global brand advertising campaign in Canada.

Through all the changes, we continued our tradition of supporting the community. This year, for example, we funded scholarships and bursaries at universities and colleges, provided a forum for exceptional women to tell their stories through the HSBC Women of Influence national speaker series and purchased renewable energy certificates to offset our carbon dioxide emissions.

The Canadian economy is expected to grow at a moderate pace through 2006. Nevertheless, we anticipate that our business will continue to face an extremely competitive environment. So our focus will be to continue to achieve strong growth in revenues and control of our costs, while reinvesting in our businesses.

In July 2006 we will celebrate our 25th anniversary and it is a great opportunity to look back on all we have accomplished. In 1981 we opened our doors as Hongkong Bank of Canada. Over the past 24 years we have grown from one office in Vancouver to over 170 offices across the country. We have been remarkably successful in a vibrantly competitive marketplace. We could not have done so without the hard work and dedication of thousands of employees who provide excellent customer service with enthusiasm every day, year in and year out. We look forward to continuing to serve both our existing customers and many new customers through an expanding network in the future.



Lindsay Gordon
President and Chief Executive Officer

Management's Discussion and Analysis

Five Year Financial Summary

(in $ millions, except where stated)	Years Ended December 31[1]				
	2005	2004	2003	2002	2001
Condensed statements of income					
Net interest income	**$ 1,010**	$ 896	$ 865	$ 855	$ 753
Non-interest revenue	**570**	526	443	425	405
Total revenue	**1,580**	1,422	1,308	1,280	1,158
Provision for credit losses	**27**	66	61	127	92
Net interest and non-interest revenue	**1,553**	1,356	1,247	1,153	1,066
Non-interest expenses					
Salaries and employee benefits	**442**	423	379	331	351
Premises and equipment[2]	**107**	101	107	105	113
Other[3]	**275**	272	259	277	223
Total non-interest expenses	**824**	796	745	713	687
Income before the undernoted	**729**	560	502	440	379
Effect of accounting change	**–**	14	–	–	–
Income before taxes	**729**	574	502	440	379
Provision for income taxes	**237**	210	188	164	148
Non-controlling interest in income of trust	**22**	16	16	16	16
Income from continuing operations	**470**	348	298	260	215
Income (loss) from discontinued operations	**–**	5	2	–	(1)
Net income	**$ 470**	$ 353	$ 300	$ 260	$ 214
Preferred share of dividends	**13**	8	8	8	8
Net income attributable to common shares[4]	**$ 457**	$ 345	$ 292	$ 252	$ 206
Basic earnings per common share ($)[5]	**0.94**	0.72	0.62	0.55	0.55
Financial ratios (%)					
Return on average common equity	**21.3**	18.3	18.7	16.4	14.9
Return on average total assets	**0.97**	0.85	0.80	0.72	0.65
Net interest margin	**2.37**	2.49	2.66	2.79	2.70
Other income percentage[6]	**36.1**	37.0	33.9	33.2	35.0
Cost:income ratio[7]	**52.2**	56.0	57.0	55.7	59.3
Credit information					
Impaired loans and acceptances	**151**	182	203	225	282
Allowance for credit losses					
Balance at end of period	**326**	349	313	311	315
As a percentage of impaired loans and acceptances (%)	**216**	192	154	138	112
As a percentage of loans outstanding (%)	**1.01**	1.22	1.24	1.29	1.42
Average Balances					
Assets	**$ 47,282**	$ 40,421	$ 36,635	$ 34,828	$ 31,847
Loans	**30,678**	26,922	24,543	22,976	21,152
Deposits	**37,340**	30,823	29,041	27,842	25,511
Common equity	**2,150**	1,886	1,563	1,538	1,386
Balance sheet highlights					
Total assets	**49,210**	43,263	37,509	35,189	33,260
Total loans, net of allowance for credit losses	**31,844**	28,319	24,933	23,869	21,870
Business and government loans	**15,571**	13,450	11,664	11,949	11,575
Residential mortgage loans	**12,865**	11,966	10,880	9,809	8,377
Total deposits	**38,608**	33,848	29,339	28,372	26,707
Deposits from individuals	**15,300**	14,818	13,924	14,432	13,390
Subordinated debentures	**423**	426	504	528	447
Shareholders' equity	**2,596**	2,197	1,819	1,673	1,612
Risk-based capital ratios (%)					
Tier 1 Capital	**9.0**	8.6	8.4	8.4	8.6
Total Capital	**11.2**	11.0	11.1	11.4	11.3
Funds under management	**$ 20,453**	$ 17,687	$ 14,323	$ 11,888	$ 9,559
Custodial accounts	**7,594**	5,077	4,409	3,208	2,686
Total assets under administration	**$ 28,047**	$ 22,764	$ 18,732	$ 15,096	$ 12,245

(1) *Certain prior years restated for the impact of discontinued operations.*
(2) *Premises and equipment expenses includes amortization.*
(3) *Other expenses in 2002 includes a $30 million restructuring charge.*
(4) *Net income attributable to common shares for 2005 would have been $432 million after the impact of certain adjustments as described on page 8. For a discussion of non-GAAP financial measures refer to page 3.*
(5) *Basic earnings per common share is not materially different from basic earnings per common share from continuing operations.*
(6) *Other income percentage is non-interest revenue as a percentage of total revenue.*
(7) *Cost:income ratio is total non-interest expenses as a percentage of total revenue.*

Management's discussion and analysis ("MD&A") is dated February 10, 2006, the date that our consolidated financial statements and MD&A for the year ended December 31, 2005 were approved by our Board of Directors.

Basis of preparation of financial information. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). The financial information included in the MD&A is either at December 31, or for the years then ended. The information is derived either directly from our consolidated financial statements or from the information we have used to prepare them. Unless otherwise stated, all references to $ means Canadian dollars. All tabular amounts are in millions of dollars except where stated. Certain financial information we are required to disclose as part of the MD&A is included in the table on page 2. With the exception of note 4 to the table, all of the performance measures shown in this table have been derived directly from financial data included in our consolidated financial statements prepared in accordance with GAAP. With respect to note 4 to the table, reference should be made to page 8. The adjusted net income figure described in note 4 to the table on page 2 and also on page 8 may be regarded as a non-GAAP financial measure that does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other issuers.

Other available information. We file all of our news releases, interim and annual consolidated financial statements, interim and annual MD&A, annual reports, and our Annual Information Form, with SEDAR. Copies of these documents can be obtained from SEDAR's website: sedar.com.

Outstanding share data. Note 11 to our consolidated financial statements on page 53 contains details of the number of preferred and common shares issued and outstanding at December 31, 2005. Note 9(a) to our consolidated financial statements on page 52 contains details of the number of HSBC Canada Asset Trust Securities outstanding at December 31, 2005. Subsequent to that date, there have been no issues of any form of shares or convertible securities.

Caution regarding forward-looking statements. This document may contain forward-looking statements, including statements regarding the business and anticipated financial performance of HSBC Bank Canada. These statements are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause such differences include legislative or regulatory developments, technological change, global capital market activity, changes in government monetary and economic policies, changes in prevailing interest rates, inflation levels and general economic conditions in geographic areas where HSBC Bank Canada operates. Canada is an extremely competitive banking environment and pressures on interest rates and our net interest margin may arise from actions taken by individual banks acting alone. Varying economic conditions may also affect equity and foreign exchange markets, which could also have an impact on our revenues. The factors disclosed above may not be complete and there could be other uncertainties and potential risk factors not considered here which may impact our results and financial condition.

Overview

We are the seventh largest bank in Canada and largest internationally-owned full service financial institution in the country with total assets of more than $49 billion as at December 31, 2005.

Originally established in 1981 with our head office located in Vancouver, British Columbia, we have grown organically by acquiring new customers resulting from our reputation for providing superior customer service, and through strategic acquisitions, to become an integrated financial services organization. With more than 170 offices across Canada, we provide personal and commercial banking services, corporate, investment banking and markets services, online and full service brokerage, investment management and personal trust services.

Management's Discussion and Analysis (continued)

The HSBC Group

We are a member of the HSBC Group, whose parent company HSBC Holdings plc ("HSBC Holdings") is headquartered in London, UK. Our clients have access to the global resources of the HSBC Group, "the world's local bank", one of the largest banking and financial services organizations in the world. The HSBC Group's international network comprises around 9,500 offices in 76 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings are held by more than 200,000 shareholders in some 100 countries and territories. The shares are traded in New York in the form of American Depositary Receipts. At December 31, 2005 HSBC Holdings' market capitalization was US$182 billion.

Through an international network linked by advanced technology, the HSBC Group provides a comprehensive range of financial services: personal financial services; consumer finance; commercial banking; corporate, investment banking and markets; and private banking.

Complete financial and operational information in respect of HSBC Holdings and the HSBC Group can be obtained from its website: hsbc.com, including copies of the HSBC Holdings plc Annual Report and Accounts 2005.

Our Business Focus

Strategy

Our objective is to be the leading international provider of financial services in Canada, committed to:

LEADING in our chosen markets;

DELIVERING an outstanding client experience based on excellence in sales, service and solutions;

ACHIEVING a superior, ethically based, long-term return for our shareholders;

BUILDING highly-motivated, high performance teams; and

CREATING a challenging, rewarding and fun work environment.

Our strategy leverages our market leading sales and service excellence and HSBC's unparalleled global network of offices to serve our customers and expand our market share in Canada.

Our strategy has the following key operating components:

Customer centered – Always provide exceptional customer service – We are customer focused in everything we do, increasing our customer base and depth of our business by better understanding and meeting their needs. We also ensure our customers have ready access to the full range of our products and services as a member of one of the leading banking groups in the North American Free Trade Agreement ("NAFTA") countries as well as the global capabilities of the HSBC Group. We continue to invest in our distribution network to enhance the access and convenience for our customers.

Execution – Perform with skill and speed – We provide high quality, quick execution in all that we do: every time and for every customer.

Profitable growth – Grow sales and increase our revenues – We invest in and enhance our business platforms to ensure we sustainably deliver high levels of value to both our customers and shareholders.

Efficiency – Lower our costs and use resources wisely – We relentlessly focus on operating efficiently to make the client experience as seamless as possible and allow increased focus by our staff on sales and relationship management. This includes reallocating resources to ensure they are deployed so as to maximize our sales potential.

Credit quality – Maintain credit quality and understand our role in managing losses – We have a top quartile ranking for controlling credit losses as a result of our strong credit culture, which we enhance through training and investment in technology and customer analytics.

People – Attract, retain and reward our top performers – We operate in teams focused on building a strong sales and service culture throughout the organization. We continue to improve our performance management, rewarding high performers and rejecting mediocrity. We also strongly support diversity in our work force and encourage alternative work/life balance arrangements.

Ownership – Own our performance and our results – We empower our staff and hold them accountable for their success.

Customer Groups

We manage and report our operations around three major customer groups as defined by the HSBC Group: Personal Financial Services; Commercial Banking; and Corporate, Investment Banking and Markets. We have built a culture that delivers service on an integrated basis ensuring customer needs are met across products, subsidiaries, and internationally through the HSBC Group's worldwide network.

Personal Financial Services provides Canadians and individuals from around the world with excellent service, access to a comprehensive range of financial products and services through a variety of delivery channels and through the HSBC Group's worldwide network of offices.

Commercial Banking serves Canadian companies with local needs and helps them with their banking requirements around the world. Of particular relevance to Canadian businesses is HSBC's unparalleled network in the NAFTA countries, Europe and Asia.

Corporate, Investment Banking and Markets provides Canadian and international corporates, institutions and governments that require both domestic and international financial services with a comprehensive range of financial services, as well as client sales, service and distribution, balance sheet management and proprietary trading.

Our affiliate, HSBC Financial Corporation Limited, which operates under the trade name HSBC Finance, delivers consumer finance products and solutions to Canadians through over 125 offices located across Canada. We work collectively with HSBC Finance to best and most profitably deliver products and services to our respective customers.

Highlights For 2005

2005 was, again, a very successful year for HSBC as we continued to execute our strategy and build our business in Canada.

Particularly noteworthy accomplishments included:

Strong momentum in our core businesses – We continued to see strong growth in our core personal, commercial and Corporate, Investment Banking and Markets businesses with residential mortgages up 16.3% before securitization, personal loans up 19.6% before securitization, commercial loans and banker's acceptances up 14.1% and core deposits up 6.6%. Total revenue grew by 11.1% over 2004.

Efficiency – Our cost:income ratio decreased to 52.2% compared with 56.0% in 2004.

Credit performance – We enjoyed exceptionally strong credit performance with total net new specific provisions comprising only 0.10% of the total loan portfolio compared to 0.16% for 2004.

Building HSBC's brand value in Canada – According to the July 2005 ranking by InterBrand, the international brand consulting firm, HSBC was the 29th most valuable brand in the world, ahead of many well known household brands. In parallel with other HSBC global and U.S. campaigns, we continued to build the HSBC brand in Canada to improve customer awareness of our value proposition and global offering as "The world's local bank". In the latter half of the year, and again with HSBC Group colleagues worldwide, we began the "yourpointofview.com" campaign, which will be continued through 2006. We worked with colleagues in our affiliate company, HSBC Financial Corporation Limited, to successfully re-brand their business, from Household to HSBC Finance, including all of their branch locations, significantly increasing the number of HSBC branded locations and the physical visibility of HSBC in Canada.

Management's Discussion and Analysis (continued)

Best of breed investment alternatives – During 2005, we deepened our full spectrum investment product offerings. We introduced multi-manager options for Personal Investment Management, our discretionary high net worth individual portfolio service, LifeMap®, a bundle of underlying mutual funds, and HSBC Monthly Income Fund, a fixed income fund. In addition, we increased sales of Portfolio Advantage®, our discretionary mid-market service for portfolios greater than $50,000 and the HSBC Chinese Equity Fund leads the market for sales in its category.

Elimination of the HSBC Group Deposit Guarantee – In July 2005, HSBC Holdings discontinued its previous unlimited deposit guarantee for new customer deposits received after June 30, 2005. Our customer deposits continue to receive the same coverage by the Canada Deposit Insurance Corporation ("CDIC") as other CDIC member banks in Canada.

Credit ratings – Commensurate with an upgrade of HSBC Holdings' long-term debt rating, Dominion Bond Rating Service ("DBRS") upgraded our long term stand alone deposit rating to AA (low), equivalent to our peer Canadian domestic banks. DBRS noted "…the Bank's efficient productivity, favorable credit quality despite some geographic and industry concentrations, and ongoing strength in providing customer service as contributing positively to the ratings on a stand-alone basis." Standard & Poor's has recently raised its outlook on the HSBC Group and HSBC Bank Canada from stable to positive.

Capital base – We grew our capital base in the year, funding our growth with two successful issues of preferred shares and a second issue of HaTS™ innovative capital.

Compliance and control environment – We continued to invest in a compliance and control culture and processes, including "Know Your Customer", anti-money laundering and risk management, allowing us to better run our business, serve our customers and mitigate operating losses and reputational damage.

Community involvement – We continued our tradition of community participation through involvement with our many established sponsorships such as the Vancouver Sun Run, HSBC Celebration of Light fireworks festival in Vancouver, HSBC Stars on Ice national figure skating tour, the Shaw Festival, and Roy Thomson / Massey Hall in Toronto. We began our sponsorship of the "HSBC Women of Influence" luncheon speaker series, and supported the "Women in the Lead" Directory, identifying and promoting more than 500 women qualified to serve on Canadian corporate boards. We are now the title sponsor of the annual Calgary Stampede Marathon, which has been renamed the HSBC Calgary Marathon. In addition, we made direct donations of funds and encouraged employees to support registered charities in Canada, taking a special interest in charities that support education and the environment. For example, we are donating funds to the University of British Columbia over seven years to support the Robson Square downtown campus, scholarships and bursaries and the Learning Exchange, and are creating a fully endowed scholarship fund at York University that will provide full scholarships to 10 students each year with a five year donation to the York University Foundation. We are also donating funds over two years to the Nature Trust of British Columbia to support the HSBC Conservation Work Crew Program where at-risk youth help with habitat restoration and take employability skills workshops. To learn more about our community involvement, see our annual publication, *HSBC Bank Canada in the Community*, available from our website: hsbc.ca.

ABM strategic alliance – We implemented a new alliance with BMO Financial Group, which together with our existing ABM network, provides our customers with surcharge free access to the third largest ABM network in Canada. We began a convenience campaign through direct mailings, over the internet and through branch promotions to let our customers know that it is now "Easier to get cash when you need it!"

Outlook For 2006

We expect 2006 to be a continuation of 2005 in terms of event risks overhanging business markets. These include the escalating price of oil, stability of the US economy, particularly US consumer demand and issues related to the US current account deficit, along with the future direction of the US dollar, particularly with respect to the Canadian dollar. Other global event risks include terrorism, the conflict in Iraq and pressures from the impact of the Chinese and Indian economies on the demand for worldwide natural resources. Though diminishing somewhat as central banks remove their liquidity stimulus from the market, the timing and degree of central bank rate changes will also add uncertainty.

The rise of China and India as global economic powers and a relatively strong Canadian dollar will challenge Canadian business, particularly our export related clients. We believe that the ascent of Asia and its demand for natural resources will continue to hold oil, gas and other commodity prices at high levels, driving growth in the Western provinces, particularly Alberta, which we are well placed to leverage.

The Canadian economy is expected to grow at a moderate pace through 2006 with gradual increases in the Bank of Canada rates toward neutral levels in the first half of 2006. We expect economic growth, combined with continuing historically low overall levels of interest rates, will support continued personal and business spending, helping our business.

We anticipate 2006 to continue to be an extremely competitive environment for both our personal and commercial businesses, with the possibility that lending, and personal borrowing in particular, will slow as a result of increased interest rates and fully valued real estate markets. This, combined with the strong revenue growth targets we have set for ourselves, will require us to enter the year with a continued emphasis on controlling costs while retaining the flexibility to take advantage of opportunities to grow as they arise.

Our Focus For 2006

During 2006 we will focus on the following specific strategies to continue to grow our business in Canada:

Managing for growth – We aim to grow sales and increase our revenues by focusing on customer acquisition and cross sell, utilizing the full benefits of our customer relationship management system (*client*CONNECT). We have expanded our target market to include "Wealth Builders": Canadians whose wealth is currently in their homes but whose investments are increasing as they save for retirement. We will exploit our strengths in cross-border capabilities, high service culture, trade services, and focus on key segments such as HSBC *Premier* and mid-market commercial. We will continue to focus on NAFTA business, delivering our leading cross-border banking capabilities. In addition, we will focus on increasing market share and scale in our retail securities, asset management and trust businesses.

Balance sheet management, including focus on growing core deposits – We will implement a number of initiatives to improve our deposit-taking capabilities, including continued improvement in our chequing and saving products. We have made significant investments in personnel and platforms in our Payments and Cash Management ("PCM") products and aim to deliver these enhancements to our customers and prospects, particularly those for whom our market leading NAFTA position is relevant.

Focus on full spectrum sales capabilities, diversifying non-interest revenues – We have always been a very strong lending bank in Canada. We aim to develop similar success in deposit taking, and investment product sales and service. We will do so by improving sales processes, supporting product and services with active sales management programs, professional sales training, and implementing a consistent, national sales process. We will continue to develop leads management strategies to promote customer acquisition, leveraging our various lead sources, such as auto finance, mortgage brokers, cards and consumer finance services for retailers. Leads will be qualified as to appropriate products and services, prioritized as to best opportunities and deployed to appropriate channels based on customer preference.

Cost management and proactive resource reallocation – We will aggressively reallocate resources to areas of higher economic value and long-term growth while implementing initiatives that lead to further operational synergies.

Realizing return on investments – We have made significant investments in people, systems, processes and platforms over the last few years and we will ensure we earn satisfactory returns on these investments in 2006.

Grow in Alberta and the Greater Toronto Area – We will continue to make significant investments in people and distribution to expand our services in Alberta and the Greater Toronto Area.

Management's Discussion and Analysis (continued)

Free up time for customer sales and service – We will continue to streamline processes for our clients through re-engineering initiatives, allowing them to directly and conveniently access our products and services and increase our own efficiency. We have expanded our Six Sigma Black Belt training initiative and applied these skills to enhance process efficiency and minimize error rates in a number of our core functions. We aim to maximize the financial benefits of being a member of the HSBC Group and, most immediately in North America, through strategic investments such as call centres, e-commerce, and customer service and data centres. We will also use HSBC Group IT solutions wherever possible as this spreads the cost of such systems over the Group's operations worldwide, enabling us to deliver more cost effective services to our customers in Canada.

Continue to realize synergies with HSBC Finance – We share a common business focus with HSBC Finance, particularly maximizing customer relationships, the HSBC brand and leverage of the HSBC Group's capabilities. We will continue to leverage HSBC Finance's expertise in customer analytics, credit scoring and leads management technologies to help grow our sales, increase our revenue and mitigate our credit risk in personal lending.

Invest in the HSBC brand – We will continue to invest in the HSBC brand in 2006, particularly in the Greater Toronto Area, to improve market awareness.

Analysis of Financial Results For 2005

Highlights

- Net income attributable to common shares was $457 million for the year ended December 31, 2005, an increase of 32.5% over 2004.
- Return on average common equity was 21.3% for the year ended December 31, 2005 compared with 18.3% for 2004.
- The cost:income ratio improved to 52.2% for the year ended December 31, 2005 compared with 56.0% for 2004.
- Total assets were $49.2 billion at December 31, 2005, an increase of $5.9 billion, or 13.6%, from $43.3 billion at December 31, 2004.
- Total funds under management were $20.5 billion at December 31, 2005, an increase of $2.8 billion, or 15.8%, from $17.7 billion at December 31, 2004.

Overview: We recorded net income attributable to common shares of $457 million for the year ended December 31, 2005, an increase of $112 million, or 32.5%, from $345 million for 2004. Net income in 2005 benefited from a $14 million reversal from the general allowance for credit losses and a $14 million adjustment to other expenses, both before income taxes. Excluding these unusual items and the related income tax adjustments, net income attributable to common shares would have been $432 million for the year ended December 31, 2005, an increase of $87 million, or 25.2%, over 2004.

The good results for 2005 reflected the robust Canadian economy and the strength of our customers. Each of our customer groups contributed to a strong increase in revenues. Net interest income was higher from continued growth in our balance sheet. Non-interest revenues were higher on increased investment administration fees, credit fees, and foreign exchange revenue. Total non-interest expenses increased as our business grew, however, the rate of expense increase was less than the rate of revenue growth, which resulted in a decrease in the cost:income ratio. Lastly, the stable credit environment in Canada throughout much of 2005 meant lower provisions for credit losses and resulted in a reversal from our general allowance for credit losses.

Net interest income: Net interest income for the year ended December 31, 2005 was $1,010 million, an increase of $114 million, or 12.7%, from $896 million for 2004. Higher net interest income throughout 2005 has resulted from continued growth in the balance sheet across all our customer groups, and the impact of a full year from the acquisition of Intesa Bank Canada ("Intesa"). Economic growth in Canada continues to be strong and sentiment remains positive despite the recent increases in interest rates in Canada during the fourth quarter of 2005. Average interest earning assets were $42.6 billion for 2005 compared with $35.9 billion for 2004.

The net interest margin, as a percentage of average interest earning assets, was 2.37% for the year ended December 31, 2005 compared to 2.49% for 2004. Net interest margins have been adversely impacted throughout 2005 by competitive pricing, which has been compounded by increased balances in lower-spread products such as residential mortgages. Net interest margins in our treasury and markets groups were adversely impacted by a flatter yield curve throughout much of 2005.

Non-interest revenue: Non-interest revenue was $570 million for the year ended December 31, 2005, an increase of $44 million, or 8.4%, compared with $526 million for 2004.

Credit fees were $14 million higher in 2005 as a result of increased activity in commercial and corporate lending, particularly in shorter-term facilities such as bankers' acceptances, guarantees, and letters of credit. Investment administration fees were $15 million higher in 2005 due to an increase in funds under management. The volatility of the Canadian dollar relative to the US dollar throughout 2005 helped increase revenues from foreign exchange activities, which increased $8 million, compared with 2004. Other non-interest revenue was higher in 2005 due to strong fee income from our Canadian Immigrant Investment Program ("CIIP").

Resolution of certain income tax issues: Prior to July 1, 2005, an HSBC Group company ("Group") provided an unlimited guarantee of our customers' deposits. As consideration for provision of this guarantee, Group charged us a fee for the guarantee based on the guaranteed deposit amounts. For income tax purposes, we deducted this fee in determining our taxable income. Following agreement with CDIC, and reflecting our significant growth since we became part of the HSBC Group, this guarantee was discontinued for customer deposits received after 30 June 2005.

In the fourth quarter of 2005, the Canadian Competent Authority of the Canada Revenue Agency ("CRA") and the UK Competent Authority of the HM Revenue and Customs in the UK agreed, in principle, to a Bilateral Advance Pricing Agreement ("BAPA"). The BAPA outlines the agreed upon rates to be used in determining the amount we can deduct as an expense for the Group guarantee, and Group includes as income, for income tax purposes for the years 2002 to 2007 inclusive. The rates in the BAPA are lower than the rate we had been using to calculate the guarantee fee expense.

In the fourth quarter of 2005, Group reimbursed us $40 million relating to 2002 to 2004, representing the non-deductible amounts as determined in the BAPA. We also recorded a $4 million receivable for excess withholding tax paid to CRA relating to this reimbursement. As this was a related party transaction, we recorded an offsetting $44 million increase in retained earnings, reflecting the gross amount of the reimbursement.

Non-interest expenses: Non-interest expenses were $824 million for the year ended December 31, 2005, an increase of $28 million, or 3.5%, compared with $796 million for 2004.

Salaries and benefits expenses in 2005 were $442 million compared with $423 million in 2004. Salary expenses were $18 million higher in 2005 due to increased staffing in key areas and a full year of costs from former Intesa Bank Canada employees. There was a $7 million increase in stock-based compensation and a $9 million increase in performance based incentives. These were partially offset by an $18 million reduction in defined benefit pension and other non-pension benefit costs.

Premises and equipment expenses in 2005 were $107 million compared with $101 million in 2004. Equipment expenses were $7 million higher in 2005 primarily from increased costs associated with maintaining our computer infrastructure, as well as increased ABM costs associated with our new agreement with BMO Bank of Montreal.

Other non-interest expenses in 2005 were $275 million compared with $272 million in 2004. As a result of the reduction in the rate of the guarantee fee noted above and the discontinuation of Group's guarantee effective close of business on 30 June 2005, the guarantee fee expense for 2005 was $26 million lower than 2004. Marketing expenses increased by $12 million as a result of higher media spend to increase awareness of the HSBC brand in Canada. Transaction costs increased by $10 million in 2005 as a result of increased volumes in our brokerage operations and activity in our CIIP. These increases were partially offset by a $7 million credit on successful resolution of certain commodity tax issues relating to prior years.

Provision for income taxes: The effective income tax rate for the year was 33.5% compared with 37.6% in 2004 and the combined statutory rate of 35.2%. The effective rate was lower in 2005 due to the resolution of the deductibility of the guarantee fee expense, as discussed above, which resulted in a net reduction of $7 million in income tax expense. In addition, we released a valuation allowance of $11 million previously established against the recoverability of certain future income tax assets that was no longer required.

Management's Discussion and Analysis (continued)

Credit quality and provision for credit losses: The provision for credit losses was $27 million for the year ended December 31, 2005 compared with $66 million for 2004. The continued strong economic conditions in Canada throughout 2005 resulted in favourable credit conditions leading to a lower provision for credit losses. We reversed $14 million of the general allowance for credit losses, primarily reflecting the consistent low losses experienced in Western Canada over the past few years and the current strength of the economy.

Gross impaired loans and acceptances decreased to $151 million at December 31, 2005 compared with $182 million at December 31, 2004. Total impaired loans and acceptances, net of specific allowances for credit losses, were $73 million at December 31, 2005 compared with $112 million at December 31, 2004. The general allowance for credit losses was $269 million at December 31, 2005 compared with $279 million at December 31, 2004. The total allowance for credit losses, as a percentage of loans outstanding was 1.01% at December 31, 2005 compared with 1.22% at December 31, 2004.

Balance sheet: Total assets at December 31, 2005 were $49.2 billion, an increase of $5.9 billion from $43.3 billion at December 31, 2004. Stable interest rates throughout 2005, strong economic conditions, and an active housing market in Canada helped spur loan growth across all customer groups. Commercial loans and bankers' acceptances increased $2.4 billion in total to $19.6 billion at December 31, 2005 compared with $17.2 billion at the same time in 2004. Residential mortgages and consumer loans increased $1.4 billion to $16.6 billion in total at December 31, 2005 compared with $15.2 billion at December 31, 2004. Cash resources increased in 2005 by $1.6 billion, primarily in deposits with other banks. Securities and assets purchased under reverse repurchase agreements were $0.8 billion higher at December 31, 2005 compared with the same time in 2004, primarily from increased trading activity.

Total deposits at December 31, 2005 were $38.6 billion, an increase of $4.8 billion from $33.8 billion at December 31, 2004. Deposits from individuals increased to $15.3 billion at December 31, 2005 compared with $14.8 billion at the same time last year. Commercial deposits increased $2.9 billion to $21.3 billion at December 31, 2005 and deposits from other banks increased to $2.0 billion at December 31, 2005 from $0.6 billion at December 31, 2004 to fund the strong asset growth experienced in 2005.

Total assets under administration: Funds under management were $20.5 billion at December 31, 2005 compared with $17.7 billion at December 31, 2004. Including custody and administration balances, total assets under administration were $28.0 billion at December 31, 2005 compared with $22.8 billion at December 31, 2004.

Growth in funds under management during 2005 resulted from continued investment in our brokerage operations during the year and from success in our Private Client products. Additionally, Canadian equity markets, which were aided by higher natural resource prices, performed substantially better in 2005 relative to the US markets.

Quarterly Summary of Condensed Statements of Income

	2005				2004			
	Quarter ended				Quarter ended			
	Dec. 31	*Sept. 30*	*June 30*	*March 31*	*Dec. 31*	*Sept. 30*	*June 30*	*March 31*
				(Unaudited)				
Net interest income	**$ 269**	**$ 261**	**$ 243**	**$ 237**	$ 229	$ 230	$ 221	$ 216
Non-interest revenue	**141**	**145**	**140**	**144**	143	126	130	127
Total revenue	**410**	**406**	**383**	**381**	372	356	351	343
Provision for credit losses	**6**	**7**	**6**	**8**	22	10	20	14
Net interest and other income	**404**	**399**	**377**	**373**	350	346	331	329
Non-interest expenses	**205**	**208**	**209**	**202**	207	207	190	192
Income before the undernoted	**199**	**191**	**168**	**171**	143	139	141	137
Accounting change	**–**	**–**	**–**	**–**	–	–	–	14
Income before taxes	**199**	**191**	**168**	**171**	143	139	141	151
Provision for income taxes	**(58)**	**(67)**	**(55)**	**(57)**	(51)	(51)	(52)	(56)
Non-controlling interest in income of trust	**(6)**	**(7)**	**(5)**	**(4)**	(4)	(4)	(4)	(4)
Income from continuing operations	**135**	**117**	**108**	**110**	88	84	85	91
Discontinued operations	**–**	**–**	**–**	**–**	–	–	4	1
Net income	**$ 135**	**$ 117**	**$ 108**	**$ 110**	$ 88	$ 84	$ 89	$ 92
Preferred share dividends	**(3)**	**(4)**	**(4)**	**(2)**	(2)	(2)	(2)	(2)
Net income attributable to common shares	**$ 132**	**$ 113**	**$ 104**	**$ 108**	$ 86	$ 82	$ 87	$ 90
Basic earnings per share ($)*	**0.27**	**0.23**	**0.21**	**0.22**	0.18	0.17	0.18	0.19

**Basic earnings per common share is not materially different from basic earnings per common share from continuing operations.*

The unaudited quarterly information contains all adjustments necessary for a fair presentation of such information. All such adjustments are of a normal and recurring nature. Most of our revenues are non-seasonal in nature, although there can be an increase in non-interest revenues in the first quarter of the year associated with personal investments arising from RRSP activity in Canada.

There has been a general trend of increases in net interest income over the most recent eight quarters, particularly since the second quarter of 2004 when we acquired Intesa. The strong economy during 2005 has resulted in growth in the balance sheet, which has increased net interest income.

Non-interest revenues increased in the fourth quarter of 2004 due to increased capital markets income arising from stronger equity markets and a significant gain on the sale of an investment in our private equity fund. Non-interest revenues benefited by $5 million in the first quarter and $4 million in the third quarter of 2005 from a new accounting standard for valuation of investment company assets.

The increase in the provision for credit losses in the second and fourth quarters of 2004 was primarily attributable to a small number of exposures across all customer groups. The lower level of provisions in 2005 reflected the continuing strength of the Canadian economy.

Since the acquisition of Intesa in the second quarter of 2004, non-interest expenses have been generally consistent. In the first quarter of 2005, we recorded a recovery in non-interest expenses of $7 million related to settlement of certain commodity tax issues.

Management's Discussion and Analysis (continued)

In the first quarter of 2004, we recorded a one-time change in accounting for mortgage loan prepayment fees totaling $14 million.

In the fourth quarter of 2005, there was a $14 million reduction in the general allowance for loan losses, although this was offset by an increase in specific provisions. The agreement in respect of the BAPA referred to on page 9 resulted in a $14 million year-to-date reduction of the guarantee fee expense, which was recorded in the fourth quarter of 2005. However, this was partially offset by a $9 million increase in marketing expenses compared to previous quarters as a result of increased media spend to promote awareness of the HSBC brand in Canada. As explained on page 9, there was a reduction of $7 million in income tax expense in the fourth quarter of 2005 primarily from the resolution of the deductibility of the guarantee fee expense.

Impact of Estimates, Judgement Issues and Selection of Accounting Policies on Financial Statements

Inherent in the preparation of financial statements is the use of estimates. We make estimates, particularly concerning the valuation of assets, allowances for impaired loans and credit losses and the estimation of liabilities and provisions, which could affect amounts reported in our consolidated financial statements.

We set out details of how we apply certain accounting policies, including changes, in note 1 to our consolidated financial statements on pages 39 to 45. The following discussion sets out areas where we believe the selection and application of our accounting policies and the use of estimates and the application of judgment, could have a material impact on our reported results. We believe that our estimates are appropriate in the circumstances where applied.

Credit losses and estimation of allowances for credit losses

We report loans as the amount advanced less an allowance for credit losses. Assessing the adequacy of the allowance for credit losses is inherently subjective, as it requires making estimates including the amount and timing of expected future cash flows that may be susceptible to significant change.

We maintain specific allowances for loans that are currently impaired. We also record a general allowance for those loans that may be impaired but have not yet been identified as so. The impaired loans and allowances section on page 24 and 25 of management's discussion and analysis and note 1(g) to our consolidated financial statements on page 40 provide further details in respect of the estimation of our general allowance.

Employee future benefits

As part of employee compensation, we provide employees with pension and other post-retirement non-pension benefits, such as extended health care, to be paid after employees retire. In certain cases, the amount of the final benefit may not be determined until some years into the future, particularly for defined benefit pensions, where the payment is based on a proportion of final salary and upon years of service. Although we contribute to several pension plans to provide for employee entitlements, the actual amount of assets required depends upon a variety of factors such as the investment return on plan assets, the rate of employee pay raises, and the number of years over which the ultimate pension is to be paid.

Due to the long-term nature of the contribution and payment periods, changes in long-term rates could have a material impact on our reported financial results. After consultation with our actuaries, we make certain assumptions regarding the long-term rate of investment return on pension plan assets, the discount rate applied to accrued benefit obligations, the rates of future compensation increases and the trends in health care costs. The assumptions we use and an analysis of the sensitivity of those assumptions on our benefits expense are set out in note 13 to our consolidated financial statements on page 56 to 58. The most significant impact is a change in the discount rate applied to accrued benefit obligations. Under current accounting standards, the discount rate to be applied is a long-term bond rate rather than the estimated future performance of plan assets. This rate has decreased in recent years resulting in a considerable increase in the amount that must be set aside to cover the obligations.

Income and other taxes

In establishing the income tax provision and the amount of the future income tax asset recorded in our consolidated financial statements, we make estimates of the expected rates at which our income will be taxed in a variety of jurisdictions in Canada as well as expectations regarding dates of changes in temporary differences. If the actual amounts or rates differ from the estimates or our interpretations of the tax legislation differ from those of the federal and provincial tax authorities, adjustments may be necessary. Details of our income tax provisions are set out in note 14 to our consolidated financial statements on page 59.

Goodwill and intangible assets

Annually, we review goodwill for impairment to assess whether its carrying value is in excess of fair value. We also regularly assess intangible assets to ensure that recoverable amounts are in excess of the book value. In determining fair value of goodwill and intangible assets, we use a variety of factors such as market comparisons, discount rates, price/earnings ratios and income estimates. The determination of values requires management judgment in the assumptions used as well as an appropriate method for determination of fair value. Any impairment in goodwill or intangible assets is charged to the consolidated income statement. Although we amortize intangible assets in accordance with our accounting policies, no charges for impairment of goodwill or intangible assets have been recorded in either 2005 or 2004.

Securitizations and variable interest entities

As part of our liquidity, funding and capital management processes, we pool residential mortgages, automobile loans and personal lines of credit, and transfer security interests in these loans to unrelated third parties. These securitizations, which are governed by purchase and sale contracts, are generally conducted through Special Purpose Variable Interest Entities ("VIEs") and are financed by investors either through commercial paper or a longer term investment.

Accounting policies for securitizations are set out in note 1(q) to our consolidated financial statements on pages 42 to 43. If the accounting requirements for sales treatment are met, we recognize in income, at the time of the transaction, the present value of the excess spread we expect to earn over the life of the transaction, net of any expected credit losses. This requires us to make assumptions regarding the expected prepayment rates of the loans securitized, as well as the amount of credit losses. To the extent that we experience higher credit losses or loans repay at faster rates than our estimates, adjustments to the retained interests recorded may be necessary. On a quarterly basis, we review the carrying value of the retained interests recorded within the consolidated financial statements for impairment.

Our obligation to cover first losses in excess of these expected credit losses are not provided for in the balance sheet. Information on our securitizations, including our assumptions and an analysis of the sensitivity of those assumptions on income, regarding repayment rates and expected credit losses and the maximum obligations under first loss protection provisions, is set out in notes 3(b) and 3(c) to our consolidated financial statements on pages 48 to 49.

Fair value of financial instruments

During the normal course of our business, we make extensive use of financial instruments, including funding loans, purchasing investments, accepting deposits and entering into various derivative contracts.

The valuation of assets or liabilities is dependent upon the original purpose of the transaction. Where we enter into transactions with the intention of resale for trading purposes they are included in our trading portfolio. We revalue this portfolio daily and any change in the fair value is recorded as trading income in our consolidated income statement.

Certain assets purchased for investment purposes and liabilities accepted are included in our banking book. We record instruments in this portfolio at cost or amortized cost and interest income or expense or investment income is recorded on an accrual basis. Assets are not revalued to reflect changes in interest and/or market rates, as the expectation is we will hold them to maturity, and the recorded value of the asset will be realized in the normal course of our business. If, however, there has been a decrease in the value of an asset included in the banking book other than on a temporary basis, we will establish a provision in accordance with our accounting policies.

Management's Discussion and Analysis (continued)

Depending on the nature of the instrument, the recorded values of banking book assets or liabilities may be different to the fair values. Information on the fair value of financial instruments is set out in note 16 to the consolidated financial statements on pages 61 to 62.

Effective January 1, 2005, we adopted new fair value accounting requirements for investments held in investment companies. As most of these investments are private equity investments no readily available market value exists and judgement is required in estimating the timing and amount of future cash flows and discount rates applicable in determining their fair values. Wherever possible, we make use of appropriate industry valuation guidelines such as those published by venture capital associations.

Off-Balance Sheet Arrangements

As part of our banking operations, we enter into a number of off-balance sheet financial transactions that have a financial impact but are not recorded on our consolidated balance sheet. These types of arrangements are contingent and may not necessarily, but in certain circumstances could, involve us incurring a liability in excess of amounts recorded on our consolidated balance sheet. In addition to securitizations and VIEs noted above, these arrangements also include financial and performance guarantees, documentary and commercial letters of credit, and derivative financial instruments.

Guarantees and letters of credit

We routinely issue financial and performance guarantees and documentary and commercial letters of credit on behalf of our customers to meet their banking needs. Guarantees are often provided on behalf of customers' contractual obligations, particularly providing credit facilities for customers' overseas trading transactions and in construction financings. Letters of credit are often used as part of the payment and documentation process in international trade arrangements. Guarantees and letters of credit are considered contingent obligations and are not included in our consolidated financial statements as there are no actual advances of funds. Any payments actually made under these obligations would be recorded as a loan to our customers.

For credit risk management purposes, we consider guarantees and letters of credit as part of our clients' credit facilities, which are subject to appropriate risk management procedures. Guarantees and letters of credit are considered part of our overall credit exposure, as set out in the analysis of our loan portfolio on pages 23 and 24, and as set out in note 15(a) to our consolidated financial statements on page 60.

Derivative financial instruments

As part of our overall risk management strategy, we enter into a variety of derivatives to manage or reduce our risks in certain areas.

Forward foreign exchange transactions are transactions where we agree to exchange foreign currencies with our counterparties at a fixed rate on a future date. Interest rate swaps are agreements to exchange cash flows of differing interest rate characteristics. Other derivatives comprise equity or credit based transactions.

We use derivatives to limit our exposure to interest rate risk on loans and deposits with differing maturity dates, or foreign currency assets and liabilities of differing amounts. Mismatches in currency or maturity dates could expose us to significant financial risks if there are adverse changes in interest rates or foreign exchange rates. The use of derivatives is subject to strict monitoring and appropriate internal control procedures to ensure no unauthorized transactions are entered into as set out in our risk management discussion on pages 18 to 22.

Our accounting policies on recording the impact of derivatives are set out in note 1(o) to our consolidated financial statements on page 42. Information on our derivative instruments is set out in note 17 to the consolidated financial statements on pages 63 to 67.

New accounting proposals issued by the Canadian Accounting Standards Board relating to financial instruments, hedges and comprehensive income have been finalized and will be effective for the 2007 fiscal year. These new standards will change how we record financial assets and liabilities, and income and expenses related to these instruments. A degree of inter-period volatility may be introduced to our net income resulting from marking to market of derivatives that no longer qualify for hedge accounting treatment. The impact of implementing these new standards is not yet determinable as it is dependent on our outstanding positions, hedging strategies and market volatility at the time of the transactions.

Capital Management

We manage our capital resources to ensure their efficient use in the generation of shareholder value while supporting business activities, including the asset base and risk positions, as well as providing prudent depositor security and complying with all applicable regulatory requirements.

Capital adequacy for Canadian federally incorporated financial institutions is regulated by the Office of the Superintendent of Financial Institutions Canada (the "Superintendent"). Guidelines issued by the Superintendent's office are based upon recommendations for capital adequacy standards provided by the Bank for International Settlements ("BIS"). Although the BIS continues to recommend financial institutions maintain 4% and 8% Tier 1 and total capital ratios, respectively, the Superintendent recommends Canadian banks maintain minimum Tier 1 and total capital ratios of 7% and 10%, respectively.

The BIS is in the process of developing new standards for capital adequacy in the Basel II capital adequacy framework expected to be effective January 1, 2008. This new framework will have a significant impact on banks, as it requires capital to be held to cover operational and market risks as well as credit risk. In addition, the calculation of risk-weighted assets will be considerably more complex than the current framework. The HSBC Group is developing a number of systems and tools in preparation for the introduction of Basel II, some of which are described in the commentary on credit risk commencing on page 22.

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of a bank, comprising common shareholders' equity, qualifying non-cumulative preferred shares, qualifying innovative capital instruments, contributed surplus and retained earnings. Tier 2 capital includes subordinated debentures, general allowances for credit losses and cumulative preferred shares. Our Tier 1 capital ratio was 9.0% and the total capital ratio was 11.2% at December 31, 2005. This compares with 8.6% and 11.0%, respectively, at December 31, 2004.

CDIC has a tiered, differential insurance premium ratings system, which includes targets for capital adequacy. One of the measures CDIC uses in determining whether a financial institution is well capitalized is an asset to regulatory capital multiple as defined by CDIC. This definition regards a financial institution as being well capitalized if it maintains an assets to regulatory capital multiple of less than 85% of the Superintendent's maximum permitted assets to capital multiple of 20 times. We target to be prudently below CDIC's more conservative threshold of 17 times and at December 31, 2005, our multiple was 14.2 times.

We have formal capital management policies, which have been approved by our Board of Directors and HSBC Holdings and which have been reviewed by the applicable regulatory authorities in Canada. Our capital management policies lay out a strict regime of capital monitoring, targets, limits and maintenance actions. Our Finance and Treasury departments manage compliance with our policies daily, with bi-monthly monitoring by our Asset and Liability Committee ("ALCO"). ALCO is chaired by our Chief Financial Officer and includes the Chief Executive Officer, Chief Operating Officer and certain of our senior executives, including those responsible for credit, risk management, marketing and sales, and treasury. Positions and limits are monitored by our Tactical ALCO ("TALCO") committee in intervening weeks. TALCO is also chaired by our Chief Financial Officer and includes members from Finance, Treasury and Marketing.

We utilize enhanced personal and commercial relationship management performance measurement tools to ensure that our shareholders' capital is efficiently deployed in our major business segments. Capital necessary to support customer loans and other asset classifications is determined according to the various specific risk weighting factors provided by the Superintendent's Capital Adequacy guidelines. We monitor and adopt a variety of capital management techniques in order to maximize shareholder value against the fundamental need to be prudently capitalized.

Management's Discussion and Analysis (continued)

Regulatory capital ratios

The components of our regulatory capital and the regulatory capital ratios are as follows:

	2005	2004
Tier 1 capital		
Common shares	**$ 1,125**	$ 1,125
Contributed surplus	**187**	177
Retained earnings	**934**	770
Non-cumulative preferred shares[1]	**314**	125
Non-controlling interests in trust and subsidiary[2]	**430**	230
Goodwill	**(15)**	(15)
Total Tier 1 capital	**2,975**	2,412
Tier 2 capital		
Non-cumulative preferred shares[1]	**36**	–
Subordinated debentures (net of regulatory amortization)	**423**	426
General allowance for losses	**269**	245
Total Tier 2 capital	**728**	671
Total Tier 1 and Tier 2 capital	**3,703**	3,083
Securitization-related deductions	**(33)**	(15)
Total capital available for regulatory purposes	**$ 3,670**	$ 3,068
Regulatory capital ratios		
Tier 1 capital	**9.0%**	8.6%
Total capital	**11.2%**	11.0%
Assets to capital multiple	**14.2x**	14.9x

(1) *Includes $175 million in each of Series C and Series D preferred shares of which $36 million is currently designated as Tier 2 Capital*
(2) *Includes $400 million of HSBC Canada Asset Trust Securities (HSBC HaTS™) (2004 – $200 million)*

Risk-weighted assets

Risk-weighted assets arise primarily from the provision of credit and other risk facilities to our customers. We determine risk-weighted assets by applying the specific risk-weighting factors provided by the Superintendent's capital adequacy guidelines. Our risk-weighted assets are as follows:

	2005	2004
On-balance sheet assets		
Cash resources	**$ 1,176**	$ 854
Securities	**410**	226
Residential mortgages	**5,821**	5,458
Other loans	**17,064**	14,605
Acceptances	**4,002**	3,754
Other assets	**887**	767
Total on-balance sheet assets	**29,360**	25,664
Off-balance sheet instruments		
Guarantees and letters of credit	**1,871**	1,594
Other	**1,522**	483
Subtotal	**3,393**	2,077
Derivatives (at risk-weighted equivalents)	**179**	212
Total off-balance sheet instruments	**3,572**	2,289
Total risk-weighted assets	**$ 32,932**	$ 27,953

Regulatory capital generation

We generated regulatory capital in 2005 through the following sources:

	2005	2004
Internally generated capital		
Net income	**$ 470**	$ 353
Dividends	**(343)**	(158)
General allowance for credit losses	**24**	34
Other	**36**	11
	187	240
External financing		
Issue of common shares	**–**	175
Redemption of preferred shares	**(125)**	–
Issues of preferred shares, net of expenses	**344**	–
Issue of innovative Tier 1 capital, net of expenses	**199**	–
Subordinated debentures (net of regulatory amortization)	**(3)**	(31)
Total increase in regulatory capital	**$ 602**	$ 384

In 2005, our operations generated more capital than was required by the business. During the year we paid quarterly dividends of 39.0625 cents per share for the first three quarters on our Class 1 Preferred Shares – Series A totaling $6 million. We paid an initial dividend of 25.2198 cents per share and two quarterly dividends of 31.8750 cents per share on our Class 1 Preferred Shares – Series C totaling $6 million. We also paid an initial dividend of 17.6663 cents per share on our Class 1 Preferred Shares – Series D totaling $1 million. Dividends on our common shares totaling $330 million were declared of which $60 million was payable at December 31, 2005.

In 2004 and 2003, we paid dividends of $1.56 per share on our Class 1 Preferred Shares Series A totaling $8 million and common share dividends totaling $150 million in each year.

In addition to internally generated capital, we issue subordinated debenture capital through private placements as well as issuing preferred shares and capital trust securities through public markets issues. We have also issued common shares and subordinated debentures to the HSBC Group. During 2005, we issued $175 million in each of Class 1 Preferred Shares Series C and Series D with coupons of 5.10% and 5.00% respectively, paid quarterly when declared. We also issued $200 million in HSBC Canada Asset Trust Units – Series 2015 with an effective yield of 5.149% based upon the initial issue price, paid semi-annually. During 2005, we redeemed the Class 1 Preferred Shares Series A for $125 million in cash.

In 2006, we expect to generate sufficient capital either through further capital issues or through operations to support our business and capital requirements. On March 1, 2006 we redeemed $60 million of 7.70% subordinated debentures due 2011 and on March 15, 2006, we issued $200 million of 4.94% subordinated debentures due 2021.

Credit Ratings

Standard & Poor's ("S&P") and Dominion Bond Rating Service ("DBRS") maintain credit ratings of our debt and securities. The ratings are made within the rating agencies' normal classification system for each type of debt or security rated.

S&P affirmed all our ratings during the year and subsequently revised its outlook of the Bank to positive from stable in December 2005.

DBRS placed our ratings under review in June 2005 with positive implications. On June 29, 2005, they upgraded their ratings of our long-term deposits and senior debt, subordinated debt, preferred shares, and capital trust securities. The DBRS rating of our short-term debt was confirmed and the trend changed back to stable at the same time.

Management's Discussion and Analysis (continued)

Our most current ratings are as follows:

	Short-Term Deposits	*Long-Term Deposits*	*Subordinated Debt*	*Preferred Shares*	*HSBC HaTS*
S&P	A-1	A+	A	P-1 (Low)(1)	P-1 (Low)(1)
DBRS	R-1 (mid)	AA (low)	A (high)	Pfd-1 (low)$_n$	A$_{yn}$

(1) *Based on S&P Canadian national preferred share scale. Ratings are A- on S&P global preferred share scale.*

Risk Management

All of our business activities require the management of particular risks or combinations of risks. Risk management is the identification, analysis, evaluation and management of the factors that could adversely affect our resources, operations, reputation and financial results. The risk factors most likely to affect us are market, structural, liquidity, fiduciary, operational and credit risks. We believe our exposure to these risks is managed conservatively. We have established formal risk management policies that identify and analyze these risks and, where required, we set appropriate risk limits. We continually monitor these risks and limits by means of internal control measures, which we consider to be up to date and reliable.

We review and modify our risk management policies and systems regularly to reflect any operational changes either internally or in the markets in which we operate. Our Board of Directors approves our risk management policies and overall risk management limits are set, taking into account HSBC Holdings' overall risk limits. Our Risk Management Committee is responsible for the strategic management of all risks to which we are exposed. The Risk Management Committee:

- Identifies and measures risks we are exposed to and considers whether those risks are significant;
- Develops and recommends for approval, appropriate risk management policies and procedures regarding those activities and units which incur significant risk, including extraordinary event planning;
- Provides direction regarding our overall risk philosophy and appetite including consideration and acceptability of new or unusual risk;
- Monitors our adherence to risk management policies and procedures; and
- Reports any policy or major practice change, unusual situations, significant exceptions, new strategy or products to our Executive Committee, Audit Committee and Board for review, ratification or approval.

The Risk Management Committee delegates day to day management of risks to a variety of sub-committees including ALCO, Credit, Operational Risk Management and Fiduciary Risk Management committees. We also have committees specifically responsible for the risk assessment and implementation of new products.

Market risk

Market risk is the risk to our financial condition resulting from adverse movements in market rates or prices, such as interest rates, foreign exchange rates, or equity prices on our portfolio of trading instruments. Trading book assets are valued at market prices and as prices rise and fall, our earnings will be directly impacted.

We make markets in interest and exchange rate instruments, as well as in debt, equity and other securities. Trading risks arise either from customer-related business or principal investing activities, where we trade instruments for our own account.

Market risk is managed through risk limits set out by ALCO and approved by our Board of Directors. We set risk limits for each of our trading operations dependent upon the size, financial and capital resources of the operations, market liquidity of the instruments traded, business plan, experience and track record of management and dealers, internal audit ratings, support function resources and support systems. Risk limits are reviewed and set by ALCO on an annual basis at a minimum.

We conduct reviews using a combination of risk measurement techniques, including present value of a basis point ("PVBP"), value at risk ("VaR"), foreign exchange exposure limits, maximum loss limits, options premium paid limits and product and issuance limits. PVBP is a sensitivity measure that calculates the impact on the present value of a transaction (or a portfolio of transactions) of a one basis point movement in rates.

VaR is a statistical technique that estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. The methodology for calculating VaR uses historical simulation to incorporate non-linear risks and a 1-day holding period at a 99% confidence level. This means that the maximum loss on our trading portfolio could potentially exceed the VaR once in every one hundred days. Trading VaR as at December 31, 2005 was $0.6 million.

Structural risk

Structural risk consists of interest rate risk and foreign exchange risk as it relates to assets and liabilities included in the banking book, including those in our consolidated balance sheet and any off-balance sheet items used as hedges. We value instruments included in the banking book at cost plus accrued interest (the accrual basis) and changes in rates and prices will not directly impact earnings. However, to the extent that assets and liabilities are not directly matched either by interest or exchange rates, any changes in the mix of assets or liabilities will affect earnings.

Interest rate risk

Interest rate risk arises primarily out of differences in the term to maturity or repricing of our assets and liabilities both on and off balance sheet. These interest rate risk exposures or "gaps" are monitored by TALCO and ALCO against prescribed limits. The gap position measures assets and liabilities based on contractual repricing data as well as incorporating assumptions on customer behaviour on products with a degree of optionality as to prepayment, redemption or repricing (such as redeemable deposit products and mortgages with prepayment options). These assumptions, which are based on historical behavioural patterns, are periodically reviewed by ALCO.

We believe in a conservative approach in setting limits on these mismatched positions. Limits are established based on the impact on the present value of all net cash flows of an immediate and parallel upward shift in all relevant yield curves of 0.01% (1 PVBP). We also have established limits on these mismatched positions in terms of Dollars at Risk and VaR. Net Interest Income is forecasted and stress tested using various interest rate and balance sheet growth scenarios to provide a comprehensive analysis of earnings at risk.

We use a variety of cash and derivative instruments, principally interest rate swaps, to manage our interest rate risk. We use derivatives to modify the interest rate characteristics of related balance sheet instruments and to hedge anticipated exposures when market conditions are considered beneficial.

In managing interest rate risk, we rely primarily upon our contractual interest rate sensitivity position adjusted for certain assumptions regarding customer behavioral preferences, which are based upon historical trends. Adjustments made include assumptions relating to early repayment of consumer loans and residential mortgages and customer preferences for demand, notice and redeemable deposits. Based upon these adjustments made to our contractual positions, it is estimated that an immediate and sustained parallel increase in interest rates of 1% across all currencies and maturities would increase net interest income by $46 million (2004 – increase of $39 million) over the next twelve months assuming no additional hedging is undertaken.

Foreign exchange risk

We are exposed to foreign exchange risk on our foreign currency denominated asset and liability positions. We buy and sell currencies in the spot, forward, futures and options markets, on behalf of our customers and for our own account, to manage our own currency exposures arising from assets and liabilities denominated in currencies other than the Canadian dollar. Limits have been established as to the magnitude of the exposure on a currency-by-currency basis as well as maximum loss limits on any position held.

Management's Discussion and Analysis (continued)

Liquidity risk

Liquidity risk is the risk that we will be unable to fund our obligations as they come due because of our inability to liquidate assets or obtain adequate funding (funding liquidity risk), or cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions (market liquidity risk).

We manage the liquidity structure of our assets, liabilities and commitments so cash flows are appropriately balanced and all funding obligations are met when due. We ensure compliance with Canadian regulatory, HSBC Group and ALCO requirements. Our Treasury department manages liquidity on a day-to-day basis.

As part of management of both our liquidity and interest rate risks, we have an overall flexible funding strategy to cover both short and long term liquidity needs, as well as a contingency plan to cover unexpected or unusual situations that could lead to market disruptions.

Customer deposits form a significant portion of our overall funding. Considerable importance is placed on the growth of our core deposit base, which provides a diversified and stable pool of funds. We access capital markets for the purposes of providing additional wholesale funding, maintaining a presence in the marketplace, and aligning asset and liability maturities. As part of our wholesale funding arrangements, we have a number of programs for fundraising activities, including arranging facilities with major Canadian institutional lenders and borrowers, so that undue reliance is not placed on any one source of funding, and asset securitizations.

In 2005, HSBC Holdings signed an undertaking with CDIC to bring the previous deposit guarantee of HSBC Bank Canada more in line with other banks covered by CDIC. Through the undertaking, HSBC Holdings confirmed that we would continue to comply with Canadian regulatory requirements, including the requirement to meet regulatory capital adequacy standards. CDIC recently revised its policy concerning third party commitments and released HSBC Holdings from the undertaking.

We have established limits for balance sheet ratios and minimum periods of forecast positive cumulative cash flow as well as contingencies to meet cash flow needs. As part of this contingency, we can access the considerable resources of the HSBC Group and currently have a US$300 million standby borrowing facility from our US affiliate, although no amounts have been drawn from this facility since its inception in 1997.

ALCO and TALCO oversee compliance with liquidity requirements by monitoring:

– Projected cash flows and the levels of related liquid assets;

– Specified balance sheet liquidity ratios against prescribed limits;

– Depositor concentration in terms of overall funding mix and to avoid undue reliance on large individual and non-core depositors; and

– Liquidity contingency plans.

As part of our normal business operations we have a number of contractual obligations for payment of liabilities. Amounts included in unsecured long-term funding in the table below are customers' term deposits with an original term to maturity more than one year based on contractual repayment dates. We manage our funding requirements based on historical customer behavioural patterns, and we may not actually be required to repay these obligations on the due date. Also included are obligations related to commitments not recorded in the balance sheet, such as those relating to operating leases.

A summary of our future contractual obligations at December 31, 2005 is as follows:

	Payments due by period				
	Less than 1 year	*1 to 3 years*	*4 to 5 years*	*After 5 years*	*Total*
Subordinated debentures	$ –	$ –	$ –	$ 423	$ 423
Operating leases	34	54	38	38	164
Committed purchase obligations	32	63	–	–	95
Unsecured long term funding	740	1,501	360	–	2,601
Total contractual obligations	$ 806	$ 1,618	$ 398	$ 461	$ 3,283

Committed purchase obligations include long term arrangements for the provision of technology and data processing services by HSBC Group companies.

Not included in the table are any commitments relating to customers utilizing undrawn portions of their loan facilities. Total undrawn facilities at December 31, 2005 were $23,768 million for facilities expiring before December 31, 2006 and $3,702 million for facilities expiring after that date.

We expect to be able to meet all of our funding and other commitments in the normal course of our operations.

Fiduciary risk

Fiduciary risk is the risk of failing to fulfill the duty to act for the benefit of another in a fiduciary relationship such as traditional fiduciary activities (trustee, executor, administrator of estates, committee), or where we provide discretionary investment services, or where any other fiduciary relationship has been established. Fiduciary risk differs from the risks we face as intermediaries, as it arises from our dealing with or advising on the assets owned by our customers. A fiduciary relationship requires us to place our customers' objectives ahead of our own interests with a duty of loyalty, care and disclosure.

Fiduciary risk is controlled and managed by ensuring our clients establish appropriate investment goals and mandates through the "Know Your Customer" process and ensuring our staff follow correct procedures when exposed to fiduciary relationships. This control structure is complemented by regular self-assessment reporting of business lines to the Fiduciary Risk Management Committee and by independent and periodic reviews by our Internal Audit and Compliance functions.

Operational risk

Operational risk is the risk of loss to us resulting from inadequate or failed internal processes and systems, human error or external events. This type of risk includes fraud, unauthorized activities, errors, and includes settlement risk arising from the large number of daily banking transactions occurring in the normal course of business. Also, there are a wide variety of business and event risks inherent in all business activities such as legal, taxation, regulatory, human resources and reputation.

We have policies for managing operational risk and aim to minimize loss through a framework requiring all units to identify, assess, monitor and control operational risk. The operating risks identified by the units are presented to the Operational Risk Management Committee who has the responsibility of challenging the risk limitation and control strategies proposed, as well as the action items being taken to mitigate the risk. This operational risk management process is subject to a review by our Risk Management Committee and approval by our Board of Directors.

We manage operational risk through disciplined application and evaluation of internal controls, appropriate segregation of duties, independent authorization of transactions, and regular, systematic reconciliation and monitoring of transactions. This control structure is complemented by independent and periodic reviews by our Internal Audit department. In addition to an enterprise-wide risk management process, we have established business continuity and event management practices so we can continue to service our customers' needs in the event of major business disruption. Back-up facilities in Vancouver and Toronto increase our recovery capabilities for key businesses.

We experienced an operational loss event during 2005 relating to a processing disruption that resulted from a hardware failure in one of our computer systems. The system outage impacted our ability to process transactions and caused a delay in providing customer service. As a result, we have implemented several improvements in our business continuity management process with further improvements planned in 2006. In common with other HSBC Group companies, as well as other Canadian banks and large organizations, we are creating a business continuity plan to prepare for the possibility of an avian influenza pandemic.

Management's Discussion and Analysis (continued)

Credit risk

Credit risk arises when we place reliance on our borrowers and other counterparties to honour their contractual obligations to us arising out of credit granting, credit substitutes (such as letters of credit and guarantees) and contingent risk relating to derivative contracts such as forward foreign exchange contracts and interest rate swaps. Concentration of credit risk may arise when the ability of a number of borrowers or other counterparties to meet their contractual obligations are similarly affected by external factors. Examples of concentration risk would include geographic, industry or environmental factors. Therefore, diversification of credit risk is a key concept by which we are guided.

Credit risk is managed in accordance with our credit policy, established after consultation with the HSBC Group, that has been approved by our Board of Directors. Risk limits and credit authorities are delegated to senior credit management staff, who in turn delegate appropriate limits to line management depending upon circumstances. Credit exposures in excess of certain levels may require the concurrence of the HSBC Group to ensure they remain within their global risk limits.

Our Board of Directors and Audit Committee meet quarterly to review: portfolio credit quality; geographic, product and industry distributions; large customer concentrations; and adequacy of loan provisions. Policies relating to large customer concentration and industry, product and geographic distribution are approved by our Board in line with HSBC Group policy. All new major authorized facilities, derivative exposures and special credit problem facilities are also reviewed quarterly by the Audit Committee. The appetite for credit risk is expressed through Commercial and Personal Lending Guidelines that conform with HSBC Group guidelines and are approved quarterly by the Audit Committee and disseminated throughout the Bank.

We have a disciplined approach to managing credit risk through ongoing monitoring of all credit exposures at branches, with weaker quality credits being reviewed at more frequent intervals. Problem and impaired loans are identified at an early stage and are actively managed by a separate dedicated Special Credit management unit. Our Credit Department reviews and adjudicates credit risk outside of branch managers' delegated lending limits and they review branch credit decisions to ensure these decisions reflect our portfolio management objectives. Our Credit Department may approve credits not meeting our lending guidelines on an exception basis with appropriate risk mitigation and reward considerations.

Exposure to banks and financial institutions involves consultation with a dedicated unit within the HSBC Group that controls and manages these exposures on a global basis. Similarly cross-border risk is also controlled globally by this unit through the imposition of country limits. A review of all credit matters undertaken by our branch and head office credit managers is completed regularly by our internal auditors to ensure all our policies, guidelines, practices, conditions and terms are followed.

Segmentation of credit risk is ensured through a formal and strictly managed risk grading system that is assigned to all borrowing clients and monitored closely to ensure changes in credit risk are mapped to the appropriate credit grade. We use credit scoring and related bureau-based management techniques, along with judgement to manage credit risk associated with our personal portfolio.

We manage real estate lending within well-defined parameters with an emphasis on relationship and project sponsorship for all new transactions. Where we are dependent upon third parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

We believe we have a strong control environment to ensure credit risks are appropriately managed through our conservative lending practices, accurate recording, and strict approval and monitoring processes. Historically, our average percentage credit loss experience has been amongst the lowest of our peer group of major Canadian chartered banks.

Significant progress continues to be made in the Basel II initiative. In 2004, we commenced the implementation of an enhanced grading system providing a more granular approach to assigning risk ratings. We are currently implementing a number of changes in respect of our commercial and retail credit infrastructure and rating systems to improve risk assessment and enhance efficiency. In 2005, we further enhanced our Credit Approval and Risk Management system and the linked assessment tool, "Moody's Risk Advisor" that drives the new commercial rating system. We completed a new retail credit rating system and database that supports more detailed risk analysis of the portfolio. We also completed the infrastructure required to populate an HSBC Group risk database and regulatory capital calculator. A project is also underway to calculate Economic Capital across the various portfolios with expected completion in 2006.

Loan portfolio

In assessing our loan portfolio, we include all of our credit exposures, including customers' liabilities under acceptances, guarantees and letters of credit.

The following is an analysis of the constituents of our portfolio:

	2005	2004
Loans included in financial statements, net of allowances	**$ 31,844**	$ 28,319
Allowance for credit losses	**326**	349
Customers' liabilities under acceptances(1)	**4,002**	3,754
Financial and performance standby letters of credit	**2,235**	1,756
Documentary and commercial letters of credit	**516**	459
Total loans	**38,923**	34,637
Impaired loans and acceptances(1)	**(151)**	(182)
Total performing loans	**$ 38,772**	$ 34,455

(1) *2005 includes $21 million of impaired acceptances.*

The following tables, in which business and government loans includes customers' liabilities under acceptances, letters of credit and guarantees, provide details of our overall performing loan portfolio including geographic and industry distribution:

Performing loan portfolio

	2005		2004	
Consumer loans	**$ 3,720**	**9.6%**	$ 3,234	9.4%
Residential mortgages	**12,852**	**33.1%**	11,943	34.7%
Total consumer	**16,572**	**42.7%**	15,177	44.1%
Business and government loans	**22,200**	**57.3%**	19,278	55.9%
Total performing loans	**$ 38,772**	**100.0%**	$ 34,455	100.0%

Geographic distribution

	2005		2004	
British Columbia	**$ 18,928**	**48.8%**	$ 16,723	48.5%
Western Canada	**5,951**	**15.4%**	4,933	14.3%
Ontario	**9,943**	**25.6%**	9,010	26.2%
Quebec and Atlantic	**3,950**	**10.2%**	3,789	11.0%
Total performing loans	**$ 38,772**	**100.0%**	$ 34,455	100.0%

Business and government loan portfolio by industry

	2005		2004	
Real estate	**$ 7,050**	**31.8%**	$ 6,002	31.1%
Hotels and hospitality	**887**	**4.0%**	867	4.5%
Trade	**2,978**	**13.4%**	2,796	14.5%
Services	**4,150**	**18.7%**	3,506	18.2%
Manufacturing	**3,031**	**13.7%**	2,762	14.3%
Other	**4,104**	**18.4%**	3,345	17.4%
Total business and government loans	**$ 22,200**	**100.0%**	$ 19,278	100.0%

Stable interest rates throughout 2005, strong economic conditions, and an active housing market in Canada helped spur loan growth across all customer groups, particularly commercial. Growth was good in all geographic regions, but particularly in British Columbia and Alberta resulting from the strength of the economy in Western Canada.

Large customer concentrations are borrowing groups where approved facilities exceed 10% of our regulatory capital base. At December 31, 2005, this amount was approximately $368 million.

Management's Discussion and Analysis (continued)

The following table provides details of our large customer concentrations:

	2005	2004
Large customer concentration	**$ 2,370**	$ 2,479
As a percentage of business and government loans	**10.7%**	12.9%
As a percentage of total performing loans	**6.1%**	7.2%

Credit quality

We categorize the credit quality of our loan portfolio as follows:

- *Satisfactory* – Borrower's financial condition and future capacity to repay is considered satisfactory.
- *Watch* – Borrower's financial condition has shown sustained or continued deterioration and requires frequent monitoring. The capacity to repay remains satisfactory.
- *Sub-standard* – Borrower's financial condition is weak. However, we still expect that full repayment will be received.
- *Impaired* – We consider loans impaired if an amount is contractually 90 days in arrears or our management is of the opinion there is no longer reasonable assurance as to the ultimate collectibility of all or some portion of principal or interest. Impaired loans are classified as non-performing. Specific provision is made for any anticipated loss.

The following table sets forth an analysis of our total loan portfolio on the basis of the above credit quality categories:

	2005		2004	
Satisfactory	**$ 37,836**	**97.2%**	$ 33,454	96.6%
Watch	**621**	**1.6%**	602	1.7%
Sub-standard	**315**	**0.8%**	399	1.2%
Impaired	**151**	**0.4%**	182	0.5%
Total loans	**$ 38,923**	**100.0%**	$ 34,637	100.0%

The vast majority of our total loan portfolio is categorized as satisfactory. Credit quality of the portfolio has remained stable over the past five years. As at December 31, 2005, $151 million (0.4%) of the loan portfolio was impaired, with specific and general allowances providing 216% (December 31, 2004 – 192%) coverage of these loans.

Impaired loans and allowances for credit losses

We maintain allowances for credit losses, which are considered adequate to absorb all estimated credit-related losses in the portfolio of both on and off-balance sheet items including deposits with other regulated financial institutions, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees. Details on how we estimate our allowance for credit losses are set out in note 1(g) to our consolidated financial statements on page 40.

The following table provides details of the impaired loan portfolio:

	2005	2004
Business and government		
Real estate	$ 21	$ 26
Manufacturing[1]	70	56
Trade	17	20
Services	9	23
Other	7	15
Total business and government loans	124	140
Personal		
Residential mortgages	13	23
Consumer loans	14	19
Total personal loans	27	42
Total impaired loans and acceptances[1]	$ 151	$ 182
Specific allowances	$ 57	$ 70
General allowances	269	279
Total allowance for credit losses	$ 326	$ 349
Net impaired loans and acceptances	$ (175)	$ (167)

(1) *2005 includes $21 million of impaired acceptances.*

The following table shows the coverage of specific allowances as a percentage of our related impaired loans and acceptances:

	2005	2004
Real estate	19%	23%
Manufacturing	47%	38%
Other	48%	43%
Total	35%	38%

The following table sets out the coverage of general provisions as a percentage of total performing loans and risk-weighted assets:

	2005	2004
Coverage by general allowance		
As a percentage of total performing loans	0.69%	0.81%
As a percentage of risk-weighted assets	0.82%	1.01%

Provisions for credit losses

The following table sets out the provisions for (reversal of) credit losses charged to income.

	2005	2004
Specific provisions	$ 40	$ 56
General provisions	(13)	10
Total provision for credit losses	$ 27	$ 66
Specific provisions as a percentage of total loan portfolio	0.10%	0.16%

Specific provisions have decreased as a result of the continuing strong economy in 2005. There was a small $1 million increase in general provisions in the earlier part of 2005. However, during the latter part of the year, we undertook a review and update of key assumptions in our general allowance methodology and determined that there was no longer a need to maintain an adjustment for geographic concentration, as a result of the consistently low loss experience in Western Canada over the past few years and the current strength of the Canadian economy. This resulted in a $14 million release from our general allowance for loan losses in the last quarter of 2005 bringing the balance down to $269 million. This reduction remains consistent with our stated methodology, within the range of values suggested by our general allowance model and consistent with the current environment of strong and stable credit conditions.

Management's Discussion and Analysis (continued)

Derivative portfolio

The credit equivalent amount of derivative exposure comprises the current replacement cost of positions plus an allowance for potential future fluctuation of interest rate or foreign exchange rate derivative contracts. We enter into derivatives primarily to support our customers' requirements and to assist us in the management of assets and liabilities particularly relating to interest and foreign exchange rate risks as noted above.

The credit equivalent amount of our derivative portfolio by product type is as follows:

Products	**2005**	2004
Interest rate contracts	**$ 130**	$ 148
Foreign exchange contracts	**409**	602
Other contracts	**63**	7
Total	**602**	757
Impact of master netting agreements	**–**	(24)
Net credit equivalent amount	**$ 602**	$ 733

A more detailed analysis of our derivative portfolios is presented in note 17 to our consolidated financial statements on pages 63 to 67.

Related Party Transactions

As a member of one of the world's largest financial services organizations, we benefit from the expertise and economies of scale provided by the HSBC Group. We outsource a number of functions to other HSBC Group companies, share costs of development for computer systems used around the world and benefit from international contracts for advertising and marketing research, training and other operational areas. Up to June 30, 2005, HSBC Holdings guaranteed all of our customers' deposits.

All such transactions are related party transactions and are subject to formal procedures we have adopted to comply with the Canadian Bank Act. All transactions must be approved either by our Compliance Department or, if above certain thresholds, by our Executive Committee. This additional scrutiny ensures that we meet our obligation to ensure transactions are priced and accounted for as if they were provided in an open market on an arms-length basis or, where no market exists, ensure we receive fair value. In addition, taxation authorities in Canada and other jurisdictions may disallow the deductibility of transactions that are not priced on an arms-length or fair value basis.

For 2005, the total amount we paid to other HSBC Group companies in respect of these transactions was $89 million. There are also a number of routine transactions occurring during the course of the year, none of which are individually material to our results. Reference should also be made to note 21 to the consolidated financial statements on pages 71 to 72.

Controls and Procedures

Management's responsibility for financial information contained in our Annual Report is set out on page 33. In addition, the Audit Committee of our Board of Directors and our Board have reviewed and approved the Consolidated Financial Statements and Management's Discussion and Analysis prior to release of the annual report.

Disclosure controls and procedures are designed to provide reasonable, but not absolute assurance, that all necessary information is reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding any necessary disclosure to the Bank's various stakeholders.

As of December 31, 2005, the Bank's management has evaluated the effectiveness of our disclosure controls and procedures, as required by the Canadian securities regulatory authorities under Multilateral Instrument 52-109. This evaluation was performed under the supervision of the Bank's Senior Management with the participation of the CEO and the CFO.

Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures were effective.

Analysis of Financial Results and Operations by Customer Group

The following is a summary of selected consolidated financial information and other data for each of our major customer groups:

	2005				
	Personal financial services	*Commercial banking*	*Corporate, investment banking & markets*	*Other*[(1)]	*Total*
Net interest income	**$ 360**	**$ 536**	**$ 114**	**$ –**	**$ 1,010**
Non-interest revenue	**267**	**191**	**112**	**–**	**570**
Total revenues	**627**	**727**	**226**	**–**	**1,580**
Provision for credit losses	**(14)**	**(13)**	**–**	**–**	**(27)**
Non-interest expenses	**(452)**	**(289)**	**(50)**	**(33)**	**(824)**
Income before taxes	**161**	**425**	**176**	**(33)**	**729**
Provision for income taxes	**(52)**	**(138)**	**(58)**	**11**	**(237)**
Non-controlling interest in income of trust	**(7)**	**(13)**	**(2)**	**–**	**(22)**
Net income from continuing operations	**102**	**274**	**116**	**(22)**	**470**
Discontinued operations	**–**	**–**	**–**	**–**	**–**
Net income	**$ 102**	**$ 274**	**$ 116**	**$ (22)**	**$ 470**
Percentage of total net income	**21.7%**	**58.3%**	**24.7%**	**(4.7%)**	**100.0%**
Average risk-weighted assets	**$ 9,523**	**$ 17,177**	**$ 3,676**		**$ 30,376**
Percentage of total average risk-weighted assets	**31.4%**	**56.5%**	**12.1%**		**100.0%**

	2004				
	Personal financial services	*Commercial banking*	*Corporate, investment banking & markets*	*Other*[(1)]	*Total*
Net interest income	$ 303	$ 472	$ 121	$ –	$ 896
Non-interest revenue	249	169	108	–	526
Total revenues	552	641	229	–	1,422
Provision for credit losses	(17)	(46)	(3)	–	(66)
Non-interest expenses	(421)	(266)	(50)	(59)	(796)
Income before the undernoted:	114	329	176	(59)	560
Effect of accounting change	7	–	7	–	14
Income before taxes	121	329	183	(59)	574
Provision for income taxes	(44)	(121)	(68)	23	(210)
Non-controlling interest in income of trust	(5)	(9)	(2)	–	(16)
Net income from continuing operations	72	199	113	(36)	348
Discontinued operations	5	–	–	–	5
Net income	$ 77	$ 199	$ 113	$ (36)	$ 353
Percentage of total net income	21.8%	56.4%	32.0%	(10.2%)	100.0%
Average risk-weighted assets	$ 8,829	$ 14,238	$ 3,140		$ 26,207
Percentage of total average risk-weighted assets	33.7%	54.3%	12.0%		100.0%

(1) *Other includes the effect of unallocated revenues and expenses.*

Management's Discussion and Analysis (continued)

Personal Financial Services

Client Base. We provide Personal Financial Services to individuals through a segmented approach to understanding and meeting customer needs. Similarly, sales management maintains a balanced approach, focused on meeting clients' needs. To build on our high level of customer satisfaction, emphasis has, and will continue to be, placed on developing people and systems infrastructure to improve relationship management and effectiveness of cross-selling. Personal Financial Services staff in branches are an important part of our strategy. We train our frontline staff to have a broad knowledge allowing them to deliver and sell a wide range of services and products to meet the needs of our clients. Our staff are also able to quickly recognize cross-selling opportunities that require additional delivery or service requirements, making recommendations to customers to consult specialists for assistance in our asset management, securities and trust subsidiaries.

Delivery Channels. We provide personal financial products and services through over 170 offices, including more than 125 branches as well as subsidiary offices including HSBC Investments (Canada) Limited and HSBC Securities (Canada) Inc., ABMs, direct debit and credit cards, Internet, and telephone call centres.

Business developments and achievements for Personal Financial Services for 2005 include:

– *Revenue growth* – Total revenue grew by 13.6% over 2004 as a result of higher average assets and growth in funds under management.

– *Core lending and deposit products* – We grew our core lending and deposit product business with residential mortgages up $2.2 billion or 16.3% to $15.4 billion (before securitization), personal loans up $750 million or 19.6% to $4.6 billion (before securitization) and personal deposits up $482 million or 3.3% to $15.3 billion.

– *Funds under management* – We had strong success in growing our funds under management with mutual fund and Portfolio Advantage growth of $403 million or 14.6%, and Personal Investment Management growth of $347 million or 37.1%. We had considerable success in growing our securities firm, HSBC Securities (Canada) Inc., which aims to be the brokerage firm of choice in its target markets. Retail brokerage funds under management grew by $1.2 billion or 12.1% to $11.1 billion and direct brokerage funds under management increased $608 million or 18.5% to $3.9 billion.

– *Assets under administration* – Assets under administration in our trust subsidiary, HSBC Trust Company (Canada), increased substantially, growing by 28.5% in 2005 to exceed $5 billion. We also added a significant number of accounts to our will bank, which provides future revenues.

– *Premier* – We exceeded our expectations with respect to acquiring *Premier* customers, growing by more than 25% of which 42% were new clients.

– *Private banking* – HSBC was ranked by EuroMoney as the 4th best private bank in Canada. We expanded our delivery of the HSBC Group's New York and European private banking capabilities to Canadian customers.

– *Auto Finance* – Our Auto Finance proposition with our affiliate company, HSBC Finance, continues to gain traction and momentum since its launch in 2004 with auto loans up $220 million or 17.3% over 2004 to $1.2 billion. We jointly offer full spectrum lending to HSBC's network of dealerships, leveraging HSBC Finance's data analytics.

– *clientCONNECT* – Following its launch in 2004, we continued to deepen our use of *client*CONNECT, our client front-end system, including sales management and data warehouse, enhancing client service. *client*CONNECT provides automatic credit approval for MasterCard and Lines of Credit, allowing enhanced sales at the point of client contact.

– *Account opening* – We piloted and began to roll out our new savings and chequing account opening process, which is far more efficient and reduces customer wait times considerably.

– *Sales management and measurement* – We deepened use of sales measurement techniques, including mortgage bundle ratio, sales per FTE per week and new savings and chequing account customers, enhancing revenue growth. We exceeded our expectations with respect to these key Personal Financial Services ratios.

– *Direct Bank* – We restructured our Direct Bank to serve customers who prefer to deal with us through our telephone or Internet channels. The Direct Bank leverages single service leads from the mortgage and deposit broker channel and our auto finance business.

– *MasterCard* – Together with our affiliate company, HSBC Finance, we successfully launched our new HSBC MasterCard, in-sourcing back office processing and receivables and offering a choice of HSBC Travel and Merchandise Rewards or 1% cash back programs to deepen client relationships and attract new customers.

– *New cheque standards* – We are implementing the Cheque Enablement initiative and New Cheque Standard established by the Canadian Payments Association, which will enable image-based clearing to allow for faster and more efficient processing and better access to cheque information, effective January 2007.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Personal Financial Services:

	2005	2004
Net interest income	**$ 360**	$ 303
Non-interest revenue	**267**	249
Total revenues	**627**	552
Provision for credit losses	**(14)**	(17)
Non-interest expenses	**(452)**	(421)
Income before the undernoted:	**161**	114
Effect of accounting change	**–**	7
Income before taxes	**161**	121
Provision for income taxes	**(52)**	(44)
Non-controlling interest in income of trust	**(7)**	(5)
Net income from continuing operations	**102**	72
Discontinued operations	**–**	5
Net income	**$ 102**	$ 77
Average risk-weighted assets	**$ 9,523**	$ 8,829

Average assets for 2005 grew compared to 2004 due to the continued growth of our residential mortgage and consumer loan portfolio. The growth was driven primarily by the historically low borrowing costs and the ongoing active housing market. In addition to the impact of strong asset growth, net interest income was higher due to a full year's benefit from the acquisition of Intesa in May 2004 and a shift in customer preference towards floating rate products. However, low interest rates and competitive pricing continue to put pressure on net interest margins which partially offset the benefits of strong asset growth.

Non-interest revenue increased 7.2% led by higher investment administration fees. This has been driven by an increase in funds under management, improvement in the equity markets and our continued investment in improving our products and delivery of wealth management services to our customers.

Improved economic conditions resulted in lower provision for credit losses, including a release from our general allowances for credit losses.

Non-interest expenses were higher in 2005 due to increased business volumes and the continued investment to expand our distribution network and wealth management business. In addition, a full year of operating costs for Intesa also accounted for part of the increase in expenses during the year. These were partially offset by lower operating losses in 2005 compared with 2004.

The results for 2004 included $7 million from an accounting change related to recognition of mortgage penalty fees and $5 million related to the discontinued operations of Canadian Direct Insurance.

Management's Discussion and Analysis (continued)

Commercial Banking

Client Base. Commercial Banking, which includes our small and medium enterprise market business, is one of the HSBC Group's traditional strengths, both in Canada and worldwide. We serve a wide range of customers, from sole proprietors to publicly listed companies. HSBC is a popular choice for commercial customers looking for a comprehensive range of financial services, assistance in overseas markets and excellent customer service.

Delivery Channels. We provide Commercial Banking services through commercial branches and subsidiary offices, including those of HSBC Securities (Canada) Inc., HSBC Investments (Canada) Limited and HSBC Capital (Canada) Inc., as well as through HSBC Group offices in 76 countries and territories. Direct delivery channels include the Internet and telephone banking.

Business developments and achievements for Commercial Banking for 2005 include:

– *Revenue growth* – Total revenue grew by 13.4% over 2004 as a result of higher average assets and an increase in lending activity.

– *Significant momentum* – We increased our core Commercial Banking business substantially with loans and acceptances up $2.4 billion or 14% over 2004 and deposits up $1.1 billion or 11.4%. Funding commitments to Commercial Banking clients are at record levels, reflecting the value of our service proposition to our customers. Our Personal Financial Services and Commercial Banking businesses successfully made a significant number of client referrals to one another, demonstrating the integrated nature of our business.

– *Payments & Cash Management* – We made a significant investment in our Payments & Cash Management team and business with a number of key senior management hires and investment in platforms, building out Canadian and NAFTA product and service capabilities. We launched *HSBCnet* in Canada, which is the HSBC Group's global internet banking solution providing commercial and corporate customers with online access to a suite of cash management and trade services, and won a number of significant mandates.

– *Business Internet banking* – We increased our penetration and utilization satisfactorily with 36.5% of our customers registered with an 18.2% utilization rate.

– *NAFTA bank* – We continued to deliver seamless credit and other product services to Canadian clients doing business in the US and Mexico. HSBC is one of the top five retail and commercial banks in Mexico and also the largest bank in New York State, USA.

– *Private Equity* – We achieved significant success in growing our merchant banking business, launching our third private equity fund and realizing for ourselves and our outside investors significant returns on our 1998 Private Equity Fund.

– *Leasing* – We significantly increased this core business, with total outstanding up $284 million or 33.9% to $1.1 billion.

– *HSBC Group connections* – We continued to deepen our network with HSBC Group colleagues in France to enhance opportunities to assist our Quebec based customers dealings in France and likewise assist French companies doing business in Canada.

– *Immigrant Investor Program* – We enjoyed significant success in our Immigrant Investor Program, assisting over 300 immigrants to come to Canada under Federal and Provincial investor programs and achieved a 40% market share in Canada for this type of business.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Commercial Banking:

	2005	2004
Net interest income	**$ 536**	$ 472
Non-interest revenue	**191**	169
Total revenues	**727**	641
Provision for credit losses	**(13)**	(46)
Non-interest expenses	**(289)**	(266)
Income before taxes	**425**	329
Provision for income taxes	**(138)**	(121)
Non-controlling interest in income of trust	**(13)**	(9)
Net income	**$ 274**	$ 199
Average risk-weighted assets	**$ 17,177**	$ 14,238

– Net interest income benefited from continued strong asset growth in 2005. Improving economic conditions in Canada and the United States, low interest rates and the Intesa acquisition were all driving factors behind this growth.

– Non-interest revenue increased, due to higher business volumes from commercial credit activities and our merchant banking operations. Commercial credit activities benefited from the healthy economic environment while our merchant banking subsidiary saw an increase in volumes for their investor immigrant program.

– Provisions for credit losses were lower in 2005, despite an increase in assets. This mainly arose from lower default rates due to the improving economy and a release from our general allowance for credit losses.

– Non-interest expenses were higher due to an increase in business activities, investments in our distribution network and the inclusion of a full year of operating costs for Intesa.

Corporate, Investment Banking and Markets

Client Base. Corporate, Investment Banking and Markets provides a comprehensive range of corporate financial services to an international group of our large multinational clients as well as managing our Treasury Department. Our focus is on entities that have a need for international value added products through investment banking, structured lending and trade services by offering the following: corporate banking, asset management, investment banking, mergers and acquisitions capabilities, advisory, treasury, and trade finance.

Delivery Channels. We provide Corporate, Investment Banking and Markets services through our principal branches and subsidiary offices of HSBC Securities (Canada) Inc. and HSBC Investments (Canada) Limited, coordinated with the HSBC Group's worldwide operations. Our customers in this group deal with the HSBC Group worldwide through a relationship manager. We provide relationship management coverage to Canadian-based multinational clients and deliver services to other multinational clients of the HSBC Group. Our ability to leverage the HSBC Group's worldwide network in providing comprehensive corporate and investment banking services to sophisticated multinational clients is a significant competitive advantage.

Business developments and achievements for Corporate, Investment Banking and Markets for 2005 include:

– *Corporate and Institutional Banking* – We upgraded our team with senior bankers all of whom have international experience and opened an office in Montreal. We also hired a new head of foreign exchange to grow sales.

– *Debt Capital Markets* – We enhanced our team delivering the HSBC Group's significantly expanded global fixed income capability to Canadian corporates. We participated in 91 deals raising over $53.1 billion for Canadian issuers.

– *Equity Capital Markets* – We also enhanced our team delivering the HSBC Group's significantly expanded equity capability to Canadian corporates. We participated in 139 deals raising over $8.7 billion for Canadian issuers.

– *Global Investment Banking* – Through *client*VISION a strategic client relationship management tool, we upgraded our approach to relationship management for our corporate banking and advisory clients. We structured our teams to focus on a sectoral basis and added resources in Toronto, Calgary and Montreal.

Management's Discussion and Analysis (continued)

– *Derivative Products Group* – Expanded our Derivative Products Group based in Toronto, leveraging our market leading structured products capability in New York to bring solutions to Canadian personal, corporate and institutional investors through a number of innovative and flexible deposit products.

– *Asset Management* – In conjunction with HSBC globally, we announced a new strategy of sustainable growth, putting customers at the centre of our product strategy and delivering consistent, long term growth in our investment business.

Selected Financial Information and Analysis. The following sets out consolidated financial information and other data for Corporate, Investment Banking and Markets:

	2005	2004
Net interest income	**$ 114**	$ 121
Non-interest revenue	**112**	108
Total revenues	**226**	229
Provision for credit losses	**–**	(3)
Non-interest expenses	**(50)**	(50)
Income before the undernoted:	**176**	176
Effect of accounting change	**–**	7
Income before taxes	**176**	183
Provision for income taxes	**(58)**	(68)
Non-controlling interest in income of trust	**(2)**	(2)
Net income	**$ 116**	$ 113
Average risk-weighted assets	**$ 3,676**	$ 3,140

– Net interest income in 2005 compared to 2004 was adversely impacted by lower securities yields from low Bank of Canada rates and a general flattening of the yield curve.

– Non-interest revenues increased in 2005 by 3.7%. Improving economic conditions in Canada and the United States contributed to an increase in revenues from our corporate banking group. Income from foreign exchange and trading income from our fixed income sales and trading group were higher compared to 2004. However, this was partially offset by lower revenues from corporate finance activities.

– Provisions for credit losses were lower in 2005 due to the improving economy and a release from our general allowance for credit losses.

– Non-interest expenses in 2005 were comparable with 2004.

– The results for 2004 benefited from an accounting change related to the recognition of mortgage penalty fees.

Statement of Management's Responsibility for Financial Information

The presentation and preparation of the annual consolidated financial statements, Management's Discussion and Analysis ("MD&A") and all other information in the Annual Report is the responsibility of the management of HSBC Bank Canada ("the Bank"). The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality.

In meeting its responsibility for the reliability of financial information, management relies on comprehensive internal accounting, operating and system controls. The Bank's overall controls include: an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability; written communication of policies and procedures of corporate conduct throughout the Bank, and careful selection and training of personnel; regular updating and application of written accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records; and a continuing program of extensive internal audit covering all aspects of the Bank's operations. These controls are designed to provide reasonable assurance that financial records are reliable for preparing the consolidated financial statements and maintaining accountability for assets, that assets are safeguarded against unauthorized use or disposition and that the Bank is in compliance with all regulatory requirements.

At least once a year, the Office of the Superintendent of Financial Institutions Canada ("the Superintendent"), makes such examination and enquiry into the affairs of the Bank as deemed necessary to ensure that the provisions of the Bank Act, having reference to the rights and interests of the depositors and the creditors of the Bank, are being complied with and that the Bank is in a sound financial position.

The Bank's Board of Directors oversees management's responsibilities for financial reporting through the Audit Committee, which is composed of directors who are not officers or employees of the Bank. The Audit Committee reviews the Bank's interim and annual consolidated financial statements and MD&A and recommends them for approval by the Board of Directors. Other key responsibilities of the Audit Committee include monitoring the Bank's system of internal control, monitoring its compliance with legal and regulatory requirements, considering the appointment of the Shareholders' auditors and reviewing the qualifications, independence and performance of Shareholders' auditors and internal auditors.

We, the Bank's Chief Executive Officer and Chief Financial Officer, will certify the Bank's annual disclosure document as required by Multilateral Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings) of the Canadian Securities Administrators.

The Shareholders' auditors, the Bank's Chief Auditor and the Superintendent have full and free access to the Board of Directors and its committees to discuss audit, financial reporting and related matters.

Lindsay Gordon
President and Chief Executive Officer

Graham McIsaac, CA
Chief Financial Officer

January 30, 2006
Vancouver, Canada

Auditors' Report

To the Shareholders of HSBC Bank Canada

We have audited the consolidated balance sheets of HSBC Bank Canada as at December 31, 2005 and 2004 and the consolidated statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP
Chartered Accountants

Vancouver, Canada
January 30, 2006

Consolidated Balance Sheets

As at December 31 *(in millions of dollars)*

	2005	2004
Assets		
Cash resources:		
Cash and deposits with Bank of Canada	**$ 409**	$ 328
Deposits with regulated financial institutions	**5,549**	4,094
	5,958	4,422
Securities: (note 2)		
Investment	**2,923**	1,967
Trading	**1,418**	1,055
	4,341	3,022
Securities purchased under reverse repurchase agreements	**1,752**	2,264
Loans: (notes 3 & 4)		
Businesses and governments	**15,571**	13,450
Residential mortgages	**12,865**	11,966
Consumer	**3,734**	3,252
Allowance for credit losses	**(326)**	(349)
	31,844	28,319
Other:		
Customers' liability under acceptances	**4,002**	3,754
Land, buildings and equipment (note 5)	**103**	101
Other assets (note 6)	**1,210**	1,381
	5,315	5,236
	$ 49,210	$ 43,263
Liabilities and Shareholders' Equity		
Deposits: (note 7)		
Regulated financial institutions	**$ 1,975**	$ 635
Individuals	**15,300**	14,818
Businesses and governments	**21,333**	18,395
	38,608	33,848
Other:		
Acceptances	**4,002**	3,754
Securities sold under repurchase agreements	**302**	23
Other liabilities (note 8)	**2,849**	2,785
Non-controlling interest in trust and subsidiary (note 9)	**430**	230
	7,583	6,792
Subordinated debentures (note 10)	**423**	426
Shareholders' equity:		
Capital stock (note 11)		
Preferred	**350**	125
Common	**1,125**	1,125
Contributed surplus (note 12)	**187**	177
Retained earnings	**934**	770
	2,596	2,197
	$ 49,210	$ 43,263

Guarantees, commitments and contingent liabilities (note 15).

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the Board:

Martin Glynn
Chairman of the Board

Lindsay Gordon
President and Chief Executive Officer

Consolidated Statements of Income

For the years ended December 31 *(in millions of dollars except per share amounts)*

	2005	2004
Interest income:		
Loans	**$ 1,631**	$ 1,396
Securities	**120**	82
Deposits with regulated financial institutions	**166**	69
	1,917	1,547
Interest expense:		
Deposits	**882**	617
Subordinated debentures	**25**	34
	907	651
Net interest income	**1,010**	896
Non-interest revenue:		
Deposit and payment service fees	**84**	81
Credit fees	**95**	81
Capital market fees	**106**	106
Investment administration fees	**80**	65
Foreign exchange	**76**	68
Trade finance	**27**	28
Trading revenue	**11**	10
Investment securities gains	**16**	17
Securitization income	**24**	25
Other	**51**	45
	570	526
Total revenue	**1,580**	1,422
Provision for credit losses (note 4)	**27**	66
Non-interest expenses:		
Salaries and employee benefits	**442**	423
Premises and equipment, including amortization	**107**	101
Other	**275**	272
	824	796
Income before the undernoted	**729**	560
Effect of accounting change (note 1(s))	**–**	14
Income before provision for income taxes and non-controlling interest in income of trust	**729**	574
Provision for income taxes (note 14)	**237**	210
Non-controlling interest in income of trust	**22**	16
Income from continuing operations	**470**	348
Income from discontinued operations (note 22)	**–**	5
Net income	**$ 470**	$ 353
Preferred share dividends (note 11)	**13**	8
Net income attributable to common shares	**$ 457**	$ 345
Average number of common shares outstanding (000's)	**488,668**	481,066
Basic earnings per common share	**$ 0.94**	$ 0.72

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31 *(in millions of dollars)*

	2005	2004
Preferred shares: (note 11)		
Balance at beginning of year	**$ 125**	$ 125
Issued	**350**	–
Redeemed	**(125)**	–
Balance at end of year	**350**	125
Common shares: (note 11)		
Balance at beginning of year	**1,125**	950
Issued	**–**	175
Balance at end of year	**1,125**	1,125
Contributed surplus:		
Balance at beginning of year	**177**	169
Stock-based compensation (note 12)	**10**	8
Balance at end of year	**187**	177
Retained earnings:		
Balance at beginning of year	**770**	575
Net income	**470**	353
Preferred share dividends (note 11)	**(13)**	(8)
Common share dividends (note 11)	**(330)**	(150)
Capital issue costs	**(7)**	–
HSBC Group reimbursement and other (note 21)	**44**	–
Balance at end of year	**934**	770
Total shareholders' equity	**$ 2,596**	$ 2,197

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended December 31 *(in millions of dollars)*

	2005	2004
Cash flows provided by (used in) operating activities:		
Net income	**$ 470**	$ 353
Adjustments to net income to determine net cash provided by (used in) operating activities:		
Amortization	**30**	31
Provision for credit losses (note 4)	**27**	66
Future income taxes (note 14)	**21**	1
Net accrued interest receivable and payable	**29**	(5)
Trading securities	**(363)**	(413)
Other, net	**170**	383
	384	416
Cash flows provided by (used in) financing activities:		
Deposits received	**4,760**	3,442
Securities sold (purchased) under repurchase agreements	**279**	(7)
Proceeds from issuance of subordinated debentures	**–**	100
Subordinated debenture redemptions and repayments	**–**	(110)
Proceeds from issuance of asset trust securities (note 9)	**200**	–
Proceeds from issuance of preferred shares (note 11)	**350**	–
Redemption of preferred shares (note 11)	**(125)**	–
Proceeds from issuance of common shares	**–**	175
HSBC Group reimbursement (note 21)	**40**	–
Dividends paid (note 11)	**(333)**	(108)
	5,171	3,492
Cash flows provided by (used in) investing activities:		
Loans funded, excluding securitizations	**(5,963)**	(3,962)
Proceeds from loans securitized	**2,409**	945
Investment securities (purchased) sold	**(956)**	673
Securities sold (purchased) under reverse repurchase agreements	**512**	(692)
Net change in non-operating deposits with regulated financial institutions	**(343)**	(235)
Acquisition of business (note 20)	**–**	(122)
Cash and cash equivalents at date of acquisition	**–**	40
Proceeds from sale of subsidiary (note 22)	**–**	25
Less cash and cash equivalents at date of sale	**–**	(10)
Acquisition of land, buildings and equipment	**(21)**	(12)
	(4,362)	(3,350)
Increase in cash and cash equivalents	**1,193**	558
Cash and cash equivalents, beginning of year	**4,007**	3,449
Cash and cash equivalents, end of year	**$ 5,200**	$ 4,007
Represented by:		
Cash resources	**$ 5,958**	$ 4,422
Less non-operating deposits with regulated financial institutions(1)	**(758)**	(415)
Cash and cash equivalents, end of year	**$ 5,200**	$ 4,007
Supplementary cash flow information:		
Interest paid during the year	**$ 843**	$ 646
Income taxes paid during the year	**$ 232**	$ 224

(1) *Non-operating deposits comprise primarily cash which reprices after 90 days and cash restricted for recourse on securitization transactions.*

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 2005 and 2004 *(all tabular amounts are in millions of dollars unless stated otherwise)*

HSBC Bank Canada is a subsidiary of HSBC Holdings plc ("the Parent"). In these consolidated financial statements, HSBC Group means the Parent and its subsidiary companies.

1 Accounting policies

We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles (GAAP). Certain prior period amounts have been reclassified to conform with the current year presentation. The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

a *Basis of consolidation*

We conduct business through a variety of corporate structures, including subsidiaries. All of the assets, liabilities, revenue and expenses of our subsidiaries are reported in the consolidated financial statements. All material intercompany transactions and balances have been eliminated.

b *Use of estimates and assumptions*

In preparing our consolidated financial statements we make estimates and assumptions which affect reported amounts of assets, liabilities, net income and related disclosures. The most significant assets and liabilities where we make estimates include measurement of the allowance for credit losses, financial instruments measured at fair value, securitizations, pension and other employee future benefits, income taxes, goodwill and intangible assets. Accordingly, actual results could differ from these and other estimates thereby impacting our consolidated financial statements.

c *Deposits with regulated financial institutions*

Deposits with regulated financial institutions are recorded at cost. Interest income on interest earning deposits is recorded on an accrual basis.

d *Securities*

Investment account securities, where our intention is to hold the securities to maturity or until market conditions render alternative investments more attractive, are carried at cost or amortized cost. If the securities held for investment account experience a decline in value that is other than temporary, the carrying value is appropriately reduced to recognize the impairment. The amortization of premiums and discounts and adjustments to the carrying value of debt securities are included in interest income. Gains and losses on the disposal of securities are included in non-interest revenue.

Trading account securities, which are purchased for resale over a short period of time, are carried at fair value. Gains and losses on disposal or revaluation are included in non-interest revenue.

e *Loans*

Loans are stated net of any unearned income, unamortized premiums or discounts and an allowance for credit losses.

Interest income is recorded on the accrual basis unless the loan is classified as an impaired loan. Loans are considered to be impaired whenever there is no longer reasonable assurance as to the ultimate collectibility of some portion of principal or interest. Loans where interest is due and has not been collected for a period of 90 days are automatically recognized as impaired, unless we determine there is no reasonable doubt as to the ultimate collectibility of principal and interest. Loans where interest is due and has not been collected for a period of 180 days are automatically classified as impaired.

Impaired loans are recorded at their estimated realizable amount. This is determined by discounting the expected future cash flows at the effective interest rate inherent in the loans. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, they are measured at the fair value of any security underlying the loans, net of expected costs of realization. When a loan is classified as impaired, recognition of interest in accordance with the terms of the original loan agreement ceases. Subsequent payments (interest or principal) received on an impaired loan are recorded as a reduction of the recorded investment in the loan. Interest income is recognized only when all allowances for credit losses have been reversed.

Fees associated with lending activities are generally deferred and amortized over the term of the loans, and are included in interest income from loans.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

f *Direct finance leases*

Direct finance leases are included in loans to Businesses and Governments. Initial direct costs of direct finance leases are expensed as incurred. The investment in the lease is defined as the minimum lease payments receivable, including the purchase option price, less unearned income.

g *Allowance for credit losses*

An allowance is maintained for credit losses which is considered adequate to absorb all estimated credit-related losses in our portfolio of both on and off-balance sheet items, including deposits with other regulated financial institutions, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees.

Assessing the adequacy of the allowance for credit losses is inherently subjective as it requires making estimates, including the amount and timing of expected future cash flows, that may be susceptible to significant change. The allowance for credit losses consists of specific and general allowances, each of which is reviewed on a regular basis.

Specific allowances are recorded on a loan-by-loan basis, for those loans where we believe the ultimate collectibility of all or some portion of principal or interest is in doubt, to reduce the carrying value of an impaired asset to its estimated realizable amount. A number of methods are used in determining specific allowances including discounted value of future cash flows, observable market values or the fair values of the underlying security. Specific allowances are determined utilizing a formula approach for personal loans with similar characteristics.

General allowances are our best estimate of probable losses in the existing portfolio, for which losses are not yet specifically identified on an item-by-item basis. In determining an appropriate level of general allowances, we have adopted a methodology that incorporates our loan loss history as the basis for determining probability of default and loss given default rates for various credit portfolios that exhibit similar loan loss characteristics. These historic rates are further refined to allow for the stage of the credit cycle and the inherent difficulties in determining whether data collection captures a complete economic cycle. These loss ratios are applied to outstanding credit exposures to determine an appropriate level of allowance. Some credit portfolios do not readily lend themselves to this approach and therefore we have estimated an allowance level for these portfolios based on externally published default data or other underlying assumptions made as to the loan loss characteristics of these portfolios.

The provision for credit losses is charged to income and comprises the amounts written off during the year, net of recoveries on amounts written off in prior years, and changes in provisions.

h *Securities purchased and sold under repurchase agreements*

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received. Conversely, securities purchased under reverse repurchase agreements are not recognized on the balance sheet and an asset is recorded representing the consideration paid. Interest income (reverse repurchase agreements) and interest expense (repurchase agreements) are recorded on an accrual basis.

i *Land, buildings and equipment*

Land is carried at cost. Buildings, leasehold improvements and equipment are carried at cost, less accumulated amortization. Amortization is calculated using the straight-line method over the estimated useful life of the related asset as follows: buildings – 20 to 40 years, equipment – 3 to 5 years, and leasehold improvements – 10 to 15 years. Gains and losses on disposal are recorded in other non-interest revenue in the year of disposal.

j *Goodwill and other intangible assets*

Goodwill represents the excess of the price paid for subsidiaries over the fair value of the net assets acquired, and is recorded in other assets.

Identifiable, reliably measured other intangible assets resulting from acquisition of subsidiaries are also recorded in other assets. Intangible assets with definite lives are amortized over their estimated useful lives, not exceeding 15 years, except where a writedown is required to reflect impairment.

1 Accounting policies *(continued)*

j *Goodwill and other intangible assets (continued)*

Goodwill and other intangible assets are reviewed at least annually for indications of impairment to ensure that their fair value is greater than or equal to their carrying value. Any excess of carrying value over fair value is charged to income in the period in which impairment is determined.

k *Customers' liability under acceptances*

Acceptances comprise undertakings by us to pay bills of exchange drawn on by customers. We expect most acceptances to be settled simultaneously with the reimbursement from the customers. Our exposure under acceptances is reported as a liability. Our recourse against customers is recorded as an equivalent offsetting asset. Fees earned are reported in credit fees in non-interest revenue.

l *Income taxes*

Income taxes are accounted for under the asset and liability method. Under this method, future income tax assets and future income tax liabilities are determined based on temporary differences (differences between the tax basis and accounting basis of assets and liabilities) and are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized. Income tax expense or recovery is the sum of the provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

m *Employee future benefits*

We sponsor a number of pension plans and arrangements covering all qualified employees. The pension plans include both defined benefit and defined contribution plans. The arrangements include supplemental pension arrangements, that provide pension benefits in excess of the benefits provided by the pension plans, and post-retirement, non-pension arrangements that provide certain benefits in retirement. The pension plans are funded by contributions from us or our employees, while the supplemental pension arrangements are not funded.

The costs of employee future benefits for defined benefit plans are determined using the projected unit credit method pro-rata on services and using management's best estimate of expected investment performance, salary escalation and expected health care costs.

For purposes of determining the expected return on pension plan assets, those assets are valued at their fair market value.

The excess of cumulative unrecognized net actuarial gains or losses over 10% of the greater of the accrued benefit obligation and the fair market value of plan assets is amortized over the expected average remaining service lifetime ("EARSL") of active employees covered under the plan in question.

Past service costs arising from retroactive benefit changes are amortized on a straight-line basis over the EARSL of active members expected to receive benefits under the plan in question.

When an event giving rise to a settlement and a curtailment occurs, the curtailment is accounted for prior to the settlement.

The transitional asset arising from a change in accounting policy in earlier years is amortized over the expected future service lifetime of the active employees.

For the purposes of determining the financial position and the costs of employee future benefits, a measurement date of September 30 has been adopted.

n *Translation of foreign currencies*

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at prevailing year-end exchange rates. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the rates in effect at the transaction date. Premiums and discounts on foreign currency forward contracts that hedge foreign currency assets and liabilities are amortized over the period to maturity as interest expense. Realized and unrealized gains and losses from foreign currency translation are included in non-interest revenue.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

o *Derivative instruments*

Derivative instruments are financial contracts whose value is derived from interest rates, foreign exchange rates or other financial or commodity indices.

In the ordinary course of business, we enter into various derivative contracts, including interest rate, foreign exchange and equity forwards, futures, swaps and options. Derivative contracts are either exchange-traded contracts (including futures and options) or negotiated over-the-counter contracts (including forwards, swaps and options). We enter into such contracts for trading purposes, as well as to manage our exposures to currency and interest rate fluctuations as part of our asset/liability management program. Trading activities are undertaken to meet the needs of our customers, as well as on our own account to earn trading income.

Derivative instruments used in trading activities are marked-to-market and the resulting net gains or losses are recognized as non-interest revenue in the current period. Unrealized gains on contracts in a favourable position are included in other assets and unrealized losses on those contracts in an unfavourable position are recorded in other liabilities.

We formally document all relationships between hedging instruments and hedged items, as well as our risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities or to specific firm commitments or forecasted transactions. We also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Gains and losses on both securities and derivative instruments used for hedging purposes, are recognized in the consolidated statement of income on the same basis and in the same period as the underlying hedged items.

Swaps and forwards entered into for the purpose of managing our currency and interest rate exposures are accounted for on the accrual basis. Futures and options entered into for this purpose are marked-to-market and the unrealized gains and losses are deferred and amortized to income over the life of the related assets and liabilities. Accrued interest receivable and deferred gains are recorded in other assets and accrued interest payable and deferred losses are recorded in other liabilities. Interest income or expense and amortized gains or losses are recorded in interest income or interest expense, as applicable.

Foreign exchange translation gains and losses on foreign currency-denominated derivative financial instruments used to hedge foreign currency debt are accrued under other assets or other liabilities, and recognized in non-interest revenue, net of expenses, offsetting the respective translation losses and gains recognized on the underlying foreign currency debt. The forward premium or discount on forward foreign exchange contracts used to hedge foreign currency debt is amortized as an adjustment of interest expense over the term of the forward contract.

Realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other assets or liabilities and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in income.

p *Trust assets under administration*

Trust assets under administration are maintained separately from our assets and are not included in the consolidated balance sheet.

q *Loan securitizations*

Groups of loans are periodically sold to unrelated third parties. Transfers of loans are treated as sales provided that control over the transferred loans has been surrendered and consideration other than beneficial interests in the transferred loans has been received in exchange. If treated as sales, the loans are removed from the balance sheet and a gain or loss is recorded in non-interest revenue based on the carrying value of the loans transferred, allocated between the assets sold and their retained interests in proportion to their fair values at the date of transfer.

1 Accounting policies *(continued)*

q *Loan securitizations (continued)*

The fair values of loans sold, retained interests and recourse liabilities are determined using market values where appropriate or pricing models taking into account our best estimates of key assumptions such as expected losses, prepayments and discount rates commensurate with the risks involved, or sales of similar assets. Retained interests, which are accounted for as investment securities, are included in other assets at fair value at the time of sale. Where we continue to service the loans sold, a servicing liability or asset is recognized and amortized over the servicing period. Revenue earned in respect of servicing the assets sold is reflected in non-interest revenue as services are provided.

r *Stock-based compensation*

We provide compensation to certain key employees in the form of share options and/or share-based awards. As well, eligible employees are invited to participate in a savings-related share option program. Fair values of share options, measured at the date of grant of the option, are estimated using a binomial option pricing model which produces similar results to the Black-Scholes option pricing model. The fair values estimated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The fair value of stock options on grant date is recorded as compensation expense over the vesting period, with a corresponding increase to contributed surplus.

Our other arrangements include award-type compensation for certain key employees. The expense for these arrangements is recognized over the vesting period or as performance conditions are met, and is based on the initial funding cost.

s *Changes in accounting policies*

Sources of GAAP

Effective January 1, 2004, we adopted new accounting requirements of the Canadian Institute of Chartered Accountants (“CICA”) that provide guidance on sources to consult when selecting accounting policies on matters not covered explicitly in Canadian accounting standards.

As a result of these new requirements, we changed our accounting policy for recognising mortgage prepayment fees. Effective January 1, 2004, mortgage prepayment fees are recognised in income when the related mortgages are repaid or renegotiated. Prior to January 1, 2004, mortgage prepayment fees were deferred and amortized to income over the average remaining term of the related mortgages. Effective January 1, 2004, we recorded in income the opening balance of deferred mortgage prepayment fees of $14 million, before taxes, with a corresponding decrease in deferred revenue.

Liabilities and Equity

Effective January 1, 2005, we adopted the approved amendments to Handbook Section 3860, which requires obligations that may be settled, at the issuer’s option, by a variable number of the issuer’s own equity instruments to be presented as liabilities, and not as equity.

There was no impact to our financial statements as a result of this adoption.

Investment Companies

Effective January 1, 2005, we prospectively adopted the CICA’s Accounting Guideline 18, which sets out new accounting requirements on the carrying value of investments held in investment companies. These investments are required to be carried at fair value when we otherwise would have had to consolidate them or account for them using the equity method.

The impact of this change, including the initial adjustment to fair value on January 1, 2005, was an increase in non-interest revenue, and a corresponding increase in investment securities, of $10 million in 2005.

Variable Interest Entities

Effective January 1, 2005, we adopted the CICA’s Accounting Guideline 15 (“AcG-15”), which sets out new accounting requirements for the consolidation of variable interest entities (“VIEs”). VIEs include entities where the equity invested is considered insufficient to finance an entity’s activities. The new rules require that we consolidate VIEs if the investments we hold in these entities and/or the relationships we have with them result in us being exposed to a majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

s *Changes in accounting policies (continued)*

Variable Interest Entities (continued)

There was no material impact to the consolidated balance sheet or consolidated statement of income upon adoption. Prior to adopting AcG-15, we fully consolidated the VIE where we were considered to be the primary beneficiary under AcG-15.

Refer to note 23 for more details of our VIEs.

t *Future accounting changes*

Comprehensive Income

In January 2005, the Accounting Standards Board ("AcSB") issued new standards for the reporting and disclosure of comprehensive income.

Unrealized gains and losses on financial assets that will be held as available for sale, unrealized foreign currency translation amounts arising from self-sustaining foreign operations, and changes in the fair value of cash flow hedging instruments, will be recorded in a Consolidated Statement of Other Comprehensive Income until recognized in the Consolidated Statement of Income. Other Comprehensive Income will form part of shareholders' equity.

The impact of implementing these new standards is not yet determinable as it is dependent on our outstanding positions, hedging strategies and market volatility at the time of transaction.

This standard is effective for us beginning on January 1, 2007.

Equity

In January 2005, the AcSB issued standards to replace Handbook Section 3250, Surplus. This Section requires an enterprise to present a separate component of equity for each category of equity that is of a different nature.

This standard is effective for us beginning on January 1, 2007.

Financial Instruments

— *Disclosure and Presentation*

In April 2005, the AcSB issued standards, which replaces Handbook Section 3860, addressing the presentation of financial statement instruments and non-financial derivatives, and identifying the information that should be disclosed about them including new disclosure requirements about fair value.

— *Recognition and Measurement*

In January 2005, the AcSB issued new standards for the recognition and measurement of financial instruments. Under the new standard, all financial instruments will be classified as one of the following: held-to-maturity, loans and receivables, held for trading or available-for-sale. Financial assets and liabilities held for trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, will be measured at amortized cost. Available for sale instruments will be measured at fair value with gains and losses recognized in other comprehensive income. The standard also permits re-designation of any financial instrument as held-for-trading upon initial recognition.

1 Accounting policies *(continued)*

t *Future accounting changes (continued)*

— *Hedges*

In January 2005, the AcSB issued new standards which specify the circumstances under which hedge accounting is permissible and how hedge accounting may be performed.

Fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation are available under the new Hedges Section. In a fair value hedging relationship, the carrying value of the hedge item is adjusted by gains or losses attributable to the hedged risk and recorded in Net interest income. This change in fair value of the hedged item, to the extent that the hedging relationship is effective, is offset by changes in the fair value of the derivative. In a cash flow hedging relationship, the effective portion of the change in fair value of the hedging derivative will be recognized in Other Comprehensive Income. The ineffective portion will be recognized in Net income. The amounts recognized in Accumulated Other Comprehensive Income will be reclassified to Net income in periods in which Net income is affected by the variability in the cash flows of the hedged item. In hedging a net investment in a foreign operation, foreign exchange gains and losses on the hedging instruments will be recognized in Other Comprehensive Income.

These standards are effective for us beginning on January 1, 2007.

Non-Monetary Transactions

In June 2005, the AcSB issued a new standard to revise and replace the current standards on non-monetary transactions to require that all non-monetary transactions be measured at fair value unless certain criteria are met.

This revised standard is effective for non-monetary transactions initiated in fiscal periods beginning on or after January 1, 2006.

Notes to Consolidated Financial Statements (continued)

2 Securities

a *Carrying value*

	2005				
	Term to maturity				
	Within 1 year	*1-5 years*	*5-10 years*	*no specific maturity*	*Total carrying value*
Investment securities:					
Securities issued or guaranteed by					
Canada	**$ 2,376**	**$ 265**	**$ –**	**$ –**	**$ 2,641**
Provinces	**62**	**63**	**–**	**–**	**125**
	2,438	**328**	**–**	**–**	**2,766**
Others	**2**	**1**	**–**	**–**	**3**
Investment funds	**–**	**–**	**–**	**26**	**26**
Equity securities	**–**	**114**	**14**	**–**	**128**
Total investment securities	**2,440**	**443**	**14**	**26**	**2,923**
Trading securities	**857**	**45**	**511**	**5**	**1,418**
Total securities	**$ 3,297**	**$ 488**	**$ 525**	**$ 31**	**$ 4,341**

	2004				
	Term to maturity				
	Within 1 year	*1-5 years*	*5-10 years*	*no specific maturity*	*Total carrying value*
Investment securities:					
Securities issued or guaranteed by					
Canada	$ 1,517	$ 325	$ 10	$ –	$ 1,852
Provinces	35	41	–	–	76
	1,552	366	10	–	1,928
Others	1	2	1	–	4
Investment funds	–	–	–	27	27
Equity securities	8	–	–	–	8
Total investment securities	1,561	368	11	27	1,967
Trading securities	487	171	375	22	1,055
Total securities	$ 2,048	$ 539	$ 386	$ 49	$ 3,022

Included in trading securities are $1,107 million of securities issued or guaranteed by Canada or Provinces (2004 – $786 million).

The total carrying value of securities includes amounts denominated in U.S. dollars of $124 million (Canadian equivalent) (2004 – $125 million).

Included in investment securities issued or guaranteed by Canada are mortgage-backed securities retained by us in connection with mortgage securitizations of $69 million (2004 – $73 million) (refer to note 3(b)).

2 Securities *(continued)*

b *Unrealized gains and losses on investment securities*

	2005			
	Carrying value	*Gross unrealized gains*	*Gross unrealized losses*	*Estimated market value*
Securities issued or guaranteed by				
Canada	**$ 2,641**	**$ 1**	**$ (4)**	**$ 2,638**
Provinces	**125**	**1**	**(1)**	**125**
	2,766	**2**	**(5)**	**2,763**
Others	**3**	**–**	**–**	**3**
Investment funds	**26**	**1**	**–**	**27**
Equity securities	**128**	**1**	**–**	**129**
Total investment securities	**$ 2,923**	**$ 4**	**$ (5)**	**$ 2,922**

	2004			
	Carrying value	*Gross unrealized gains*	*Gross unrealized losses*	*Estimated market value*
Securities issued or guaranteed by				
Canada	$ 1,852	$ 6	$ –	$ 1,858
Provinces	76	1	–	77
	1,928	7	–	1,935
Others	4	–	–	4
Investment funds	27	8	–	35
Equity securities	8	–	–	8
Total investment securities	$ 1,967	$ 15	$ –	$ 1,982

3 Loans

a Loans outstanding, net of the allowance for credit losses, are as follows:

	2005	2004
Businesses and governments:		
Real estate	**$ 5,528**	$ 4,705
Hotels and hospitality	**553**	628
Manufacturing	**2,203**	2,055
Trade	**3,084**	2,741
Services	**2,481**	2,171
Direct finance leases	**1,122**	841
Other	**600**	309
Total businesses and governments	**15,571**	13,450
Residential mortgages	**12,865**	11,966
Consumer	**3,734**	3,252
Allowance for credit losses	**(326)**	(349)
Total	**$ 31,844**	$ 28,319

Total net loans includes amounts denominated in U.S. dollars of $957 million (Canadian equivalent) (2004 – $1,035 million) and other foreign currencies of $211 million (Canadian equivalent) (2004 – $62 million). Included in residential mortgages are $1,008 million of NHA insured mortgages (2004 – $985 million).

Notes to Consolidated Financial Statements (continued)

3 Loans *(continued)*

b The outstanding securitized loans sold to unrelated third parties and removed from the consolidated balance sheet are as follows:

	2005	2004
Residential mortgages		
Conventional	**$ 1,639**	$ 505
Mortgage-backed securities[1]	**898**	741
	2,537	1,246
Consumer loans		
Personal lines of credit	**700**	300
Term loans	**146**	85
	846	385
	$ 3,383	$ 1,631

(1) *Excludes insured mortgages which were securitized and retained by us of $69 million (2004 – $73 million). These assets are classified as investment securities (refer to note 2(a)).*

Securitization activity during the year is as follows:

	2005				2004			
	Residential mortgages	*Personal lines of credit*	*Consumer term loans*	*Total*	*Residential mortgages*	*Personal lines of credit*	*Consumer term loans*	*Total*
New securitization activity								
Securitized and sold	**$ 1,828**	**$ 400**	**$ 215**	**$ 2,443**	$ 893	$ –	$ 121	$ 1,014
Net cash proceeds received	**1,807**	**390**	**212**	**2,409**	890	–	119	1,009
Retained rights to future excess interest	**19**	**3**	**9**	**31**	25	–	7	32
Retained servicing liability	**8**	**1**	**1**	**10**	4	–	1	5
Pre-tax gain on sale	**5**	**2**	**9**	**16**	16	–	6	22
Key assumptions at time of sale (%)								
Prepayment rate	**25.40**	**100.00**	**12.68**		18.41	–	15.00	
Excess spread	**0.63**	**1.81**	**4.63**		1.71	–	4.87	
Expected credit losses	**0.01**	**0.20**	**0.23**		0.01	–	0.21	
Discount rate	**4.39**	**5.24**	**3.25**		3.91	–	3.13	

Servicing and other income from securitized assets was $8 million during the year (2004 – $3 million). No delinquent securitized mortgages were repurchased by us during the year (2004 – nil) and credit losses of $1 million were realized on securitized consumer loans (2004 – $1 million). No consumer term loans were repurchased during the year (2004 – $64 million).

3 Loans *(continued)*

c *Sensitivity of assumptions*

Key weighted-average economic assumptions used in measuring the retained interests are outlined in the following table. The sensitivity analysis provided in the table should be used with caution as it is hypothetical and changes in each key assumption may not be linear. The sensitivities in each key variable have been calculated independently of changes in other key variables.

Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce certain sensitivities.

	2005		
	Residential mortgages	*Personal lines of credit*	*Consumer term loans*
Fair value of retained interests	34	20	5
Discount rate	4.82%	4.98%	7.73%
Impact of 10% increase	–	–	–
Impact of 20% increase	(1)	–	–
Prepayment rate	20.78%	100.00%	22.65%
Impact of 10% increase	(1)	–	–
Impact of 20% increase	(3)	–	–
Expected credit losses	0.01%	4.98%	0.14%
Impact of 10% increase	–	–	–
Impact of 20% increase	–	(1)	–

4 Impaired loans and allowance for credit losses

a Total gross impaired loans and the related specific allowances are as follows:

	2005			2004		
	Gross amount	*Specific allowances*	*Carrying amount*	*Gross amount*	*Specific allowances*	*Carrying amount*
Businesses and governments						
Real estate	**$ 21**	**$ 4**	**$ 17**	$ 26	$ 6	$ 20
Manufacturing	**49**	**23**	**26**	56	21	35
Trade	**17**	**10**	**7**	20	13	7
Services	**9**	**6**	**3**	23	10	13
Other	**7**	**–**	**7**	15	3	12
Residential mortgages	**13**	**1**	**12**	23	1	22
Consumer	**14**	**13**	**1**	19	16	3
Total	**$ 130**	**$ 57**	**$ 73**	$ 182	$ 70	$ 112

Notes to Consolidated Financial Statements (continued)

4 Impaired loans and allowance for credit losses *(continued)*

b The allowance for credit losses is as follows:

	2005				
	Balance at beginning of the year	*Provision for (reversal of) credit losses*	*Write-offs*	*Recoveries and other*	*Balance at end of the year*
Specific allowances:					
Businesses and governments:					
Real estate	**$ 6**	**$ 5**	**$ (7)**	**$ –**	**$ 4**
Manufacturing	**21**	**17**	**(15)**	**–**	**23**
Trade	**13**	**1**	**(4)**	**–**	**10**
Services	**10**	**(1)**	**(2)**	**(1)**	**6**
Other	**3**	**2**	**(5)**	**–**	**–**
Residential mortgages	**1**	**1**	**(1)**	**–**	**1**
Consumer	**16**	**15**	**(18)**	**–**	**13**
Total specific allowances	**70**	**40**	**(52)**	**(1)**	**57**
General allowance	**279**	**(13)**	**–**	**3**	**269**
Total	**$ 349**	**$ 27**	**$ (52)**	**$ 2**	**$ 326**

	2004				
	Balance at beginning of the year	*Provision for credit losses*	*Write-offs*	*Recoveries and other*(1)	*Balance at end of the year*
Specific allowances:					
Businesses and governments:					
Real estate	$ 6	$ 1	$ (1)	$ –	$ 6
Manufacturing	10	7	(17)	21	21
Trade	7	16	(10)	–	13
Services	5	13	(8)	–	10
Other	18	2	(17)	–	3
Residential mortgages	1	1	(1)	–	1
Consumer	8	16	(8)	–	16
Total specific allowances	55	56	(62)	21	70
General allowance	258	10	–	11	279
Total	$ 313	$ 66	$ (62)	$ 32	$ 349

(1) *Recoveries and other comprise $21 million (specific) and $5 million (general) arising from the acquisition of a subsidiary (note 20).*

5 Land, buildings and equipment

	Cost	*Accumulated amortization*	*Net Book value* **2005**	*Net Book value* 2004
Land	$ 2	$ –	**$ 2**	$ 2
Buildings	19	3	**16**	17
Furniture and equipment	56	30	**26**	25
Computer equipment	15	12	**3**	3
Leasehold improvements	98	42	**56**	54
Total	$ 190	$ 87	**$ 103**	$ 101

Amortization charged to income for the year ended December 31, 2005 amounted to $19 million (2004 – $21 million).

6 Other assets

	2005	2004
Accrued interest receivable	**$ 132**	$ 97
Interest earning other assets	**221**	215
Due from clients, dealers and clearing corporations	**62**	68
Market revaluation of trading derivatives (note 17)	**195**	421
Future income taxes, net (note 14)	**105**	122
Goodwill and other intangible assets, net	**41**	52
Pension asset (note 13)	**53**	50
Loans held for sale	**–**	200
Accounts receivable and other	**401**	156
Total	**$ 1,210**	$ 1,381

Amortization of intangible assets charged to income for the year ended December 31, 2005 amounted to $11 million (2004 – $10 million).

7 Deposits

	2005			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	**$ 339**	**$ –**	**$ 2,214**	**$ 2,553**
Notice	**–**	**3,362**	**6,024**	**9,386**
Fixed date	**1,636**	**11,938**	**13,095**	**26,669**
Total	**$ 1,975**	**$ 15,300**	**$ 21,333**	**$ 38,608**

	2004			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	$ 157	$ –	$ 1,929	$ 2,086
Notice	–	3,317	5,187	8,504
Fixed date	478	11,501	11,279	23,258
Total	$ 635	$ 14,818	$ 18,395	$ 33,848

Deposits denominated in U.S. dollars amount to $8,856 million (Canadian equivalent) (2004 – $7,112 million) and in other foreign currencies amount to $1,560 million (Canadian equivalent) (2004 – $974 million).

8 Other liabilities

	2005	2004
Accrued interest payable	**$ 261**	$ 197
Mortgages sold with recourse (note 15)	**379**	203
Interest bearing other liabilities	**518**	559
Payable to clients, dealers and clearing corporations	**220**	255
Market revaluation of trading derivatives (note 17)	**191**	421
Obligations related to securities sold short	**559**	564
Pension liability (note 13)	**13**	17
Other employee future benefits liability (note 13)	**54**	47
Accounts payable and other	**654**	522
Total	**$ 2,849**	$ 2,785

Notes to Consolidated Financial Statements (continued)

9 Non-controlling interest in trust and subsidiary

a *HSBC Canada Asset Trust*

HSBC Canada Asset Trust (the "Trust") is a closed-end trust. The Trust was established by HSBC Trust Company (Canada), our wholly owned subsidiary, as trustee. The Trust's objective is to hold qualifying assets which will generate net income for distribution to holders of securities issued by the Trust ("HaTS"). The Trust assets are primarily undivided co-ownership interests in pools of Canada Mortgage and Housing Corporation ("CMHC") insured first mortgages originated by us, and Trust deposits with us.

Unless we fail to declare dividends on our preferred shares, the Trust will make non-cumulative semi-annual cash distributions to the holders of the HaTS. We have covenanted that if the Trust fails to pay the indicated yield in full on the HaTS, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 11).

	2005		2004	
	Units	*Amount*	*Units*	*Amount*
HSBC Canada Asset Trust				
Securities ("HaTS") – Series 2010[(1)]	**200,000**	**$ 200**	200,000	$ 200
– Series 2015[(2)]	**200,000**	**200**	–	–
		$ 400		$ 200

(1) *Each Series 2010 unit was issued at $1,000 per unit to provide an effective annual yield of 7.78% to December 31, 2010 and the six month bankers' acceptance rate plus 2.37% thereafter. The units are not redeemable by the holders. The Trust may redeem the units on any distribution date, subject to regulatory approval.*

(2) *Each Series 2015 unit was issued at $1,000 per unit to provide an effective annual yield of 5.149% to June 30, 2015 and the six month bankers' acceptance rate plus 1.50% thereafter. The units are not redeemable by the holders. The Trust may redeem the units on June 30, 2010 and on any distribution date thereafter, subject to regulatory approval.*

b *HSBC Mortgage Corporation (Canada)*

Group holds $30 million, a 100% interest, of class B perpetual preferred shares issued by HSBC Mortgage Corporation (Canada) ("HMC"), a wholly owned subsidiary. No dividends were paid or payable on these perpetual preferred shares for the years ended December 31, 2005 and 2004. Dividends may be declared at the discretion of the directors of HMC.

10 Subordinated debentures

Debentures, which are unsecured and subordinated in right of payment to the claims of depositors and certain other creditors, comprise:

Interest rate (%)	*Year of maturity*	*Foreign currency amount*	**2005**	2004
Issued to Group companies				
4.822[(1)]	2094	US$85	**$ 98**	$ 101
Issued to third parties				
7.70[(2)]	2011		**60**	60
6.65[(3)]	2012		**25**	25
5.60[(4)]	2012		**100**	100
4.39[(5)]	2015		**100**	100
30 day bankers' acceptance rate plus 0.50%	2083		**40**	40
			325	325
Total			**$ 423**	$ 426

(1) *The interest rate is fixed at 4.822% until July 2010. Prior to July 2005, the interest rate was fixed at 7.09%. Interest expense for the year amounted to $6 million (2004 – $8 million).*

(2) *The interest rate is fixed at 7.70% until February 2006 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%.*

(3) *The interest rate is fixed at 6.65% until September 2007 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%.*

(4) *The interest rate is fixed at 5.60% until June 2007 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%.*

(5) *The interest rate is fixed at 4.39% until January 2010 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%.*

11 Capital stock

Authorized:

Preferred – Unlimited number of Class 1 preferred shares in one or more series and unlimited number of Class 2 preferred shares in one or more series. We may, from time to time, divide any unissued Class 1 preferred shares into separate series and fix the number of shares in each series along with the associated rights, privileges, restrictions and conditions.

Common – 993,677,000 common shares without par value.

Issued and fully paid:

	2005		2004	
	Number of shares	*Amount*	*Number of shares*	*Amount*
Preferred – Class 1, Series A[(1)]	**–**	**$ –**	5,000,000	$ 125
– Class 1, Series C[(2)]	**7,000,000**	**175**	–	–
– Class 1, Series D[(3)]	**7,000,000**	**175**	–	–
Common[(4)]	**488,668,000**	**1,125**	488,668,000	1,125
		$ 1,475		$ 1,250

(1) *These shares were redeemed on September 30, 2005 at $25 per share. During 2005, $6 million (2004 – $8 million) in dividends were declared and paid.*

(2) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.10%, payable quarterly, as and when declared. During 2005, $6 million in dividends were declared and paid.*

The shares will not be redeemable by us prior to June 30, 2010. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing June 30, 2010 at a declining premium up to June 30, 2014, and at par thereafter. In each case declared and unpaid dividends will also be paid thereon to the date fixed for redemption.

We may also, at any time, but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

(3) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.00%, payable quarterly, as and when declared. During 2005, $1 million in dividends were declared and paid.*

The shares will not be redeemable by us prior to December 31, 2010. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing December 31, 2010 at a declining premium up to December 31, 2014, and at par thereafter. In each case declared and unpaid dividends will also be paid thereon to the date fixed for redemption.

We may also, at any time but only with the prior consent of the regulator, give shareholders notice that they have the right, at their option, to convert their shares into a new series of Class 1 Preferred Shares on a share-for-share basis.

(4) *During the year, $330 million (2004 – $150 million) in dividends were declared, of which $60 million was payable at December 31, 2005 (2004 – $50 million).*

Dividend restrictions:

We have covenanted that if the Trust fails to pay the indicated yield in full on the HaTS, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 9).

12 Stock-based compensation

We award compensation to certain key employees in the form of options or shares. In addition, all eligible employees may participate in savings-related share option programs. Options have been granted to certain of our employees under the HSBC Holdings Group Share Option Plan (the "Group Share Option Plan") and the HSBC Savings-Related Share Option Scheme (the "Savings-Related Share Option Scheme"). Since the shares and contribution commitment have been granted directly by the Parent, the corresponding offset to compensation expense is an increase to contributed surplus, representing a contribution of capital from the Parent. As the shares and awards are in ordinary shares of the Parent traded on the London Stock Exchange, individual share information disclosed below is in Pounds Sterling. As at December 31, 2005 one Pound Sterling was equivalent to $2.00.

Notes to Consolidated Financial Statements (continued)

12 Stock-based compensation *(continued)*

The significant weighted average assumptions used to estimate the fair value of the options granted in 2005 are as follows:

	Group share option plan	*Savings-related share option scheme – 3 year*	*Savings-related share option scheme – 5 year*
Risk-free interest rate (%)	4.6	4.3	4.3
Expected life (years)	3.0	3.0	5.0
Expected volatility (%)	20	20	20

Group Share Option Plan

The Group Share Option Plan is a long-term incentive compensation plan available to certain of our employees with grants usually made each year. Options are granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

The fair value of options granted in 2005 was £1.61 (2004 – £1.59) per option.

	2005		2004	
	Number of options	*Weighted average exercise price*	*Number of options*	*Weighted average exercise price*
Group Share Option Plan				
Options outstanding, beginning of year	**12,822,095**	**£7.64**	12,778,726	£7.72
Granted in the year	**–**	**–**	1,533,381	£8.28
Exercised	**(1,149,484)**	**£7.12**	(1,142,550)	£6.72
Forfeited/expired	**(431,750)**	**£7.87**	(347,462)	£7.76
Options outstanding, end of year	**11,240,861**	**£7.69**	12,822,095	£7.64
Options exercisable, end of year	**7,499,040**		6,438,914	

The fair value of share options charged to income as compensation expense in 2005 was $6 million (2004 – $5 million) with a corresponding credit to contributed surplus.

For options outstanding at the end of the year, the weighted average remaining contractual life was 5.8 years. The range of exercise prices was £3.33 – £8.71.

For options exercisable at the end of the year, the weighted average exercise price was £5.21.

12 Stock-based compensation *(continued)*

Savings-Related Share Option Schemes

The Savings-Related Share Option Schemes invite eligible employees to enter into savings contracts to save up to the equivalent of £250 per month, with the option to use the savings to acquire shares. The options are exercisable within six months following either the third or the fifth anniversary of the commencement of the savings contract depending on conditions set at grant. The exercise price is at a 20 per cent discount to the market value at the date of grant.

The fair value of share options charged to income as compensation expense in 2005, under both savings related schemes, was $4 million (2004 – $3 million) with a corresponding credit to contributed surplus.

	2005		2004	
	Number of options	*Weighted average exercise price*	*Number of options*	*Weighted average exercise price*
Savings related share option plan – 5 year				
Options outstanding, beginning of year	**1,277,410**	**£5.84**	1,656,948	£5.70
Granted in the year	**150,896**	**£6.67**	158,694	£6.47
Exercised	**(514,003)**	**£5.99**	(412,125)	£5.42
Forfeited/expired	**(78,029)**	**£5.80**	(126,107)	£5.74
Options outstanding, end of year	**836,274**	**£6.07**	1,277,410	£5.84
Options exercisable, end of year	**45,812**		47,102	

The fair value of options granted in 2005 was £2.07 (2004 – £2.14) per option.

For options outstanding at the end of the year, the weighted average remaining contractual life was 2.6 years. The range of exercise prices was £5.35 – £6.75.

For options exercisable at the end of the year, the weighted average exercise price was £6.03.

	2005		2004	
	Number of options	*Weighted average exercise price*	*Number of options*	*Weighted average exercise price*
Savings related share option plan – 3 year				
Options outstanding, beginning of year	**1,721,575**	**£5.70**	1,602,510	£5.61
Granted in the year	**567,550**	**£6.67**	396,704	£6.47
Exercised	**(150,382)**	**£6.31**	(168,679)	£6.68
Forfeited/expired	**(126,882)**	**£6.07**	(108,960)	£5.73
Options outstanding, end of year	**2,011,861**	**£6.19**	1,721,575	£5.70
Options exercisable, end of year	**10,388**		36,381	

The fair value of options granted in 2005 was £2.04 (2004 – £1.94) per option.

For options outstanding at the end of the year, the weighted average remaining contractual life was 1.2 years. The range of exercise prices was £5.35 – £6.75.

For options exercisable at the end of the year, the weighted average exercise price was £6.32.

Notes to Consolidated Financial Statements (continued)

12 Stock-based compensation *(continued)*

Restricted Share Plan

We provide awards to certain of our employees in the form of performance and non-performance restricted shares of the Parent. Performance related restricted shares generally vest after three years from date of grant, based on certain performance targets. Non-performance related restricted shares are released to the recipients based on continued service, typically at the end of a three year vesting period from date of grant. The restricted shares are purchased in the open market and are held in trust on behalf of the employee until vesting. The cost of these shares purchased is recorded as compensation expense over the vesting period. The cost of shares charged to income as compensation expense in 2005 was $6 million (2004 – $1 million).

13 Employee future benefits

We sponsor a number of pension arrangements and post-retirement, non-pension arrangements covering our employees.

With the exception of one plan, the most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at December 31, 2003 (one plan was valued as at December 31, 2002). The next actuarial valuations for funding purposes of these plans are required as at December 31, 2006 (December 31, 2005 for one plan).

Information about the defined benefit plans, in aggregate, as at December 31 (using a measurement date of September 30 – see note 1(m)) is as follows:

	Pension benefits		*Other benefits*	
	2005	2004	**2005**	2004
Accrued benefit obligations				
Balance, beginning of year	**$ 207**	$ 186	**$ 105**	$ 94
Current service cost	**8**	8	**3**	7
Interest cost	**14**	13	**4**	6
Benefits paid	**(12)**	(11)	**(1)**	(1)
Settlements	**–**	(10)	**–**	–
Plan amendments	**1**	3	**(51)**	–
Actuarial loss (gain)	**66**	12	**15**	(1)
Acquisitions	**–**	5	**–**	–
Employee contributions	**1**	1	**–**	–
Balance, end of year	**$ 285**	$ 207	**$ 75**	$ 105
Plan assets				
Fair value, beginning of year	**$ 214**	$ 161	**$ –**	$ –
Actual return on plan assets	**35**	22	**–**	–
Bank contributions	**8**	43	**1**	1
Acquisitions	**–**	8	**–**	–
Employee contributions	**1**	1	**–**	–
Benefits paid	**(12)**	(11)	**(1)**	(1)
Settlements	**–**	(10)	**–**	–
Fair value, end of year	**$ 246**	$ 214	**$ –**	$ –
Funded status				
Funded status – surplus (deficit)	**$ (39)**	$ 7	**$ (75)**	$ (105)
Bank contributions after measurement date	**2**	2	**–**	–
Unamortized net actuarial loss	**118**	75	**44**	30
Unamortized past service costs	**4**	3	**(23)**	–
Unamortized transitional (asset) obligations	**(37)**	(41)	**–**	28
Accrued benefit asset (liability)	**48**	46	**(54)**	(47)
Valuation allowance	**(8)**	(13)	**–**	–
Accrued benefit asset (liability), net of valuation allowance	**$ 40**	$ 33	**$ (54)**	$ (47)

13 Employee future benefits *(continued)*

The accrued benefit asset (liability), net of valuation allowance, is included in the consolidated balance sheet as follows:

	Pension plans		*Non-pension*	
	2005	2004	**2005**	2004
Other assets (note 6)	**$ 53**	$ 50	**$ –**	$ –
Other liabilities (note 8)	**(13)**	(17)	**(54)**	(47)
Total	**$ 40**	$ 33	**$ (54)**	$ (47)

Effective December 1, 2004 we amended our post-retirement, non-pension arrangements. Employees retiring between January 1, 2005 and December 31, 2007 will have the option of participating in the current plan or in a new flexible benefits plan. After January 1, 2008, retiring employees will participate only in the new flexible benefits plan. This amendment resulted in a significant reduction in the accrued benefit obligations for the non-pension arrangements which are reflected for the fiscal year ending December 31, 2005.

Included in the accrued benefit obligations and fair value of pension plan assets at year-end are the following amounts in respect of pension plans that are not fully funded:

	2005	2004
Accrued benefit obligations	**$ 180**	$ 110
Fair value of plan assets	**117**	86
Funded status – deficit, measurement date	**63**	24
Bank contributions after measurement date	**2**	2
Funded status – deficit, at year end	**$ 61**	$ 22

The distribution of the pension plan assets at December 31 is shown below:

	Percentage of pension plan assets	
	2005	2004
Equity securities	**72%**	68%
Debt securities	**27%**	31%
Other	**1%**	1%
Total	**100%**	100%

The expense for employee future benefits for the years ended December 31 is as follows:

	Pension benefits		*Other benefits*	
	2005	2004	**2005**	2004
Service cost	**$ 8**	$ 8	**$ 3**	$ 7
Interest cost	**14**	13	**4**	6
Actual return on plan assets	**(35)**	(22)	**–**	–
Actuarial loss on accrued benefit obligation	**66**	12	**15**	–
Plan amendments	**1**	3	**(51)**	–
Settlement loss	**–**	2	**–**	–
Costs arising in the year	**54**	16	**(29)**	13
Differences between costs arising in the year and costs recognized in the year in respect of:				
– Actual and expected return on plan assets	**19**	9	**–**	–
– Actuarial gain	**(62)**	(9)	**(14)**	(1)
– Plan amendments	**–**	(2)	**50**	–
– Amortization of transitional obligation (asset)	**(4)**	(4)	**–**	2
Net benefit plan expense recognized before increase in valuation allowance	**7**	10	**7**	14
Increase (decrease) in valuation allowance	**(5)**	6	**–**	–
Net benefit plan expense	**2**	16	**7**	14
Defined contribution plan expense	**11**	8	**–**	–
Total	**$ 13**	$ 24	**$ 7**	$ 14

Notes to Consolidated Financial Statements (continued)

13 Employee future benefits *(continued)*

The total cash payments for employee future benefits for 2005, consisting of cash contributed by us to our funded pension plans, cash paid directly to beneficiaries for our unfunded pension arrangements and payments to third party service providers in respect of our post-retirement, non-pension arrangements were $20 million (2004 – $28 million).

The significant actuarial assumptions adopted in measuring the accrued benefit obligations and determining the net benefit plan expense were as follows:

	Pension benefits		*Other benefits*	
	2005	2004	**2005**	2004
Accrued benefit obligations as at December 31				
Discount rate (%)	**5.25**	6.50	**5.25**	6.50
Rate of compensation increase (%)	**3.30**	3.30	**3.30**	3.30
Net benefit plan expense for years ended December 31				
Discount rate (%)	**6.50**	6.75	**6.50**	6.75
Expected long-term rate of return on plan assets (%)	**7.25**	7.25	**–**	–
Rate of compensation increase (%)	**3.30**	3.30	**3.30**	3.30

For measurement purposes for 2005, a 6.30% health care cost trend rate was assumed grading down to 4.60% by 2009 and assumed to remain level thereafter (2004 – 7.70% grading down to 4.60% by 2009 and assumed to remain level thereafter).

The weighted-average EARSL of the active employees under the pension plans is 15 years and 19 years under the post-retirement, non-pension arrangements.

Sensitivity of Assumptions

The following table shows the sensitivity of the accrued benefit obligations at the end of 2005, as well as the net benefits expense for 2005, to changes in the significant actuarial assumptions. The sensitivities in each key variable have been calculated independently of changes in other key variables.

	Pension benefits		*Other benefits*	
	Accrued benefit obligation	*Benefits expense*	*Accrued benefit obligation*	*Benefits expense*
Expected rate of return on plan assets	–	7.25%	–	–
Impact of 1% increase	$ –	$ (2)	$ –	$ –
Impact of 1% decrease	$ –	$ 2	$ –	$ –
Discount rate	5.25%	6.50%	5.25%	6.50%
Impact of 1% increase	$ (45)	$ (4)	$ (12)	$ (1)
Impact of 1% decrease	$ 59	$ 5	$ 16	$ 1
Rate of compensation increase	3.3%	3.3%	3.3%	3.3%
Impact of 0.25% increase	$ 7	$ 1	–	–
Impact of 0.25% decrease	$ (7)	$ (1)	–	–
Assumed overall health care cost trend	–	–	6.3%(1)	6.8%(1)
Impact of 1% increase	$ –	$ –	$ 7	$ 1
Impact of 1% decrease	$ –	$ –	$ (5)	$ (1)

(1) *Grading down to 4.5% per year in 2009 and thereafter.*

14 Income taxes

a *Components of the provision for income taxes reported in the consolidated statement of income are:*

	2005	2004
Current income taxes:		
Federal	**$ 136**	$ 130
Provincial	**80**	79
	216	209
Future income taxes:		
Federal	**13**	1
Provincial	**8**	–
	21	1
Total provision for income taxes	**$ 237**	$ 210

b *The provision for income taxes shown in the consolidated statement of income is at a rate that is different than the combined federal and provincial statutory income tax rate for the following reasons:*

	2005	2004
Combined federal and provincial income tax rate	**35.2%**	35.5%
Adjustments resulting from:		
Adjustment for tax exempt income	**(0.1)**	(0.1)
Utilization of tax losses carried forward and other deductions	**(0.6)**	–
Substantively enacted tax rate changes	**0.2**	–
Additional financial institution taxes	**0.1**	0.1
Other, net	**(1.3)**	2.1
Effective tax rate	**33.5%**	37.6%

c *The components of the net future income tax asset reported in other assets (note 6) is comprised as follows:*

	2005	2004
Future income tax assets:		
Allowance for credit losses	**$ 94**	$ 100
Other available deductions	**52**	43
Non-capital losses	**8**	19
Net capital losses	**–**	2
Buildings and equipment	**9**	10
Other	**4**	5
	167	179
Valuation allowance	**–**	(11)
	167	168
Future income tax liabilities:		
Leases	**(15)**	(2)
Intangible assets	**(7)**	(11)
Other	**(40)**	(33)
	(62)	(46)
Net future income tax asset	**$ 105**	$ 122

Notes to Consolidated Financial Statements (continued)

15 Guarantees, commitments and contingent liabilities

a *Credit-related*

In the normal course of business, we enter into various off-balance sheet commitments and contingent liability contracts. The primary purpose of these contracts is to make funds available for the financing needs of customers. The policy for requiring collateral security with respect to these contracts and the types of collateral security held is generally the same as those for loans advanced.

Financial and performance standby letters of credit represent irrevocable assurances that payments will be made in the event that a customer cannot meet its obligations to third parties and they carry the same credit risk, recourse and collateral security requirements as loans extended to customers. Documentary and commercial letters of credit are instruments issued on behalf of a customer authorizing a third party to draw drafts on us up to a certain amount subject to specific terms and conditions. We are at risk for any drafts drawn that are not ultimately settled by the customer, and the amounts are collateralized by the goods to which they relate. Commitments to extend credit represent unutilized portions of authorizations to extend credit in the form of loans and customers' liability under acceptances.

The credit instruments reported below represent the maximum amount of additional credit that we could be obligated to extend should contracts be fully utilized.

	2005	2004
Financial and performance standby letters of credit	**$ 2,235**	$ 1,756
Documentary and commercial letters of credit	**516**	459
Commitments to extend credit:		
Original term of one year or less	**23,768**	20,974
Original term of more than one year	**3,702**	3,510
Credit and yield enhancement	**32**	14
	$ 30,253	$ 26,713

b *Pledged assets and collateral*

In the ordinary course of business, we pledge assets recorded on our balance sheet. Details of pledged assets against liabilities are as follows:

	2005	2004
Assets pledged to:		
Bank of Canada	**$ 2,715**	$ 1,108
Clearing systems, payment systems and depositories	**61**	61
Assets pledged in relation to:		
Borrowing, securities lending and securities sold under repurchase agreements	**497**	327
Derivative transactions and other	**2**	69
Total	**$ 3,275**	$ 1,565

As at December 31, 2005, the approximate market value of collateral accepted for our securities lent and securities purchased under reverse repurchase agreements was $1,754 million (2004 – $2,288 million).

c *Long-term lease commitments*

Future minimum lease payments for all lease commitments under long-term leases of premises are as follows:

2006	$ 34
2007	29
2008	25
2009	21
2010	17
2011 and thereafter	38
	$ 164

The total rental expense charged in respect of premises for the year was $43 million (2004 – $44 million).

15 Guarantees, commitments and contingent liabilities *(continued)*

d *Mortgages sold with recourse*

We have agreed to repurchase any mortgage purchased from us by the HSBC Mortgage Mutual Fund if any principal and interest payments due are more than 90 days in arrears. The amount of mortgages sold with recourse as at December 31, 2005 was $379 million (2004 – $203 million) and are included in other liabilities (note 8).

e *Litigation*

We are subject to a number of legal proceedings arising in the normal course of our business. We do not expect the outcome of any of these proceedings, in aggregate, to have a material effect on our consolidated financial position or our results of operations.

We are also subject to a number of legal proceedings arising from businesses acquired. In these matters, we have full indemnifications against any claims and therefore have not provided for these in our financial statements.

f *Contingent liabilities*

During 2004, the Canada Revenue Agency ("CRA") issued Notices of Reassessments pertaining to specific issues with respect to past taxation years. We are addressing these with CRA through the filing of Notices of Objections and other avenues. The ultimate resolution of these issues is indeterminate at this stage. However, we believe that provisions to cover these matters are adequately reflected in the Consolidated Balance Sheet as at December 31, 2005.

16 Fair value of financial instruments

The amounts below represent the fair values of the on-balance sheet financial instruments as at December 31. Fair value is the estimated amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable and willing parties who are under no compulsion to act and is best evidenced by a quoted market price, if one exists. Many of the financial instruments lack an available trading market. Therefore, these instruments have been valued using present value or other valuation techniques and may not necessarily be indicative of the amounts realizable in an immediate settlement of the instruments. In addition, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

Changes in interest rates are the main cause of changes in the fair value of the financial instruments. The majority of the financial instruments are carried at historical cost and are not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes. For those financial instruments held for trading purposes, the carrying value is adjusted daily to reflect the fair value.

The following table sets out the fair values of on-balance sheet financial instruments using the valuation methods and assumptions described below. The fair values disclosed do not reflect the value of assets and liabilities that are not considered financial instruments, such as land, buildings and equipment, goodwill and other intangible assets, and future income taxes.

Notes to Consolidated Financial Statements (continued)

16 Fair value of financial instruments *(continued)*

	2005			2004		
	Book value	*Fair value*	*Fair value over (under) book value*	*Book value*	*Fair value*	*Fair value over (under) book value*
Assets						
Cash resources	**$ 5,958**	**$ 5,958**	**$ –**	$ 4,422	$ 4,422	$ –
Securities	**4,341**	**4,340**	**(1)**	3,022	3,037	15
Securities purchased under reverse repurchase agreements	**1,752**	**1,752**	**–**	2,264	2,264	–
Loans	**31,844**	**31,839**	**(5)**	28,319	28,359	40
Acceptances	**4,002**	**4,002**	**–**	3,754	3,754	–
Other assets	**1,065**	**1,065**	**–**	1,207	1,207	–
Liabilities						
Deposits	**$ 38,608**	**$ 38,585**	**$ (23)**	$ 33,848	$ 33,980	$ 132
Acceptances	**4,002**	**4,002**	**–**	3,754	3,754	–
Securities sold under repurchase agreements	**302**	**302**	**–**	23	23	–
Other liabilities	**3,279**	**3,279**	**–**	3,015	3,015	–
Debentures	**423**	**424**	**1**	426	437	11

The determination of fair values of financial instruments for which there are no quoted market values requires that a number of assumptions are made for which there exists a significant degree of subjectivity. The following methods and assumptions were used to estimate the fair value of these financial instruments:

— Cash resources, acceptances, securities purchased under reverse repurchase agreements, other assets, securities sold under repurchase agreements and other liabilities are assumed to approximate their carrying values, due to their short term nature.

— Investment securities are assumed to be equal to the estimated market value of securities provided in Note 2. These values are based on quoted market prices where available. If quoted market prices are not available, fair values are estimated using quoted market prices of similar securities or other valuation techniques. Trading securities have carrying values which are equal to their estimated market value.

— Floating rate loans are assumed to be equal to their book value. The fair values of loans with fixed terms are estimated using a discounted cash flow calculation at current rates for loans with similar terms and risks.

— Demand and floating rate deposits are assumed to be equal to their carrying value. The fair values of fixed rate deposits are estimated using a discounted cash flow calculation at current rates for deposits with similar terms and risks.

— The fair value of debentures is determined by reference to current market prices for debt with similar terms and risks.

17 Derivative instruments

In the ordinary course of business, we enter into various derivative contracts such as foreign exchange contracts, interest rate swaps, forward rate agreements and financial futures contracts whose notional principal is not included in the consolidated balance sheet. Derivatives are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. Derivatives are used for both trading and asset/liability management purposes. Trading related activity includes transactions undertaken on our behalf or our customers ("Trading"). Asset/liability management ("ALM") derivatives are used by us to manage exposures to interest rate and foreign currency fluctuations. Where appropriate, customer related trading transactions may be used as part of the ALM program.

A derivative qualifies as a hedge if the hedging relationship is designated and formally documented at inception, detailing the particular risk management objective and strategy for the hedge, the specific asset, liability or cash flow being hedged, as well as how effectiveness of the hedge is being assessed. In addition, changes in the fair value of the derivative must be highly effective in offsetting either changes in the fair value of on-balance sheet items or changes in the amount of future cash flows. The effectiveness of these hedging relationships is evaluated at inception of the hedge and on an ongoing basis, both retrospectively and prospectively using quantitative statistical measures of correlation. Where a non-trading derivative has been designated and functions effectively as a hedge, the existing accounting treatment will continue as described in note 1(o).

Hedge accounting will be discontinued prospectively if the derivative ceases to qualify as an effective hedge, and the fair value of the derivative will be recognized on the consolidated balance sheet at that time. The amounts required to record the derivative at this fair value would be deferred and recognized in income as the hedged item affects net income. Subsequent changes in fair value will be recognized immediately in non-interest revenue until the derivative qualifies for hedge accounting again. The fair value at the time the derivative qualifies again will be recognized in income as the hedged item affects net income.

We strictly adhere to our formalized risk management policies and procedures. Risk limits are determined for each portfolio of derivative instruments based on product, currency, interest rate repricing and market volatility. All limits are monitored on a daily basis. Derivative instruments are subject to both market risk and credit risk. Market risk is the risk that the fair value of derivatives will fluctuate due to changes in interest or foreign exchange rates, and equity markets. Market risk is managed on a consolidated basis. Credit risk for derivative instruments is not equal to the notional amount of the principal as it is with assets recorded on the consolidated balance sheets. The credit risk for derivatives is principally the replacement cost of any contract with a positive market value plus an estimate for future fluctuation risk. Credit risk for derivatives is managed using our risk management policies.

17 Derivative instruments *(continued)*

a An analysis of the derivative portfolio and related credit exposure at December 31 is as follows:

	2005				2004			
	Notional amount	*Current replace-ment cost*	*Credit equiva-lent amount*	*Risk weighted balance*	*Notional amount*	*Current replace-ment cost*	*Credit equiva-lent amount*	*Risk weighted balance*
Interest rate contracts								
Forward rate agreements	**$ –**	**$ –**	**$ –**	**$ –**	$ 200	$ –	$ –	$ –
Futures	**1,445**	**–**	**–**	**–**	1,148	–	–	–
Swaps	**12,643**	**78**	**130**	**39**	11,607	102	147	42
Caps	**43**	**–**	**–**	**–**	43	–	1	–
	14,131	**78**	**130**	**39**	12,998	102	148	42
Foreign exchange contracts								
Spot contracts	**246**	**1**	**1**	**–**	606	2	2	–
Forward contracts	**15,500**	**134**	**324**	**107**	14,088	333	508	136
Currency futures	**13**	**–**	**–**	**–**	46	–	–	–
Currency swaps and options	**2,380**	**42**	**84**	**29**	1,551	56	92	35
	18,139	**177**	**409**	**136**	16,291	391	602	171
Other derivative contracts								
Credit	**290**	**17**	**52**	**10**	290	1	1	–
Equity	**103**	**4**	**11**	**4**	84	1	6	2
	393	**21**	**63**	**14**	374	2	7	2
Total	**$ 32,663**	**$ 276**	**$ 602**	**$ 189**	$ 29,663	$ 495	$ 757	$ 215
Impact of master netting agreements		**–**	**–**	**–**		(21)	(24)	(5)
		$ 276	**$ 602**	**$ 189**		$ 474	$ 733	$ 210

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure.

Current replacement cost represents the estimated cost of replacing, at current fair value, all contracts with a positive value.

Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by the Superintendent in its capital adequacy guidelines.

Risk-weighted balance represents the amount of regulatory capital required to support the derivative activities. It is estimated by risk weighting the credit equivalent amounts according to the creditworthiness of the counter parties using factors prescribed by the Superintendent in its capital adequacy guidelines.

Interest rate and currency futures are exchange traded. All other contracts are over-the-counter.

17 Derivative instruments *(continued)*

b The following tables summarize the notional amounts by remaining term to maturity of the derivative portfolio at December 31:

	2005								
	Trading				*ALM*				
	Under 1 year	*1 – 5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1 – 5 years*	*Over 5 years*	*Total ALM*	*Total*
Interest rate contracts									
Futures	**$ 1,445**	**$ –**	**$ –**	**$ 1,445**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 1,445**
Swaps	**946**	**2,718**	**847**	**4,511**	**3,477**	**4,433**	**222**	**8,132**	**12,643**
Caps	**–**	**43**	**–**	**43**	**–**	**–**	**–**	**–**	**43**
	2,391	**2,761**	**847**	**5,999**	**3,477**	**4,433**	**222**	**8,132**	**14,131**
Foreign exchange contracts									
Spot contracts	**133**	**–**	**–**	**133**	**113**	**–**	**–**	**113**	**246**
Forward contracts	**8,496**	**878**	**–**	**9,374**	**6,090**	**36**	**–**	**6,126**	**15,500**
Currency futures	**13**	**–**	**–**	**13**	**–**	**–**	**–**	**–**	**13**
Currency swaps and options	**1,862**	**174**	**336**	**2,372**	**–**	**8**	**–**	**8**	**2,380**
	10,504	**1,052**	**336**	**11,892**	**6,203**	**44**	**–**	**6,247**	**18,139**
Other derivative contracts									
Credit	**–**	**–**	**–**	**–**	**–**	**290**	**–**	**290**	**290**
Equity	**72**	**31**	**–**	**103**	**–**	**–**	**–**	**–**	**103**
	72	**31**	**–**	**103**	**–**	**290**	**–**	**290**	**393**
Total	**$ 12,967**	**$ 3,844**	**$ 1,183**	**$ 17,994**	**$ 9,680**	**$ 4,767**	**$ 222**	**$ 14,669**	**$ 32,663**

17 Derivative instruments *(continued)*

	2004								
	Trading				*ALM*				
	Under 1 year	*1 – 5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1 – 5 years*	*Over 5 years*	*Total ALM*	*Total*
Interest rate contracts									
Forward rate agreements	$ 200	$ –	$ –	$ 200	$ –	$ –	$ –	$ –	$ 200
Futures	1,148	–	–	1,148	–	–	–	–	1,148
Swaps	1,265	2,669	876	4,810	3,825	2,595	377	6,797	11,607
Caps	–	43	–	43	–	–	–	–	43
	2,613	2,712	876	6,201	3,825	2,595	377	6,797	12,998
Foreign exchange contracts									
Spot contracts	572	–	–	572	34	–	–	34	606
Forward contracts	9,295	695	–	9,990	3,958	140	–	4,098	14,088
Currency futures	46	–	–	46	–	–	–	–	46
Currency swaps and options	936	418	189	1,543	–	8	–	8	1,551
	10,849	1,113	189	12,151	3,992	148	–	4,140	16,291
Other derivative contracts									
Credit	–	–	–	–	–	290	–	290	290
Equity	53	31	–	84	–	–	–	–	84
	53	31	–	84	–	290	–	290	374
Total	$ 13,515	$ 3,856	$ 1,065	$ 18,436	$ 7,817	$ 3,033	$ 377	$ 11,227	$ 29,663

17 Derivative instruments *(continued)*

c The following tables summarize the fair values, as represented by the sum of the net unrealized gains and losses, accrued interest receivable and payable and premiums paid or received, of the derivative portfolio at December 31: Fair values of derivative instruments are determined using quoted market prices, if one exists.

	2005						
	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	**$ 21**	**$ (29)**	**$ (8)**	**$ 57**	**$ (46)**	**$ 11**	**$ 3**
Foreign exchange contracts							
Spot contracts	**1**	**(1)**	**–**	**–**	**–**	**–**	**–**
Forward contracts	**127**	**(116)**	**11**	**7**	**(89)**	**(82)**	**(71)**
Currency swaps and options	**42**	**(41)**	**1**	**–**	**(1)**	**(1)**	**–**
	170	**(158)**	**12**	**7**	**(90)**	**(83)**	**(71)**
Other derivative contracts							
Credit	**–**	**–**	**–**	**17**	**–**	**17**	**17**
Equity	**4**	**(4)**	**–**	**–**	**–**	**–**	**–**
	4	**(4)**	**–**	**17**	**–**	**17**	**17**
Total	**$ 195**	**$ (191)**	**$ 4**	**$ 81**	**$ (136)**	**$ (55)**	**$ (51)**

	2004						
	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	$ 46	$ (52)	$ (6)	$ 56	$ (20)	$ 36	$ 30
Foreign exchange contracts							
Spot contracts	2	(2)	–	–	–	–	–
Forward contracts	316	(310)	6	17	(132)	(115)	(109)
Currency swaps and options	56	(56)	–	–	(1)	(1)	(1)
	374	(368)	6	17	(133)	(116)	(110)
Other derivative contracts							
Credit	–	–	–	1	–	1	1
Equity	1	(1)	–	–	–	–	–
	1	(1)	–	1	–	1	1
Total	$ 421	$ (421)	$ –	$ 74	$ (153)	$ (79)	$ (79)

Notes to Consolidated Financial Statements (continued)

18 Interest rate sensitivity position

The following table provides an analysis of the interest rate sensitivity position at December 31 based on contractual repricing dates of assets and liabilities:

	2005									
	Floating rate	*Within 3 months*	*3 to 12 months*	*Effective interest rate (%)*	*1 to 5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	**$ 1,003**	**$ 3,805**	**$ 740**	**3.8**	**$ –**	**–**	**$ –**	**–**	**$ 410**	**$ 5,958**
Securities	**1,414**	**1,574**	**963**	**3.2**	**344**	**3.3**	**14**	**3.5**	**32**	**4,341**
Securities purchased under reverse repurchase agreements	**–**	**1,752**	**–**	**3.3**	**–**	**–**	**–**	**–**	**–**	**1,752**
Loans	**19,832**	**1,449**	**2,537**	**5.0**	**8,013**	**5.0**	**209**	**5.8**	**(196)**	**31,844**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**4,002**	**4,002**
Other assets	**221**	**–**	**–**	**6.0**	**–**	**–**	**–**	**–**	**1,092**	**1,313**
Total assets	**22,470**	**8,580**	**4,240**	**–**	**8,357**	**–**	**223**	**–**	**5,340**	**49,210**
Deposits	**6,435**	**14,920**	**8,389**	**3.0**	**3,360**	**3.7**	**–**	**–**	**5,504**	**38,608**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**4,002**	**4,002**
Securities sold under repurchase agreements	**–**	**302**	**–**	**3.3**	**–**	**–**	**–**	**–**	**–**	**302**
Other liabilities	**1,077**	**–**	**–**	**1.0**	**–**	**–**	**–**	**–**	**1,772**	**2,849**
Non-controlling interest in subsidiaries	**–**	**–**	**–**	**–**	**200**	**7.8**	**200**	**5.1**	**30**	**430**
Subordinated debt	**–**	**99**	**–**	**4.8**	**324**	**5.4**	**–**	**–**	**–**	**423**
Shareholders' equity	**–**	**–**	**–**	**–**	**350**	**5.1**	**–**	**–**	**2,246**	**2,596**
Total liabilities & shareholders' equity	**7,512**	**15,321**	**8,389**	**–**	**4,234**	**–**	**200**	**–**	**13,554**	**49,210**
On balance sheet gap	**14,958**	**(6,741)**	**(4,149)**	**–**	**4,123**	**–**	**23**	**–**	**(8,214)**	**–**
Off balance sheet positions	**–**	**(3,473)**	**910**	**–**	**2,563**	**–**	**–**	**–**	**–**	**–**
Total interest rate gap	**$ 14,958**	**$ (10,214)**	**$ (3,239)**	**–**	**$ 6,686**	**–**	**$ 23**	**–**	**$ (8,214)**	**$ –**

18 Interest rate sensitivity position *(continued)*

	2004									
	Floating rate	*Within 3 months*	*3 to 12 months*	*Effective interest rate (%)*	*1 to 5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	$ 761	$ 2,925	$ 408	2.3	$ –	–	$ –	–	$ 328	$ 4,422
Securities	1,033	1,002	556	3.1	370	4.1	10	3.9	51	3,022
Securities purchased under reverse repurchase agreements	–	2,264	–	2.3	–	–	–	–	–	2,264
Loans	15,731	1,609	2,838	4.6	8,147	5.1	160	6.4	(166)	28,319
Acceptances	–	–	–	–	–	–	–	–	3,754	3,754
Other assets	215	–	–	5.3	–	–	–	–	1,267	1,482
Total assets	17,740	7,800	3,802	–	8,517	–	170	–	5,234	43,263
Deposits	5,619	13,691	6,892	1.8	2,675	3.8	–	–	4,971	33,848
Acceptances	–	–	–	–	–	–	–	–	3,754	3,754
Securities sold under repurchase agreements	–	23	–	2.5	–	–	–	–	–	23
Other liabilities	1,123	–	–	1.0	–	–	–	–	1,662	2,785
Non-controlling interest in subsidiaries	–	–	–	–	–	–	200	7.8	30	230
Subordinated debt	–	40	101	5.9	185	6.4	100	4.4	–	426
Shareholders' equity	–	–	125	6.3	–	–	–	–	2,072	2,197
Total liabilities & shareholders' equity	6,742	13,754	7,118	–	2,860	–	300	–	12,489	43,263
On balance sheet gap	10,998	(5,954)	(3,316)	–	5,657	–	(130)	–	(7,255)	–
Off balance sheet positions	–	(171)	(670)	–	641	–	200	–	–	–
Total interest rate gap	$ 10,998	$ (6,125)	$ (3,986)	–	$ 6,298	–	$ 70	–	$ (7,255)	$ –

19 Segmented information

a *Customer groups*

We manage and report our operations according to the customer group definitions used by the HSBC Group.

A description of each segment is as follows:

Personal Financial Services provides services to individuals by offering a comprehensive range of financial products and services, which include retail banking, asset management, full service and discount brokerage, and trust and advisory services.

Commercial Banking meets the needs of Canadian commercial and corporate clients by offering commercial and corporate banking, asset management, mergers and acquisitions ("M&A") advisory, merchant banking, treasury, and trade finance.

Notes to Consolidated Financial Statements (continued)

19 Segmented information *(continued)*

Corporate, Investment Banking and Markets provides a comprehensive range of financial services to an international group of HSBC's large multinational clients as well as client sales, service and distribution, balance sheet management, and proprietary trading. The focus is on entities that have a need for global value added products by offering the following services: corporate banking; asset management; M&A, advisory; treasury; and trade finance.

Other includes the effect of unallocated revenues and expenses.

The accounting policies of the segments are generally consistent with those followed in the preparation of the consolidated financial statements as disclosed in Note 1.

	Year ended December 31, 2005				
	Personal financial services	*Commercial banking*	*Corporate, investment banking and markets*	*Other*	*Total*
Net interest income	**$ 360**	**$ 536**	**$ 114**	**$ –**	**$ 1,010**
Non-interest revenue	**267**	**191**	**112**	**–**	**570**
Total revenue	**627**	**727**	**226**	**–**	**1,580**
Provision for credit losses	**(14)**	**(13)**	**–**	**–**	**(27)**
Non-interest expenses	**(452)**	**(289)**	**(50)**	**(33)**	**(824)**
Income before the undernoted	**161**	**425**	**176**	**(33)**	**729**
Provision for income taxes	**(52)**	**(138)**	**(58)**	**11**	**(237)**
Non-controlling interest in income of trust	**(7)**	**(13)**	**(2)**	**–**	**(22)**
Net income	**$ 102**	**$ 274**	**$ 116**	**$ (22)**	**$ 470**
Average assets	**$ 16,750**	**$ 17,187**	**$ 13,347**	**$ –**	**$ 47,284**

	Year ended December 31, 2004				
	Personal financial services	*Commercial banking*	*Corporate, investment banking and markets*	*Other*	*Total*
Net interest income	$ 303	$ 472	$ 121	$ –	$ 896
Non-interest revenue	249	169	108	–	526
Total revenue	552	641	229	–	1,422
Provision for credit losses	(17)	(46)	(3)	–	(66)
Non-interest expenses	(421)	(266)	(50)	(59)	(796)
Income before the undernoted	114	329	176	(59)	560
Effect of accounting change (note 1)	7	–	7	–	14
	121	329	183	(59)	574
Provision for income taxes	(44)	(121)	(68)	23	(210)
Non-controlling interest in income of trust	(5)	(9)	(2)	–	(16)
Income from continuing operations	72	199	113	(36)	348
Income from discontinued operations (note 22)	5	–	–	–	5
Net income	$ 77	$ 199	$ 113	$ (36)	$ 353
Average assets	$ 15,183	$ 14,284	$ 10,954	$ –	$ 40,421

19 Segmented information *(continued)*

b *Geographic*

	2005			
	Assets		*Liabilities*	
	Amount	*Percent*	*Amount*	*Percent*
Canada	**$ 44,889**	**91.2**	**$ 41,889**	**89.8**
United States	**3,147**	**6.4**	**838**	**1.8**
Hong Kong SAR	**74**	**0.2**	**1,338**	**2.9**
Other	**1,100**	**2.2**	**2,549**	**5.5**
Total	**$ 49,210**	**100.0**	**$ 46,614**	**100.0**

	2004			
	Assets		*Liabilities*	
	Amount	*Percent*	*Amount*	*Percent*
Canada	$ 39,629	91.6	$ 37,162	90.5
United States	2,250	5.2	1,006	2.5
Hong Kong SAR	79	0.2	1,077	2.6
Other	1,305	3.0	1,821	4.4
Total	$ 43,263	100.0	$ 41,066	100.0

Assets are allocated on the basis of the location of ultimate risk. Liabilities are allocated on the basis of the residence status of the bearer of the deposit, bankers' acceptances or other liability.

20 Business acquisition

On May 31, 2004, we acquired all the issued and outstanding shares of Intesa Bank Canada ("Intesa"). Effective June 1, 2004, Intesa and HSBC Bank Canada were amalgamated and continued operations as HSBC Bank Canada. Consolidated net income for 2004 includes net income for Intesa from June 1, 2004.

The acquisition was accounted for using the purchase method. Consideration for the shares acquired was paid in cash. The estimated fair values of the assets acquired and the liabilities assumed were as follows:

Cash resources	$ 40
Securities	451
Loans, net	641
Intangible assets	15
Other assets	26
Total assets	1,173
Deposits	1,007
Other liabilities	44
Total liabilities	1,051
Net assets acquired at fair value, being consideration paid	$ 122

21 Related party transactions

Fees are charged by HSBC Group companies with respect to guarantees of deposits, and administrative and technical services provided to us. The total fees for the year amounted to $89 million (2004 – $101 million) and were recorded in non-interest expenses.

For deposits received by us prior to July 1, 2005, another HSBC Group company ("Group") provided unlimited guarantees for our customers on these deposits. As consideration for provision of this guarantee, Group charged us a fee based on a historical defined rate applied against a defined subject liability base. For income tax purposes, we deducted the annual fee paid in determining our taxable income. This guarantee was discontinued for customer deposits received after June 30, 2005.

Notes to Consolidated Financial Statements (continued)

21 Related party transactions *(continued)*

In the fourth quarter of 2005, the Canadian Competent Authority of the Canada Revenue Agency ("CRA") and the UK Competent Authority of the HM Revenue & Customs in the UK agreed, in principle, to a Bilateral Advance Pricing Agreement ("BAPA"). The BAPA outlines the agreed upon rates to be used in determining the amount we can deduct as an expense for the HSBC Group guarantee, and Group includes as income, for income tax purposes for the years 2002 to 2007 inclusive. The rates in the BAPA are lower than the historical defined rate we had been using to calculate the guarantee fee expense. We will also be entering into a separate agreement with CRA to acknowledge this arrangement under the BAPA. We also concluded a separate agreement, in principle, which required Group to reimburse us for the non-deductible portion of the fee paid in excess of the amount as outlined in the BAPA relating to the 2002 to 2004 years.

As a result of these agreements, Group reimbursed us $40 million in December 2005. We recorded a $4 million receivable for excess withholding tax paid to CRA relating to the non-deductible portion of the guarantee fee in 2002 to 2004. As this was a related party transaction, we recorded an offsetting $44 million increase in retained earnings, reflecting the gross amount of the reimbursement.

Group companies hold certain debentures and preferred shares (notes 9 and 10).

A Group company has agreed to provide a standby borrowing facility of up to US$300 million to us at market rates and conditions. Funds have not been drawn from the facility since entering into the agreement.

In addition to the above related party transactions, transactions of a routine nature are completed with Group companies, none of which are material to these financial statements.

22 Discontinued operations

In the first quarter of 2004, Canadian Western Bank ("CWB") and HSBC Bank Canada signed a letter of intent for CWB to acquire all of the shares of HSBC Canadian Direct Insurance Incorporated ("CDII") for a cash payment of $25 million. The transaction closed in the second quarter of 2004, resulting in a gain on sale of $4 million.

Results for discontinued operations, included in Personal Financial Services for the year ended December 31, 2004, were as follows:

	2004
Net interest income	$ –
Non-interest revenue	6
Salaries and benefits	(3)
Premises and equipment	(1)
Other non-interest expenses	(1)
Net income from CDII operations	1
Gain on sale of CDII	4
Provision for income taxes	–
Income from discontinued operations	$ 5

23 Variable interest entities

Effective January 1, 2005, we adopted the CICA's Accounting Guideline 15 ("AcG-15"), which sets out new accounting requirements for the consolidation of variable interest entities ("VIEs"). VIEs include entities where the equity invested is considered insufficient to finance an entity's activities. The new rules require that we consolidate VIEs if the investments we hold in these entities and/or the relationships we have with them result in us being exposed to a majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both.

There was no material impact to the consolidated balance sheet or consolidated statement of income upon adoption. Prior to adopting AcG-15, we fully consolidated the VIE where we are considered to be the primary beneficiary under AcG-15.

The following table provides information about unconsolidated VIEs in which we have a significant variable interest and a VIE that we consolidated under AcG-15.

	2005	
	Total assets	*Maximum exposure to loss*
Unconsolidated VIEs:		
Securitization vehicles managed by the Bank[(1)]	**$ 379**	**$ 90**
Securitization vehicles managed by others[(2)]	**31,362**	**71**
Investment funds[(3)]	**2,732**	**3**
Consolidated VIEs:		
Specialised Financing Entity[(4)]	**700**	**–**

(1) *The maximum exposure to loss consists of liquidity facilities provided for general market disruption events.*

(2) *The maximum exposure to loss consists mainly of segregated deposits provided as first loss protection and retained interests in securitizations where we have sold loans. We have recognized this exposure on our consolidated balance sheet.*

(3) *The maximum exposure to loss consists mainly of seed capital in mutual and investment funds.*

(4) *We have issued innovative Tier 1 capital under a capital trust (note 9). This trust is a VIE, but we are considered its primary beneficiary and, therefore, consolidate this structure in our consolidated balance sheet.*

24 Principal subsidiaries

Principal subsidiaries (wholly-owned)	*Principal office address*	*Shareholders' equity*
HSBC Capital (Canada) Inc.	Vancouver, British Columbia	$ 40
HSBC Investments (Canada) Limited	Vancouver, British Columbia	10
HSBC Investment Funds (Canada) Inc.	Vancouver, British Columbia	8
HSBC Loan Corporation (Canada)	Vancouver, British Columbia	8
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia	179
HSBC Securities (Canada) Inc.	Toronto, Ontario	294
HSBC Trust Company (Canada)	Edmonton, Alberta	55

The HSBC Group: International Network*

Services are provided by around 9,500 offices in 76 countries and territories:

Europe	Offices
Armenia	2
Belgium	2
Channel Islands	38
Cyprus	3
Czech Republic	9
France	807
Germany	11
Greece	79
Hungary	11
Ireland	8
Isle of Man	5
Italy	4
Luxembourg	4
Malta	61
Monaco	2
Netherlands	2
Poland	10
Russia	2
Slovakia	3
Spain	2
Sweden	4
Switzerland	12
Turkey	165
United Kingdom	1,743

Asia-Pacific	Offices
Australia	33
Bangladesh	7
Brunei Darussalam	13
China	50
Cook Islands	1
Hong Kong Special Administrative Region	357
India	61
Indonesia	4
Japan	5
Kazakhstan	1
Korea, Republic of	14
Macau Special Administrative Region	6
Malaysia	42
Maldives	1
New Zealand	9
Pakistan	2
Philippines	23
Singapore	21
Sri Lanka	11
Taiwan	18
Thailand	1
Vietnam	3

Americas	Offices
Argentina	147
Bahamas	6
Bermuda	15
Brazil	1,675
British Virgin Islands	1
Canada	317
Cayman Islands	5
Chile	3
Mexico	1,579
Panama	33
United States of America	1,922
Uruguay	4
Venezuela	1

Middle East and Africa	Offices
Algeria	1
Bahrain	7
Egypt	22
Iran	1
Iraq	13
Israel	4
Jordan	2
Kuwait	1
Lebanon	6
Libya	1
Mauritius	12
Oman	5
Palestinian Autonomous Area	1
Qatar	4
Saudi Arabia	72
South Africa	4
United Arab Emirates	16

Associated companies are included in the network of offices.

HSBC Bank Canada Branches and Subsidiaries*

British Columbia:
Abbotsford
Burnaby (3)
Campbell River
Chilliwack
Coquitlam (2)
Cranbrook
Kamloops
Kelowna (2)
Langley
Maple Ridge
Nanaimo
New Westminster
North Vancouver (2)
Penticton
Port Coquitlam
Prince George
Richmond (4)
Surrey (3)
Vancouver (16)
Vernon
Victoria (3)
West Vancouver
White Rock

Alberta:
Calgary (4)
Edmonton (4)
Lethbridge
Medicine Hat
Red Deer

Saskatchewan:
Regina
Saskatoon

Manitoba:
Winnipeg

Ontario:
Barrie
Brampton
Concord
Etobicoke
Hamilton
Kanata
Kingston
Kitchener
London
Markham (3)
Mississauga (3)
Oakville
Ottawa
Richmond Hill (2)
St. Catharines
Sault Ste. Marie
Scarborough (2)
Thunder Bay
Timmins
Toronto (13)
Unionville
Vaughan
Whitby
Willowdale
Windsor
Woodbridge

Quebec:
Brossard
Chicoutimi
Laval
Longueuil
Montreal (4)
Pointe-Claire
Quebec City
Saint Leonard (2)
Sherbrooke
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HSBC Investments (Canada) Limited
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HSBC Trust Company (Canada)
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For more information, or to find the HSBC Bank Canada branch nearest you, call 1 (800) 310-4722 or visit our website: hsbc.ca

**All information on pages 74 and 75 is at March 6, 2006.*

Management*

EXECUTIVE COMMITTEE

Lindsay Gordon
President and
Chief Executive Officer
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Notes

Form number 1040146 (03/06). Published by Public Affairs Department, HSBC Bank Canada, Vancouver.

Designed by Signals Design Group Inc. Vancouver, Canada.

Printed by Metropolitan Fine Printers, Vancouver, Canada on Mega Paper. Made in Germany, the paper comprises 50% recycled and de-inked fibres from pre- and post-consumer waste, and 50% virgin fibre. Pulps used are totally chlorine free.

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