2006

Annual Report and Accounts
HSBC Bank Canada

The world's local bank

HSBC

Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 170 offices and is the leading international bank in Canada. With around 10,000 offices in 82 countries and territories and assets of US$1,861 billion at 31 December 2006, the HSBC Group is one of the world's largest banking and financial services organizations.

Shareholder Information

PRINCIPAL ADDRESSES:

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WEBSITE:

hsbc.ca

HSBC BANK CANADA SECURITIES ARE LISTED ON THE TORONTO STOCK EXCHANGE:

HSBC Bank Canada
Class 1 Preferred Shares – Series C
(HSB.PR.C)
Class 1 Preferred Shares – Series D
(HSB.PR.D)

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

TRANSFER AGENT AND REGISTRAR:

Computershare Investor Services Inc.
Shareholder Service Department
9th Floor, 100 University Avenue
Toronto, Ontario
Canada M5J 2Y1
Tel: 1 (800) 564-6253
Fax: 1 (888) 453-0330

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:

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

Shareholder Relations:
Chris Young (604) 641-1976
Santokh Birk (604) 641-1918

Dividend record and payable dates in 2007 for our preferred shares, subject to approval by our Board of Directors, are:

Record Date	*Payable Date*
March 15	March 31
June 15	June 30
September 14	September 30
December 14	December 31

Distribution dates on our HSBC HaTS™ are June 30 and December 31.

Designation of Eligible Dividends
For the purposes of the Income Tax Act, Canada, and any similar provincial legislation, HSBC Bank Canada advises that all of its dividends paid in 2006 are eligible dividends and all dividends paid hereafter will be eligible dividends unless indicated otherwise.

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Message from the President and Chief Executive Officer

Looking back at 2006, our results reflect good momentum in the growth of our various lines of business.

In 2006, we began a significant expansion of our branch network in the Greater Toronto Area and in Alberta, moving a number of branches to better locations and opening five of the 30 new branches we expect to open in the next two years. We also provided additional convenience for our customers by adding the ability to make surcharge free deposits at BMO Bank of Montreal Automated Banking Machines (ABMs).

We improved our product offering by adding multi-currency corporate liquidity solutions through HSBC Investments (Canada) Limited and along with our US and Mexican colleagues, launched a NAFTA payments and cash management service for corporate customers. We launched an On-line Savings and a High Rate Savings Account for our personal financial services customers and significantly upgraded HSBC InvestDirect. We also increased our HSBC brand awareness activities and plan to continue this in 2007.

As we celebrated our 25th anniversary in 2006 we were very proud to see our results recognized in several important ways. In October, Standard & Poor's Ratings Services ("S&P") raised its counterparty credit rating on HSBC Bank Canada to 'AA'. This upgrade is a reflection of the quality and success of our business in Canada and followed S&P's revision of our status to a core holding within the HSBC Group based on our growing integration with and increasing contribution to the HSBC Group.

Engaged employees result in engaged customers, which in turn leads to sustainable growth of our company. We were particularly pleased to be selected as one of *The Financial Post's* "10 Best Companies to Work For" and one of MediaCorp's "Canada's Top 100 Employers" as published in *Maclean's Magazine* recognizing our commitment to programs that allow our employees to find a good balance between work and life and the present and future. To assist them in achieving balance we offer training and career development, and flexible benefits packages and working arrangements.

With HSBC Bank Canada having been recognized as a top employer, I would be remiss if I did not recognize the thousands of employees across Canada who deliver excellent customer service as our business grows and changes. I am inspired by the enthusiasm and dedication they show in serving our existing and new customers.

Lindsay Gordon
President and Chief Executive Officer

January 31, 2007
Vancouver, Canada

Management's Discussion and Analysis

Five Year Financial Summary

(in $ millions, except where stated)	Years Ended December 31				
	2006	2005	2004[1]	2003[1]	2002
Condensed statements of income					
Net interest income	$ **1,115**	$ 1,010	$ 896	$ 865	$ 855
Non-interest revenue	**651**	570	526	443	425
Total revenue	**1,766**	1,580	1,422	1,308	1,280
Non-interest expenses					
Salaries and employee benefits	**503**	442	423	379	331
Premises and equipment[2]	**116**	107	101	107	105
Other[3]	**287**	275	272	259	277
Total non-interest expenses	**906**	824	796	745	713
Net operating income before provision for credit losses	**860**	756	626	563	567
Provision for credit losses	**34**	27	66	61	127
Income before the undernoted	**826**	729	560	502	440
Effect of accounting change	**–**	–	14	–	–
Income before taxes	**826**	729	574	502	440
Provision for income taxes	**285**	237	210	188	164
Non-controlling interest in income of trust	**26**	22	16	16	16
Income from continuing operations	**515**	470	348	298	260
Income from discontinued operations	**–**	–	5	2	–
Net income	$ **515**	$ 470	$ 353	$ 300	$ 260
Preferred share dividends	**18**	13	8	8	8
Net income attributable to common shares	$ **497**	$ 457	$ 345	$ 292	$ 252
Basic earnings per common share ($)[4]	**1.02**	0.94	0.72	0.62	0.55
Financial ratios (%)[5]					
Return on average common equity	**21.1**	21.3	18.3	18.7	16.4
Return on average total assets	**0.91**	0.97	0.85	0.80	0.72
Net interest margin	**2.33**	2.37	2.49	2.66	2.79
Non-interest revenue:total revenue ratio	**36.9**	36.1	37.0	33.9	33.2
Cost efficiency ratio	**51.3**	52.2	56.0	57.0	55.7
Credit information					
Impaired credit facilities	**177**	151	182	203	225
Allowance for credit losses					
Balance at end of period	**327**	326	349	313	311
As a percentage of impaired credit facilities (%)	**185**	216	192	154	138
As a percentage of loans outstanding (%)	**0.92**	1.01	1.22	1.24	1.29
Average Balances[5]					
Assets	$ **54,118**	$ 47,282	$ 40,421	$ 36,635	$ 34,828
Loans	**33,659**	30,678	26,922	24,543	22,976
Deposits	**41,904**	37,340	30,823	29,041	27,842
Common equity	**2,360**	2,150	1,886	1,563	1,538
Balance sheet highlights					
Total assets	**56,770**	49,210	43,263	37,509	35,189
Total loans and acceptances, net of allowance for credit losses	**40,366**	35,846	32,073	28,180	26,243
Business and government loans	**17,819**	15,571	13,450	11,664	11,949
Residential mortgage loans	**14,016**	12,865	11,966	10,880	9,809
Total deposits	**44,173**	38,608	33,848	29,339	28,372
Deposits from individuals	**17,039**	15,300	14,818	13,924	14,432
Shareholders' equity	**2,868**	2,596	2,197	1,819	1,673
Risk-based capital ratios (%)[6]					
Tier 1 capital	**9.0**	9.0	8.6	8.4	8.4
Total capital	**11.1**	11.2	11.0	11.1	11.4
Funds under management	$ **23,340**	$ 20,453	$ 17,687	$ 14,323	$ 11,888
Custodial accounts	**8,574**	7,594	5,077	4,409	3,208
Total assets under administration	$ **31,914**	$ 28,047	$ 22,764	$ 18,732	$ 15,096

(1) *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) *Basic earnings per common share is not materially different from basic earnings per common share from continuing operations.*
(5) *These are non-GAAP amounts or non-GAAP measures. Please refer to the discussion outlining the use of non-GAAP measures in this document on page 3.*
(6) *Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada.*

Management's discussion and analysis ("MD&A") is dated February 15, 2007, the date that our consolidated financial statements and MD&A for the year ended December 31, 2006 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, which also includes a number of GAAP and non-GAAP measures. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP may not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other issuers. The following outlines various GAAP or non-GAAP measures which management regularly monitors, to more clearly indicate the derivation of the measure:

- *Return on average common equity* – Calculated as net income attributable to common shares divided by average common equity.
- *Return on average assets* – Calculated as net income attributable to common shares divided by average assets.
- *Net interest margin* – Calculated as net interest income divided by average interest earning assets.
- *Cost efficiency ratio* – Calculated as non-interest expenses divided by total revenue.
- *Non-interest revenue:total revenue ratio* – Calculated as non-interest revenue divided by total revenue.
- *Average balances* – Average assets, average interest earning assets, loans, and deposits are calculated using daily average balances for the year. Average common equity is calculated using month end balances of common equity for the year.

We make a number of references throughout this MD&A to "notes" which means notes to the 2006 audited consolidated financial statements, which are included with the MD&A in our annual report.

Other available information. We file all of our news releases regarding material matters, interim and annual consolidated financial statements, interim and annual MD&A, annual reports, Annual Information Form, as well as certifications by our Chief Executive Officer and Chief Financial Officer, with SEDAR. Copies of these documents can be obtained from SEDAR's website: sedar.com.

Outstanding securities data. Note 11 on page 52 contains details of the number of preferred and common shares issued and outstanding at December 31, 2006. Note 9 on page 50 contains details of the number of HSBC Canada Asset Trust Securities ("HSBC HaTS™") outstanding at December 31, 2006. Subsequent to that date and up to the date of this MD&A, there have been no issues of any form of 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 our net interest margin may arise from actions taken by individual banks or other financial institutions 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.

Management's Discussion and Analysis (continued)

Overview

In Canada, we are the largest full-service, internationally owned bank and the seventh largest bank overall with operations across the country and total assets of more than $56 billion as at December 31, 2006.

Originally established in 1981 with our head office located in Vancouver, British Columbia, we have grown organically and through strategic acquisitions, to become an integrated financial services organization. With more than 170 offices across Canada, including 127 branches, we provide personal and commercial banking services, corporate, investment banking and market services, retail brokerage, wealth management, and personal trust services.

Customers are able to conduct their business conveniently through our branch network, automated banking machines, direct debit and credit cards, internet banking, and telephone call centres.

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 customers have access to the worldwide resources of the HSBC Group. Known as "The world's local bank", the HSBC Group is one of the largest banking and financial services organizations in the world, with an international network of around 10,000 offices in 82 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, 2006 HSBC Holdings' market capitalization was US$212 billion.

Through an international network linked by advanced technology, including a rapidly growing e-commerce capability, the HSBC Group provides a comprehensive range of financial services: personal financial services, including 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 2006 *Annual Review* and *Annual Report and Accounts.*

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 sales and service excellence and HSBC's worldwide network of offices to serve our customers and expand our market share in Canada. Our strategy has the following key 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 our customers' needs. We 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 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 focus on operating efficiently to make the customer experience as seamless as possible. This also allows our staff to spend more time on customer relationship management and maximizing sales opportunities.

Credit quality – Maintain credit quality and understand our role in managing losses – We have an excellent record for managing credit losses as a result of our conservative credit culture, which we enhance through training and investment in technology.

People – Attract, retain and reward our top performers – We focus 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 ensure that all of our employees are engaged in their responsibilities and that they understand how they can contribute to the successful achievement of our objectives.

Customer Groups

We manage and report our operations around 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 integrated service ensuring customer needs are met across products, subsidiaries, and internationally through the HSBC Group's worldwide network.

Personal Financial Services provides individual and self-employed customers with a wide range of banking and related financial services. Products provided include current and savings accounts, mortgages and personal loans, credit cards, and local and international payment services. We also make available a wide range of wealth management products and services through our branches and our wealth management businesses, HSBC Securities (Canada) Inc., HSBC Investments (Canada) Limited, and HSBC Trust Company (Canada).

Commercial Banking provides financial services and products to small, medium-sized and middle market businesses, including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly traded companies. In addition to direct lending, our range of products and services includes payments and cash management, treasury and capital markets, investment and merchant banking, wealth management services, trade services and leasing. Of particular relevance to Canadian businesses is the HSBC Group's extensive network in the NAFTA countries, South America, Europe and Asia. We provide these 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 the HSBC Group's worldwide network.

Corporate, Investment Banking and Markets ("CIBM") serves Canadian and international corporates, institutions and governments that require both domestic and international financial services. CIBM provides a comprehensive range of financial services including treasury and capital markets services, raising public and private capital, corporate finance and advisory services, direct lending, leasing finance and deposit-taking. We also offer payments and cash management and trade services. We provide CIBM services through our principal branches and subsidiary offices, coordinated with the HSBC Group's worldwide operations through one relationship manager. 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.

Our affiliate, HSBC Financial Corporation Limited ("HSBC Finance"), delivers consumer finance products and solutions to Canadians through more than 130 offices located across Canada. We work collectively with HSBC Finance to deliver products and services to our mutual customers.

Management's Discussion and Analysis (continued)

Highlights For 2006

2006 was another successful year for us as we continued to execute our strategy to build our business in Canada. Particularly noteworthy accomplishments included:

Continued growth in our core businesses – We continued to see strong growth in our core commercial, personal and CIBM businesses in 2006. Commercial loans and bankers' acceptances were up 16.5%, personal loans were up 15.3% (before securitization), residential mortgages were up 7.9% (before securitization), funds under management were 14.1% higher, and core deposits were up 16.2%. Total revenue grew by 11.8% over 2005 and net income was 9.6% higher.

Efficiency – We continued initiatives aimed at optimizing the overall cost structure of the organization through a combination of process efficiency, risk-based elimination of low value activities and use of HSBC Group Service Centres. Our cost efficiency ratio decreased to 51.3% compared with 52.2% in 2005.

Direct and alternate channels – We successfully launched Online Savings and High Rate Savings accounts which helped grow total personal deposits. Our Online Savings Account is priced to match other online competitors and was developed to meet the needs of online customers exclusively, driving differentiated pricing for self serve only products, with our High Rate Savings Account ("HRSA") competing with similar branch based products.

Building HSBC's brand value in Canada – HSBC is one of the fastest growing global brands and increased its ranking to 28th on the *BusinessWeek*/Interbrand Annual Ranking of the 2006 Best Global Brands. Building on the five HSBC brand values (progressive, perceptive, responsive, respectful and fair), we continued HSBC Group's "yourpointofview.com" campaign in Canada, which stresses the importance of valuing different points of view. Results of Brand Tracker research indicated strong impact in the Toronto market, with advertising recall, brand awareness and consideration improving sharply from two years ago and the brand seen as newer and more differentiated in the Greater Toronto Area.

Credit ratings – DBRS (formerly Dominion Bond Rating Service) upgraded its ratings of our short and long term deposits from R-1(mid) and AA(low) to R-1(high) and AA, respectively reflecting the implementation of a new support assessment methodology for banks and strengthening of the financial services industry in general in Canada. Following their revision of our status to a core holding within the HSBC Group, Standard & Poor's ("S&P") raised its counterparty credit rating on HSBC to AA putting our credit ratings on par with or better than the domestic Canadian banks for the first time in our history.

Employer of choice – HSBC was selected as one of the "*Financial Post*'s 10 Best Companies to Work For (2007)" in Canada. Companies selected are business success stories drawn from MediaCorp's "Canada's Top 100 Employers" list, and combine first-class human resources practices with remarkable business growth, to offer excellent career prospects and advancement opportunities.

Payments and Cash Management ("PCM") – We realized significant returns on our people and product investments, winning key Canadian, NAFTA and global mandates. In addition, we expanded our customer service offerings with a dedicated PCM Service Centre launched to provide support to commercial banking customers and branches through Commercial e-Banking and Branch Resource Centre. In addition, a Gold Service team was established to deliver dedicated, one-stop service to CIBM and globally managed commercial customers.

Credit performance – We continue to enjoy exceptionally strong credit performance with total net new specific provisions comprising only 0.10% of the total loan portfolio, the same as 2005. We also continue to make significant investments in retail credit scoring systems and in ensuring our ability to meet the requirements of the new Basel II capital adequacy framework.

Community involvement – We have a long-standing tradition of community participation through sponsorships and charitable donations. This year we continued many established sponsorships and began a new sponsorship of the Calgary Flames National Hockey League team. We also made direct donations of funds and encouraged employees to support registered charities in Canada, with a focus on organizations that support education and the environment. To learn more about our community involvement, see our annual publication, *HSBC Bank Canada in the Community*, available from our website: hsbc.ca.

Enhanced ABM strategic alliance – We expanded our alliance with BMO Financial Group by introducing a surcharge-free deposit capability using ABMs at BMO Bank of Montreal locations. Together with our existing ABM network, this provides our customers with surcharge free withdrawal and deposit access to one of the largest ABM networks in Canada.

Outlook For 2007

Global growth is expected to continue as the economies of Europe and Japan continue to accelerate. For Canada, the US economy remains the key, although globalization continues to hold challenges with the rise of China and India as competitive forces. The economic slowdown in the second half of 2006 is expected to lead to lower growth in the first half of 2007 given the loss in economic momentum. We look for Canada's prospects to pick up in the second half of the year as the economy moves toward trend like growth just slightly below 3%. Retail and business domestic demand in Canada is expected to remain robust, supported by solid employment growth over the course of 2007 and high levels of corporate profitability. Although the housing and real estate market is expected to moderate, the strength of previous market activity will continue to positively influence consumer demand. However, there may be some impact on the western provinces from weaker prices for energy and commodities.

After having posted a 28-year high against the US dollar in 2006, the trend on the currency has turned and will benefit central Canada and exporters generally, although trade volumes are still dependent upon US economic growth. Inflation remains an issue with core prices running above the Bank of Canada's 2% target despite a well-documented deceleration in economic activity. A weaker Canadian dollar also provides an element of inflation risk through higher import prices. Against this pricing backdrop and the potential for an economic recovery in the second half of the year, the Bank of Canada is expected to leave central bank rates largely unchanged for the balance of 2007.

We anticipate 2007 to be a continuation of the extremely competitive environment for both our personal and commercial businesses, with the possibility that lending, and personal borrowing growth in particular, will moderate as a result of fully valued real estate markets and a slower US economy. However, with our strong presence in Western Canada, as well as an increasing footprint in the Greater Toronto Area, we are well positioned to benefit from the anticipated recovery in the second half of 2007.

Our Focus For 2007

During 2007 we will continue to grow our business in Canada by focusing on the following:

Service excellence – We aim to offer an improved and consistent customer service proposition tied to management objectives and will aggressively roll out the Active Sales Leadership Program to our relationship managers, given excellent 2006 sales program results. By better utilizing our enhanced data analytics group we expect to segment target markets more accurately; specifically, we want to be recognized as the leading global private banking proposition in Canada. A new leads management initiative will support the sales drive across branch, direct mail and the direct bank channels. We aim to simplify the sales processes of anchor products while improving customer service in both the sales and service managed segments.

Invest in the HSBC brand – We will continue to invest in the HSBC brand, positioning HSBC as Canada's leading full service "challenger" brand, while at the same time leveraging HSBC's status as one of the fastest growing global brands and its ranking as the second most recognized brand in the financial services industry.

Best place to work – Leveraging off of our external recognition as an 'Employer of Choice' we will enhance recruitment initiatives and engage employees while tying management performance more closely to our annual employee engagement surveys.

Global advantage – We will continue to look for opportunities to leverage the HSBC Group in our *Premier* offering, integrate with HSBC Group Private Banking, lead in the commercial banking international business arena and continue to leverage the CIBM global platform. In North America, we expect to continue to see benefits from strategic investments in call centres, e-commerce, and customer service and data centres.

Building for sustained growth – We plan to continue investing in the Greater Toronto Area, Alberta and British Columbia branch networks, and will enhance our direct bank offering. We aim to roll out new products in payments and cash management, building upon the new product and people investments made in 2006. We aim to have better synergy and cross-sell between HSBC entities following investments in wealth management systems, data analytics/leads management, and customer relationship management capabilities.

Management's Discussion and Analysis (continued)

Business transformation – We will continue to re-engineer our business, particularly Personal Financial Services, by reallocating resources to areas of higher economic value through better client segmentation, giving clients improved access directly and conveniently to our products and services. We will increase our efficiency, accelerate use of HSBC Group Service Centres, increase technology spending, and expand straight through processing capabilities.

Analysis of Financial Results For 2006

Highlights

— Net income attributable to common shares was $497 million for the year ended December 31, 2006, an increase of 8.8% over the year ended December 31, 2005.

— Return on average common equity was 21.1% for the year ended December 31, 2006 compared with 21.3% for 2005.

— The cost efficiency ratio was 51.3% for the year ended December 31, 2006 compared with 52.2% for 2005.

— Total assets were $56.8 billion at December 31, 2006, an increase of $7.6 billion, or 15.4%, from $49.2 billion at December 31, 2005.

— Total funds under management were $31.9 billion at December 31, 2006, an increase of $3.9 billion, or 13.9%, from $28.0 billion at December 31, 2005.

We recorded net income attributable to common shares of $497 million for the year ended December 31, 2006, an increase of $40 million, or 8.8%, from $457 million for 2005. Excluding the effect of a recovery of $14 million in our general allowance for credit losses in 2005 and the related income tax effect, the increase would have been 10.9%. The results for the year were good, reflecting strong growth in our commercial banking business and good momentum in our wealth management businesses. Net interest income was higher from strong loan growth, despite a competitive pricing environment. Non-interest revenues were higher on increased investment administration fees, higher credit fees and higher investment gains. Although we continued to invest in our businesses, the increase in our revenues exceeded the increase in the total non-interest expenses, resulting in an improved efficiency ratio.

Net interest income

Net interest income for the year ended December 31, 2006 was $1,115 million, an increase of $105 million, or 10.4%, from $1,010 million for 2005. This was driven by growth in the balance sheet across all customer groups, partially offset by lower net interest margins due to the competitive pricing environment. Corporate and commercial lending grew as Canadian customers continued to invest heavily in developing their businesses. Consumer spending remained strong, driving personal lending and residential mortgage borrowing continued to grow. Average deposits grew due to the success of new products, such as our HRSA and enhanced services created by our Payments and Cash Management business. Average interest earning assets were $47.9 billion for 2006 compared with $42.6 billion for 2005. Although prime rates increased during the year, net interest margins as a percentage of interest earning assets decreased from 2.37% in 2005 to 2.33% in 2006. This was primarily as a result of competitive pricing, particularly in personal products such as residential mortgages and deposits.

Non-interest revenue

For the year ended December 31, 2006, non-interest revenue was $651 million, $81 million or 14.2% higher, compared with 2005. Increased investment administration fees resulted from the success of our Private Client products and services helping to grow personal funds under management, which also benefited from increases in equity markets. The volatility in the exchange rate between the Canadian and US dollars during 2006 resulted in higher trading and foreign exchange revenues. Higher securitization income resulted from increased recurring income from previous securitizations, increased gains on sales as well as the impact in 2005 of a life-to-date write down of the retained interests of previous securitizations. We also benefited from higher credit fees resulting from increased customer activity particularly in acceptance and standby fees, higher Global Investment Banking revenues and higher gains on our investments in private equity funds. These were partially offset by lower Immigrant Investor Program fees, which are dependant on the timing and approvals from government agencies.

Non-interest expenses and operating efficiency

For the year ended December 31, 2006, non-interest expenses were $906 million, an increase of $82 million, or 10.0%, compared with $824 million for 2005. Salaries and benefits expenses were $61 million higher due to a larger work force to fulfill strategic growth initiatives, increased incentive compensation resulting from higher revenues and higher stock based compensation due to an $8 million charge, arising from the waiver of the total shareholders return-related performance condition in respect of the 2003 awards under the HSBC Holdings Group Share Option Plan. These were partially offset by the capitalization of costs related to internally developed software in the fourth quarter of 2006.

Premises and equipment expenses were $116 million, an increase of $9 million compared to 2005. This was almost entirely due to an expense of $8 million recorded in the fourth quarter of 2006 relating to a change in the estimated useful life of improvements made to leased properties.

Other expenses of $287 million were $12 million higher due to increased marketing spend on further developing the HSBC brand and a higher business tax expense due to a recovery in 2005 on the successful resolution of certain commodity tax issues. These were partially offset by lower deposit guarantee fee expense due to the discontinuation of the HSBC Group's guarantee on new deposits subsequent to June 2005.

Although we continued to invest in our business, total revenue growth of 11.8% exceeded expense growth of 10.0% resulting in an increase in operating efficiency to 51.3 % compared to 52.2% in 2005.

Income taxes

The effective income tax rate for the year ended December 31, 2006 was 35.6%, compared with 33.5% in 2005. The effective rate was lower in 2005 due to benefits from changes in the net realizable value of certain future income tax assets and the resolution of the amount deductible as a deposit guarantee fee expense for certain years. Also, lower corporate income tax rates enacted by the federal government budget in 2006 resulted in a write down of our future income tax asset and the expense relating to the 2003 option awards for stock based compensation recognized in 2006 is not deductible for tax thereby increasing the 2006 effective income tax rate.

Credit quality and provision for credit losses

For the year ended December 31, 2006, the provision for credit losses was $34 million, compared with $27 million for 2005, which benefited from a $14 million fourth quarter release of general provisions. Gross impaired loans increased to $164 million at December 31, 2006 compared with $130 million at December 31, 2005. Total impaired loans, net of specific allowances for credit losses, were $106 million at December 31, 2006 compared with $73 million at December 31, 2005. The total allowance for credit losses, as a percentage of loans outstanding was 0.92% at December 31, 2006 compared with 1.01% at December 31, 2005.

Balance sheet

Total assets at December 31, 2006 were $56.8 billion, an increase of $7.6 billion from $49.2 billion at December 31, 2005. Strong economic conditions helped spur growth in commercial loans and deposits. Commercial loans and bankers' acceptances increased $3.3 billion in total to $22.9 billion at December 31, 2006 compared with $19.6 billion at December 31, 2005. Continued strength in the housing market across Canada and the strong economy helped residential mortgages and consumer loans to increase $1.1 billion to $17.7 billion at December 31, 2006 compared with $16.6 billion at December 31, 2005. Increased trading and balance sheet management activity increased assets purchased under reverse repurchase agreements by $3.0 billion at December 31, 2006 compared with December 31, 2005 while cash resources decreased by $1.2 billion.

Total deposits at December 31, 2006 were $44.2 billion, an increase of $5.6 billion from $38.6 billion at December 31, 2005. Launch of our HRSA and growth of our wealth management businesses helped increase deposits from individuals to $17.0 billion at December 31, 2006 from $15.3 billion at the same time last year. Investments in our payments and cash management services contributed to a $4.4 billion increase in commercial deposits to $25.7 billion at December 31, 2006. As a result of the growth in core customer deposits, less reliance was placed on deposits from other banks, which decreased to $1.5 billion at December 31, 2006 from $2.0 billion at December 31, 2005.

Management's Discussion and Analysis (continued)

Total assets under administration

Funds under management were $23.3 billion at December 31, 2006 compared with $20.5 billion at December 31, 2005. Including custody and administration balances, total assets under administration were $31.9 billion at December 31, 2006 compared with $28.0 billion at December 31, 2005.

Growth in funds under management during 2006 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 strongly in 2006.

Quarterly Summary of Condensed Statements of Income

	2006				2005			
	Quarter ended				Quarter ended			
	Dec. 31	***Sept. 30***	***June 30***	***March 31***	*Dec. 31*	*Sept. 30*	*June 30*	*March 31*
				(Unaudited)				
Net interest income	**$ 291**	**$ 282**	**$ 276**	**$ 266**	$ 269	$ 261	$ 243	$ 237
Non-interest revenue	**168**	**160**	**167**	**156**	141	145	140	144
Total revenue	**459**	**442**	**443**	**422**	410	406	383	381
Non-interest expenses	**236**	**213**	**233**	**224**	205	208	209	202
Net operating income before provision for credit losses	**223**	**229**	**210**	**198**	205	198	174	179
Provision for credit losses	**17**	**5**	**6**	**6**	6	7	6	8
Income before taxes	**206**	**224**	**204**	**192**	199	191	168	171
Provision for income taxes	**66**	**76**	**78**	**65**	58	67	55	57
Non-controlling interest in income of trust	**7**	**6**	**6**	**7**	6	7	5	4
Net income	**$ 133**	**$ 142**	**$ 120**	**$ 120**	$ 135	$ 117	$ 108	$ 110
Preferred share dividends	**5**	**4**	**5**	**4**	3	4	4	2
Net income attributable to common shares	**$ 128**	**$ 138**	**$ 115**	**$ 116**	$ 132	$ 113	$ 104	$ 108
Basic earnings per share ($)	**0.26**	**0.28**	**0.24**	**0.24**	0.27	0.23	0.21	0.22

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 retirement planning activity in Canada. Other seasonal factors have a minor impact on our results in most quarters. The first quarter has the fewest number of days, and therefore net interest income is lower compared with the other three quarters. The second and third quarters generally have lower capital market revenues, as market activity is slower than in the first and fourth quarters.

Strong economic conditions over the past eight quarters have impacted our businesses favourably. The low, but rising, interest rate environment, and higher consumer and business spending has resulted in growth in our loans and deposits. Additionally, this has benefited our wealth management businesses. The favourable economic conditions, along with our risk management efforts, have positively impacted our loan portfolio, which has resulted in relatively low loan losses each quarter.

Competitive factors have increased over the eight quarters, resulting in spread compression in loan and deposit products, particularly in Personal Financial Services.

Over the last eight quarters, our business has been affected by a number of favourable and unfavourable items. In the second quarter of 2006, we recorded an incremental expense relating to an increase in the fair value of stock options issued in 2003, and a write-down of our future income tax assets. In that same quarter, we recorded a significant gain on our investment in private equity funds. In the fourth quarter of 2005, resolution of the tax deductibility of our guarantee expense reduced non-interest expenses and income taxes. In the first quarter of 2005, non-interest expenses were lower as a result of the successful resolution of certain commodity tax issues from previous years.

Analysis of performance for the fourth quarter 2006

Net income attributable to common shares for the quarter ended December 31, 2006 was $128 million, a decrease of $4 million, or 3%, compared with $132 million for the same period in 2005. The fourth quarter of 2005 included a recovery of $14 million in our general allowance for credit losses and a one-time reduction of $14 million in deposit guarantee fees following a transfer pricing settlement with the Canada Revenue Agency. Excluding the impact of these items and the related income tax effects, net income attributable to common shares for the fourth quarter of 2006 was 19.6% higher than the same quarter in 2005.

Net interest income for the fourth quarter of 2006 was $291 million, an increase of $22 million, or 8.2%, from the same quarter in 2005, driven primarily by growth in the balance sheet across all our customer groups. Average interest earning assets were $50.1 billion, compared with $45.2 billion for the fourth quarter of 2005 while net interest margin, as a percentage of average interest earning assets decreased modestly to 2.30% from 2.36%. Net interest income for the fourth quarter of 2006 was $9 million higher than the previous quarter, primarily due to growth in deposits and loans. Average interest earning assets were $1.7 billion higher than the previous quarter. Average deposits were $2.3 billion higher than the previous quarter and average loans were $0.8 billion higher.

Non-interest revenue for the fourth quarter of 2006 was $168 million, $27 million or 19.2% higher, compared with the fourth quarter of 2005. Growth in non-interest revenue benefited from higher investment administration fees as a result of growth in our wealth management businesses as well as an appreciation in equity markets. Higher securitization income, increases in the value of our investments in private equity funds and higher capital markets fees in our Global Investment Banking business also benefited non-interest revenue. Non-interest revenue for the fourth quarter of 2006 was $8 million higher than the previous quarter due to higher capital markets fees and increases in the value of our investments in private equity funds as well as higher securitization income.

Non-interest expenses for the fourth quarter of 2006 were $236 million, an increase of $31 million or 15.1% compared with the fourth quarter of 2005. Excluding the $14 million reduction of deposit guarantee fees made in the fourth quarter of 2005, non-interest expenses increased by 7.8% in the fourth quarter of 2006 compared with the fourth quarter of 2005. Salaries and benefits in the fourth quarter of 2006 increased by $13 million from the same period in 2005 due to an expanding workforce to meet growth initiatives particularly in our wealth management businesses. Also, higher incentive compensation reflected higher revenues. Premises and equipment expenses increased by $7 million primarily due to an $8 million expense related to a change in the estimated useful life of improvements made to leased properties recorded in the fourth quarter of 2006. Deposit guarantee fees to the HSBC Group were higher as a year-to-date reversal of $14 million was recorded in the fourth quarter of 2005 following agreement between various tax authorities relating to a reduction in rate applicable to the HSBC Group's deposit guarantee. Non-interest expenses in the fourth quarter of 2006 were $23 million higher than the previous quarter primarily due to higher premises costs, arising from the change in estimate of the useful life of improvements made to leased properties, and higher marketing expenditure on the HSBC brand.

The effective income tax rate for the fourth quarter of 2006 was 33.2%, compared with 30.0%, for the fourth quarter in 2005. The tax rate in the fourth quarter of 2005 was lower due to a year-to-date expense reduction recorded on the resolution of the amount deductible for deposit guarantee fees for the years 2002 to 2005. The effective income tax rate for the fourth quarter of 2006 decreased by 1.7% from the previous quarter, due to a decrease in certain non-deductible expenses.

The credit environment remained stable in the fourth quarter of 2006 with a low level of corporate default rates. The provision for credit losses in the fourth quarter of 2006 was $17 million compared with $6 million for the same period in 2005 which benefited from a reversal of $14 million of our general allowance for credit losses due to favourable economic conditions. The provision for credit losses for the fourth quarter of 2006 increased by $12 million from the previous quarter largely due to provisions in two specified commercial exposures.

Management's Discussion and Analysis (continued)

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 on pages 38 to 43. 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, particularly in periods where the underlying economic conditions are changing.

We maintain specific allowances for loans that have been identified as currently impaired. We also record a general allowance for those loans that are impaired but have not yet been individually identified as such. The impaired loans and allowances section on pages 26 and 27 of management's discussion and analysis and note 1(g) on page 39 provide further details regarding the estimation of our general allowance.

Employee future benefits

As part of employee compensation, we provide employees with pension and other post-retirement 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 on pages 54 to 56. 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.

Income taxes

In establishing the income tax provision and the amount of the net future income tax asset recorded in our consolidated financial statements, we estimate the rates at which our income will be taxed in a variety of jurisdictions in Canada as well as expectations regarding dates of reversal of temporary differences. If the actual amounts, timing 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 and net future income tax asset are set out in note 14 on page 57.

Goodwill and intangible assets

Annually, we review goodwill and intangible assets for impairment to ensure that the fair values are in excess of book values. 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.

Securitizations and variable interest entities

As part of our liquidity, funding and capital management processes, we pool various types of consumer loans and transfer security interests in these loans to various securitization conduits. These securitizations, which are governed by purchase and sale contracts, are generally conducted through securitization conduits which are 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) on pages 41 and 42. 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 estimated credit losses and transaction costs. This requires us to make assumptions regarding the expected cash flows of the loans securitized, including the amount of credit losses, discount rates and future servicing liabilities. To the extent that cash flows including the impact of credit losses vary from our estimates, adjustments to the carrying value of retained interests may be necessary. On a quarterly basis, we review the carrying value of the retained interests recorded within the consolidated financial statements for impairment. Any impairment is recorded in our consolidated income statement as a reduction of other income.

Our obligations to cover first losses in excess of these estimated 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 loan repayment rates, estimated credit losses and maximum obligations under first loss protection provisions, is set out in notes 3(b) and 3(c) on pages 46 and 47.

Fair values 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 which is revalued daily. Interest income or expense on trading assets or liabilities is recorded in net interest income, with any other changes in the fair values of trading instruments recorded as trading income in our consolidated income statement.

Certain assets purchased for investment purposes and liabilities accepted are included in our banking portfolio. 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. These assets are not revalued to reflect changes in interest or market rates, as the expectation is we will not be trading them, 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 other than on a temporary basis, we will establish a provision in accordance with our accounting policies. Depending on the nature of the instrument, the recorded values of banking book assets or liabilities may be different from their fair values. Information on the fair value of financial instruments is set out in note 16 on pages 59 and 60.

Effective January 1, 2007 we adopted three new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA") relating to financial instruments, hedges and comprehensive income. These standards provide guidance on the recognition, measurement and classification of financial assets, financial liabilities and non-financial derivatives. All financial assets, including derivatives, will be measured at fair value on the consolidated balance sheet with the exception of loans, receivables and investments classified as held to maturity, which will be measured at cost or amortized cost. Unrealized gains and losses, including the impact of changes in foreign exchange rates, arising on financial assets classified as available for sale will be recorded in other comprehensive income. Financial liabilities that are held for trading or are derivatives will be recorded on the consolidated balance sheet at fair value. Other financial liabilities will be recorded at amortized cost.

These new standards also establish the accounting requirements for hedges. Any hedge ineffectiveness will be recognized immediately in income, while any changes in the fair value of effective cash flow hedges will be recorded in other comprehensive income.

Accumulated other comprehensive income ("AOCI") will be included in the consolidated balance sheet as a separate component of shareholders' equity.

Management's Discussion and Analysis (continued)

The changes in carrying value of financial instruments and related deferred balances as a result of initial adoption of these new standards will be recorded as adjustments to opening retained earnings and opening AOCI on January 1, 2007. We estimate that these amounts are not likely to be material to our consolidated balance sheet.

The impact of implementing these new standards on our annual financial results is not yet determinable as it is dependent on our outstanding positions, hedging strategies and market volatility at the time of any transactions. There would be considerable additional cost to fully implement the accounting requirements to adopt hedge accounting for all the hedging we currently undertake. The adoption of hedge accounting impacts the timing of recognition of hedging transactions rather than the absolute amounts. Although there will be no changes in our overall hedging policy, we have chosen to implement a strategy of adopting hedge accounting for only those transactions that are potentially more volatile. Accordingly, there will now be a number of economic hedges where we will not apply hedge accounting. A degree of inter-period volatility may be introduced to our net income resulting from marking to market of hedging derivatives that we no longer qualify for hedge accounting treatment.

The tax consequences, if any, of the new standards on the transition or subsequent accounting for financial instruments are unknown. The tax authorities are currently reviewing the new standards to determine their implications for tax purposes. However, any changes are more likely to affect the timing of tax payments rather than the absolute amount of income taxes paid. This would be reflected in reclassification of amounts between current and future income taxes.

Investments held in investment companies are recorded at fair values. 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. Changes in the fair value of these investments are recorded in our consolidated income statement as other income.

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 24 and 25, and as set out in note 15(a) on page 58.

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 counter-parties 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 internal control procedures as set out in our risk management discussion on pages 19 to 27.

Our existing accounting policies on recording the impact of derivatives are set out in note 1(o) on page 41. Information on our derivative instruments is set out in note 17 on pages 61 to 65. As noted above, effective January 1, 2007, we will be adopting new CICA standards relating to accounting for financial instruments including derivatives.

Controls and Procedures

Management's responsibility for financial information contained in our annual report is set out on page 32. In addition, the Audit Committee of our Board of Directors and our Board of Directors 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 our various stakeholders.

As at December 31, 2006, we 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 our 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.

Internal control over financial reporting is a process for providing reasonable assurance regarding the reliability of financial reporting and preparation of our consolidated financial statements in accordance with Canadian GAAP. However, because of inherent limitations in all control systems, absolute assurance cannot be provided that all misstatements have been detected. As at December 31, 2006, an evaluation was carried out of the design of internal controls over financial reporting. Based on that evaluation, the CEO and CFO have concluded that the design of internal controls over financial reporting was effective.

There were no changes in internal controls over financial reporting that occurred during the year ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

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 technology platforms used around the world and benefit from worldwide contracts for advertising, 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 ensure compliance 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 2006, the total amount we paid to other HSBC Group companies in respect of these transactions was $68 million (2005 – $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 20 on page 69.

Management's Discussion and Analysis (continued)

Capital Management

We have 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 policies lay out a strict regime of capital monitoring, targets, limits and maintenance actions. We manage our financial 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. 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 CFO and includes the CEO, Chief Operating Officer, and our senior executives responsible for credit, risk management, marketing and sales, and treasury. Positions and limits are monitored by its sub committee, Tactical ALCO ("TALCO") committee, in intervening weeks. TALCO is also chaired by our CFO and includes members responsible for finance, treasury and marketing.

We use 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 classes is determined according to the various specific risk weighting factors provided by the Office of the Superintendent of Financial Institutions Canada ("OSFI") capital adequacy guidelines. We use a variety of capital management techniques in order to maximize shareholder value against the fundamental need to be prudently capitalized.

OSFI regulates capital adequacy for Canadian federally incorporated financial institutions. Current capital adequacy guidelines issued by OSFI are based upon the Basel I recommendations for capital adequacy standards introduced in 1988 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 (as a percentage of risk-weighted assets), respectively, OSFI recommends Canadian banks maintain minimum Tier 1 and total capital ratios of 7% and 10%, respectively.

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of a bank, comprising common shareholder's 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 11.1% at December 31, 2006. This compares with 9.0% and 11.2%, respectively, at December 31, 2005.

The Canada Deposit Insurance Corporation ("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 OSFI'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, 2006, our multiple was 14.6 times.

The BIS has finalized new standards for capital adequacy in the Basel II capital adequacy framework that are expected to be effective January 1, 2008. OSFI has endorsed these guidelines for Canadian federally-regulated financial institutions. This new framework will have a significant impact on banks, as it requires a more comprehensive risk management framework and requires capital to be held to cover operational, market and credit risks. In addition, the calculation of risk-weighted assets will be considerably more complex than the current framework.

We are implementing Basel II in accordance with OSFI's guidance and timelines. We will adopt an Advanced Internal Ratings Based Approach for credit risk regulatory capital calculations and the Standardized Approach for operational risk capital calculations. We have an integrated enterprise-wide program for managing the implementation of Basel II. 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 23. Leadership and oversight are provided by an executive steering committee, as well as by the HSBC Group.

Regulatory capital ratios

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

	2006	2005
Tier 1 capital		
Common shares	**$ 1,125**	$ 1,125
Contributed surplus	**202**	187
Retained earnings	**1,191**	934
Non-cumulative preferred shares[1]	**350**	314
Non-controlling interests in trust and subsidiary[2]	**430**	430
Goodwill	**(15)**	(15)
Total Tier 1 capital	**3,283**	2,975
Tier 2 capital		
Non-cumulative preferred shares	**–**	36
Subordinated debentures (net of regulatory amortization)	**563**	423
General allowance for losses	**269**	269
Total Tier 2 capital	**832**	728
Total Tier 1 and Tier 2 capital	**4,115**	3,703
Securitization-related deductions	**(52)**	(33)
Total capital available for regulatory purposes	**$ 4,063**	$ 3,670
Total risk-weighted assets	**$ 36,606**	$ 32,928
Regulatory capital ratios		
Tier 1 capital	**9.0%**	9.0%
Total capital	**11.1%**	11.2%
Assets to capital multiple	**14.6x**	14.2x

(1) *Represents $175 million in each of Series C and Series D preferred shares.*
(2) *Includes $400 million of HSBC HaTS™.*

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 OSFI's capital adequacy guidelines. Our risk-weighted assets are as follows:

	2006	2005
On-balance sheet assets		
Cash resources	**$ 921**	$ 1,176
Securities	**513**	410
Residential mortgages	**6,312**	5,821
Other loans	**19,105**	17,061
Acceptances	**5,130**	4,002
Other assets	**934**	887
Total on-balance sheet assets	**32,915**	29,357
Off-balance sheet instruments		
Guarantees and letters of credit	**1,716**	1,870
Other	**1,642**	1,522
Subtotal	**3,358**	3,392
Derivatives (at risk-weighted equivalents)	**333**	179
Total off-balance sheet instruments	**3,691**	3,571
Total risk-weighted assets	**$ 36,606**	$ 32,928

Management's Discussion and Analysis (continued)

Regulatory capital generation

We generated regulatory capital in 2006 through the following sources:

	2006	2005
Internally generated capital		
Net income	**$ 515**	$ 470
Dividends	**(258)**	(343)
General allowance for credit losses	**–**	24
Other	**(4)**	36
	253	187
External financing		
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)	**140**	(3)
Total increase in regulatory capital	**$ 393**	$ 602

In addition to internally generated capital, we issue subordinated debentures, preferred shares, and asset trust securities. These sources of external capital may either be through private placements or through public capital markets. We have also issued common shares and subordinated debentures to the HSBC Group.

In 2006, we issued $200 million in 4.94% series C subordinated debentures 2021 and redeemed $60 million in 7.70% debentures 2011. 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. In 2005, we also issued $200 million in HSBC HaTS™ – 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 at par for $125 million in cash.

In 2007, we expect to generate sufficient capital either through further capital issues or through operations to support our business and capital requirements.

Dividends per share on our preferred shares and distributions per unit on our HSBC HaTS™ were as follows:

	2006	2005	2004
	$	$	$
Preferred Shares Class 1			
– Series A	**–**	1.17	1.56
– Series C	**1.275**	0.89	–
– Series D	**1.250**	0.18	–
HSBC HaTS™			
– Series 2010	**77.80**	77.80	77.80
– Series 2015	**51.50**	33.93	–
Total dividends declared on common shares (in $ millions)	**240**	330	150

Credit Ratings

S&P and 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.

On June 19, 2006, S&P raised our short and long-term counterparty credit ratings concurrent with an upgrade of its ratings of our parent, HSBC Holdings.

On October 25, 2006, S&P raised its ratings of our long-term counterparty credit, preferred shares, senior debt and subordinated debt. These ratings upgrades followed S&P's revision of our status to a core holding within the HSBC Group based on our growing integration with and increasing contribution to the HSBC Group.

On October 6, 2006, DBRS upgraded its ratings of our deposits, debt instruments and preferred shares, as a result of implementation of a new support assessment methodology for banks.

Our ratings at December 31, 2006 were as follows:

	S&P	*DBRS*
Short-term instruments	A-1+	R-1 (high)
Deposits and senior debt	AA	AA
Subordinated debt	AA-	AA (low)
Preferred shares	P-1[(1)]	Pfd-1
HSBC HaTS™	P-1[(1)]	A (high)

(1) *Based on S&P's 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 a corporate governance framework, which establishes 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 regularly review and modify our risk management policies and systems 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 significant risks we are exposed to and measures for these risks;

— Develops and recommends for approval appropriate risk management policies and procedures regarding those activities and units which incur significant risk, including business continuity planning;

— Provides direction regarding our overall risk philosophy and appetite including the 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 of Directors for review, ratification or approval.

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

In addition to the risks that arise on a daily basis identified above, we are also exposed to strategic risk that arises if we fail to identify opportunities and/or threats arising from changes in the market, some of which may emerge over a number of years. These strategic opportunities or threats arise from a range of factors which might include, for example, changing economic and political circumstances, changing customer requirements, demographic trends, regulatory developments or competitor action. This risk is mitigated by consideration of the potential opportunities and challenges through the strategic planning process, which we undertake in conjunction with the HSBC Group.

Management's Discussion and Analysis (continued)

Market risk

Market risk is the risk to our financial position 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. Minimum, maximum and average amounts of VaR for our trading portfolio for 2006 and 2005 are as follows:

	2006	2005
	$'000	$'000
Minimum	**93**	99
Maximum	**863**	1,487
Average	**337**	407

Structural risk

Structural risk is the impact of interest rate and foreign exchange rate risks on 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 amortized cost 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 using various interest rate and balance sheet growth scenarios to provide a comprehensive analysis of spread 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 assumptions regarding customer behavior. 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 $41 million (2005 – increase of $46 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.

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 asset securitizations and facilities with major Canadian institutional lenders and borrowers, so that undue reliance is not placed on any one source of funding.

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;
- Operational cash flow scenarios used to evaluate differing market or crisis situations where cash inflows may be restricted and cash outflows may be accelerated;
- 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 contractual obligations for payment of liabilities. Amounts included in unsecured long-term funding in the table below are wholesale term deposits with an original term to maturity of more than one year, based on contractual repayment dates. Also included are obligations related to commitments not recorded in the balance sheet, such as those relating to operating leases.

Management's Discussion and Analysis (continued)

A summary of our future contractual obligations at December 31, 2006 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	$ –	$ –	$ –	$ 563	$ 563
Operating leases	36	62	45	53	196
Committed purchase obligations	30	52	–	–	82
Unsecured long term funding	671	2,038	95	166	2,970
Total contractual obligations	$ 737	$ 2,152	$ 140	$ 782	$ 3,811

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, 2006 were $29.5 billion for facilities expiring before December 31, 2007 and $4.4 billion 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) 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 client" 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 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 business units to identify, assess, monitor and control operational risk. The operating risks identified by the units are presented to the Operational Risk Management Committee which has the responsibility of challenging the risk identification and control strategies proposed, as well as the actions 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. We have a dedicated function that proactively manages our compliance process, and we maintain high ethical standards. These processes together with our control structure help ensure that our exposure to reputational risk is managed. This control structure is complemented by independent and periodic reviews by our Internal Audit department.

We also work with our HSBC Group colleagues in ensuring that our business fulfils the HSBC Group's corporate responsibility commitment to behave responsibly and ethically in all aspects of its business as well as recognizing that sound business management must take into account the effects of its businesses on the environment. Information on our commitment to corporate responsibility is included in our annual publication, *HSBC Bank Canada in the Community*, available from our website: hsbc.ca.

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 various cities across North America increase our recovery capabilities for key businesses.

In 2006 we invested in high availability software that we expect to minimize the effect of any hardware failure in our computer systems. We have implemented several other improvements in our business continuity management process with further improvements planned in 2007. In common with other HSBC Group companies, as well as other Canadian banks and large organizations, we are continuing to expand our business continuity planning efforts to prepare for the possibility of an avian influenza pandemic.

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, and 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 limits and industry, product and geographic concentration are approved by our Board of Directors in line with HSBC Group policy. All new and renewed major authorized facilities, derivative exposures and special credit problem and impaired facilities are also reported quarterly to 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 our business.

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 risk grade. We use credit scoring and related bureau-based management techniques, along with judgement, to manage credit risk associated with our retail and some small and medium sized enterprises credit portfolios.

We manage real estate lending within well-defined parameters with an emphasis on relationship and project sponsorship for all new transactions. We are actively managing the growth of this portfolio given the strong demand for credit from this sector and its cyclical nature. 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 data collection recording, and strict approval and monitoring processes. Historically, our credit loss experience as a percentage of assets has been amongst the lowest of our peer group of major Canadian chartered banks.

Management's Discussion and Analysis (continued)

Significant progress continues to be made in the Basel II initiative. During 2005 and 2006 a revised credit risk rating system was adopted for all relevant credit portfolios and in 2006 we introduced tools to assist in the calculation and recording of key Basel II credit metrics. We continued to develop the credit risk management infrastructure and data management tools to capture and populate a number of databases with these key credit metrics and other obligor data. We will continue to enhance and validate this credit data during 2007. These data elements are key inputs for calculating regulatory capital under Basel II and producing granular credit management reporting.

Loan portfolio

In assessing the risks of our credit portfolio, we aggregate loan exposures with customers' liabilities under acceptances, guarantees and letters of credit.

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

	2006	2005
Loans included in financial statements, net of allowances	**$ 35,236**	$ 31,844
Allowance for credit losses	**327**	326
Customers' liabilities under acceptances[1]	**5,130**	4,002
Financial and performance standby letters of credit[1]	**2,046**	2,235
Documentary and commercial letters of credit	**492**	516
Total loans	**43,231**	38,923
Impaired loans and acceptances[1]	**(177)**	(151)
Total performing loans	**$ 43,054**	$ 38,772

(1) *Includes $13 million (2005 – $21 million) of impaired acceptances and letters of credit.*

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

	2006		2005	
Consumer loans	**$ 3,718**	**8.7%**	$ 3,720	9.6%
Residential mortgages	**14,005**	**32.5%**	12,852	33.1%
Total consumer	**17,723**	**41.2%**	16,572	42.7%
Business and government loans	**25,331**	**58.8%**	22,200	57.3%
Total performing loans	**$ 43,054**	**100.0%**	$ 38,772	100.0%

Geographic distribution

	2006		2005	
British Columbia	**$ 19,256**	**44.7%**	$ 18,928	48.8%
Western Canada	**7,912**	**18.4%**	5,951	15.4%
Ontario	**11,056**	**25.7%**	9,943	25.6%
Quebec and Atlantic	**4,830**	**11.2%**	3,950	10.2%
Total performing loans	**$ 43,054**	**100.0%**	$ 38,772	100.0%

Business and government loan portfolio by industry

	2006		2005	
Real estate	**$ 8,648**	**34.2%**	$ 7,050	31.8%
Hotels and hospitality	**1,013**	**4.0%**	887	4.0%
Trade	**3,381**	**13.3%**	2,978	13.4%
Services	**4,687**	**18.5%**	4,150	18.7%
Manufacturing	**2,781**	**11.0%**	3,031	13.7%
Other	**4,821**	**19.0%**	4,104	18.4%
Total business and government loans	**$ 25,331**	**100.0%**	$ 22,200	100.0%

Good economic growth, low interest rates and strong consumer demand were constant features throughout 2006. As a result demand for credit from all customer groups was strong and in a very competitive environment, we experienced growth in all loan portfolios.

Large customer concentrations are borrowing groups where approved facilities exceed 10% of our regulatory capital base. At December 31, 2006, this amount was approximately $406 million (2005 – $367 million).

The following table provides details of our large customer concentrations:

		2006		2005
Large customer concentration	**$**	**2,838**	$	2,370
As a percentage of business and government loans		**11.2%**		10.7%
As a percentage of total performing loans		**6.6%**		6.1%

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 future 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:

	2006			2005		
Satisfactory	**$**	**42,308**	**97.8%**	$	37,836	97.2%
Watch		**506**	**1.2%**		621	1.6%
Sub-standard		**240**	**0.6%**		315	0.8%
Impaired		**177**	**0.4%**		151	0.4%
Total loans	**$**	**43,231**	**100.0%**	$	38,923	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, 2006, $177 million (0.4%) of the loan portfolio was impaired, with specific and general allowances providing 185% (December 31, 2005 – 216%) coverage of these loans.

Management's Discussion and Analysis (continued)

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) on page 39.

The following table provides details of the impaired loan portfolio:

	2006	2005
Business and government		
Real estate	**$ 13**	$ 21
Manufacturing(1)	**121**	70
Trade	**7**	17
Services	**12**	9
Other	**3**	7
Total business and government loans(1)	**156**	124
Personal		
Residential mortgages	**10**	13
Consumer loans	**11**	14
Total personal loans	**21**	27
Total impaired loans, acceptances and letters of credit(1)	**$ 177**	$ 151
Specific allowances	**$ 58**	$ 57
General allowances	**269**	269
Total allowance for credit losses(1)	**$ 327**	$ 326
Net impaired loans and acceptances	**$ (150)**	$ (175)

(1) *Includes $13 million (2005 – $21 million) of impaired acceptances and letters of credit.*

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

	2006	2005
Real estate	**23%**	19%
Manufacturing	**25%**	47%
Other	**55%**	48%
Total	**29%**	35%

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

	2006	2005
Coverage by general allowance		
As a percentage of total performing loans	**0.62%**	0.69%
As a percentage of risk-weighted assets	**0.74%**	0.82%

Provisions for credit losses

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

	2006	2005
Specific provisions	**$ 34**	$ 40
General provisions	**–**	(13)
Total provision for credit losses	**$ 34**	$ 27
Specific provisions as a percentage of total loan portfolio	**0.10%**	0.10%

Specific provisions have decreased as a result of the continuing strong economy in 2006. General provisions remained constant in absolute terms and as a percentage of risk-weighted assets declined in line with asset growth. General provisions remain within the range of values produced by our current methodology. During 2006, we began developing a more risk sensitive approach to provisioning that utilizes obligor credit metrics being developed under Basel II. We expect that this new methodology will give us more enhanced factors to model the risks associated with our portfolios.

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	**2006**	2005
Interest rate contracts	**$ 151**	$ 130
Foreign exchange contracts	**903**	409
Other contracts	**73**	63
Net credit equivalent amount	**$ 1,127**	$ 602

This increase in 2006 was due to an increase in foreign exchange contracts arising from continued volatility of the Canadian dollar relative to the US dollar.

A more detailed analysis of our derivative portfolios is presented in note 17 on pages 61 to 65.

Analysis of Financial Results and Operations by Customer Group

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

Prior to 2006, we primarily measured the performance of each customer group based on its net income, excluding expenses related to the deposit guarantee. These expenses were previously consolidated and disclosed separately in a customer group entitled "Other". With the termination of the deposit guarantee for new deposits after June 30, 2005, customer group results are now measured including all relevant expenses. As a result, beginning in fiscal 2006, expenses related to the deposit guarantee have been included in non-interest expenses of each customer group. Certain comparative amounts have been restated to conform with the current period's disclosure.

A summary of the breakdown of selected consolidated financial information and other data by major customer groups is included in note 19 (a) on pages 67 and 68.

Management's Discussion and Analysis (continued)

Personal Financial Services

Business developments and achievements for 2006 include:

— *Revenue growth* – Total revenue grew by 9.3% over 2005 as a result of increased customer acquisition and investments in the wealth management businesses. Growth also benefited from our deepened use of clientCONNECT, our client front-end system, to enhance customer service and use of sales measurement techniques.

— *Core lending and deposit products* – We grew our core lending and deposits with personal loans up $699 million or 15.3% to $5.3 billion (before securitization), residential mortgages up $1.2 billion or 7.9% to $16.7 billion (before securitization), and personal deposits up $1.7 billion or 11.4% to $17.0 billion. We successfully launched our new HRSA product which contributed towards this growth.

— *Funds under management* – Our funds under management grew to $23.3 billion, up $2.9 billion or 14.1% over the prior year, with growth spread across our wealth management businesses. Retail brokerage funds under management grew by $1.2 billion or 10.9% to $12.3 billion. Growth was driven by fee-based assets, up 31%, particularly the separately managed Diamond Portfolio, which has grown over 120% to $0.6 billion. HSBC InvestDirect, the direct brokerage division of HSBC Securities (Canada) Inc., launched a new client site and grew funds under management by $0.6 billion or 14.8% to $4.5 billion. Private Client funds grew by $0.5 billion on the success of existing products.

— *Assets under administration* – Custodial assets under administration in our trust subsidiary, HSBC Trust Company (Canada), increased substantially, growing more than $500 million, or 9.7%, to $6.4 billion. The company successfully migrated its client reporting functions to a new system bringing significant operational advantages, including full multi-currency capability, and facilitating anticipated strong future growth in the company's assets and revenue.

— *Direct Bank* – We successfully upgraded our Personal Internet Banking site with a number of high impact features, including the launch of an Online Savings Account, a new online account opening process, electronic funds transfer functionality between the HRSA account and other financial institutions, and increased security via new sign-on procedures.

— *Account packages* – Released a simplified day-to-day banking initiative with a suite of chequing and savings accounts presenting simple, clearly differentiated options which improved account profitability and contributed to overall deposit growth.

— *Enhanced ABM strategic alliance* – We expanded our alliance with BMO Financial Group by introducing a surcharge-free deposit capability using ABMs at BMO Bank of Montreal locations. Together with our existing ABM network, this provides our customers with surcharge free withdrawal and deposit access to one of the largest ABM networks in Canada.

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

	2006	2005
Net interest income	**$ 380**	$ 360
Non-interest revenue	**305**	267
Total revenue	**685**	627
Non-interest expenses	**522**	466
Provision for credit losses	**20**	14
Income before taxes	**143**	147
Provision for income taxes	**48**	47
Non-controlling interest in income of trust	**7**	7
Net income	**$ 88**	$ 93
Percentage of total net income	**17.1%**	19.8%
Average risk-weighted assets	**$ 9,542**	$ 9,563
Percentage of total average risk-weighted assets	**27.2%**	31.4%

Income, before taxes and non-controlling interest in income of trust, was $143 million for 2006 compared with $147 million for 2005.

Net interest income increased by 5.6% compared to 2005. There was good growth in our underlying residential mortgage and consumer loan portfolio business, which before securitizations, grew by $1.2 billion, or 7.9%, and $699 million, or 15.3% respectively, driven primarily by the historically low borrowing costs and the ongoing active housing market. Although this growth was more than offset by securitizations, net interest income also benefited from a shift in customer preference towards floating rate products and improvement in margin on both fixed and notice deposits. We also benefited from growth of deposits arising from the success of our HRSA. However, low interest rates and competitive pricing continue to put pressure on net interest margins.

Non-interest revenue increased 14.2% 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. We also benefited from an increase in securitization income.

The provision for credit losses was higher compared to 2005 largely due to an increase in provisioning in our growing auto finance business although 2005 benefited from a release in general allowances.

Non-interest expenses were higher in 2006 due to increased business volumes and continued investments to expand our distribution network and wealth management businesses, and the impact of a one time fair value adjustment to stock option expenses. These were partially offset by a lower deposit guarantee fee expense in 2006. In addition, 2005 results included reversals in commodity tax and incentive accruals.

Commercial Banking

Business developments and achievements for 2006 include:

— *Revenue growth* – Total revenue grew by 12.2% over 2005 as a result of increased client acquisition, deepened existing relationships, and new products such as enhanced payments and cash management accounts.

— *Significant momentum* – We increased our core business substantially with loans, acceptances and leasing up $3.3 billion or 17.1% over 2005 and deposits up $2.6 billion or 22.8%. Funding commitments to clients are at record levels, reflecting the value of our service to our customers. Investment initiatives to grow our operations in Alberta and the Greater Toronto Area showed promising results. In Calgary, significant activity in both the energy and real estate sectors is contributing to good growth. In Ontario, there was strong momentum in deposits.

— *Payments and Cash Management (“PCM”)* – We realized significant returns on our people and product investments, winning key Canadian, NAFTA and global mandates. In addition, we expanded our customer service offerings with a dedicated PCM Service Centre launched to provide support to commercial banking customers and branches through Commercial e-Banking and Branch Resource Centre. In addition, a Gold Service team was established to deliver dedicated, one-stop service to CIBM and globally managed commercial customers.

— *Small and Medium Enterprise (“SME”)* – We rebranded our SME business externally as Business Banking to bring more focus to the segment, while at the same time respecting customer preferences.

— *NAFTA banking* – We continue to lead international business in the NAFTA region and are the largest issuer of Export Development Canada performance guarantees into Mexico; we issue more in dollar volume terms than all other Canadian banks combined. This contributed greatly to our export finance success with related fees now accounting for 26% of total trade finance revenue, compared to 21% last year. We continued to deliver seamless credit and other product services to Canadian clients doing business in the US and Mexico.

— *Private Equity* – We achieved great success in growing our merchant banking business realizing significant returns for ourselves and our outside investors, with revenues up over 100% year over year.

— *Leasing* – We continued to grow this core business, with total outstandings up $304 million or 27.1% to $1.4 billion.

— *HSBC Group connections* – We continued to deepen our network with our colleagues worldwide and hosted an HSBC Group global commercial banking conference in Vancouver, showcasing the tagline ‘we value the difference in business’, at the same time sharing best practices and ideas. We successfully leveraged Global-Links, the HSBC Group’s web based, global cross border business tracking and reporting system, driving cross-border business and highlighting areas of opportunity.

Management's Discussion and Analysis (continued)

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

	2006	2005
Net interest income	**$ 611**	$ 536
Non-interest revenue	**207**	193
Total revenue	**818**	729
Non-interest expenses	**315**	303
Provision for credit losses	**14**	13
Income before taxes	**489**	413
Provision for income taxes	**169**	134
Non-controlling interest in income of trust	**15**	13
Net income	**$ 305**	$ 266
Percentage of total net income	**59.2%**	56.6%
Average risk-weighted assets	**$ 19,684**	$ 17,177
Percentage of total average risk-weighted assets	**56.1%**	56.5%

Income, before taxes and non-controlling interest in income of trust, was $489 million compared with $413 million in the same period last year.

Net interest income grew by 14.0% in 2006, benefiting from continued strong asset growth in 2006. The strong economic conditions in Canada and the United States, low interest rates and improving margins on fixed and notice deposits, together with our investments in Alberta and the Greater Toronto Area, were all driving factors behind this growth.

Non-interest revenue increased by 7.3%, due to higher commercial credit activities particularly from acceptance and standby fees, activity charges and investment gains from our merchant banking investments. These were partially offset by lower trade finance income and a decrease in revenues from the Immigrant Investor Program as a result of decreased processing of government immigration visas in 2006.

The provision for credit losses was consistent with 2005 despite an increase in assets and the impact of a release in the general allowance for credit losses in the prior year. This mainly arose from lower default rates due to the improving economy.

Non-interest expenses were higher by 4.0% due largely to continued investments in our distribution network, which increased salaries and benefits, and other expenses, together with the impact of a one-time fair value adjustment to stock option expenses. These were partially offset by a lower deposit guarantee fee expense in 2006. In addition, the 2005 results included reversals in commodity tax and incentive accruals.

Corporate, Investment Banking and Markets

Business developments and achievements for 2006 include:

— *Revenue Growth* – Total revenue grew 17.4%, largely on increased capital markets activity.

— *Global Corporate Banking* – We increased coverage of priority clients in 2006 – focusing on energy, mining, infrastructure and financials, which are the growth sectors in the Canadian economy. Our coverage model is integrated with Global Investment Banking and leverages the overall CIBM platform.

— *Debt Capital Markets* – We enhanced our team to effectively leverage the HSBC Group's global fixed income capability. During 2006 we participated in 121 deals raising over $5 billion for domestic and foreign issuers in the Canadian marketplace.

— *Equity Capital Markets* – We delivered the HSBC Group's expanded equity capability to Canadian corporates. We participated in 134 deals helping raise over $14.6 billion for Canadian issuers.

— *Global Investment Banking* – Significant progress in 2006 in securing cross border advisory mandates in the natural resources and infrastructure sectors moving HSBC into the top ten in the mergers and acquisitions advisory league table rankings in Canada.

— *Asset Management* – In manufacturing, emphasis was placed on enhancing our open architecture platform and expanding HSBC Multimanager's best of breed suite of investment offerings. In distribution, we successfully distributed the HSBC Group's global specialist "Sinopia" and "Halbis" capabilities to the country's top pension plans.

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

	2006	2005
Net interest income	**$ 124**	$ 114
Non-interest revenue	**139**	110
Total revenue	**263**	224
Non-interest expenses	**69**	55
Income before taxes	**194**	169
Provision for income taxes	**68**	56
Non-controlling interest in income of trust	**4**	2
Net income	**$ 122**	$ 111
Percentage of total net income	**23.7%**	23.6%
Average risk-weighted assets	**$ 5,846**	$ 3,676
Percentage of total average risk-weighted assets	**16.7%**	12.1%

Income before taxes and non-controlling interest in income of trust, was $194 million compared with $169 million in 2005.

Net interest income increased by 8.8% in 2006 and was positively impacted by loan and deposit growth due to continued strong economic conditions in Canada.

Non-interest revenues increased in 2006 by 26.4%. Improving economic conditions in Canada and the US contributed to an increase in revenues from our corporate banking group. The volatility of the Canada:US dollar exchange rate drove foreign exchange and trading income from our fixed income sales and trading group, which was higher compared to 2005.

Non-interest expenses in 2006 were higher than 2005 primarily due to increase in variable compensation consistent with increase in revenues, offset by a lower deposit guarantee fee expense.

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 ("OSFI") 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 OSFI 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 A. McIsaac, FCA
Chief Financial Officer

January 31, 2007
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, 2006 and 2005 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 management of HSBC Bank Canada. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 HSBC Bank Canada as at December 31, 2006 and 2005 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
Chartered Accountants

Vancouver, Canada
January 31, 2007

Consolidated Balance Sheets

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

	2006	2005
Assets		
Cash resources:		
Cash and deposits with Bank of Canada	**$ 368**	$ 409
Deposits with regulated financial institutions	**4,346**	5,549
	4,714	5,958
Securities: (note 2)		
Investment	**3,604**	2,923
Trading	**1,162**	1,418
	4,766	4,341
Securities purchased under reverse repurchase agreements	**4,760**	1,752
Loans: (notes 3 & 4)		
Businesses and governments	**17,819**	15,571
Residential mortgages	**14,016**	12,865
Consumer	**3,728**	3,734
Allowance for credit losses	**(327)**	(326)
	35,236	31,844
Other:		
Customers' liability under acceptances	**5,130**	4,002
Land, buildings and equipment (note 5)	**121**	103
Other assets (note 6)	**2,043**	1,210
	7,294	5,315
	$ 56,770	$ 49,210
Liabilities and Shareholders' Equity		
Deposits: (note 7)		
Regulated financial institutions	**$ 1,469**	$ 1,975
Individuals	**17,039**	15,300
Businesses and governments	**25,665**	21,333
	44,173	38,608
Other:		
Acceptances	**5,130**	4,002
Securities sold under repurchase agreements	**162**	302
Other liabilities (note 8)	**3,444**	2,849
Non-controlling interest in trust and subsidiary (note 9)	**430**	430
	9,166	7,583
Subordinated debentures (note 10)	**563**	423
Shareholders' equity:		
Capital stock (note 11)		
Preferred	**350**	350
Common	**1,125**	1,125
Contributed surplus (note 12)	**202**	187
Retained earnings	**1,191**	934
	2,868	2,596
	$ 56,770	$ 49,210

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

Approved on behalf of the Board of Directors:

Robert Martin
Director

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)*

	2006	2005
Interest income:		
Loans	**$ 2,144**	$ 1,631
Securities	**186**	120
Deposits with regulated financial institutions	**234**	166
	2,564	1,917
Interest expense:		
Deposits	**1,422**	882
Subordinated debentures	**27**	25
	1,449	907
Net interest income	**1,115**	1,010
Non-interest revenue:		
Deposit and payment service fees	**90**	84
Credit fees	**106**	95
Capital market fees	**115**	106
Investment administration fees	**103**	80
Foreign exchange	**32**	27
Trade finance	**24**	27
Trading revenue	**69**	60
Investment securities gains	**30**	16
Securitization income	**42**	24
Other	**40**	51
	651	570
Total revenue	**1,766**	1,580
Non-interest expenses:		
Salaries and employee benefits	**503**	442
Premises and equipment, including amortization	**116**	107
Other	**287**	275
	906	824
Net operating income before provision for credit losses	**860**	756
Provision for credit losses (note 4)	**34**	27
Income before provision for income taxes and non-controlling interest in income of trust	**826**	729
Provision for income taxes (note 14)	**285**	237
Non-controlling interest in income of trust	**26**	22
Net income	**$ 515**	$ 470
Preferred share dividends (note 11)	**18**	13
Net income attributable to common shares	**$ 497**	$ 457
Average number of common shares outstanding (000's)	**488,668**	488,668
Basic earnings per common share	**$ 1.02**	$ 0.94

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)*

	2006	2005
Preferred shares: (note 11)		
Balance at beginning of year	**$ 350**	$ 125
Issued	**–**	350
Redeemed	**–**	(125)
Balance at end of year	**350**	350
Common shares: (note 11)		
Balance at beginning and end of year	**1,125**	1,125
Contributed surplus:		
Balance at beginning of year	**187**	177
Stock-based compensation (note 12)	**15**	10
Balance at end of year	**202**	187
Retained earnings:		
Balance at beginning of year	**934**	770
Net income	**515**	470
Preferred share dividends (note 11)	**(18)**	(13)
Common share dividends (note 11)	**(240)**	(330)
Capital issue costs	**–**	(7)
Other (note 20)	**–**	44
Balance at end of year	**1,191**	934
Total shareholders' equity	**$ 2,868**	$ 2,596

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)*

	2006	2005
Cash flows provided by (used in) operating activities:		
Net income	**$ 515**	$ 470
Adjustments to net income to determine net cash provided by operating activities:		
Amortization expense	**39**	30
Provision for credit losses	**34**	27
Future income taxes	**12**	21
Net accrued interest receivable and payable	**38**	29
Trading securities	**256**	(363)
Other, net	**(221)**	170
	673	384
Cash flows provided by (used in) financing activities:		
Deposits received	**5,565**	4,760
Securities (purchased) sold under repurchase agreements	**(140)**	279
Proceeds from issuance of subordinated debentures	**200**	–
Subordinated debenture redemptions and repayments	**(60)**	–
Proceeds from issuance of asset trust securities	**–**	200
Proceeds from issuance of preferred shares	**–**	350
Redemption of preferred shares	**–**	(125)
HSBC Group reimbursement	**–**	40
Dividends paid	**(318)**	(333)
	5,247	5,171
Cash flows provided by (used in) investing activities:		
Loans funded, excluding securitizations	**(5,409)**	(5,963)
Proceeds from loans securitized	**1,981**	2,409
Investment securities purchased	**(681)**	(956)
Securities (purchased) sold under reverse repurchase agreements	**(3,008)**	512
Net change in non-operating deposits with regulated financial institutions	**82**	(343)
Acquisition of land, buildings and equipment	**(47)**	(21)
	(7,082)	(4,362)
(Decrease) increase in cash and cash equivalents	**(1,162)**	1,193
Cash and cash equivalents, beginning of year	**5,200**	4,007
Cash and cash equivalents, end of year	**$ 4,038**	$ 5,200
Represented by:		
Cash resources	**$ 4,714**	$ 5,958
Less non-operating deposits with regulated financial institutions[1]	**(676)**	(758)
Cash and cash equivalents, end of year	**$ 4,038**	$ 5,200
Supplementary cash flow information:		
Interest paid during the year	**$ 1,333**	$ 843
Income taxes paid during the year	**$ 266**	$ 232

(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, 2006 and 2005 *(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.

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, internally developed software – 5 years and leasehold improvements – various lease terms. 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.

Notes to Consolidated Financial Statements (continued)

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 represent a form of negotiable short-term debt that is issued by our customers and which we guarantee for a fee. 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.

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 hedge our exposures to currency and interest rate fluctuations as part of our risk management program. Trading activities are undertaken to meet the needs of our customers, as well as on our own account to earn trading income, and on any contracts that do not qualify for hedge accounting.

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 are included in other assets and unrealized losses on those contracts 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.

Derivatives that qualify for hedge accounting are accounted for on the accrual basis. 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 various securitization conduits. 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.

Notes to Consolidated Financial Statements (continued)

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 of shares of our Parent. 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, or subsequent re-measurement date, 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 *Investment companies*

We carry our investments held in investment companies at fair value when we otherwise would have had to consolidate them or account for them using the equity method.

t *Variable interest entities*

Variable interest entities ("VIEs") include entities where the equity invested is considered insufficient to finance an entity's activities. 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.

u *Future accounting changes*

The Accounting Standards Board ("AcSB") issued new standards for the reporting and disclosure of comprehensive income, equity, and financial instruments, which we will adopt on January 1, 2007. We estimate that the impact on our consolidated financial statements of implementing these new standards is not likely to be material.

Comprehensive Income

Unrealized gains and losses on financial assets that will be held as available for sale, 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.

Equity

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.

u *Future accounting changes (continued)*

Financial Instruments

— *Disclosure and Presentation*

The AcSB issued standards to replace 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*

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 unrealized gains and losses recognized in other comprehensive income. The standard also permits designation of any financial instrument as held-for-trading upon initial recognition.

— *Hedges*

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.

Notes to Consolidated Financial Statements (continued)

2 Securities

a *Carrying value*

	2006									
	Term to maturity									*Total*
		Within 1 year		*1-5 years*		*5-10 years*		*No specific maturity*		*carrying value*
Investment securities:										
Securities issued or guaranteed by										
Canada	**$**	**2,858**	**$**	**166**	**$**	**–**	**$**	**–**	**$**	**3,024**
Provinces		**345**		**34**		**–**		**–**		**379**
		3,203		**200**		**–**		**–**		**3,403**
Others		**–**		**1**		**–**		**–**		**1**
Investment funds		**–**		**–**		**–**		**42**		**42**
Equity securities		**29**		**110**		**19**		**–**		**158**
Total investment securities		**3,232**		**311**		**19**		**42**		**3,604**
Trading securities		**613**		**103**		**404**		**42**		**1,162**
Total securities	**$**	**3,845**	**$**	**414**	**$**	**423**	**$**	**84**	**$**	**4,766**

	2005									
	Term to maturity									*Total*
		Within 1 year		*1-5 years*		*5-10 years*		*No specific maturity*		*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

Included in trading securities are $800 million of securities issued or guaranteed by Canada or provinces (2005 – $1,107 million).

The total carrying value of securities includes amounts denominated in currency other than Canadian dollars of $103 million (Canadian equivalent) (2005 – $124 million).

Included in investment securities issued or guaranteed by Canada are mortgage-backed securities retained by us in connection with mortgage securitizations of $33 million (2005 – $69 million) (refer to note 3(b)).

2 Securities *(continued)*

b *Unrealized gains and losses on investment securities*

	2006			
	Carrying value	*Gross unrealized gains*	*Gross unrealized losses*	*Estimated market value*
Securities issued or guaranteed by				
Canada	**$ 3,024**	**$ –**	**$ (1)**	**$ 3,023**
Provinces	**379**	**1**	**–**	**380**
	3,403	**1**	**(1)**	**3,403**
Others	**1**	**–**	**–**	**1**
Investment funds	**42**	**–**	**–**	**42**
Equity securities	**158**	**3**	**–**	**161**
Total investment securities	**$ 3,604**	**$ 4**	**$ (1)**	**$ 3,607**

	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

3 Loans

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

	2006	2005
Businesses and governments:		
Real estate	**$ 7,048**	$ 5,528
Hotels and hospitality	**571**	553
Manufacturing	**1,958**	2,203
Trade	**3,616**	3,084
Services	**2,737**	2,481
Direct finance leases	**1,436**	1,122
Other	**453**	600
Total businesses and governments	**17,819**	15,571
Residential mortgages	**14,016**	12,865
Consumer	**3,728**	3,734
Allowance for credit losses	**(327)**	(326)
Total	**$ 35,236**	$ 31,844

Total net loans includes amounts denominated in U.S. dollars of $1,303 million (Canadian equivalent) (2005 – $957 million) and other foreign currencies of $30 million (Canadian equivalent) (2005 – $211 million). Included in residential mortgages are $1,053 million of NHA insured mortgages (2005 – $1,008 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:*

	2006	2005
Residential mortgages		
Conventional	**$ 1,844**	$ 1,639
Mortgage-backed securities[1]	**768**	898
	2,612	2,537
Consumer loans		
Personal lines of credit	**1,200**	700
Term loans	**349**	146
	1,549	846
	$ 4,161	$ 3,383

(1) *Excludes insured mortgages which were securitized and retained by us of $33 million (2005 – $69 million). These assets are classified as investment securities (refer to note 2(a)).*

Securitization activity during the year is as follows:

	2006				2005			
	Residential mortgages	*Personal lines of credit*	*Consumer term loans*	*Total*	*Residential mortgages*	*Personal lines of credit*	*Consumer term loans*	*Total*
Securitized and sold	**$ 1,203**	**$ 500**	**$ 303**	**$ 2,006**	$ 1,828	$ 400	$ 215	$ 2,443
Net cash proceeds received	**1,197**	**487**	**297**	**1,981**	1,807	390	212	2,409
Retained rights to future excess interest	**12**	**4**	**12**	**28**	19	3	9	31
Retained servicing liability	**5**	**1**	**1**	**7**	8	1	1	10
Pre-tax gain on sale	**5**	**3**	**2**	**10**	5	2	9	16
Weighted average key assumptions at time of sale (%)								
Prepayment rate	**32.94**	**100.00**	**26.82**		25.40	100.00	12.68	
Excess spread	**0.65**	**1.89**	**3.22**		0.63	1.81	4.63	
Expected credit losses	**0.02**	**0.20**	**0.63**		0.01	0.20	0.23	
Discount rate	**5.25**	**5.71**	**8.24**		4.39	5.24	3.25	

Servicing and other income from securitized assets was $12 million during the year (2005 – $8 million). Credit losses of $1 million were realized on securitized consumer loans (2005 – $1 million).

3 Loans *(continued)*

c *Sensitivity of assumptions*

The following table outlines key economic assumptions used in measuring fair value of retained interests and the sensitivity of retained interests as at December 31, 2006 to immediate 10% and 20% adverse changes in theses assumptions. The base case for each assumption is the weighted average for all assets at year end. 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.

	2006		
	Residential mortgages	*Personal lines of credit*	*Consumer term loans*
Carrying value of retained interests	26	20	12
Fair value of retained interests	30	22	13
Discount rate (%)	4.98%	6.35%	8.12%
Impact of 10% increase	–	–	–
Impact of 20% increase	–	–	–
Prepayment rate (%)	24.94%	100.00%	23.95%
Impact of 10% increase	(1)	(1)	–
Impact of 20% increase	(2)	(1)	–
Expected credit losses (%)	0.01%	0.18%	0.54%
Impact of 10% increase	–	–	–
Impact of 20% increase	–	–	–

4 Impaired loans and allowance for credit losses

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

	2006			2005		
	Gross amount	*Specific allowances*	*Carrying amount*	*Gross amount*	*Specific allowances*	*Carrying amount*
Businesses and governments						
Real estate	**$ 13**	**$ 3**	**$ 10**	$ 21	$ 4	$ 17
Manufacturing	**109**	**31**	**78**	49	23	26
Trade	**7**	**7**	**–**	17	10	7
Services	**11**	**6**	**5**	9	6	3
Other	**3**	**–**	**3**	7	–	7
Residential mortgages	**11**	**1**	**10**	13	1	12
Consumer	**10**	**10**	**–**	14	13	1
Total	**$ 164**	**$ 58**	**$ 106**	$ 130	$ 57	$ 73

Notes to Consolidated Financial Statements (continued)

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

b *The allowance for credit losses is as follows:*

	2006				
	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	**$ 4**	**$ 2**	**$ (3)**	**$ –**	**$ 3**
Manufacturing	**23**	**11**	**(5)**	**2**	**31**
Trade	**10**	**(2)**	**(2)**	**1**	**7**
Services	**6**	**2**	**(2)**	**–**	**6**
Residential mortgages	**1**	**1**	**(1)**	**–**	**1**
Consumer	**13**	**20**	**(22)**	**(1)**	**10**
Total specific allowances	**57**	**34**	**(35)**	**2**	**58**
General allowance	**269**	**–**	**–**	**–**	**269**
Total	**$ 326**	**$ 34**	**$ (35)**	**$ 2**	**$ 327**

	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

5 Land, buildings and equipment

	Cost	*Accumulated amortization*	*Net Book value* **2006**	*Net Book value* 2005
Land	**$ 2**	**$ –**	**$ 2**	$ 2
Buildings	**20**	**5**	**15**	16
Furniture and equipment	**67**	**37**	**30**	26
Computer equipment and software	**28**	**10**	**18**	3
Leasehold improvements	**111**	**55**	**56**	56
Total	**$ 228**	**$ 107**	**$ 121**	$ 103

Amortization charged to income for the year ended December 31, 2006 amounted to $28 million (2005 – $19 million).

6 Other assets

	2006	2005
Accrued interest receivable	**$ 210**	$ 132
Interest earning other assets	**254**	221
Due from clients, dealers and clearing corporations	**544**	62
Market revaluation of trading derivatives (note 17)	**308**	195
Future income taxes, net (note 14)	**94**	105
Goodwill and other intangible assets, net	**30**	41
Pension asset (note 13)	**54**	53
Accounts receivable and other	**549**	401
Total	**$ 2,043**	$ 1,210

Amortization of intangible assets charged to income for the year ended December 31, 2006 amounted to $11 million (2005 – $11 million).

7 Deposits

	2006			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	**$ 327**	**$ –**	**$ 2,493**	**$ 2,820**
Notice	**–**	**4,169**	**7,869**	**12,038**
Fixed date	**1,142**	**12,870**	**15,303**	**29,315**
Total	**$ 1,469**	**$ 17,039**	**$ 25,665**	**$ 44,173**

	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

Deposits denominated in U.S. dollars amount to $8,216 million (Canadian equivalent) (2005 – $8,856 million) and in other foreign currencies amount to $1,873 million (Canadian equivalent) (2005 – $1,560 million).

Notes to Consolidated Financial Statements (continued)

8 Other liabilities

	2006	2005
Accrued interest payable	**$ 377**	$ 261
Mortgages sold with recourse (note 15)	**403**	379
Interest bearing other liabilities	**498**	518
Payable to clients, dealers and clearing corporations	**423**	220
Market revaluation of trading derivatives (note 17)	**316**	191
Obligations related to securities sold short	**715**	559
Pension liability (note 13)	**17**	13
Other employee future benefits liability (note 13)	**60**	54
Accounts payable and other	**635**	654
Total	**$ 3,444**	$ 2,849

9 Non-controlling interest in trust and subsidiary

	2006	2005
HSBC Canada Asset Trust	**$ 400**	$ 400
HSBC Mortgage Corporation (Canada)	**30**	30
	$ 430	$ 430

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 ("HSBC HaTS™"). The Trust assets are primarily undivided co-ownership interests in pools of Canada Mortgage and Housing Corporation 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 HSBC HaTS™. We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 11).

	2006		2005	
	Units	*Amount*	*Units*	*Amount*
HSBC Canada Asset Trust				
HSBC HaTS™ – Series 2010[(1)]	**200,000**	**$ 200**	200,000	$ 200
– Series 2015[(2)]	**200,000**	**200**	200,000	200
		$ 400		$ 400

(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)*

The HSBC 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, 2006 and 2005. 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*	**2006**	2005
Issued to HSBC Group companies				
4.822[1]	2094	US$85	**$ 98**	$ 98
Issued to third parties				
7.70[2]	2011		**–**	60
6.65[3]	2012		**25**	25
5.60[4]	2012		**100**	100
4.39[5]	2015		**100**	100
4.94[6]	2021		**200**	–
30 day bankers' acceptance rate plus 0.50%	2083		**40**	40
			465	325
Total			**$ 563**	$ 423

(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 $5 million (2005 – $6 million).*

(2) *The debentures were redeemed at par in 2006.*

(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%.*

(6) *The interest rate is fixed at 4.94% until March 2016 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%.*

Notes to Consolidated Financial Statements (continued)

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:

	2006		2005	
	Number of shares	*Amount*	*Number of shares*	*Amount*
Preferred[3] – Class 1, Series C[1]	**7,000,000**	**$ 175**	7,000,000	$ 175
– Class 1, Series D[2]	**7,000,000**	**175**	7,000,000	175
		$ 350		$ 350
Common[4]	**488,668,000**	**$ 1,125**	488,668,000	$ 1,125

(1) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.10%, payable quarterly, as and when declared. During 2006, $9 million (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.

(2) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.00%, payable quarterly, as and when declared. During 2006, $9 million (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.

(3) *Preferred shares, class 1, Series A were fully redeemed in 2005 at par. During 2005, $6 million in dividends were declared and paid.*

(4) *During the year, $240 million (2005 – $330 million) in dividends were declared, of which nil (2005 – $60 million) was payable at December 31, 2006.*

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"). No options were granted under the Group Share Option Plan since the plan was terminated by the Parent in May 2005. In lieu of options under the Group Share Option Plan, eligible employees now receive grants of ordinary shares of the Parent subject to certain vesting conditions ("Discretionary Awards"). 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 in Canadian dollars has been converted from Pounds Sterling at the date of issue of options or at the date of funding of share purchases.

The following table presents information for each plan. Descriptions of each plan follow the table.

	2006	2005
Group Share Option Plan:		
Total compensation expense recognized (in millions)	**$ 11**	$ 6
Savings-Related Share Option Scheme (5 year vesting period):		
Total options granted	**84,504**	150,896
Fair value per option granted	**$ 4.08**	$ 4.76
Total compensation expense recognized (in millions)	**$ 1**	$ 1
Significant assumptions used to calculate fair value:		
Risk free interest rate	**4.5%**	4.3%
Expected life (years)	**5**	5
Expected volatility	**17%**	20%
Savings-Related Share Option Scheme (3 year vesting period):		
Total options granted	**437,617**	567,550
Fair value per option granted	**$ 4.00**	$ 4.70
Total compensation expense recognized (in millions)	**$ 2**	$ 3
Significant assumptions used to calculate fair value:		
Risk free interest rate	**4.5%**	4.3%
Expected life (years)	**3**	3
Expected volatility	**17%**	20%
Savings-Related Share Option Scheme (1 year vesting period):		
Total options granted	**207,907**	–
Fair value per option granted	**$ 3.78**	–
Total compensation expense recognized (in millions)	**$ 1**	–
Significant assumptions used to calculate fair value:		
Risk free interest rate	**4.5%**	–
Expected life (years)	**1**	–
Expected volatility	**17%**	–
Discretionary Awards:		
Total compensation expense recognized (in millions)	**$ 15**	$ 6

Group Share Option Plan

The Group Share Option Plan was a long-term incentive compensation plan available to certain of our employees with grants usually made each year prior to 2005. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

Notes to Consolidated Financial Statements (continued)

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 first, 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% discount to the market value at the date of grant.

Discretionary Awards

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.

13 Employee future benefits

We sponsor a number of pension plans and 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, 2005). The next actuarial valuations for funding purposes of these plans are required as at December 31, 2006 (December 31, 2008 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*	
	2006	2005	**2006**	2005
Accrued benefit obligations				
Balance, beginning of year	**$ 285**	$ 207	**$ 75**	$ 105
Current service cost	**12**	8	**3**	3
Interest cost	**15**	14	**4**	4
Benefits paid	**(13)**	(12)	**(1)**	(1)
Amendments	**3**	1	**–**	(51)
Actuarial loss (gain)	**–**	66	**10**	15
Employee contributions	**1**	1	**–**	–
Balance, end of year	**$ 303**	$ 285	**$ 91**	$ 75
Plan assets				
Fair value, beginning of year	**$ 246**	$ 214	**$ –**	$ –
Actual return on plan assets	**19**	35	**–**	–
Bank contributions	**6**	8	**1**	1
Employee contributions	**1**	1	**–**	–
Benefits paid	**(13)**	(12)	**(1)**	(1)
Fair value, end of year	**$ 259**	$ 246	**$ –**	$ –
Funded status				
Funded status – surplus (deficit)	**$ (44)**	$ (39)	**$ (91)**	$ (75)
Bank contributions after measurement date	**1**	2	**–**	–
Unamortized net actuarial loss	**110**	118	**53**	44
Unamortized past service costs	**7**	4	**(22)**	(23)
Unamortized transitional (asset) obligations	**(33)**	(37)	**–**	–
Accrued benefit asset (liability)	**41**	48	**(60)**	(54)
Valuation allowance	**(4)**	(8)	**–**	–
Accrued benefit asset (liability), net of valuation allowance	**$ 37**	$ 40	**$ (60)**	$ (54)

13 Employee future benefits *(continued)*

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

	Pension benefits		*Non-pension benefits*	
	2006	2005	**2006**	2005
Other assets (note 6)	**$ 54**	$ 53	**$ –**	$ –
Other liabilities (note 8)	**(17)**	(13)	**(60)**	(54)
Total	**$ 37**	$ 40	**$ (60)**	$ (54)

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. Commencing 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:

	2006	2005
Accrued benefit obligations	**$ 192**	$ 180
Fair value of plan assets	**129**	117
Funded status – deficit, measurement date	**63**	63
Bank contributions after measurement date	**1**	2
Funded status – deficit, at year end	**$ 62**	$ 61

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

	Percentage of pension plan assets	
	2006	2005
Equity securities	**70%**	72%
Debt securities	**29%**	27%
Other	**1%**	1%
Total	**100%**	100%

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

	Pension benefits		*Non-pension benefits*	
	2006	2005	**2006**	2005
Service cost	**$ 12**	$ 8	**$ 3**	$ 3
Interest cost	**15**	14	**4**	4
Actual return on plan assets	**(19)**	(35)	**–**	–
Actuarial loss on accrued benefit obligation	**–**	66	**11**	15
Amendments	**3**	1	**–**	(51)
Costs arising in the year	**11**	54	**18**	(29)
Differences between costs arising in the year and costs recognized in the year in respect of:				
– Actual and expected return on plan assets	**2**	19	**–**	–
– Actuarial gain	**6**	(62)	**(9)**	(14)
– Amendments	**(2)**	–	**(2)**	50
– Amortization of transitional obligation (asset)	**(4)**	(4)	**–**	–
Net benefit plan expense recognized before change in valuation allowance	**13**	7	**7**	7
Decrease in valuation allowance	**(4)**	(5)	**–**	–
Net benefit plan expense	**9**	2	**7**	7
Defined contribution plan expense	**13**	11	**–**	–
Total expense	**$ 22**	$ 13	**$ 7**	$ 7

Notes to Consolidated Financial Statements (continued)

13 Employee future benefits *(continued)*

The total cash payments for employee future benefits for 2006, 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 $21 million (2005 – $20 million).

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

	Pension benefits		*Non-pension benefits*	
	2006	2005	**2006**	2005
Accrued benefit obligations as at December 31				
Discount rate (%)	**5.25**	5.25	**5.25**	5.25
Rate of compensation increase (%)	**3.30**	3.30	**3.30**	3.30
Net benefit plan expense for years ended December 31				
Discount rate (%)	**5.25**	6.50	**5.25**	6.50
Expected long-term rate of return on plan assets (%)	**7.00**	7.25	**–**	–
Rate of compensation increase (%)	**3.30**	3.30	**3.30**	3.30

For measurement purposes for 2006, a 9.90% health care cost trend rate was assumed grading down to 4.90% by 2012 and assumed to remain level thereafter (2005 – 6.30% grading down to 4.60% by 2009 and assumed to remain level thereafter).

The weighted-average expected average remaining service lives 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 2006, as well as the net benefits expense for 2006, 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		*Non-pension benefits*	
	Accrued benefit obligation	*Benefits expense*	*Accrued benefit obligation*	*Benefits expense*
Expected rate of return on plan assets (%)	–	7.00%	–	–
Impact of 1% increase	$ –	$ (2)	$ –	$ –
Impact of 1% decrease	$ –	$ 2	$ –	$ –
Discount rate (%)	5.25%	5.25%	5.25%	5.25%
Impact of 1% increase	$ (56)	$ (2)	$ (15)	$ (1)
Impact of 1% decrease	$ 61	$ 2	$ 19	$ 2
Rate of compensation increase (%)	3.30%	3.30%	3.30%	3.30%
Impact of 0.25% increase	$ 8	$ 1	–	–
Impact of 0.25% decrease	$ (9)	$ (1)	–	–
Assumed overall health care cost trend (%)	–	–	9.90%(1)	6.30%(1)
Impact of 1% increase	$ –	$ –	$ 6	$ 1
Impact of 1% decrease	$ –	$ –	$ (5)	$ (1)

(1) *Grading down to 4.9% per year in 2012 and thereafter.*

14 Income taxes

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

	2006	2005
Current income taxes:		
Federal	**$ 173**	$ 136
Provincial	**100**	80
	273	216
Future income taxes:		
Federal	**8**	13
Provincial	**4**	8
	12	21
Total provision for income taxes	**$ 285**	$ 237

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

	2006	2005
Combined federal and provincial income tax rate	**34.8%**	35.2%
Adjustments resulting from:		
Adjustment for tax exempt income	**(0.2)**	(0.1)
Utilization of tax losses carried forward and other deductions	**–**	(0.6)
Substantively enacted tax rate changes	**0.8**	0.2
Additional financial institution taxes	**(0.1)**	0.1
Other, net	**0.3**	(1.3)
Effective tax rate	**35.6%**	33.5%

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

	2006	2005
Future income tax assets:		
Allowance for credit losses	**$ 88**	$ 94
Other available deductions	**60**	52
Non-capital losses	**–**	8
Buildings and equipment	**8**	9
Other	**–**	4
	156	167
Future income tax liabilities:		
Leases	**20**	15
Intangible assets	**4**	7
Deferred charges	**13**	11
Securitization related	**13**	14
Other	**12**	15
	62	62
Net future income tax asset	**$ 94**	$ 105

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.

	2006	2005
Financial and performance standby letters of credit	**$ 2,046**	$ 2,235
Documentary and commercial letters of credit	**492**	516
Commitments to extend credit:		
Original term of one year or less	**29,451**	23,768
Original term of more than one year	**4,401**	3,702
Credit and yield enhancement	**51**	32
	$ 36,441	$ 30,253

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:

	2006	2005
Assets pledged to:		
Bank of Canada	**$ 2,421**	$ 2,715
Clearing systems, payment systems and depositories	**89**	61
Assets pledged in relation to:		
Borrowing, securities lending and securities sold under repurchase agreements	**372**	497
Derivative transactions and other	**8**	2
Total	**$ 2,890**	$ 3,275

As at December 31, 2006, the approximate market value of collateral accepted for our securities lent and securities purchased under reverse repurchase agreements was $4,971 million (2005 – $1,754 million).

c *Long-term lease commitments*

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

2007	$ 36
2008	33
2009	29
2010	25
2011	20
2012 and thereafter	53
	$ 196

The total rental expense charged in respect of premises for the year was $47 million (2005 – $43 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. Total mortgages sold with recourse as at December 31, 2006 were $403 million (2005 – $379 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 issues by filing Notices of Objections. 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, 2006.

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.

Notes to Consolidated Financial Statements (continued)

16 Fair value of financial instruments *(continued)*

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.

	2006			2005		
	Book value	*Fair value*	*Fair value over (under) book value*	*Book value*	*Fair value*	*Fair value over (under) book value*
Assets						
Cash resources	**$ 4,714**	**$ 4,714**	**$ –**	$ 5,958	$ 5,958	$ –
Securities	**4,766**	**4,769**	**3**	4,341	4,340	(1)
Securities purchased under reverse repurchase agreements	**4,760**	**4,760**	**–**	1,752	1,752	–
Loans	**35,236**	**35,147**	**(89)**	31,844	31,839	(5)
Acceptances	**5,130**	**5,130**	**–**	4,002	4,002	–
Other assets	**1,919**	**1,919**	**–**	1,065	1,065	–
Liabilities						
Deposits	**$ 44,173**	**$ 44,153**	**$ (20)**	$ 38,608	$ 38,585	$ (23)
Acceptances	**5,130**	**5,130**	**–**	4,002	4,002	–
Securities sold under repurchase agreements	**162**	**162**	**–**	302	302	–
Other liabilities	**3,874**	**3,874**	**–**	3,279	3,279	–
Debentures	**563**	**565**	**2**	423	424	1

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 risk exposure or exposures 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.

Notes to Consolidated Financial Statements (continued)

17 Derivative instruments *(continued)*

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

	2006				2005			
	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								
Futures	**$ 765**	**$ –**	**$ –**	**$ –**	$ 1,445	$ –	$ –	$ –
Swaps	**17,350**	**96**	**151**	**41**	12,643	78	130	39
Caps	**40**	**–**	**–**	**–**	43	–	–	–
	18,155	**96**	**151**	**41**	14,131	78	130	39
Foreign exchange contracts								
Spot contracts	**880**	**1**	**1**	**–**	246	1	1	–
Forward contracts	**28,216**	**425**	**734**	**233**	15,500	134	324	107
Currency futures	**15**	**–**	**–**	**–**	13	–	–	–
Currency swaps and options	**3,538**	**58**	**168**	**61**	2,380	42	84	29
	32,649	**484**	**903**	**294**	18,139	177	409	136
Other derivative contracts								
Credit	**290**	**27**	**62**	**12**	290	17	52	10
Equity	**151**	**2**	**11**	**4**	103	4	11	4
Long dated forwards	**1,016**	**9**	**–**	**–**	–	–	–	–
	1,457	**38**	**73**	**16**	393	21	63	14
Total	**$ 52,261**	**$ 618**	**$ 1,127**	**$ 351**	$ 32,663	$ 276	$ 602	$ 189

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 OSFI 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 OSFI 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:*

	2006								
	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	**$ 765**	**$ –**	**$ –**	**$ 765**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 765**
Swaps	**1,056**	**3,287**	**683**	**5,026**	**5,987**	**5,965**	**372**	**12,324**	**17,350**
Caps	**–**	**40**	**–**	**40**	**–**	**–**	**–**	**–**	**40**
	1,821	**3,327**	**683**	**5,831**	**5,987**	**5,965**	**372**	**12,324**	**18,155**
Foreign exchange contracts									
Spot contracts	**829**	**–**	**–**	**829**	**51**	**–**	**–**	**51**	**880**
Forward contracts	**20,864**	**440**	**–**	**21,304**	**6,893**	**19**	**–**	**6,912**	**28,216**
Currency futures	**15**	**–**	**–**	**15**	**–**	**–**	**–**	**–**	**15**
Currency swaps and options	**1,555**	**1,316**	**659**	**3,530**	**–**	**8**	**–**	**8**	**3,538**
	23,263	**1,756**	**659**	**25,678**	**6,944**	**27**	**–**	**6,971**	**32,649**
Other derivative contracts									
Credit	**–**	**–**	**–**	**–**	**–**	**290**	**–**	**290**	**290**
Equity	**151**	**–**	**–**	**151**	**–**	**–**	**–**	**–**	**151**
Long dated forwards	**1,016**	**–**	**–**	**1,016**	**–**	**–**	**–**	**–**	**1,016**
	1,167	**–**	**–**	**1,167**	**–**	**290**	**–**	**290**	**1,457**
Total	**$ 26,251**	**$ 5,083**	**$ 1,342**	**$ 32,676**	**$ 12,931**	**$ 6,282**	**$ 372**	**$ 19,585**	**$ 52,261**

Notes to Consolidated Financial Statements (continued)

17 Derivative instruments *(continued)*

	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)*

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.

	2006						
	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	**$ 20**	**$ (29)**	**$ (9)**	**$ 76**	**$ (39)**	**$ 37**	**$ 28**
Foreign exchange contracts							
Spot contracts	**1**	**(1)**	**–**	**–**	**–**	**–**	**–**
Forward contracts	**218**	**(219)**	**(1)**	**207**	**(5)**	**202**	**201**
Currency swaps and options	**58**	**(56)**	**2**	**–**	**–**	**–**	**2**
	277	**(276)**	**1**	**207**	**(5)**	**202**	**203**
Other derivative contracts							
Credit	**–**	**–**	**–**	**27**	**–**	**27**	**27**
Equity	**2**	**(2)**	**–**	**–**	**–**	**–**	**–**
Long dated forwards	**9**	**(9)**	**–**	**–**	**–**	**–**	**–**
	11	**(11)**	**–**	**27**	**–**	**27**	**27**
Total	**$ 308**	**$ (316)**	**$ (8)**	**$ 310**	**$ (44)**	**$ 266**	**$ 258**

	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)

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:

	2006									
	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	**$ 1,074**	**$ 2,616**	**$ 656**	**5.1**	**$ –**	**–**	**$ –**	**–**	**$ 368**	**$ 4,714**
Securities	**1,119**	**2,308**	**1,024**	**4.2**	**208**	**4.3**	**23**	**4.7**	**84**	**4,766**
Securities purchased under reverse repurchase agreements	**–**	**4,760**	**–**	**4.3**	**–**	**–**	**–**	**–**	**–**	**4,760**
Loans	**21,688**	**1,451**	**2,560**	**6.1**	**9,581**	**5.5**	**119**	**6.7**	**(163)**	**35,236**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**5,130**	**5,130**
Other assets	**254**	**–**	**–**	**7.5**	**–**	**–**	**–**	**–**	**1,910**	**2,164**
Total assets	**24,135**	**11,135**	**4,240**	**–**	**9,789**	**–**	**142**	**–**	**7,329**	**56,770**
Deposits	**9,420**	**15,873**	**10,078**	**3.4**	**3,358**	**4.1**	**6**	**4.5**	**5,438**	**44,173**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**5,130**	**5,130**
Securities sold under repurchase agreements	**–**	**162**	**–**	**4.3**	**–**	**–**	**–**	**–**	**–**	**162**
Other liabilities	**1,212**	**–**	**–**	**2.5**	**–**	**–**	**–**	**–**	**2,232**	**3,444**
Non-controlling interest in subsidiaries	**–**	**–**	**–**	**–**	**200**	**7.8**	**200**	**5.1**	**30**	**430**
Subordinated debt	**–**	**39**	**125**	**5.6**	**199**	**4.6**	**200**	**4.9**	**–**	**563**
Shareholders' equity	**–**	**–**	**–**	**–**	**350**	**5.1**	**–**	**–**	**2,518**	**2,868**
Total liabilities & shareholders' equity	**10,632**	**16,074**	**10,203**	**–**	**4,107**	**–**	**406**	**–**	**15,348**	**56,770**
On balance sheet gap	**13,503**	**(4,939)**	**(5,963)**	**–**	**5,682**	**–**	**(264)**	**–**	**(8,019)**	**–**
Off balance sheet positions	**–**	**(4,857)**	**2,185**	**–**	**2,467**	**–**	**205**	**–**	**–**	**–**
Total interest rate gap	**$ 13,503**	**$ (9,796)**	**$ (3,778)**	**–**	**$ 8,149**	**–**	**$ (59)**	**–**	**$ (8,019)**	**$ –**

18 Interest rate sensitivity position *(continued)*

	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)	$ –

19 Segmented information

a *Customer groups*

We manage and report our operations according to the customer group definitions used by Group. Various estimates and allocation methodologies are used in the preparation of the customer groups' financial information. We allocate expenses directly related to earning revenue to the groups that earned the related revenue. Expenses not directly related to earning revenue, such as overhead expenses, are allocated to customer groups using allocation formulas applied on a consistent basis. Customer group net interest income reflects internal funding charges and credits on the groups' assets, liabilities and capital, at market rates, taking into account relevant terms and currency considerations. The offset of the net impact of these charges and credits is reflected in Corporate, Investment Banking and Markets.

Notes to Consolidated Financial Statements (continued)

19 Segmented information *(continued)*

a *Customer groups (continued)*

A description of each customer group 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.

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.

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, 2006			
	Personal financial services	*Commercial banking*	*Corporate, investment banking and markets*	*Total*
Net interest income	**$ 380**	**$ 611**	**$ 124**	**$ 1,115**
Other income	**305**	**207**	**139**	**651**
Total revenue	**685**	**818**	**263**	**1,766**
Non-interest expenses	**522**	**315**	**69**	**906**
Net operating income	**163**	**503**	**194**	**860**
Provision for credit losses	**20**	**14**	**–**	**34**
Income before undernoted	**143**	**489**	**194**	**826**
Provision for income taxes	**48**	**169**	**68**	**285**
Minority interest	**7**	**15**	**4**	**26**
Net income	**$ 88**	**$ 305**	**$ 122**	**$ 515**
Average assets	**$ 18,307**	**$ 19,651**	**$ 16,160**	**$ 54,118**

	Year ended December 31, 2005			
	Personal financial services	*Commercial banking*	*Corporate, investment banking and markets*	*Total*
Net interest income	$ 360	$ 536	$ 114	$ 1,010
Other income	267	193	110	570
Total revenue	627	729	224	1,580
Non-interest expenses	466	303	55	824
Net operating income	161	426	169	756
Provision for credit losses	14	13	–	27
Income before undernoted	147	413	169	729
Provision for income taxes	47	134	56	237
Minority interest	7	13	2	22
Net income	$ 93	$ 266	$ 111	$ 470
Average assets	$ 16,750	$ 17,185	$ 13,347	$ 47,282

19 Segmented information *(continued)*

b *Geographic*

	2006			
	Assets		*Liabilities*	
	Amount	*Percent*	*Amount*	*Percent*
Canada	**$ 54,332**	**95.7**	**$ 49,588**	**92.0**
United States	**1,268**	**2.2**	**429**	**0.8**
Other countries	**1,170**	**2.1**	**3,885**	**7.2**
Total	**$ 56,770**	**100.0**	**$ 53,902**	**100.0**

	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
Other countries	1,174	2.4	3,887	8.4
Total	$ 49,210	100.0	$ 46,614	100.0

20 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 $68 million (2005 – $89 million) and were recorded in non-interest expenses.

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

An HSBC 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 HSBC Group companies, none of which are material to these financial statements.

For deposits received by us prior to July 1, 2005, the HSBC Group provided unlimited guarantees for our customers on these deposits. As consideration for provision of this guarantee, the HSBC 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.

In 2005, the Canadian Competent Authority of the Canada Revenue Agency (“CRA”) and the UK Competent Authority of 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 the HSBC 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 also entered into a separate agreement with CRA to acknowledge this arrangement under the BAPA. We also concluded a separate agreement, in principle, which required the HSBC 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. In 2006, all of the agreements summarized above were finalized as agreed.

As a result of these agreements, the HSBC Group reimbursed us $40 million in 2005. In 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 also recorded an offsetting $44 million increase in retained earnings, reflecting the gross amount of the reimbursement in 2005.

Notes to Consolidated Financial Statements (continued)

21 Variable interest entities

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.

	2006		2005	
	Total assets	*Maximum exposure to loss*	*Total assets*	*Maximum exposure to loss*
Unconsolidated VIEs:				
Securitization vehicles managed by the Bank(1)	**$ 524**	**$ 380**	$ 379	$ 90
Securitization vehicles managed by others(2)	**25,108**	**84**	31,362	71
Investment funds(3)	**1**	**1**	2,732	3
Consolidated VIEs:				
Specialised Financing Entity(4)	**700**	**–**	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.*

22 Principal subsidiaries

Principal subsidiaries (wholly-owned)	*Principal office address*	*Shareholders' equity*
HSBC Capital (Canada) Inc.	Vancouver, British Columbia	$ 52
HSBC Investments (Canada) Limited	Vancouver, British Columbia	13
HSBC Investment Funds (Canada) Inc.	Vancouver, British Columbia	9
HSBC Loan Corporation (Canada)	Vancouver, British Columbia	8
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia	99
HSBC Securities (Canada) Inc.	Toronto, Ontario	314
HSBC Trust Company (Canada)	Vancouver, British Columbia	55

The HSBC Group: International Network*

Services are provided by around 10,000 offices in 82 countries and territories:

Europe	Offices
Armenia	4
Belgium	3
Channel Islands	36
Cyprus	2
Czech Republic	11
France	822
Germany	12
Greece	27
Hungary	11
Ireland	13
Isle of Man	8
Italy	4
Luxembourg	4
Malta	54
Monaco	2
Netherlands	1
Poland	16
Russia	2
Slovakia	3
Spain	2
Sweden	4
Switzerland	10
Turkey	198
United Kingdom	1,668

Asia-Pacific	Offices
Australia	35
Bangladesh	9
Brunei Darussalam	12
China	69
Cook Islands	1
Hong Kong Special Administrative Region	340
India	69
Indonesia	14
Japan	5
Kazakhstan	1
Korea, Republic of	14
Macau Special Administrative Region	6
Malaysia	45
Maldives	1
New Zealand	8
Pakistan	5
Philippines	25
Singapore	23
Sri Lanka	12
Taiwan	16
Thailand	1
Vietnam	4

Americas	Offices
Argentina	248
Bahamas	8
Bermuda	17
Brazil	1,725
British Virgin Islands	1
Canada**	329
Cayman Islands	6
Chile	3
Colombia	31
Costa Rica	40
El Salvador	62
Honduras	74
Mexico	1,623
Nicaragua	1
Panama	78
Peru	1
United States of America	1,920
Uruguay	5
Venezuela	1

Middle East and Africa	Offices
Algeria	1
Bahrain	7
Egypt	34
Iran	1
Iraq	13
Israel	4
Jordan	2
Kuwait	1
Lebanon	6
Libya	2
Mauritius	12
Oman	6
Palestinian Autonomous Area	1
Qatar	6
Saudi Arabia	74
South Africa	4
United Arab Emirates	16

Associated companies are included in the network of offices.

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hsbc.ca/trust

For more information, or to find the HSBC Bank Canada branch nearest you, call 1 (888) 310-4722 or visit our website: hsbc.ca

* *As at March 5, 2007.*
** *Includes 133 offices of HSBC Financial Corporation Limited and 19 offices of its subsidiary Invis Inc.*

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** As at March 5, 2007.*

Form number 1040146 (03/07). Published by Public Affairs Department, HSBC Bank Canada, Vancouver

Cover designed by Addison Corporate Marketing Limited, London; text pages designed by Group Public Affairs, The Hongkong and Shanghai Banking Corporation Limited, Hong Kong

Printed by Hemlock Printers, Burnaby, BC, Canada, on ChorusArt Silk paper using vegetable oil-based inks. Made in Italy, the paper comprises 50% virgin fibre, 25% de-inked post-consumer waste and 25% pre-consumer waste. Pulps used are elemental chlorine free.

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SW-COC-1563
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