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HSBC Bank Canada

Annual Report and Accounts 2008

2008
HSBC Bank Canada Annual Report and Accounts

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Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 290 offices, including over 140 bank branches. With around 9,500 offices in 86 countries and territories and assets of US$2,527 billion at December 31, 2008, the HSBC Group is one of the world's largest banking and financial services organizations.

Shareholder Information

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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 (866) 249-7775

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

Dividend record and payable dates in 2009 for our preferred shares, subject to approval by our Board of Directors, are:

Record Date	*Payable Date*
March 13	March 31
June 15	June 30
September 15	September 30
December 15	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 to Canadian residents in 2006 and subsequent years are eligible dividends unless indicated otherwise.

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Message from the President and Chief Executive Officer

In a year marked by significant market volatility and economic pressures, I am pleased with the way HSBC Bank Canada has been able to manage through these challenges. I would like to thank our customers for their continued commitment to the bank and recognize the strength we draw from being a member of one of the most strongly capitalized and liquid banks in the world. Despite the difficult environment we have been able to build on past successes and position the bank for the future.

HSBC remains committed to growing our business in Canada, opening nine new branches in Alberta and Ontario in 2008, bringing our network to over 140 bank branches across the country. Our branch network was also realigned to provide more specialized service to our customers and enhance the work experience for our staff.

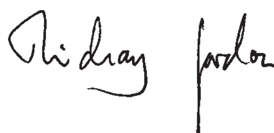
To move towards our goal of becoming the Best Bank for Small Business, we launched *HSBC BusinessVantage*, a portfolio of services designed to meet the needs of small to medium sized business banking clients and upgraded our Business Internet Banking.

For personal financial services clients we leveraged our global connections to introduce the HSBC Global Climate Change Fund, new British Pound and Euro High Rate Savings Accounts, and expanded our Global Investor Immigration Services in Quebec. We also saw continued strong growth in HSBC Premier, our global banking and wealth management service.

As part of an international branding exercise and to improve our brand visibility, HSBC signed a five-year agreement to brand the fixed links and jet bridges that carry passengers to aircraft at Toronto's Pearson International Airport in 2008 and recently announced a similar project with the Vancouver International Airport.

HSBC is committed to employee engagement and we make considerable efforts to ensure that we are an employer of choice in order to attract and retain the best and brightest employees in the country. We are pleased to have been selected as one of MediaCorp's "Canada's Top 100 Employers" for the third year running. We also received recognition as one of "BC's Top 50 Employers", "Canada's Most Earth-Friendly Employers", "Best Employers for 50-Plus Canadians" and "Canada's Best Diversity Employers".

Our achievements in a turbulent period are a testament to our dedicated staff in all areas of the organization. I would like to thank all of our employees who work diligently to deliver the highest level of customer service of 'The world's local bank' each and every day. Their energy and drive to improve the organization are a source of great pride.



Lindsay Gordon
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
February 18, 2009

Management's Discussion and Analysis

Five Year Financial Summary

(in $ millions, except where stated)	Years Ended December 31				
	2008	2007(1)	2006(1)	2005(1)	2004(1)
Condensed statements of income					
Net interest income	**$ 1,644**	$ 1,718	$ 1,545	$ 1,391	$ 1,218
Non-interest revenue	**837**	781	690	598	539
Total revenue	**2,481**	2,499	2,235	1,989	1,757
Non-interest expenses					
Salaries and employee benefits	**644**	687	624	543	496
Premises and equipment(2)	**165**	153	140	126	113
Other	**421**	431	365	340	314
Total non-interest expenses	**1,230**	1,271	1,129	1,009	923
Net operating income before provision for credit losses	**1,251**	1,228	1,106	980	834
Provision for credit losses	**379**	239	175	157	180
Income before the undernoted	**872**	989	931	823	654
Effect of accounting change	**–**	–	–	–	14
Income before taxes	**872**	989	931	823	668
Provision for income taxes	**253**	347	324	270	241
Non-controlling interest in income of trust	**26**	26	26	22	16
Income from continuing operations	**593**	616	581	531	411
Income from discontinued operations	**–**	–	–	–	5
Net income	**$ 593**	$ 616	$ 581	$ 531	$ 416
Preferred share dividends	**20**	18	18	13	8
Net income attributable to common shares	**$ 573**	$ 598	$ 563	$ 518	$ 408
Basic earnings per common share ($)(3)	**1.09**	1.16	1.09	1.00	0.80
Financial ratios (%)(4)					
Return on average common equity	**16.6**	19.6	20.8	21.1	18.9
Return on average total assets	**0.77**	0.88	0.96	1.02	0.94
Net interest margin	**2.59**	2.91	2.97	3.03	3.15
Non-interest revenue: total revenue ratio	**33.7**	31.3	30.9	30.1	30.7
Cost efficiency ratio	**49.6**	50.9	50.5	50.7	52.5
Credit information					
Gross impaired credit exposures	**932**	420	302	269	287
Allowance for credit losses					
Balance at end of period	**615**	514	473	459	468
As a percentage of gross impaired credit exposures (%)	**66**	122	157	171	163
As a percentage of gross loans and acceptances outstanding (%)	**1.24**	1.03	1.05	1.15	1.32
Average balances(4)					
Assets	**$ 73,952**	$ 68,194	$ 58,464	$ 50,777	$ 43,182
Loans	**44,331**	42,351	37,818	34,053	29,668
Deposits	**52,109**	47,484	41,906	37,342	30,825
Common equity	**3,462**	3,051	2,705	2,457	2,162
Balance sheet highlights					
Total assets	**72,049**	68,130	61,448	53,082	46,209
Total loans and acceptances, net of allowance for credit losses	**48,855**	49,322	44,707	39,469	34,875
Business and government loans	**23,067**	21,322	17,819	15,571	13,450
Residential mortgage loans	**11,869**	12,920	14,016	12,865	11,966
Total deposits	**51,962**	48,878	44,174	38,610	33,850
Deposits from individuals	**21,064**	18,292	17,040	15,302	14,820
Shareholders' equity	**4,153**	3,612	3,210	2,898	2,466
Risk-based capital ratios (%)(5)					
Tier 1 capital	**10.1**	8.8	9.0	9.0	8.6
Total capital	**12.5**	11.3	11.1	11.2	11.0
Funds under management	**$ 21,287**	$ 26,213	$ 23,340	$ 20,453	$ 17,687
Custodial accounts	**9,221**	10,914	8,574	7,594	5,077
Total assets under administration	**$ 30,508**	$ 37,127	$ 31,914	$ 28,047	$ 22,764

(1) *Reported comparative periods restated for the impact of the acquisition of HSBC Financial Corporation Limited (note 2 on pages 58 to 61). 2004 also restated for the impact of discontinued operations.*
(2) *Premises and equipment expenses includes amortization.*
(3) *Basic earnings per common share is not materially different from basic earnings per common share from continuing operations.*
(4) *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 4.*
(5) *Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada ("OSFI"). Effective January 1, 2008, the bank has adopted a revised capital adequacy framework, refer to page 22 for further information. Reported comparative periods' capital ratios have not been restated for the impact of the acquisition of HSBC Financial Corporation Limited as it is not meaningful to restate these ratios.*

Management's Discussion and Analysis (continued)

HSBC Bank Canada's ("the bank", "we", "our") Management's Discussion and Analysis ("MD&A") is dated February 18, 2009, the date that our consolidated financial statements and MD&A for the year ended December 31, 2008 were approved by our Board of Directors ("the Board").

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 otherwise stated. Certain financial information we are required to disclose as part of the MD&A is included in the table on page 3, 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 are 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.

The sections included in the MD&A on risk management where indicated on pages 23 to 37 form an integral part of the consolidated financial statements and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2008 and the related auditors' report.

We make a number of references throughout this MD&A to "notes" which means notes to the 2008 audited consolidated financial statements, which are included with the MD&A in our Annual Report and Accounts.

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, certifications by our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as well as other continuous disclosure documents, with SEDAR. Copies of these documents can be obtained from SEDAR's website: sedar.com and our website: hsbc.ca. Certain financial information for one of the bank's subsidiaries, HSBC Financial Corporation Limited ("HSBC Financial") can also be located on sedar.com.

Outstanding securities data. Note 13 on page 69 contains details of the number of preferred and common shares issued and outstanding at December 31, 2008. Note 11 on pages 67 and 68 contains details of the number of HSBC Canada Asset Trust Securities ("HSBC HaTS™") outstanding at December 31, 2008. 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.

Overview

In Canada, we are the largest full-service, internationally owned bank and seventh largest bank overall with operations across the country and total assets of more than $72 billion at December 31, 2008.

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 290 offices across Canada, including over 140 bank branches, we provide personal and commercial banking services, global 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 centers.

In 2008, we acquired HSBC Financial from a US affiliate. HSBC Financial was originally established in 1928 and provides a wide range of consumer finance products and services to Canadian customers though its network of over 90 branches.

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 world-wide 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 offices in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. Shares in HSBC Holdings are listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges. The shares are traded in New York in the form of American Depositary Receipts.

Through an international network linked by advanced technology, the HSBC Group provides a comprehensive range of financial services: personal financial services, including consumer finance, insurance, commercial banking, global 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 HSBC Holdings plc 2008 Annual Review and its 2008 Annual Report and Accounts.

Our Business Focus

Strategy

We aspire to be the leading international financial services company in Canada. We want to be the best place to bank for our customers and the best place to work for our employees. To achieve this ambition, we will execute along the following key areas of focus:

Our Customers
Customers are our foundation and our future. We will improve the customer experience by living our brand values, so that customers feel HSBC is the best place to bank.

Our Brand
We want to be the world's best financial services brand. We have operations in an international network throughout Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. We want a customer's perception of HSBC, wherever they are in the world, to be uniformly excellent.

Our Culture
We want to be recognized as the world's most respected and customer-driven financial services employer because we know that the motivation, or engagement, of our employees is a critical factor in business performance.

Management's Discussion and Analysis (continued)

Our Global Distribution
HSBC's global reach is its key competitive advantage. In today's globalizing world, we can offer our customers an unparalleled international service and we are working to create a truly joined up network, with seamless referrals between countries, to support customers around the world.

Our Businesses
We will prioritize the allocation of our capital so that it generates the best return for shareholders in the long term. We want our businesses to be self-funding. We will focus capital investment in areas with strong growth potential in relation to risk taken.

Our Technology and Process
We will use technology to make it easier for customers to do business with us, when and where they want it. At the same time, we will improve our efficiency by simplifying our product range and automating our processing. Where possible, we will leverage technology and processes developed by HSBC Group.

Our Organization
We will give responsibility for delivery of our objectives to branch managers and heads of customer groups and global businesses, with HSBC Group, regional and country head offices providing guidance and, where appropriate, delegating authority.

Customer Groups

We manage and report our operations around the following customer groups: Personal Financial Services, Commercial Banking, Global Banking and Markets and Consumer Finance. 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 Global Asset Management (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 quoted 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 HSBC's extensive network in the NAFTA countries, South America, Europe and Asia. We provide this service through commercial branches and subsidiary offices, including those of HSBC Securities (Canada) Inc., HSBC Global Asset Management (Canada) Limited and HSBC Capital (Canada) Inc., as well as through HSBC Group's worldwide network.

Global Banking and Markets serves Canadian and international corporations, institutions and governments that require both domestic and international financial services. Global Banking and Markets 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 Global Banking and Markets services through our principal branches and subsidiary offices, coordinated with HSBC Group worldwide operations through one relationship manager. Our ability to leverage the HSBC Group's worldwide network in providing comprehensive global banking and market services to sophisticated multinational clients is a significant competitive advantage.

Consumer Finance, through the bank's wholly-owned subsidiary, HSBC Financial, acquired in 2008, provides consumer finance products and solutions to Canadians through a network of 93 retail branches and other distribution channels. Products include real estate secured loans, personal loans and specialty insurance products and credit cards including private-label credit cards to retail merchants. The bank's branch network works collectively with HSBC Financial to deliver products and services to benefit mutual customers.

Highlights For 2008

2008 was another year of progress for us, despite significant market turmoil, as we continued to execute our strategy to build our business in Canada. Particularly noteworthy accomplishments included:

Our Customers – We have realigned our branch network to provide greater depth of expertise and specialization within Personal Financial Services and Commercial Banking, with the objective of better serving our customers and enhancing work experience for our staff.

Our Brand – HSBC's global brand is based on our core belief that differences create value. We combine our global reach with local knowledge to meet the needs of different customers around the world. We have developed HSBC as a "challenger" brand in Canada, offering a full range of financial services in a different way from our competitors. This means helping clients reach their goals faster through fresh ideas and innovative solutions.

As part of our branding efforts in Canada, in 2008 HSBC signed a five year agreement with Toronto Pearson International Airport to brand the interiors and exteriors of the fixed links and jet bridges that carry passengers to aircrafts. A similar agreement with the Vancouver International Airport was recently announced. This is part of a unique international branding strategy undertaken by HSBC Group to demonstrate our global presence at a local level, covering global centers such as London (Heathrow), New York (Kennedy and LaGuardia) and Tokyo (Narita).

We have changed the name of our asset management business to HSBC Global Asset Management (Canada) Limited, consistent with HSBC Group's asset management businesses around the world. The name change better reflects the breadth, strength and expertise of our business and highlights one of our key competitive advantages, our global footprint, which complements our deep roots in local markets.

In 2008, we used a Green Focus campaign to raise awareness both internally and externally of HSBC's global commitment to corporate sustainability. This program engaged and encouraged active staff participation in adopting greener habits and recognized clients who took advantage of special green offers, including the new HSBC Global Climate Change Fund.

Our Culture – For the third year running, we have been selected as one of MediaCorp's "Canada's Top 100 Employers" as featured in *Maclean's* Magazine. We have also received recognition from MediaCorp as one of "BC's Top 50 Employers" as well as one of twenty-five "Canada's Best Diversity Employers", one of "Canada's Most Earth Friendly Employers" and from Canada's Association for the Fifty-Plus as the "Best Employers for 50-Plus Canadians". We were commended for creating an internal scorecard for diversity initiatives, performance objectives, training and an awards program.

Our Global Distribution – We continued to build on the earlier relaunch of HSBC Premier. The HSBC Group increased the international network of Premier offices to 41 countries and territories, offering the first truly global personal banking service for the world's mass affluent and internationally mobile consumers. We have achieved successful referral results from the re-launch of Global Links, a system which tracks and measures cross-border referrals within HSBC worldwide.

Our Businesses – We launched *HSBC BusinessVantage*, a portfolio of services designed to meet the needs of small to medium sized business banking clients. With this launch, we aim to emphasize the importance of Business Banking in Canada and deliver on HSBC Group's mandate to be "The Best Bank for Small Business". We have also introduced Online Margining that allows our commercial clients to upload their financial information directly to our software using the Internet instead of mailing, faxing or emailing it to their relationship managers. The new online system performs detailed financial statement spreading, margin calculation and covenant analysis, which allows HSBC to make credit decisions more quickly.

We expanded our Global Investor Immigration Services ("GIIS") in Quebec and opened a new HSBC Capital (Canada) Inc. office in Montreal. The Immigrant Investor Program ("IIP") was created by the Quebec Government to attract successful business immigrants and new investment capital to Quebec. The addition of Quebec to our list of destinations is of tremendous interest for our commercial banking clients.

We launched a number of new products including the HSBC Global Climate Change Fund and new High Rate Savings accounts in European currencies.

Management's Discussion and Analysis (continued)

As a result of an ongoing strategic review of the HSBC Group's North American operations, we acquired HSBC Financial from HSBC Finance Corporation in the US to "join up" all members of the HSBC Group in Canada under one corporate structure.

Nationally, we continued to expand our footprint opening nine new bank branches in growing communities.

Our Technology and Process – The HSBC Group has embarked on a global "One HSBC" project to streamline its business processes and products around the needs of its customers, and provide world class globally consistent technology to support the HSBC business across all geographies and across all customer groups. The HSBC Global Finance Change Program is an initiative to design a global function, which delivers to HSBC a professional, effective and responsive finance service, employing a common and transparent global model.

Business Internet Banking ("BIB") was upgraded to the new "2nd Generation" platform, creating a common system with the existing Personal Internet Banking service. This also allowed BIB to be fully integrated with the public website to provide a fused navigation experience for our customers.

Our Organization – Amidst a challenging year in 2008, the execution of our strategy, including our prudent lending standards has helped us maintain our strong capital base, strong liquidity and diversified income stream. We plan to continue our existing strategy of working with customers to meet their personal and business needs while maintaining close control over credit quality.

Our focus on enterprise wide risk management activities includes a newly created position of Chief Risk Officer and development of new risk management tools.

Following a strategic review of the Canadian Auto Finance business we sold the majority of our auto finance portfolio. The strategic review was prompted as a result of the performance of the auto finance receivables and the business being viewed as a largely stand-alone portfolio not within the bank's current strategic focus.

We fully adopted and implemented the Basel II framework for calculating capital requirements for credit risk. We received OSFI approval for calculating our capital requirements for credit risk under the Advanced Internal Ratings Based ("AIRB") approach. This approach permits the bank to use internal estimates for certain risk measures, for calculating risk weights for credit risk. This is a significantly different approach than the treatment under the Basel I accord, providing a more accurate alignment of minimum capital requirements to the institution's underlying risk profile.

Outlook For 2009

We believe 2009 will be a challenging year. The recent market turmoil resulted in further depreciation of the Canadian dollar, a drop in commodity prices resulting in a steep drop in export prices, gradually rising unemployment, falling real estate prices, and a decline in terms of trade and real income growth. The Canadian economy has entered a recession as a result of the deteriorating world economy. The economic slowdown experienced in the second half of 2008 is expected to continue throughout 2009 with a consequent shrinkage in Gross Domestic Product. Inflation is expected to remain low and real estate and equity markets will remain under pressure.

We anticipate 2009 to be a continuation of the extremely competitive environment for both personal and commercial businesses in Canada, with continued pressure on margins and funding. In our Consumer Finance segment, we expect continued pressure on credit losses because of reductions in property values and higher unemployment. However, with our focus on key principles of a strong capital base, a diversified income stream and strong liquidity, we intend to position the bank to maximize opportunities when conditions improve.

Our Focus For 2009

During 2009, we plan to grow our business amidst a deteriorating global economic outlook by focusing on the following:

Our Customers – We will focus on our customers and segments where we have a natural "right to win" and ensure effective implementation of a business re-alignment of Personal and Commercial Banking to offer improved and customer-focused services. We will continue to focus on our Premier and Direct customer base in order to grow our core deposits and wealth management revenue-earning opportunities. We will continue to support our customers during expected difficult economic conditions when appropriate to do so.

Our Brand – Consistent with HSBC Group strategy of "The world's local bank", we will continue to invest in and develop our differentiated "challenger" brand and support local events and venues across Canada to help build stronger communities.

Our Culture – In order to build on our customer service excellence, we will leverage off consecutive years of external recognition as a Top Employer, by enhancing recruitment initiatives and engaging employees while tying management performance more closely to our annual employee engagement surveys. We have joined up with HSBC North America's Human Resources teams to provide Canadian staff with improved guidance, advice and support and greater career opportunities.

Our Global Distribution – We continue to focus on opportunities and product support (IT, Marketing and Product) throughout the HSBC Group to leverage and drive growth across all business lines. Specifically, we aim to improve efficiency through the "One HSBC" business platform and leverage off Centres of Excellence and Global Resourcing Centres. We will continue to leverage our Global Centres of Excellence in our Consumer Finance segment to drive down costs and minimize loan delinquency during the economic slowdown. We continue to drive new leads via Global Links, our international customer referral system, and align key performance metrics to drive referral business internally.

Our Business – We will expand our small to medium enterprise customer segment, including launching Business Direct. We aim to enhance our payments and cash management capabilities, improve wealth management capabilities, integrate and better cross-sell between HSBC entities. Finally, as part of our effort to increase our presence in communities across the country, we will continue our branch expansion efforts.

Our Technology and Process – We plan to ensure successful phased implementation of "One HSBC" in 2009, "joining up" with HSBC on a global level. The objective of "One HSBC" is to build a single, modern global business platform to meet the needs of our customers, shareholders and staff. "One HSBC" will allow us to deliver a consistent customer experience worldwide, while leveraging our global scale. It will also contribute to reduction of waste through the elimination of inefficient processes and unnecessary costs from the business while supporting our environmental sustainability targets through a paperless system. We also plan to improve our direct banking capabilities and leverage HSBC Group's Global Resourcing Centres to strategically manage our costs.

Our Organization – 2009 is expected to be a challenging year as the Canadian and global economic outlook is expected to continue to deteriorate. However, HSBC Group remains one of the largest and most strongly capitalized banks in the world. We will continue to aggressively manage loan delinquency and maximize capital efficiency. As a result, we are very well positioned to weather the storm and have a long history of meeting such challenges. We plan to meet or exceed all regulatory capital requirements, continue to operate within HSBC Group limits and guidelines, deepen management experience through HSBC Group's resources, ensure investments made meet HSBC Group's key performance metrics and leverage off HSBC Group first as we "join up". We will continue to manage and mitigate our credit and operational risk by staying close to our customers.

Management's Discussion and Analysis (continued)

Analysis of Financial Results For 2008

- Net income attributable to common shares was $573 million for 2008, a decrease of 4.2 per cent compared with $598 million for 2007.
- Return on average common equity was 16.6 per cent for 2008 compared with 19.6 per cent for 2007.
- The cost efficiency ratio was 49.6 per cent for 2008 compared with 50.9 per cent for 2007.
- Total assets were $72.0 billion at December 31, 2008, an increase of $3.9 billion, or 5.7 per cent, from $68.1 billion at December 31, 2007.
- Total funds under management were $21.3 billion at December 31, 2008, a decrease of $4.9 billion, or 18.7 per cent, from $26.2 billion at December 31, 2007.

Overview

Effective November 30, 2008, the bank completed the acquisition of HSBC Financial. Results for 2008 and prior years have been restated to combine the previously reported results of the bank with those of HSBC Financial to reflect the continuity of interests method of accounting. References in this MD&A to "banking operations" relate to those excluding the Consumer Finance business of HSBC Financial. For full details on the impact of the acquisition of HSBC Financial, reference should be made to note 2 to the Consolidated Financial Statements.

Net income attributable to common shares for 2008 was $573 million, a decrease of $25 million or 4.2 per cent compared with $598 million on a restated basis for 2007. We recorded an additional charge in respect of our holdings of Canadian non-bank sponsored Asset Backed Commercial Paper ("non-bank ABCP") of $49 million, net of income taxes of $24 million, compared to $30 million for 2007. In addition, a loss of $24 million, net of income taxes of $12 million, was recorded arising from the sale of the automobile loan portfolio, of which $4 million related to the portion of the portfolio previously held by HSBC Financial. In 2007 a gain of $21 million after income taxes was recorded on the disposal of shares in the Montreal Stock Exchange.

Net interest income

As a result of the wider interest margin earned in the Consumer Finance business, net interest margins have increased compared to those reported prior to the acquisition of HSBC Financial.

For 2008, net interest income was $1,644 million compared with $1,718 million for 2007, a decrease of $74 million, or 4.3 per cent. For the year as a whole, the increases derived from the growth in assets were more than offset by the adverse effect of the challenging interest rate environment on net interest margin, which decreased to 2.59 per cent compared with 2.91 per cent in 2007. Ongoing reductions in prime rates during 2008 resulted in reduced interest income on our floating rate loans, which was not offset by an equal reduction in interest expense as our deposits repriced downwards less quickly. Also impacting spread was the reduction in the value of interest free funds and low interest deposits in a falling interest rate environment as well as the lower rates earned on government and other high quality securities, which have increased following a planned increase in liquidity. In addition, wider credit spreads experienced across the banking industry also adversely impacted the cost of wholesale funding.

Net interest income from banking operations decreased by $55 million in 2008 compared with the prior year, of which $15 million was related to the sale of the bank's automobile loan portfolio, in July 2008, which also had an adverse impact on net interest margin. This decreased from 2.26 per cent to 1.99 per cent in 2007, resulting from the impacts on margins also noted above. Net interest income for the Consumer Finance business decreased by $19 million and net interest margin decreased from 10.13 per cent to 9.71 per cent, including a $10 million impact from the sale of the auto finance portfolio and lower average receivable and investment balances.

Non-interest revenue

For 2008, non-interest revenue was $837 million, $56 million, or 7.2 per cent, higher compared with $781 million for 2007. Trading revenue increased by $97 million, primarily due to an $86 million increase in the fair value of certain debt obligations recorded at fair value due to widening credit spreads, a $62 million increase in foreign exchange revenue resulting from initiatives undertaken to improve business with customers and from the volatility in foreign exchange markets, the benefit of lower foreign currency funding in the lower interest rate environment in the United States, and a $14 million increase in trading gains on fixed income securities. These increases were partially offset by $61 million of mark-to-market losses on interest rate derivatives used in balance sheet management activities that arose from falling interest rates as well as $11 million of trading losses on non-bank ABCP compared with $8 million in 2007. Securitization income increased by $45 million as a result of increased activity and from the beneficial impact of falling interest rates. Revenues from customer banking activities, including deposit and payment service charges and credit fees, were $20 million higher due to increased customer activity, reflecting the underlying strength of the banking business. Following revisions to the terms of the Montreal Accord as well as a deterioration in market conditions during 2008, the bank recorded an additional impairment of $62 million on non-bank ABCP, compared with $38 million in 2007, recorded as losses on available-for-sale securities. This write-down, along with an other-than-temporary impairment on other available-for-sale ("AFS") securities, resulted in a $55 million increase in losses on AFS securities compared to 2007, which included a gain of $25 million on the sale of Montreal Stock Exchange shares. Other non-interest revenue decreased in 2008 by $26 million, mainly as a result of a $36 million loss on the disposal of the automobile loan portfolio, partially offset by a $10 million increase in fees from the Canadian IIP. Capital market fees decreased by $21 million due to lower market activity in 2008, particularly new issue and underwriting mandates, resulting from market uncertainties. Gains on other securities decreased by $9 million due to a lower contribution from private equity fund investments compared with the prior year.

Non-interest expenses and operating efficiency

For 2008, non-interest expenses were $1,230 million compared with $1,271 million for 2007, a decrease of $41 million, or 3.2 per cent. Salaries and employee benefits were $43 million lower primarily due to lower staff costs in Consumer Finance operations due to a contraction in their branch network, lower variable compensation and a lower charge for pension and benefits resulting from the release of a valuation allowance previously applicable to pension plan assets. Expenses related to premises and equipment increased by $12 million due to new banking branches and higher information technology costs, but were largely offset by decreases in other expenses including a restructuring charge recorded by HSBC Financial in 2007 to reduce the size of their branch network. The cost efficiency ratio was 49.6 per cent in 2008 compared with 50.9 per cent for 2007.

Credit quality and provision for credit losses

The provision for credit losses for 2008 was $379 million compared to $239 million for 2007. The increased charge in 2008 compared to 2007 was due to an increase in credit losses arising from the deteriorating credit environment. The increase in provision for credit losses from banking operations arose entirely in the Commercial Banking segment with an increase of $84 million arising from exposures across all business sectors compared to previous periods which reflected a benign credit environment with historically low losses. Credit loss provisions for Consumer Finance operations for 2008 increased by $56 million to $228 million compared with $172 million in 2007.

Gross impaired credit exposures were $932 million, or $512 million higher compared with $420 million at December 31, 2007. Total impaired exposures, net of specific allowances for credit losses, were $770 million at December 31, 2008 and $336 million at December 31, 2007. However, the total of impaired exposures includes $207 million (2007 – $172 million) of Consumer Finance and other consumer loans, for which impairment is assessed collectively and no specific impairment is recorded. The increase in impaired credit exposures was driven by the deterioration of economic conditions across all business sectors.

Management's Discussion and Analysis (continued)

The general allowance for credit losses of $259 million applicable to the banking portfolio was $10 million lower compared to $269 million at December 31, 2007 as a result of the sale of the automobile loan portfolio. During the fourth quarter of 2008, our provision methodologies were amended for both our retail and commercial portfolios that reflect increased granularity and risk sensitivity. The general allowance applicable to Consumer Finance loans was $194 million compared to $161 million at December 31, 2007. The total allowance for credit losses, as a percentage of loans and acceptances outstanding, was 1.24 per cent at December 31, 2008 compared with 1.03 per cent at December 31, 2007. The bank considers the total allowance for credit losses to be appropriate given the credit quality of its portfolios and the current credit environment.

Income taxes

The effective tax rate for 2008 was 29.9 per cent compared with 36.0 per cent in 2007. The lower tax rate in 2008 arises from a reduction in statutory tax rates, together with the impact of the release of a pension plan allowance which is not taxable and the impact of lower tax rates on future income.

Balance sheet

Total assets at December 31, 2008 were $72.0 billion, an increase of $3.9 billion from December 31, 2007 restated to reflect the acquisition of HSBC Financial.

We further strengthened our liquidity with increased holdings of treasury bills and other government guaranteed securities. The securities portfolio increased by $3.8 billion, and there were increases in balances under reverse repurchase agreements of $0.6 billion.

Although there has been a slowdown in business activity, commercial loans grew by $1.8 billion, partially offset by a reduction in acceptances of $0.5 billion. Residential mortgages increased by $0.9 billion during 2008, but, as a result of securitization, there was a net decrease of $1.0 billion.

The mark-to-market amount of derivatives, principally interest rate swaps and forward foreign exchange contracts, increased considerably as a result of significant changes in the underlying interest and foreign exchange rates on which derivative valuations are based.

Total deposits increased by $3.1 billion to $52.0 billion at December 31, 2008 from $48.9 billion at December 31, 2007. Growth in personal deposits resulted largely from the new High Rate and Direct Savings accounts. Commercial deposits were higher due to growth in term products, driven by improved product offerings in the Payments and Cash Management business and growth in commercial banking relationships as we targeted an increase in our portfolio of core customer deposits. These increases were partially offset by a reduction in wholesale deposits of $1.8 billion.

Total assets under administration

Declines in equity markets, particularly over the last few months of 2008, had an adverse impact on funds under management, which decreased to $21.3 billion at December 31, 2008 compared with $26.2 billion at December 31, 2007. Including custody and administration balances, total assets under administration were $30.5 billion compared with $37.1 billion at December 31, 2007.

Quarterly Summary of Condensed Statements of Income

	2008				2007			
	Quarter ended				Quarter ended			
	Dec. 31	***Sept. 30*** [(1)]	***June 30*** [(1)]	***March 31*** [(1)]	*Dec. 31* [(1)]	*Sept. 30* [(1)]	*June 30* [(1)]	*March 31* [(1)]
				(Unaudited)				
Net interest income	**$ 375**	**$ 421**	**$ 423**	**$ 425**	$ 429	$ 445	$ 430	$ 414
Non-interest revenue	**223**	**171**	**204**	**239**	198	202	187	194
Total revenue	**598**	**592**	**627**	**664**	627	647	617	608
Non-interest expenses	**295**	**314**	**311**	**310**	339	311	312	309
Net operating income before provision for credit losses	**303**	**278**	**316**	**354**	288	336	305	299
Provision for credit losses	**136**	**86**	**82**	**75**	72	65	53	49
Income before taxes	**167**	**192**	**234**	**279**	216	271	252	250
Provision for income taxes	**38**	**62**	**64**	**89**	85	94	87	81
Non-controlling interest in income of trust	**7**	**6**	**7**	**6**	7	6	7	6
Net income	**$ 122**	**$ 124**	**$ 163**	**$ 184**	$ 124	$ 171	$ 158	$ 163
Preferred share dividends	**7**	**4**	**5**	**4**	5	4	5	4
Net income attributable to common shares	**$ 115**	**$ 120**	**$ 158**	**$ 180**	$ 119	$ 167	$ 153	$ 159
Basic earnings per share ($)	**0.22**	**0.23**	**0.30**	**0.34**	0.23	0.32	0.30	0.31

(1) *Reported comparative periods restated for the impact of the acquisition of HSBC Financial (note 2 on pages 58 to 61).*

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 may be lower compared with the other three quarters.

The credit and liquidity crisis have affected market rates over the last eight quarters resulting in increased credit spreads, falling interest margins and lower value from interest free deposits which led to a consequent reduction of net interest income since the end of 2007.

Weakening economic conditions over the past twelve to eighteen months have impacted our business. We have experienced higher levels of loan delinquency as a result of weakening economic conditions over the past year resulting in increased provisions for credit losses.

Costs have remained mostly stable over the past two years except for restructuring costs recorded by HSBC Financial as well as a pension valuation allowance due to the increase in the value of pension plan assets in the fourth quarter of 2007. In the fourth quarter of 2008, lower costs were caused by a release in the pension valuation allowance due to a reduction in the value of pension plan assets and lower variable compensation.

Over the last eight quarters, our business has been affected by a number of favourable and unfavourable items. In the first and second quarters of 2007, exceptional gains were recognized in non-interest revenue due to the sale of Montreal Stock Exchange shares. In the fourth quarter of 2007, we recorded a $42 million charge related to non-bank ABCP and a tax increase of $11 million resulting from a write-off of future income taxes. In the third quarter of 2008, a loss of $36 million was recorded as a reduction of other income related to the sale of the automobile loan portfolio. During the third and fourth quarters of 2008, we recorded additional charges and write-downs related to our holdings of non-bank ABCP of $15 million and $58 million, respectively.

Management's Discussion and Analysis (continued)

Analysis of financial results for the fourth quarter, 2008

Net interest income

Net interest income was $375 million for the fourth quarter of 2008 compared with $429 million for the same quarter in 2007, a decrease of $54 million, or 12.6 per cent. Average interest earning assets decreased to $61.1 billion from $61.6 billion, which was further affected by the challenging interest rate environment on the net interest margin, which decreased to 2.44 per cent in the fourth quarter of 2008 compared with 2.76 per cent in the same period in 2007.

Net interest income from banking operations for the fourth quarter of 2008 decreased by $35 million compared to the same quarter in 2007, and the net interest margin decreased to 1.87 per cent from 2.13 per cent. Ongoing reductions in prime rates during 2008 resulted in reduced interest income on our floating rate loans, which was not offset by an equal reduction in interest expense as our deposits repriced downwards more slowly. As a result of the sale of the automobile loan portfolio, net interest income decreased by $11 million, which also had an adverse impact on net interest margin. Also impacting net interest margin was the reduction in the value of interest free funds and low interest deposits in a falling interest rate environment as well as the lower rates earned on government and other high quality securities, which have increased following a planned increase in liquidity. In addition, wider credit spreads experienced across the banking industry also adversely impacted the cost of wholesale funding. Net interest income for the Consumer Finance business decreased by $19 million in the fourth quarter of 2008 compared to the same quarter in 2007. This was due to lower average receivable and investment balances and a $7 million decrease in net interest income following the sale of the auto finance portfolio.

Net interest income in the fourth quarter of 2008 was $46 million lower than the third quarter of 2008. While customer loans continued to grow during the quarter, this was partially offset by a decrease in interest income arising from a reduction in net interest margin, from 2.63 per cent in the third quarter of 2008 to 2.44 per cent in the fourth quarter of 2008, driven by the factors referred to above.

Net interest income for banking operations decreased by $39 million and net interest margin decreased from 2.07 per cent in the third quarter of 2008 to 1.87 per cent in the fourth quarter of 2008 largely due to reductions in prime lending rates. Net interest income for Consumer Finance decreased by $7 million in the fourth quarter of 2008 due to lower average receivable and investment balances.

Non-interest revenue

Non-interest revenue was $223 million for the fourth quarter of 2008 compared with $198 million in the same quarter of 2007, an increase of $25 million, or 12.6 per cent. Trading revenue was $63 million higher in the fourth quarter, primarily due to a $73 million positive impact of widening credit spreads on the value of certain debt obligations recorded at fair value, a $54 million increase in foreign exchange trading revenue arising from increased customer activity and volatile foreign exchange markets as well as the favourable impact of foreign currency funding in a lower interest rate environment. These increases were partially offset by $69 million of mark-to-market losses relating to the effect of falling interest rates on interest rate derivatives used for economic hedging and balance sheet management activities. Securitization income was $9 million higher as a result of increased transaction volumes as well as the beneficial impact of falling interest rates. Deposit and payment service fees were $3 million higher due to increased customer banking activities.

In the fourth quarter, following revisions to the terms of the Montreal Accord, as well as further deteriorations in market conditions, the bank recorded a further impairment write-down of $58 million on non-bank ABCP, of which $9 million was recorded as a reduction of trading revenues and $49 million recorded as a loss on AFS securities. The increased write-down of non-bank ABCP and an other than temporary impairment of $8 million recorded on holdings of preferred shares and other securities contributed to a $21 million increase in losses on AFS securities compared to the fourth quarter of 2007. Other non-interest revenue decreased by $18 million, primarily due to a reduction of mortgage brokerage fees as a result of the disposal of HSBC Financial's mortgage brokerage business, and a decrease in credit insurance income. Capital market and investment administration fees were down by $12 million, as a result of lower trading volumes arising from decreased market trading and underwriting activity and decreases in the value of investments under management caused by lower equity markets.

In the fourth quarter of 2008, non-interest revenue was $52 million higher compared with the third quarter. Trading income increased by $67 million, primarily due to a $60 million increase in foreign exchange trading revenue, a $61 million favourable change in the carrying value of certain debt obligations recorded at fair value and favourable impacts on foreign currency funding noted above. These increases were partially offset by $61 million of mark-to-market losses on interest rate derivatives noted above. Securitization income was $7 million higher as a result of increased transaction volumes. Other non-interest revenue was $18 million higher as a result of a $36 million loss before taxes recorded in the third quarter related to the sale of the automobile loan portfolio, of which $7 million related to the portion of the portfolio previously held by HSBC Financial. This was partially offset by a $4 million reduction in fees from the Canadian IIP. Capital markets fees were $5 million higher due to increased capital market activity in the fourth quarter. Losses on AFS securities were $42 million higher than in the prior quarter, primarily due to the impairment of non-bank ABCP and other AFS securities. Investment administration fees were $6 million lower due to a reduction in managed assets caused by lower equity markets.

Non-interest expenses and operating efficiency

Non-interest expenses were $295 million for the fourth quarter of 2008 compared with $339 million in the same quarter of 2007, a decrease of $44 million, or 13.0 per cent. Salaries and employee benefit expenses were $31 million lower in the fourth quarter of 2008 as a result of lower variable compensation as well as a reduction in pension and benefit expense resulting from the release of a valuation allowance previously applicable to pension plan assets. Other expenses were $15 million lower, due to a restructuring charge recorded by HSBC Financial in 2007 following a reduction of their branch network. The cost efficiency ratio for the fourth quarter of 2008 decreased to 49.3 per cent compared to 54.1 per cent for 2007.

Non-interest expenses of $295 million for the fourth quarter of 2008 were $19 million, or 6.1 per cent lower, compared with the third quarter of 2008. Salaries and employee benefits were $30 million lower due to reductions in variable compensation and pension and benefit expenses and lower staff levels in the Consumer Finance segment. This decrease was partially offset by slight increases in expenses related to premises, equipment and other costs.

Income taxes

The effective tax rate in the fourth quarter of 2008 was 23.8 per cent, which compares to 40.7 per cent in the same quarter of 2007 and 33.3 per cent in the third quarter of 2008. The reduction in tax rate in the fourth quarter of 2008 was primarily due to the release of a pension plan allowance, which is not taxable, as well as the impact of lower tax on future income, while the tax rate in the fourth quarter of 2007 included the impact of a write-down of future income tax assets due to a reduction in tax rates.

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 51 to 58. 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 judgement, 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.

Management's Discussion and Analysis (continued)

The allowance for credit losses consists of both specific and general impairment 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 a portion of the principal and interest is in doubt. General impairment allowances are our best estimate of incurred losses for groups of individually significant loans for which no evidence of impairment has been individually identified or for high volume groups of homogeneous loans that are not considered individually significant.

The impaired loans and allowances section in the MD&A on pages 30 and 31 and note 1(f) on page 53 provides further details of the estimation of our impairment allowances.

We continually update economic factors in our assessments of potential specific loan loss allowances as well as any adjustments that may be required to the amount of the provision for general allowance for loan losses. During 2008, the level of economic uncertainty resulted in a considerable increase in the provision for credit losses compared with 2007 and prior years.

Employee future benefits

As part of employee compensation, the bank provides employees with pension and other post-retirement benefits, such as extended health care, to be paid after employees retire. All new employees participate in a defined contribution pension plan; therefore, there is a lower sensitivity toward adverse economic factors than might be the case for a defined benefit only plan. 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 for defined benefit plans, 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 and accrued benefit obligations are set out in note 25 on pages 85 to 87. 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.

The level of funding required for the bank's older defined benefit pension plans is based on a formal triennial actuarial valuation. This means that recent decreases in the value of plan assets will not be reflected in the bank's funding requirements until the next actuarial valuation is complete. Only one of the bank's plans is subject to an actuarial valuation in 2009; however, at the previous valuation this plan had a substantial surplus with the result that recent decreases in the value of plan assets may not lead to a substantial rise in funding requirements. The remaining plans are not subject to actuarial valuations until 2010, at which point there may be an increase in funding requirements if no recovery of plan asset values takes place prior to December 31, 2009. Although it is not possible to determine the amount of any additional funding requirements at this time, the bank expects to be able to meet any additional funding requirements in full.

In the current year, the bank recognized a decrease in the valuation allowance of approximately $11 million related to pension plan assets resulting in a decreased pension expense. This allowance is calculated annually by our actuaries and included in the actuarial report. The decrease in the valuation allowance was a result of a reduction in the value of assets, which were impacted by weakness in global markets experienced in 2008. This decrease in plan assets was somewhat offset by a lower accrued benefit obligation arising from higher long-term bond rates.

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 assets are set out in note 26 on page 88.

Goodwill and intangible assets

We review goodwill and intangible assets for impairment at least annually, to ensure that the fair values are in excess of carrying 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 judgement 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 non-interest expense in the consolidated income statements. Although there were indicators of market weaknesses during 2008, the carrying amount of our goodwill was not impacted by these weaknesses. In addition, the operating segments to which the goodwill relates continued to be profitable during the year and there was no indication that, at December 31, 2008, there was any impairment in the carrying value of goodwill.

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 financed by investors either through commercial paper or a longer-term investment.

Accounting policies for securitizations are set out in note 1(r) on page 57. If the accounting requirements for sales treatment are met, we recognize in income, at the time of the transfer, 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 regular 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 statements 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 consolidated balance sheets. 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 note 5 on pages 65 and 66.

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.

All financial assets, on initial recognition, are measured at fair value in the consolidated balance sheets. Subsequent to initial recognition, loans and receivables, deposits with regulated financial institutions and investments classified as held to maturity ("HTM") are measured at amortized cost using the effective interest rate method. Unrealized gains and losses, including the impact of changes in foreign exchange rates, arising on financial assets classified as AFS are recorded in other comprehensive income ("OCI"), except for other-than-temporary impairment losses, which are recognized in income. Financial liabilities that are held-for-trading ("HFT"), including those that we have elected to recognize at fair value, or are derivatives, are recorded in the consolidated balance sheets at fair value. Other financial liabilities are recorded at amortized cost.

Information on the fair value of financial instruments is set out in note 1(d) on pages 51 and 52 and note 18 on pages 74 and 75.

The majority of our HFT and AFS securities are either issued or guaranteed by Canadian Federal and Provincial governments, and the reducing interest rate environment caused an increase in the fair values of these securities, which has been included in accumulated other comprehensive income. However, the widening of credit spreads led to an adverse impact on the fair value of our non-bank ABCP and other equity securities. As this negative impact became somewhat prolonged, in addition to writing down the carrying value of non-bank ABCP, we reached a decision to record an other-than-temporary impairment in the carrying value of other equity securities reflecting a decline in their market value. However, apart from non-bank ABCP, the value of these securities is not material to the bank's overall financial position.

Management's Discussion and Analysis (continued)

Future accounting and reporting changes

Effective January 1, 2009, Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, *Goodwill and Intangible Assets*, replaces CICA Handbook Sections 3062, *Goodwill and Other Intangible Assets*, and 3450, *Research and Development Costs*. Section 3064 provides guidance on the definition of an intangible asset and the recognition of internally generated intangible assets. Although the bank will adopt this standard in 2009, it is not expected to have a material impact on the bank's financial position and results of operations.

On January 20, 2009, the CICA issued an abstract, EIC-173, *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, which requires entities to take into account their own credit risk and the credit risk of counterparties when determining the fair value of derivative instruments. EIC-173 is required to be applied retrospectively without restatement. The bank is in the process of considering the impact of this abstract.

Transition to International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board announced that for fiscal years commencing on or after January 1, 2011, all publicly accountable enterprises will be required to report financial results in accordance with IFRS. The purpose for adopting IFRS is to promote the comparability of worldwide financial reporting.

Accordingly, all interim and annual financial reporting, including comparative figures, will be prepared in accordance with IFRS from January 1, 2011 onwards. In the reporting periods leading up to the first fiscal year of reporting in accordance with IFRS in 2011, we will disclose the impact of the transition on our financial results as it becomes known. During the 2011 reporting period, we will compare financial results prepared using IFRS with the replaced GAAP.

HSBC Holdings, our ultimate parent, adopted IFRS in 2005. Accordingly for a number of years, we have been reporting our results on an IFRS basis for inclusion in the HSBC Group's consolidated financial results and have identified the most significant differences between Canadian GAAP and IFRS. As a result, our financial systems are able to process and report financial information on an IFRS basis. In addition, prior to the adoption of IFRS we plan to replace one of our core financial reporting systems which will give us an enhanced ability to report financial results using various GAAP standards, including IFRS. Our transition to IFRS for local reporting will build on our existing HSBC Group IFRS reporting process.

During 2008 we have developed an implementation strategy and timetable for our transition, which consists of the following phases:

— A detailed assessment to enhance our present IFRS reporting process.

— Changes to our financial processes and systems needed to bridge any identified gaps.

— An implementation of financial process and system changes including addressing training needs of our accounting staff.

We commenced the detailed assessment of remaining differences during the third quarter of 2008 and anticipate substantial completion in early 2009, during which we plan to establish an appropriate governance structure to manage resource commitments and the execution of the implementation.

Management believes that it has made available sufficient resources to successfully complete the transition on time. At present, we are unable to quantify and disclose the estimated potential impact of the transition on our financial results as we have not finalized our detailed assessment, and, in addition, accounting standards and their interpretation are subject to change prior to eventual adoption.

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 may not be recognized in our consolidated balance sheets. 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 in our consolidated balance sheets. 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. Although guarantees and letters of credit are financial instruments, they are considered contingent obligations and the notional amounts 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. As a result of accounting standards for financial instruments, we record the fair value of guarantees made on behalf of 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 page 28 of the MD&A, and as set out in note 30 on pages 92 to 94.

Derivative financial instruments

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

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

We use derivatives to limit our exposure to interest rate risk on loans and deposits with differing maturity dates, or foreign currency assets and liabilities of differing amounts. Mismatches in currency or maturity dates could expose us to significant financial risks if there are adverse changes in interest rates or foreign exchange rates. The use of derivatives is subject to strict monitoring and internal control procedures as set out in our risk management discussion in the MD&A on pages 23 to 38.

Our accounting policies on recording the impact of derivatives are set out in note 1(p) on page 56. Quantitative information on our derivative instruments is set out in note 19 on pages 76 to 80.

Disclosure Controls and Procedures and Internal Control over Financial Reporting

Management's responsibility for financial information contained in our Annual Report is set out on page 45.

Disclosure controls and procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information required to be disclosed in reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified under those laws. These include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the CEO and the CFO, to allow timely decisions regarding required disclosure.

As of December 31, 2008, management evaluated, under the supervision and with the participation of the CEO and the CFO, the effectiveness of our disclosure controls and procedures as defined by the Canadian securities regulatory authorities under National Instrument 52-109. Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures are effective as of December 31, 2008.

Management's Discussion and Analysis (continued)

Internal control over financial reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with GAAP. Management is responsible for establishing and maintaining adequate internal control over financial reporting. These controls include those policies and procedures that: pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial statements. Because of the inherent limitations in all control systems, there is a risk that all material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting.

Management has evaluated the design and effectiveness of the internal control over financial reporting as required by the Canadian securities regulatory authorities under National Instrument 52-109. This evaluation was performed using the framework and criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, the CEO and the CFO have concluded that such internal control over financial reporting was effective as at December 31, 2008.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting in 2008 that have materially affected, or are reasonably likely to materially affect, our 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.

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 Legal and Compliance departments 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.

In 2008, we completed the acquisition of HSBC Financial from another HSBC Group company. As part of the acquisition, we obtained an independent valuation of HSBC Financial, with the fair value of the company acquired approximating the book value as at the date of acquisition. For further information, refer to note 2 on pages 58 to 61.

Fees are charged by HSBC Group with respect to guarantees of deposits, and administrative and technical services provided to us. For 2008, the total amount we expensed related to fees paid to other HSBC Group companies in respect of these transactions was $120 million (2007 – $98 million).

Included in non-interest revenue were fees of $16 million (2007 – $19 million) received from a HSBC Group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

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 14 on page 70 and note 29 on page 92.

Dividends

Dividends on our shares declared, and unless otherwise indicated, paid, and distributions per unit on our HSBC HaTS™ in each of the last three years were as follows:

	2008	2007	2006
Preferred Shares Class 1 ($ per share)			
Series C	**$ 1.275**	$ 1.275	$ 1.275
Series D	**1.250**	1.250	1.250
Preferred Shares Class 2 ($ per share)			
Series B	**0.025**[(1)]	–	–
HSBC HaTS™ ($ per unit)			
Series 2010	**77.80**	77.80	77.80
Series 2015	**51.50**	51.50	51.50
Common Shares ($ millions)			
HSBC Bank Canada	**270**	260	240
HSBC Financial Corporation Limited	**50**	50[(2)]	30

(1) *Declared in 2008 and paid in 2009.*

(2) *Declared in 2007 and paid in 2008.*

Credit Ratings

Standard & Poor's ("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.

Our credit ratings influence our ability to secure cost-efficient wholesale funding. Our investment grade ratings are unchanged from 2007 and remain among the highest assigned to the Canadian banks.

Our ratings at December 31, 2008 were as follows:

	S&P[(1)]	*DBRS*[(2)]
Short-term instruments	A-1+	R-1 (high)
Deposits and senior debt	AA	AA
Subordinated debt	AA-	AA (low)
Preferred shares	P-1[(3)]	Pfd-1
HSBC HaTS™	P-1[(3)]	A (high)

(1) *On December 19, 2008, S&P revised its outlook for the bank from stable to negative in conjunction with a similar revision in the outlook of HSBC Holdings and other HSBC subsidiaries.*

(2) *On March 3, 2009, DBRS® revised its rating trends for the bank from stable to negative in conjunction with a revision to the trend of HSBC Holdings' long-term debt ratings.*

(3) *Based on S&P's Canadian national preferred share scale. Ratings are A+ on S&P global preferred share scale.*

Capital Management

Objectives, policies and processes

Our objectives in managing our financial capital resources include: generating shareholder value while supporting business activities including the asset base and risk positions; providing prudent depositor security; and exceeding applicable regulatory requirements and long-term internal targets.

To ensure our processes are appropriately governed and to meet our objectives, we enforce policies approved by the Board and HSBC Holdings. During 2008, we developed a comprehensive Internal Capital Adequacy Assessment Process ("ICAAP") with oversight by the capital governance group. This program uses various risk measurement tools, including economic capital models and stress testing techniques, to ensure that the bank's capital is adequate to meet current and future risks and to achieve its strategic objectives. An annual capital plan is prepared and approved by the Board and HSBC Holdings with the objective of ensuring that the level of capital supply from both regulatory and economic capital viewpoints:

Management's Discussion and Analysis (continued)

— Supports our risk profile and outstanding commitments;

— Exceeds our formal, minimum regulatory capital requirements by an agreed margin;

— Withstands a severe economic downturn stress scenario; and

— Remains consistent with our strategic and operational goals, and shareholders' and rating agencies' expectations.

Our Finance and Treasury Departments manage compliance with our policies daily, with monthly monitoring by our Asset and Liability Committee ("ALCO"). ALCO is chaired by our CFO and includes the CEO, Deputy Chief Executive 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"). TALCO is also chaired by our CFO and includes members responsible for finance, treasury and marketing.

In order to maintain the most cost effective capital structure, we redeem or issue capital instruments as deemed necessary. Our capital management process includes:

— Establishing appropriate risk-based financial metrics and targets which relate capital to risk;

— Assessing capital adequacy in the context of its current position and various expected scenarios;

— Active senior management monitoring and control; and

— Regular Board oversight.

Capital managed and capital ratio regulations

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of the bank, comprising common shareholder's equity, qualifying non-cumulative preferred shares, qualifying innovative capital instruments, contributed surplus, retained earnings and certain other adjustments. Tier 2 capital includes subordinated debentures together with certain other adjustments. There are restrictions on the amount of Tier 2 capital as a percentage of total capital that qualifies in the calculation of capital adequacy.

OSFI regulates capital adequacy for Canadian federally incorporated financial institutions including banks. OSFI's regulations are based on international standards set by the Bank for International Settlements ("BIS"). Although BIS sets minimum limits for financial institutions to maintain 4 per cent and 8 per cent 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 per cent and 10 per cent, respectively. The bank maintained ratios that satisfied these requirements in both 2008 and 2007.

Revision of capital framework in the calculation of capital ratios

The bank has adopted and implemented the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version (June 2006)", commonly known as the Basel II framework. Of the various approaches available in the framework, the bank, in concurrence with HSBC Group, has adopted the AIRB approach for calculating capital requirements for credit risk. The AIRB approach allows the bank to use the internal estimates for certain risk measures, including probability of default ("PD"), loss given default ("LGD"), exposure at default ("EAD") and effective maturity for calculating risk-weighted assets for credit risk. This, compared to the treatment under the Basel I accord, aligns regulatory capital requirements more closely with the risk profile of the business. For operational risk, a new requirement of the Basel II framework, the bank has adopted the Standardized Approach. Operational risk capital is required to cover the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Under the Standardized Approach, the capital required is calculated by applying a specific factor, ranging from 12 per cent to 18 per cent, to the gross income of specific business lines.

Reporting under the AIRB approach requires the approval of OSFI. Once banks have demonstrated full compliance with the requirements for the use of the AIRB approach, and OSFI has approved its use, they may apply the AIRB approach in computing risk-weighted assets and minimum capital requirements. However, certain capital floors are in place after full implementation of AIRB. A capital floor of 90 per cent of the Basel I based minimum capital calculation will apply in the first year of full approval and in the second year this may be reduced to 80 per cent, subject to OSFI approval.

In February 2008, OSFI provided the bank with conditional approval, subject to certain conditions, to use the AIRB approach for calculating regulatory capital under the new framework. In September 2008, OSFI advised the bank that it had satisfied the conditions that will allow the bank to reduce the transitional floor for regulatory capital, as required under OSFI's capital adequacy guidelines, from 100 per cent to 90 per cent, commencing with the third quarter 2008 regulatory reporting period.

Capital requirements for credit risk for HSBC Financial are calculated using the Standardized Approach on an interim basis until OSFI's approval for the use of the AIRB for HSBC Financial's assets is obtained. Under this approach, risk weightings prescribed by OSFI are used to calculate risk-weighted assets for credit exposures.

Regulatory capital ratios

The components of our regulatory capital and our actual regulatory capital ratios are stated in the table below. As mentioned above, we have adopted a revised Basel II framework as of January 1, 2008 that changes how capital ratios are calculated. Due to the adoption of the revised Basel II framework, the prior year's figures presented below are not comparable.

The Canada Deposit Insurance Corporation ("CDIC") has a tiered, differential insurance premium ratings system, which includes targets for capital adequacy. One of the other 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 OSFI's maximum permitted assets to capital multiple. The bank targets to be prudently below this threshold and has met the assets to capital multiple test comfortably in both 2008 and 2007.

On November 30, 2008, we acquired 100 per cent of the voting share capital of HSBC Financial (note 2 on pages 58 to 61). Comparative figures, presented below, were not restated because it is not meaningful to do so.

	2008 *(Basel II)*	2007 *(Basel I)*
Tier 1 capital	**$ 4,197**	$ 3,658
Tier 2 capital	**1,004**	1,070
Total Tier 1 and Tier 2 capital	**5,201**	4,728
Securitization-related deductions	**–**	(50)
Total capital available for regulatory purposes	**$ 5,201**	$ 4,678
Total risk-weighted assets	**$ 41,623**	$ 41,372
Actual regulatory capital ratios		
Tier 1 capital	**10.1%**	8.8%
Total capital	**12.5%**	11.3%
Actual assets to capital multiple	**14.0x**	14.1x
Minimum regulatory capital ratios required		
Tier 1 capital	**7.0%**	7.0%
Total capital	**10.0%**	10.0%

Risk Management

(Certain information within this section, where indicated, forms an integral part of the audited financial statements)

All of our business activities involve the measurement, evaluation, acceptance and management of some degree of risk, 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 most important risk categories that we are exposed to include credit, liquidity and funding, market, structural, fiduciary and operational risks. The management of these various risk categories is discussed below. The risk management framework established seeks an integrated evaluation of risks and their interdependencies to foster the continuous monitoring of the risk environment.

Management's Discussion and Analysis (continued)

Risk governance

A well-established risk governance structure ensures oversight of, and accountability for, the effective management of risk. Our Risk Management Committee ("RMC") is responsible for the strategic management of all risks to which the bank and its subsidiaries are exposed by performing the following functions:

— Identifying significant risks and measurement thereof;

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

— Providing direction regarding our overall risk philosophy and appetite, including the acceptability of new or unusual risk;

— Monitoring adherence to risk management policies and procedures; and

— Reporting any policy or major practice change, unusual situations, significant exceptions, new strategy or products to our Executive Committee and, where appropriate, to the Audit Committee and the Board for review, ratification and/or approval.

Our Board approves our risk management policies presented by the RMC. Overall risk management limits are set, taking into account HSBC Group's risk limits.

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

Consistent with the concept of enterprise wide risk management, where all risks within the business are measured holistically, the bank employs a Chief Risk Officer. This allows a central unit to monitor risk across the different risk silos including credit, market and operational risk.

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 changing economic and political circumstances, changing customer requirements, demographic trends, regulatory developments and competitor actions. This risk is mitigated by consideration of the potential opportunities and challenges through the strategic planning process, which we undertake in conjunction with HSBC Group.

Credit risk

(Information that is an integral part of the audited financial statements)

Credit risk is the risk of financial loss if a customer or counterparty fails to meet its contractual obligations. It arises principally from direct lending, trade finance and leasing business, but also from certain off-balance sheet products such as guarantees and counterparty credit risk on derivatives, and from our holdings of certain types of securities, particularly debt securities.

The objectives of credit risk management, underpinning sustainably profitable business, are principally to:

— Maintain a strong culture of responsible lending, supported by a robust risk policy and control framework;

— Partner and challenge business originators effectively in defining and implementing risk appetite, and its re-evaluation under actual and scenario conditions; and

— Ensure independent, expert scrutiny and approval of credit risks, their costs and their mitigation.

Policies and procedures

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

Our Risk Management and Credit Committees meet quarterly as does our Audit Committee and the Board to review: portfolio credit quality, geographic, product and industry distributions, large customer concentrations, adequacy of loan provisions and rating system performance. Policies relating to large customer limits and industry, product and geographic concentration are approved by the Board in line with HSBC Group policy. All new and renewed major authorized facilities, derivative exposures, "watch list" exposures 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 which are approved quarterly by the Audit Committee and disseminated throughout our business along with various credit manuals.

Our Credit Department reviews and adjudicates credit risk outside of business line 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. 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.

Integrity of underlying credit metrics is also ensured by the review of applications and ongoing monitoring and review by our Credit and Risk Management department. This includes review of rating system application especially where manual override of system generated values takes place.

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.

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 exposure level and composition of this portfolio given its concentration in our credit portfolio and indication of softening of real estate asset prices. 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.

Credit risk rating framework

(Information that is an integral part of the audited financial statements)

Under Basel II, two principal approaches are available for measuring credit risk: AIRB and Standardized. Most of the bank's credit risk exposure is measured using the AIRB approach.

Under the AIRB approach, the bank's credit risk rating framework incorporates PD of an obligor and loss severity expressed in terms of EAD and LGD. These measures are used to calculate expected loss and minimum capital requirements. They are also used in conjunction with other inputs to inform rating assessments and other risk management decisions.

All estimates are subject to pre-implementation and post-implementation validation and/or monitoring, including a variety of tests designed to ensure the ongoing accuracy and validity of the data used.

For wholesale business (bank, sovereign and corporate), obligor PD is estimated using a 22-grade Customer Risk Rating scale, of which 20 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. Scores generated by models and/or scorecards for individual obligors are reviewed by credit approvers. The final approved customer risk ratings are mapped to a PD value range of which the 'mid-point' is used in the regulatory capital calculation.

Models for LGD/EAD estimation for wholesale business (bank, sovereign and corporate) were developed within HSBC Group's framework of basic principles, which permits flexibility in the application of parameters by HSBC's operating entities to suit conditions in their own jurisdictions. EAD is estimated to a 12-month horizon and is, broadly speaking, the sum of current exposure and, where applicable, an estimate for future increases in the exposure. LGD is expressed as a percentage of EAD.

Management's Discussion and Analysis (continued)

For all retail business, exposures are segmented into homogeneous pools of accounts with similar risk characteristics. PD, LGD and EAD parameters are estimated for each pool based on observed historical loss data. The segmentation of exposures into different pools is carried out every month based on the characteristics associated with the exposures at the time of monthly review while the risk measures applied to the exposures are based on the measures associated with the pools that have been derived using data over an entire economic cycle.

HSBC Financial applies the simplified Standardized approach with the Basel II framework to calculate the risk weighting of credit exposures.

Stress testing and sensitivity analysis

(Information that is an integral part of the audited financial statements)

In order to estimate both expected and unexpected losses under extreme, but plausible scenarios, we have established a framework for conducting stress testing around our credit portfolios. These scenarios are used to inform management about risks in the portfolio and implications for both capital requirements and income statement impacts. Stress testing also plays an important role in the ICAAP process.

Scenarios considered may be wide ranging, such as macroeconomic stresses or focused on particular industry or other portfolio issues. While there are a wide range of techniques that can be employed in such stress testing, our aim is to produce an estimate of potential outcomes and their likelihood of occurrence. Therefore a combination of quantitative and qualitative approaches is employed. There is naturally a significant degree of interpretation in these stress tests and therefore a range of outcomes is typically provided for management's review.

Maximum exposure to credit risk

(Information that is an integral part of the audited financial statements)

The following table presents the maximum exposure to credit risk of balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements. For on-balance sheet financial assets, the exposure to credit risk equals their carrying amount. For financial guarantees, the maximum exposure to credit risk is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

	2008	2007
On-balance sheet exposure		
Cash held at Bank of Canada and other regulated financial institutions	**$ 1,855**	$ 3,674
Securities		
As disclosed on balance sheet	**10,818**	6,991
Less: Equity securities not exposed to credit risk	**(189)**	(214)
Securities purchased under reverse repurchase agreements	**6,682**	6,122
Loans	**43,646**	43,595
Customers' liability under acceptances	**5,209**	5,727
Derivatives	**2,448**	623
Included within other assets		
Accrued interest receivable	**177**	215
Interest earning other assets	**175**	224
Due from clients, dealers and clearing corporations	**306**	236
Accounts receivable and other	**427**	375
Total on-balance sheet exposure	**71,554**	67,568
Off-balance sheet exposure		
Financial and performance standby letters of credit	**2,570**	2,420
Documentary and commercial standby letters of credit	**397**	322
Commitments to extend credit	**37,426**	41,329
Credit and yield enhancement	**14**	50
Total off-balance sheet exposure	**40,407**	44,121
Maximum exposure	**$ 111,961**	$ 111,689

Collateral and other credit enhancemets

(Information that is an integral part of the audited financial statements)

Our lending policy assesses the customer's capacity to repay, rather than relying excessively on the underlying collateral security. Depending on the customer's standing and the type of product, some facilities may be unsecured. Nevertheless, collateral is an important mitigant of credit risk.

The principal collateral types are as follows:

— In the personal sector, mortgages over residential properties or charges over other personal assets being financed;

— In the commercial and industrial sector, charges over business assets such as land, buildings and equipment, inventory and receivables;

— In the commercial real estate sector, charges over the properties being financed; and

— In the financial sector, charges over financial instruments such as debt and equity securities in support of trading facilities.

Our credit risk management policies include appropriate guidelines on the acceptability of specific classes of collateral or credit risk mitigation. Valuation parameters are updated periodically depending on the nature of the collateral. Full covering corporate guarantees as well as bank and sovereign guarantees are recognized as credit mitigants for capital purposes.

The bank does not disclose the fair value of collateral held as security or other credit enhancements on loans past due but not impaired or individually assessed impaired loans, as it is not practical to do so.

Collateral held as security for financial assets other than loans is determined by the nature of the instrument. Government and other debt securities, including money market instruments, are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by pools of financial assets.

The bank has policies in place to monitor the existence of undesirable concentration of the collateral supporting our credit exposures.

Loan portfolio diversity

(Information that is an integral part of the audited financial statements)

Concentration of credit risk may arise when the ability of a number of borrowers or counterparties to meet their contractual obligations are similarly affected by external factors. Examples of concentration risk would include geographic, industry and environmental factors. Therefore, diversification of credit risk is a key concept by which we are guided.

In assessing the risks of our credit portfolio, we aggregate all exposure types that result in credit risk.

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

	2008	2007
Loans included in financial statements, net of allowances	**$ 43,646**	$ 43,595
Allowance for credit losses	**615**	514
Customers' liabilities under acceptances[1]	**5,209**	5,727
Financial and performance standby letters of credit[1]	**2,570**	2,420
Documentary and commercial letters of credit	**397**	322
Total loans	**52,437**	52,578
Impaired loans and other impaired credit exposures[1]	**(932)**	(420)
Total performing loans	**$ 51,505**	$ 52,158

(1) *Includes $5 million (2007 – $3 million) of impaired acceptances and letters of credit.*

Management's Discussion and Analysis (continued)

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

	2008		2007	
Business and government loans[1]	**$ 31,183**	**60.5%**	$ 30,152	57.8%
Residential mortgages	**11,204**	**21.8**	12,311	23.6
Consumer finance loans	**3,848**	**7.5**	4,893	9.4
Other consumer loans	**5,270**	**10.2**	4,802	9.2
Total performing loans	**$ 51,505**	**100.0%**	$ 52,158	100.0%

(1) *Includes $628 million (2007 – $587 million) of construction and other loans secured by mortgages over residential property.*

Geographic distribution

	2008		2007	
British Columbia	**$ 21,295**	**41.3%**	$ 20,945	40.2%
Ontario	**12,905**	**25.1**	13,208	25.3
Western Canada, excluding British Columbia	**11,022**	**21.4**	11,141	21.4
Quebec and Atlantic	**6,283**	**12.2**	6,864	13.1
Total performing loans	**$ 51,505**	**100.0%**	$ 52,158	100.0%

Business and government loan portfolio by industry

	2008		2007	
Real estate	**$ 9,730**	**31.2%**	$ 10,417	34.6%
Services	**5,851**	**18.8**	5,520	18.3
Trade	**4,462**	**14.3**	5,103	16.9
Manufacturing	**3,543**	**11.4**	3,681	12.2
Hotels and hospitality	**1,004**	**3.2**	1,003	3.3
Other	**6,593**	**21.1**	4,428	14.7
Total business and government loans	**$ 31,183**	**100.0%**	$ 30,152	100.0%

Large customer concentrations are borrowing groups where approved facilities exceed 10 per cent of our regulatory capital base. At December 31, 2008, this amount was approximately $496 million (2007 – $468 million).

The following table provides details of our large customer concentrations:

	2008	2007
Large customer concentration	**$ 2,737**	$ 2,819
As a percentage of business and government loans	**8.8%**	9.3%
As a percentage of total performing loans	**5.3%**	5.4%

Credit quality of financial assets

For the bank, excluding our Consumer Finance segment, the vast majority of the total loan portfolio is categorized as strong. Credit quality of the portfolio has remained stable over the past five years although in the latter part of 2007, credit quality began to deteriorate. At December 31, 2008, $751 million (1.6 per cent) of the loan portfolio was impaired, with specific and general allowances providing 56 per cent (2007 – 130 per cent) coverage of these loans. Overall credit quality remains sound, reflecting our prudent lending standards; however, Canadian economic conditions deteriorated in late 2008. An increase in provisions for 2008 compared to the prior year arose in our Commercial Banking segment across all business sectors.

For our Consumer Finance segment, as a result of deteriorating economic conditions in 2008, we experienced higher levels of delinquency in our portfolio. At December 31, 2008, $181 million or 4.5 per cent of the loan portfolio was impaired (2007 – $148 million or 2.9 per cent), with general allowances providing 108 per cent coverage of these loans (2007 – 109 per cent). Overall credit quality has deteriorated as a result of weakening economic conditions in Canada, including higher bankruptcy, higher unemployment levels and a slower residential real estate market in Canada.

The bank describes credit quality in reference to the following categories:

Category	*Our internal customer risk rating*	*Standard & Poor's equivalent risk rating*	*Moody's equivalent risk rating*
Strong	Minimal to low default risk	AAA to A–	Aaa to A3
Medium	Satisfactory to moderate default risk	BBB+ to B+	Baa1 to B1
Sub-standard	Significant default risk to special management	B to CCC	B2 to C
Impaired	Default	D	C

With the exception of the Consumer Finance segment, the credit quality of financial assets is presented using EAD and will therefore not agree to the carrying values as disclosed within the consolidated balance sheets. EAD represents the outstanding or drawn amount of a credit exposure, before deducting any specific provision or amounts written off as well as an undrawn portion, which represents estimated amounts not recognized in the balance sheet that could be drawn at time of default by the credit party. The credit quality of financial assets in the Consumer Finance segment is presented at their carrying values included in the consolidated balance sheets.

Credit quality of commercial financial assets

	2008 (EAD)		
	Drawn	*Undrawn*	*Total*
Strong	$ 16,836	$ 3,889	$ 20,725
Medium	29,500	8,462	37,962
Sub-standard	1,427	178	1,605
Impaired	912	81	993
	$ 48,675	$ 12,610	$ 61,285

Credit quality of retail financial assets (excluding Consumer Finance segment)

	2008 (EAD)		
	Drawn	*Undrawn*	*Total*
Strong	$ 6,936	$ 1,294	$ 8,230
Medium	16,081	2,629	18,710
Sub-standard	406	16	422
Impaired	138	–	138
	$ 23,561	$ 3,939	$ 27,500

Credit quality of retail financial assets (Consumer Finance segment)

	2008
	Drawn
Strong	$ 1,381
Medium	1,950
Sub-standard	83
Past due not impaired	495
Impaired	181
	$ 4,090

Loans past due but not impaired

(Information that is an integral part of the audited financial statements)

Examples of exposures considered past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; loans fully secured by cash collateral; residential mortgages in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

Management's Discussion and Analysis (continued)

The aging analysis below includes past due loans on which general impairment allowances have been assessed, though at their early stage of arrears, there is normally no identifiable impairment.

	2008	2007
Past due up to 29 days	**$ 597**	$ 670
Past due 30–59 days	**168**	161
Past due 60–89 days	**65**	53
Past due 90 days and over	**9**	9
	$ 839	$ 893

Impaired loans and allowance for credit losses

(Information that is an integral part of the audited financial statements)

When impairment losses occur, we reduce the carrying amount of loans through the use of an allowance account with a charge to income. The allowance for credit losses consists of both specific and general allowance provisions, each of which is reviewed on a regular basis. The allowance for credit losses reduces the gross value of an asset to its net carrying value.

An allowance is maintained for credit losses which, in management's opinion, is considered adequate to absorb all incurred 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 that maybe susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

Individually significant accounts are treated as impaired as soon as there is objective evidence that an impairment loss has been incurred. The criteria used by us to determine that there is such objective evidence include:

— Known cash flow difficulties experienced by the borrower;

— Past due contractual payments of either principal or interest;

— Breach of loan covenants or conditions;

— The probability that the borrower will enter bankruptcy or other financial realization; and

— A significant downgrading in credit rating by an external credit rating agency.

Specific allowances are recorded on these individual accounts on an account-by-account basis to reduce their carrying value to estimated realizable amount.

The general impairment allowance is our best estimate of incurred losses in the portfolio for those individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant. In determining an appropriate level of general impairment, we apply the following methodologies:

Business and government – For these loans, the underlying credit metrics including PD, LGD and EAD, for each customer are derived from the bank's internal rating system as a basis for the general allowance. Management is able to amend these metrics for some or all borrowers where they consider that the rating system metrics do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

Residential mortgages – Historic average loss rates are used to determine the general provision for these portfolios. Management may consider other current information should they believe that these historic loss rates do not fully reflect incurred losses in these portfolios.

Consumer Finance and other consumer loans – Analysis of historical delinquency movements by product type is used as the basis for the general allowance for these loan portfolios. By tracking delinquency movement among pools of homogeneous loans, an estimate of incurred losses in each pool is determined. These estimates can be amended should management believe they do not fully reflect incurred losses. This judgemental adjustment employs an established

framework and references both internal and external indicators of credit quality.

In addition to the methodologies outlined on the previous page, the balance of the general allowance is also analyzed as a function of risk-weighted assets and is also referenced to the allowances held by our peer group.

The following table provides details of the impaired loan portfolio:

	2008	2007
Business and government		
Real estate	**$ 452**	$ 112
Manufacturing[1]	**143**	68
Trade	**30**	15
Services	**39**	28
Other	**24**	3
Total business and government loans	**688**	226
Personal		
Residential mortgages	**37**	22
Consumer finance loans	**181**	148
Other consumer loans	**26**	24
Total personal loans	**244**	194
Total impaired loans, acceptances and letters of credit[1]	**$ 932**	$ 420
Specific allowances	**$ 162**	$ 84
General allowances	**453**	430
Total allowance for credit losses	**$ 615**	$ 514
Net impaired loans and acceptances	**$ 317**	$ (94)

(1) *Includes $5 million (2007 – $3 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:

	2008	2007
Real estate	**12%**	13%
Manufacturing	**43%**	44%
Other[1]	**51%**	52%
Total	**23%**	30%

(1) *Includes business and government loans.*

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

Coverage by general allowance[1]

	2008	2007
As a percentage of total performing loans	**0.88%**	0.82%
As a percentage of risk-weighted assets	**1.09%**	0.65%[2]

(1) *Information does not form an integral part of the audited financial statements.*

(2) *Prior year's general allowance as a per cent of risk-weighted assets has not been restated for the acquisition of HSBC Financial as it is not meaningful to do so.*

Provisions for credit losses

(Information that is an integral part of the audited financial statements)

The following table sets out the provisions for credit losses charged to income:

	2008	2007
Specific provisions	**$ 130**	$ 67
Collective provisions	**249**	172
Total provision for credit losses	**$ 379**	$ 239
Specific provisions as a percentage of total loan portfolio	**0.25%**	0.13%

Management's Discussion and Analysis (continued)

For the bank, excluding our Consumer Finance segment, the level of general provisions has been stable increasing only slightly as a percentage of risk-weighted assets. The general impairment will be maintained at a level consistent with the underlying risk profile of the loan book and management's view of economic and other conditions that impact incurred losses in the loan portfolio.

For our Consumer Finance segment, general provisions increased by $56 million in 2008 to reflect the higher levels of write-offs and higher delinquency in the portfolio.

Impaired securities

(Information that is an integral part of the audited financial statements)

Asset backed commercial paper

At December 31, 2008, we held $330 million (December 31, 2007 – $328 million) in par value holdings of non-bank ABCP that was subject to the standstill and court approved restructuring plan proposed by signatories to the Montreal Accord ("the Plan"). These non-bank ABCP are backed by traditional securitization assets and leveraged and unleveraged collateralized debt obligations, some of which have indirect US sub-prime exposures. On January 21, 2009, the Plan was successfully implemented.

Under the terms of the Plan, non-bank ABCP was replaced with longer-term floating rate notes with maturities more closely matching the maturities of the underlying assets, which were allocated into one of three Master Asset Vehicles ("MAV1", "MAV2" or "MAV3"), with MAV1 noteholders being self-funded. On January 21, 2009, our non-bank ABCP was exchanged for $164 million in senior Class A-1 notes, $102 million in senior Class A-2 notes, $18 million in Class B notes, $9 million in Class C notes, $31 million in various tracking notes issued by MAV2, and $4 million in tracking notes issued by MAV3. The repayment of the Class A-1 and A-2 notes is expected in January, 2017.

The bank determined the fair value of our non-bank ABCP using a discounted cash flow model that estimates the fair value of the notes. In the current year, we updated our non-bank ABCP valuation model's assumptions, including increasing the discount rate as a result of widening credit spreads, adjusting for the change in expected credit ratings for the new Class A-1 and Class A-2 notes and decreasing the expected recovery value on the MAV2 tracking notes backed by ineligible assets. As a result of these updates, our estimate of the fair value of our non-bank ABCP decreased and an additional impairment charge of $73 million was recognized in the current year. The recorded net carrying value of $212 million represents management's best estimate of the fair value of the non-bank ABCP at December 31, 2008.

Our valuation was based on our assessment, at December 31, 2008, of estimates and circumstances that may change in subsequent periods. Items that may have a material impact on the fair value of the non-bank ABCP or subsequent notes under the Plan include any further changes in economic conditions including market liquidity and interest rates. At December 31, 2008, the effect of a 100 basis point adverse change in the discount rate, the valuation model's significant non-observable input, would result in a further provision of approximately $14 million.

For further information on the Plan and the determination of the fair value of our non-bank ABCP, refer to note 3 on pages 61 to 63.

Other available-for-sale securities

At December 31, 2008, certain of our preferred shares and mutual fund investments suffered a significant decline in market value in relation to their original cost. As a result, a charge for other-than-temporary impairment of $8 million was recognized in the current year's income statement as a loss on available-for-sale securities.

Derivative portfolio

(Information that is an integral part of the audited financial statements)

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:

	2008	2007
Interest rate contracts	$ 816	$ 165
Foreign exchange contracts	2,024	1,173
Other contracts	–	37
Net credit equivalent amount	$ 2,840	$ 1,375

A more detailed analysis of our derivative portfolios is presented in note 19 on pages 76 to 80.

Liquidity and funding risk

(Information that is an integral part of the audited financial statements)

Liquidity risk is the risk that we do not have sufficient financial resources to meet our obligations as they fall due or will have to obtain such resources at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk, a form of liquidity risk, arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of our liquidity and funding management strategy is to ensure that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that access to the wholesale markets is coordinated and cost-effective.

Policies and procedures

(Information that is an integral part of the audited financial statements)

The management of liquidity and funding is carried out by our Treasury Department in accordance with practices and limits approved by ALCO, the Board and HSBC Holdings. Compliance with policies is regularly monitored by ALCO.

Our liquidity and funding management process includes:

- Projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- Monitoring balance sheet liquidity ratios against internal measures;
- Maintaining a diverse range of funding sources with adequate back-up facilities;
- Managing the concentration and profile of debt maturities;
- Managing contingent liquidity commitment exposures within pre-determined caps;
- Maintaining debt financing plans;
- Monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- Maintaining liquidity and funding contingency plans.

Liquidity and funding contingency plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimizing adverse long-term implications for the business.

Primary sources of funding

(Information that is an integral part of the audited financial statements)

Current accounts and savings deposits payable on demand or on short notice form a significant part of our funding. We place considerable importance on maintaining the stability and growth of these deposits, which provide a diversified pool of funds.

We also access professional markets in order to maintain a presence in local money markets and to optimize the funding of asset maturities not naturally matched by core deposit funding.

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.

Management's Discussion and Analysis (continued)

As a result of the global and credit market conditions in 2008, which caused a significant widening of credit spreads and a tightening of available credit, we expanded our sources of funding. We incorporated a new subsidiary in Barbados as part of a transaction to raise unsecured term funding. We used the proceeds to increase liquidity, as part of the funding of our banking operations. We also expanded our securitization of National Housing Act Mortgage Backed Securities in the Canada Mortgage Bond program.

As part of the HSBC Group's worldwide liquidity and funding management process, 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 these contingencies, we can access the considerable resources of the HSBC Group and currently have a US$500 million standby borrowing facility from our US affiliate, although no amounts have been drawn from this facility since its inception in 1997.

Cash flows payable under financial liabilities by remaining contractual maturities are as follows:

	2008			
	On demand and due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*
Deposits	$ 36,363	$ 10,804	$ 5,950	$ 4
Acceptances	5,241	–	–	–
Interest bearing liabilities of subsidiaries, other than deposits	674	1,073	2,444	–
Derivatives	2,023	–	–	–
Securities sold under repurchase agreements	719	–	–	–
Securities sold short	635	–	–	–
Subordinated debentures	19	20	152	935
Other financial liabilities	1,713	–	–	–
	47,387	11,897	8,546	939
Loan commitments	24,113	12,134	237	942
	$ 71,500	$ 24,031	$ 8,783	$ 1,881

Certain balances in the above table will not agree directly to the balances in the consolidated balance sheets as the table incorporates cash flows for both principal and interest, on an undiscounted basis, except for derivatives. Furthermore, loan commitments are not recognized on the balance sheet. Derivatives have been classified as "On demand and due within 3 months", and not by contractual maturity, because they are typically held for short periods of time.

Cash flows payable in respect of deposits are primarily contractually repayable on demand or on short notice. However, in practice, short-term deposit balances remain stable as cash inflows and outflows broadly match. Deposits on demand and due within 3 months include personal savings, and personal and commercial notice accounts of $24 billion.

Contractual obligations

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 consolidated balance sheets, such as those relating to operating leases.

A summary of our future contractual payments due by period is as follows:

	2008				
	Less than 1 year	*1 to 3 years*	*4 to 5 years*	*After 5 years*	*Total*
Subordinated debentures[1]	$ –	$ –	$ –	$ 843	$ 843
Operating leases	49	77	50	55	231
Committed purchase obligations	57	59	40	41	197
Unsecured long-term funding[1]	2,515	3,847	484	82	6,928
Total contractual obligations	$ 2,621	$ 3,983	$ 574	$ 1,021	$ 8,199

(1) *Includes principal amounts only.*

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. As a result of our ongoing funding and liquidity management process which we monitor regularly, we expect to be able to meet all of our funding and other commitments in the normal course of our operations despite the economic uncertainty.

Market risk

(Information that is an integral part of the audited financial statements)

Market risk is the risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

The objective of market risk management is to identify, measure and control market risk exposures in order to optimize return on risk.

We separate exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other positions designated as HFT. Non-trading portfolios include positions that arise from the interest rate management of our retail and commercial banking assets and liabilities and financial investments designated as AFS and HTM.

Policies and procedures

(Information that is an integral part of the audited financial statements)

Market risk is managed through strategies in accordance with policies and risk limits set out by ALCO and approved by the Board as well as centrally by HSBC Group Risk Management. 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 use a range of tools to monitor and limit market risk exposures. These include: present value of a basis point, Value at Risk ("VaR"), foreign exchange exposure limits, maximum loss limits, options premium paid limits, and product and issuance limits.

Value at Risk

(Information that is an integral part of the audited financial statements)

VaR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VaR models used are predominantly based on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking account of inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

— Potential market movements are calculated with reference to data from the past two years;

Management's Discussion and Analysis (continued)

— Historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;

— VaR is calculated to a 99 per cent confidence level; and

— VaR is calculated for a one-day holding period.

Statistically, we would expect to see losses in excess of VaR only one per cent of the time over a one-year period.

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations:

— The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

— The use of a one-day holding period assumes that all positions can be liquidated or hedged in one day, which may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;

— The use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;

— VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and

— VaR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

VaR disclosed in the table and graph below is the bank's total VaR for both trading and non-trading financial instruments. The information presented below does not include the results of HSBC Financial because the subsidiary employed other methods to measure and manage market risk prior to acquisition (note 2 on pages 58 to 61).

Daily Value at Risk

(Information that is an integral part of the audited financial statements)

Summary Value at Risk information

(Information that is an integral part of the audited financial statements)

	2008	2007
End of year	**$ 15**	$ 4
Average	**7**	4
Minimum	**3**	2
Maximum	**$ 17**	$ 5

The significant increase in VaR in 2008 was caused primarily by the high market volatility encountered in the third and fourth quarters of 2008 and its associated influence in historical VaR computation, rather than any conscious change in strategy or increase in risk appetite. VaR levels remained within our approved entity limits throughout 2008.

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 sheets. We value instruments included in the banking book at cost plus accrued interest (the effective interest rate method) 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 per cent. 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 per cent across all currencies and maturities would increase net interest income by $37 million (2007 – increase of $57 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.

Fiduciary risk

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

Fiduciary risk is controlled and managed by ensuring our clients establish appropriate investment goals and mandates through the "know your 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.

Management's Discussion and Analysis (continued)

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. Operational risks are identified by the units and 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 RMC and approval by our Board.

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.

As part of the 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 common with other HSBC Group companies, as well as other Canadian banks and large organizations, we have business continuity plans in place to deal with events that could impact banking operations, from health concerns to weather related events to power outages and beyond. We monitor emerging issues and review, test and upgrade plans to prepare for foreseen and unforeseen events.

Analysis of Financial Results and Operations by Customer Group

We report and manage our operations according to our major customer groups.

A summary of the breakdown of selected consolidated financial information and other data by major customer groups is included in note 28 on pages 90 to 92.

Personal Financial Services

Business developments and achievements for 2008 include:

— *Deposit and mortgage products* – We supported our customers growing core deposits, breaking through the $20 billion mark with $23.4 billion of total deposits with over $4.2 billion or 21.9 per cent growth for the year. Residential mortgages were up $0.9 billion or 4.8 per cent to $18.9 billion.

— *Premier* – We continued to grow Premier, HSBC's offering of seamless global banking, with over 6,000 Premier branches worldwide, attracting over 23,000 customers of which 50 per cent were new to the bank.

— *Funds under management* – HSBC Global Asset Management received Globe Fund's Five Star award, the top decile, for the HSBC Lifemap Conservative and HSBC Lifemap Moderate Conservative portfolios and Four Stars, the top quartile, for the HSBC Equity Fund, HSBC Monthly Income Fund, HSBC Mortgage Fund and HSBC Lifemap Multimanager Moderate Conservative portfolio.

— *Direct Bank* – The Direct Savings Account ("DSA") product was successful, achieving $2.1 billion in deposits by year-end, an increase of $1.2 billion year-over-year, and over 106,000 customers. Our direct channel year-to-date sales excluding DSA of $825 million are up 21 per cent year-over-year. We launched the HSBC InvestDirect Prestige Program, offering qualifying investors complimentary HSBC Premier services and discounted prices on trades.

— *Product innovations* – We launched the national Global Investing themed Summer Focus campaign featuring a series of High Rate Savings Accounts ("HRSA"), including a new Pounds Sterling and EURO HRSA, and first time offer of Great Rate Term Deposits in multiple currencies as well as Stock Market GICs to grow deposit business, acquire new customers and deepen relationships with existing customers. We re-launched the Mortgage Onboarding Program offering a pricing discount to qualified clients taking advantage of our mortgage bundle package, which includes a line of credit and HSBC MasterCard. Our HSBC Passport product, a packaged account for new immigrants, continues to perform well with over a 10 per cent increase in new customers.

— *Other* – We implemented a line of business realignment initiative, a network wide reorganization of staff, establishing the right infrastructure to improve customer experience, offering specialized service to our customers and improve career paths for staff. We also sold the assets of the Auto Finance business in Canada.

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

	2008	2007
Net interest income	**$ 395**	$ 402
Non-interest revenue	**265**	269
Total revenue	**660**	671
Non-interest expenses	**569**	536
Provision for credit losses	**21**	24
Income before taxes	**70**	111
Provision for income taxes	**19**	36
Non-controlling interest in income of trust	**6**	7
Net income	**45**	68
Preferred share dividends	**4**	4
Net income attributable to common shares	**$ 41**	$ 64
Percentage of total net income	**7.6%**	11.0%
Average assets	**$ 19,401**	$ 19,528
Percentage of total average assets	**26.2%**	28.6%

Results for 2008 were impacted by a loss of $29 million, arising from the sale of the bank's $1.5 billion automobile loan portfolio and a $24 million write-down on non-bank ABCP. Income before taxes and non-controlling interest in income of trust for 2007 included a $9 million gain on the sale of the bank's shares in the Montreal Exchange and a $16 million write-down on non-bank ABCP.

Excluding the items noted above, income before taxes and non-controlling interest in income of trust, was $123 million, an increase of $5 million, or 4 per cent, compared with $118 million for 2007.

Net interest income was $395 million, a decrease of $7 million, or 2 per cent, compared with $402 million for 2007. Loans continued to grow with increases in the residential mortgage and personal loan portfolios. This was offset by the sale of the automobile loan portfolio and securitization activities. Deposit growth was strong, largely due to increases in volumes experienced at the Direct Bank. Net interest margin decreased compared to the prior year due to the challenging interest rate and competitive environment particularly for deposits.

Excluding the items noted above, underlying non-interest revenue increased by $42 million in 2008, or 15 per cent. Securitization income increased on higher volumes and gains on securitization of loans. Revenues from the IIP were higher due to an increase in the volume of customers served. Foreign exchange and service charge revenues were higher compared to prior year from increased customer activity. These were partially offset by lower retail brokerage revenues compared to the prior year due to the downturn in equity markets and lower client trading volumes.

Non-interest expenses of $569 million increased $33 million, or 6 per cent, compared with $536 million for 2007. The increase was largely attributable to increased support costs. Underlying non-interest expense growth was 2 per cent and driven by higher marketing costs, IIP brokerage expenses, increased staff costs and continued business growth, partially offset by decreased variable compensation in line with lower retail brokerage revenues and lower overall performance compared to prior year.

Management's Discussion and Analysis (continued)

The provision for credit losses was lower compared to 2007 due to the sale of the automobile loan portfolio and an update in provisioning methodology, with loans now being assessed for impairment on a general basis.

Commercial Banking

Business developments and achievements for 2008 include:

— *Redefined business segments* – As part of the bank's line of business realignment, Commercial Banking has been reorganized and defined into three distinct segments – Business Banking, Mid-Market and Commercial Real Estate – which will benefit customers by providing more specialized service.

— *First overall SME Bank* – Recognized as the leading bank for small business by the Canadian Federation of Independent Business.

— *Small and Medium Enterprise offerings* – We launched *HSBC BusinessVantage*, a portfolio of services designed to meet the needs of small to medium business banking clients. We aimed to emphasize the importance of business banking in Canada and follow suit with HSBC Group's mandate to be "The Best Bank for Small Business".

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

	2008	2007
Net interest income	**$ 694**	$ 704
Non-interest revenue	**181**	179
Total revenue	**875**	883
Non-interest expenses	**317**	329
Provision for credit losses	**130**	43
Income before taxes	**428**	511
Provision for income taxes	**118**	173
Non-controlling interest in income of trust	**16**	15
Net income	**294**	323
Preferred share dividends	**11**	11
Net income attributable to common shares	**$ 283**	$ 312
Percentage of total net income	**49.6%**	52.5%
Average assets	**$ 26,912**	$ 24,232
Percentage of total average assets	**36.4%**	35.5%

Income before taxes and non-controlling interest in income of trust was $428 million, a decrease of $83 million, or 16 per cent, compared with $511 million for 2007. The results for 2008 included a $25 million write-down on non-bank ABCP compared to $16 million in 2007.

Net interest income decreased $10 million, or 1 per cent, to $694 million in 2008 as high funding costs arising from dislocated financial markets and widening credit spreads adversely impacted net interest margins. This was partially offset by continued growth in business volumes despite weaker market conditions.

Non-interest revenue increased $2 million, or 1 per cent, to $181 million in 2008 driven by growth of fees on banker's acceptances and other financial guarantees, revenues from the Payments and Cash Management business, and foreign exchange commissions. These increases were partially offset by higher write-downs on non-bank ABCP and lower gains recognized from Private Equity investments.

Non-interest expenses decreased by $12 million or 4 per cent due largely to lower central support costs. Underlying non-interest expenses increased $13 million, or 4 per cent due to increased staff costs and higher occupancy and equipment expenses arising from continued growth and investment in the business. These were partially offset by decreased variable compensation reflecting lower overall performance compared to prior year.

The provision for credit losses increased to $130 million due to increased levels of impaired loans and weakening credit conditions.

Global Banking and Markets

Business developments and achievements for 2008 include:

- *Revenue Growth* – Total revenue grew 9 per cent, largely on increased customer flow in foreign exchange and rates businesses.
- *Global Corporate Banking* – We leveraged our Global Banking and Markets platform in building relationships with target clients in energy, infrastructure and financial sectors. Our joined up approach continued to lead to a substantial increase in lead roles on cross-border debt financing for target clients.
- *Debt Capital Markets* – We led or co-lead eight transactions raising a total of $1.7 billion for domestic and foreign issuers and participated in 95 transactions raising a total of $83 billion for domestic and foreign issuers.
- *Equity Capital Markets* – We participated in deals raising almost $18 billion.
- *Global Investment Banking* – We were engaged on seven mergers and acquisitions advisory mandates in the financial services, energy and real estate sectors.
- *Asset Management* – We launched the new HSBC Global Climate Change Fund which was featured in the Green Focus program that aimed to raise awareness of HSBC global commitment to corporate sustainability. In addition, a new Premium series of investments over $100,000 was introduced which generated total sales of $391 million.

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

	2008	2007
Net interest income	**$ 78**	$ 116
Non-interest revenue	**333**	260
Total revenue	**411**	376
Non-interest expenses	**122**	132
Income before taxes	**289**	244
Provision for income taxes	**82**	83
Non-controlling interest in income of trust	**4**	4
Net income	**203**	157
Preferred share dividends	**3**	3
Net income attributable to common shares	**$ 200**	$ 154
Percentage of total net income	**34.2%**	25.5%
Average assets	**$ 22,759**	$ 19,513
Percentage of total average assets	**30.8%**	28.6%

Income before taxes and non controlling interest in income of trust was $289 million compared with $244 million in 2007, an increase of $45 million, or 18 per cent. This included write-downs on non-bank ABCP of $24 million in 2008 and $15 million in 2007, respectively.

Net interest income decreased by $38 million, or 33 per cent, in 2008 to $78 million reflecting lower net interest margins and dislocated financial markets. Falling interest rates, combined with widened credit spreads, resulted in higher funding and liquidity costs which compressed interest margins.

Non-interest revenue increased by $73 million, or 28 per cent, to $333 million. The volatility of the Canada-US dollar exchange rate and widening credit spreads which impacted the carrying value of certain debt obligations recorded at fair value drove trading income higher compared to 2007. Additionally, 2008 included increased foreign exchange trading revenue and a $9 million gain recognized as part of a transaction to raise unsecured term funding. These were partially offset by decreased Global Investment Banking revenues due to unfavourable market conditions and higher write-downs on non-bank ABCP, as well as prior year including a $16 million gain on the sale of Montreal Exchange shares.

Non-interest expenses decreased $10 million to $122 million due to lower variable compensation and capital taxes. This was partially offset by increased marketing costs due to branding initiatives.

Management's Discussion and Analysis (continued)

Consumer Finance

Business developments and achievements for 2008 include:

— *Reduced risk in business* – As a result of weakening economic conditions, we tightened underwriting criteria for all products including reductions in real estate loan-to-value ratios for first and second lien mortgages. The branch network of HSBC Financial was reduced from 109 to 93 branches to align our capacity with forecasted demand and reduced credit risk. In addition, we closed our centralized sales channel which marketed real estate and unsecured loans to consumers across Canada.

— *Cost containment* – During 2008, we continued to implement in-depth cost containment measures. This includes centralizing cost functions and increasing the use of HSBC affiliates in North America and globally to provide various support services to our operations, including, among other areas, customer service, collections, compliance and accounting functions.

— *Strengthened risk management and controls* – We developed more sophisticated risk models making them more forward looking and in particular including home price appreciation or depreciation into those models. We increased our collections effectiveness by implementing process improvements including new staff and an integrated call model. The integrated call model provides us with capabilities to deploy rapid changes in how we address some of the current changes in the business environment.

— *Product innovations* – We introduced risk-based pricing to align customers' needs and circumstances with a variety of price points. We now offer products at different interest rates to benefit our near prime customers. As a result, we are able to serve a wider spectrum of near prime customers than we have traditionally been able to serve. We successfully launched new and innovative rewards for MasterCard, including customers' ability to redeem points for mortgage principal payments or contributions to HSBC DSAs.

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

	2008	2007
Net interest income	**$ 477**	$ 496
Non-interest revenue	**58**	73
Total revenue	**535**	569
Non-interest expenses	**222**	274
Provision for credit losses	**228**	172
Income before taxes	**85**	123
Provision for income taxes	**34**	55
Net income	**51**	68
Preferred share dividends	**2**	–
Net income attributable to common shares	**$ 49**	$ 68
Percentage of total net income	**8.6%**	11.0%
Average assets	**$ 4,880**	$ 4,921
Percentage of total average assets	**6.6%**	7.3%

Income before taxes was $85 million compared to $123 million in 2007.

Net interest income was $477 million, a decrease of $19 million, or 4 per cent, compared with $496 million for 2007. In July 2008, we exited our non-prime auto finance business and sold the existing portfolio resulting in lower net interest income in 2008 when compared to 2007. In addition, as a result of our credit tightening decisions made in the fourth quarter of 2007 and during 2008, we experienced lower loan volumes in our core businesses. Receivables declined approximately $1 billion including the sale of the auto finance business, resulting in lower net interest income in 2008 when compared to 2007.

Non-interest revenue decreased $15 million, or 21 per cent in 2008, from $73 million. Excluding the loss on sale of the non-prime auto portfolio and the loss of fee revenue from the first quarter 2008 sale of our mortgage broker business, non-interest revenue was generally in line with the prior year.

Excluding one-time restructuring and other charges recorded in 2008 and 2007, non-interest expense declined $38 million or 15 per cent due to lower staff cost, incentives and lower business volumes. Marketing expenses decreased due to fewer marketing campaigns in 2008 due to continued credit tightening initiatives.

The provision for credit losses increased $56 million or 33 per cent in 2008 due to higher charge-offs resulting from portfolio seasoning, a slower economy and lower real estate values. We also increased our judgemental and statistical reserves as a result of higher levels of delinquency at December 31, 2008.

Consolidated Financial Statements

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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.

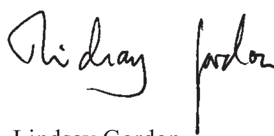
In meeting its responsibility for the reliability of financial information, management relies on comprehensive internal accounting, operating and system controls. The bank's overall controls include: an organizational structure providing for effective segregation of responsibilities, delegation of authority 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.

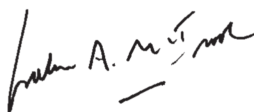
The bank's Board of Directors oversees management's responsibilities for financial reporting through the Audit Committee, which is composed of directors who are not officers or employees of the bank. The Audit Committee reviews the bank's interim and annual consolidated financial statements and MD&A 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, have certified the effectiveness of our internal control over financial reporting as at December 31, 2008, as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings).

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

Vancouver, Canada
February 16, 2009

Auditors' Report

To the Shareholders of HSBC Bank Canada

We have audited the consolidated balance sheets of HSBC Bank Canada as at December 31, 2008 and 2007 and the consolidated statements of income, changes in shareholders' equity, comprehensive income 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, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Vancouver, Canada
February 16, 2009

Consolidated Balance Sheets

At December 31 *(in millions of dollars)*

	2008	2007[1]
Assets		
Cash resources:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	**$ 434**	$ 554
Deposits with regulated financial institutions	**1,421**	3,120
	1,855	3,674
Securities: (note 3)		
Available-for-sale	**9,683**	5,704
Held-for-trading	**1,079**	1,227
Other	**56**	60
	10,818	6,991
Securities purchased under reverse repurchase agreements	**6,682**	6,122
Loans: (note 4)		
Business and government	**23,067**	21,322
Residential mortgages	**11,869**	12,920
Consumer finance loans	**4,029**	5,041
Other consumer loans	**5,296**	4,826
Allowance for credit losses	**(615)**	(514)
	43,646	43,595
Other:		
Customers' liability under acceptances	**5,209**	5,727
Derivatives (note 19)	**2,448**	623
Land, buildings and equipment (note 6)	**180**	172
Other assets (note 7)	**1,211**	1,226
	9,048	7,748
	$ 72,049	$ 68,130
Liabilities and Shareholders' Equity		
Deposits: (note 8)		
Regulated financial institutions	**$ 1,264**	$ 1,535
Individuals	**21,064**	18,292
Businesses and governments	**29,634**	29,051
	51,962	48,878
Other:		
Acceptances	**5,209**	5,727
Interest bearing liabilities of subsidiaries, other than deposits (note 9)	**4,164**	5,182
Derivatives (note 19)	**2,023**	660
Securities sold under repurchase agreements	**715**	320
Securities sold short	**631**	623
Other liabilities (note 10)	**1,974**	1,897
Non-controlling interest in trust and subsidiary (note 11)	**430**	430
	15,146	14,839
Subordinated debentures (note 12)	**788**	801
Shareholders' equity:		
Capital stock (note 13)		
Preferred shares	**696**	350
Common shares	**1,225**	1,293
Contributed surplus	**–**	232
Retained earnings	**1,950**	1,736
Accumulated other comprehensive income	**282**	1
	4,153	3,612
	$ 72,049	$ 68,130

(1) *Restated to reflect the acquisition of HSBC Financial Corporation Limited (note 2).*

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

Approved on behalf of the Board of Directors:

Robert W. 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)*

	2008	2007[1]
Interest income:		
Loans	**$ 3,016**	$ 3,234
Securities	**288**	285
Deposits with regulated financial institutions	**94**	242
	3,398	3,761
Interest expense:		
Deposits	**1,520**	1,791
Interest bearing liabilities of subsidiaries, other than deposits	**195**	213
Subordinated debentures	**39**	39
	1,754	2,043
Net interest income	**1,644**	1,718
Non-interest revenue:		
Deposit and payment service fees	**112**	100
Credit fees	**124**	116
Capital market fees	**88**	109
Investment administration fees	**130**	131
Foreign exchange	**49**	44
Trade finance	**24**	23
Trading revenue	**209**	112
Losses on available-for-sale securities (note 3(c))	**(68)**	(13)
Gains on other securities	**2**	11
Securitization income	**87**	42
Other	**80**	106
	837	781
Total revenue	**2,481**	2,499
Non-interest expenses:		
Salaries and employee benefits	**644**	687
Premises and equipment, including amortization	**165**	153
Other	**421**	431
	1,230	1,271
Net operating income before provision for credit losses	**1,251**	1,228
Provision for credit losses (note 4)	**379**	239
Income before provision for income taxes and non-controlling interest in income of trust	**872**	989
Provision for income taxes (note 26)	**253**	347
Non-controlling interest in income of trust	**26**	26
Net income	**$ 593**	$ 616
Preferred share dividends (note 13)	**20**	18
Net income attributable to common shares	**$ 573**	$ 598
Average number of common shares outstanding (000's)	**524,042**	517,599
Basic earnings per common share	**$ 1.09**	$ 1.16

(1) *Restated to reflect the acquisition of HSBC Financial Corporation Limited (note 2).*

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)*

	2008	2007[1]
Preferred shares: (note 13)		
Balance at beginning of year	**$ 350**	$ 350
Issued	**346**	–
Balance at end of year	**696**	350
Common shares: (note 13)		
Balance at beginning of year	**1,293**	1,193
Issued	**–**	100
Recapitalization (note 2)	**(68)**	–
Balance at end of year	**1,225**	1,293
Contributed surplus:		
Balance at beginning of year	**232**	224
Stock-based compensation (note 24)	**7**	8
Recapitalization (note 2)	**(239)**	–
Balance at end of year	**–**	232
Retained earnings:		
Balance at beginning of year	**1,736**	1,448
Net income	**593**	616
Preferred share dividends (note 13)	**(20)**	(18)
Common share dividends (note 13)	**(320)**	(310)
Recapitalization (note 2)	**(39)**	–
Balance at end of year	**1,950**	1,736
Accumulated other comprehensive income		
Balance at beginning of year	**1**	4
Net change in unrealized gains and losses on available-for-sale securities	**84**	(5)
Net change for cash flow hedges	**197**	2
Balance at end of year[2]	**282**	1
Total shareholders' equity	**$ 4,153**	$ 3,612

(1) *Restated to reflect the acquisition of HSBC Financial Corporation Limited (note 2).*

(2) *Comprises $85 million (2007 – $1 million) unrealized gains on available-for-sale securities, and $197 million (2007 – $nil) unrealized gains on cash flow hedges.*

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

Consolidated Statements of Comprehensive Income

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

	2008	2007[1]
Net Income	**$ 593**	$ 616
Other comprehensive income on available-for-sale securities		
Net unrealized gains from changes in fair value (net of income taxes of $34, $1)	**70**	2
Recycling of realized gains/(losses) to earnings (net of income taxes of $6, $(2))	**14**	(7)
	84	(5)
Other comprehensive income on cash flow hedges		
Unrealized gains from changes in fair value (net of income taxes of $94, $1)	**197**	2
Comprehensive income for the year	**$ 874**	$ 613

(1) *Restated to reflect the acquisition of HSBC Financial Corporation Limited (note 2).*

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)*

	2008	2007[1]
Cash flows provided by (used in) operating activities:		
Net income	**$ 593**	$ 616
Adjustments to net income to determine net cash provided by operating activities:		
Amortization expense	**46**	46
Provision for credit losses (note 4)	**379**	239
Provision for impairment of available-for-sale securities	**69**	39
Future income taxes (note 26)	**54**	21
Net accrued interest receivable and payable	**13**	77
Trading securities	**148**	(65)
Other, net	**(90)**	286
	1,212	1,259
Net cash flows provided by (used in) financing activities:		
Deposits received	**3,084**	4,704
Interest bearing liabilities of subsidiaries, other than deposits	**(1,018)**	481
Securities sold under repurchase agreements	**395**	158
Proceeds from issue of subordinated debentures	**–**	400
Redemption of subordinated debentures	**–**	(125)
Proceeds from issue of common shares (note 13)	**–**	100
Dividends paid (note 13)	**(388)**	(278)
	2,073	5,440
Net cash flows provided by (used in) investing activities:		
Loans funded, excluding securitizations	**(4,955)**	(8,066)
Proceeds from loans securitized (note 5)	**4,286**	2,394
Proceeds from sale of loans	**1,850**	32
Loans purchased from securitization conduits	**(1,062)**	–
Non-trading securities purchased	**(12,428)**	(8,095)
Non-trading securities sold	**1,483**	15
Non-trading securities matured	**6,334**	7,374
Securities purchased under reverse repurchase agreements	**(560)**	(1,362)
Net change in non-operating and other deposits with regulated financial institutions	**1,711**	1,221
Acquisition of land, buildings and equipment	**(52)**	(66)
	(3,393)	(6,553)
(Decrease) increase in cash and cash equivalents	**(108)**	146
Cash and cash equivalents, beginning of year	**528**	382
Cash and cash equivalents, end of year	**$ 420**	$ 528
Represented by:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	**$ 434**	$ 554
Less non-operating deposits with other banks[2]	**(14)**	(26)
Cash and cash equivalents, end of year	**$ 420**	$ 528
Supplementary cash flow information:		
Interest paid during the year	**$ 1,779**	$ 2,024
Income taxes paid during the year	**$ 364**	$ 409

(1) *Restated to reflect the acquisition of HSBC Financial Corporation Limited (note 2).*

(2) *Non-operating deposits comprise 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, 2008 and 2007 *(all tabular amounts are in millions of dollars unless stated otherwise)*

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

On November 30, 2008, the bank acquired from a United States ("US") affiliate, HSBC Finance Corporation, 100 per cent of the voting share capital of HSBC Financial Corporation Limited ("HSBC Financial"), the Canadian holding company for its Canadian consumer finance activities. The acquisition was accounted for using the continuity of interests method and, therefore, these consolidated financial statements and notes have been restated to include the financial position, the results of operations and changes in cash flows of HSBC Financial for all periods. See note 2, "Business combination" for further information.

1 Accounting policies

These consolidated financial statements have been prepared in accordance with Section 308(4) of the *Bank Act* which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions Canada ("OSFI"), the consolidated financial statements are to be prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The significant accounting policies used in the preparation of these consolidated financial statements conform, in all material respects, to GAAP. They also meet the accounting requirements of OSFI.

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 the 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, other-than-temporary impairment of available-for-sale securities ("AFS"), 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 *Cash resources*

Deposits with regulated financial institutions are recorded at amortized cost, except for certain instruments which are recorded as AFS or held-for-trading ("HFT"), as appropriate. Interest income on interest earning deposits is recorded on an accrual basis using the effective interest rate method.

d *Financial instruments*

All financial instruments, with certain exceptions, are classified into one of the following categories: held to maturity ("HTM"), loans and receivables, HFT, AFS or other financial liabilities. All financial instruments are recognized at fair value on initial recognition. Fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets and offer prices for financial liabilities. For derivative or other financial instruments where an active market does not exist, fair values are determined using valuation techniques that refer to observable market data including discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Financial instruments classified as HFT are purchased for resale generally for the short term. Subsequent to initial recognition, financial assets and liabilities classified as HFT are recorded at fair value. Gains and losses realized on disposal and unrealized gains and losses from market fluctuations are reported as trading revenue. Dividends and interest earned and interest incurred are included in interest income and expense, respectively.

Notes to Consolidated Financial Statements

1 Accounting policies *(continued)*

d *Financial instruments (continued)*

The standard also permits designation of a financial instrument as HFT on initial recognition ("the fair value option"). The use of the fair value option requires that fair values of such instruments can be measured reliably. Financial instruments designated at fair value under the fair value option are accounted for in the same manner as other financial instruments classified as HFT. OSFI has imposed restrictions on the use of the fair value option whereby its use must significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring the financial instrument or recognizing gains and losses on them on a different basis, or it belongs to a group of financial instruments that are managed on a fair value basis in accordance with the bank's risk management or investment strategy, or it is an embedded derivative that is not closely related to the host contract. In addition, OSFI places restrictions on designating retail exposures using the fair value option.

AFS financial assets are those non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, HTM, HFT or designated at fair value. Financial instruments classified and designated as AFS are carried at fair value whereby unrealized gains and losses are included in accumulated other comprehensive income ("AOCI") until sale when the cumulative gain or loss is recycled to income. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairments in value are included in non-interest revenue. Interest income and dividends from financial instruments designated as AFS are included in interest income using the effective interest rate method.

HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables, that an entity has the positive intention and ability to hold to maturity. Financial instruments designated as HTM, loans and receivables and other financial liabilities other than those designated or classified as HFT are measured at amortized cost using the effective interest rate method. Provisions for other-than-temporary impairment on assets designated as AFS or HTM are charged to income.

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal payments, plus or minus the cumulative amortization using the effective interest rate method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Transaction costs related to trading securities or those designated as HFT are expensed as incurred. Transaction costs related to AFS and HTM securities and loans and receivables are generally capitalized and are then amortized over the expected life of the instrument using the effective interest rate method.

The effective interest rate method is used for allocating the related interest income or interest expense for financial instruments measured at amortized cost, including amortization of transaction costs and fees as well as accretion of premiums or discounts over the expected life of the instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset or liability and is not subsequently revised.

e *Securities*

Securities are designated as HFT or AFS, with certain exceptions. Securities are accounted for on a trade date basis.

Non-trading securities are designated as AFS, with the exception of merchant banking investments carried at fair value and an investment designated as HTM. Equities that do not have quoted market values in an active market are carried at cost, as the values are not reliably measurable. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect other-than-temporary impairment in value are included in non-interest revenue. Interest income and dividends from these securities are included in interest income using the effective interest rate method.

f *Loans*

Loans, including direct finance leases, are initially measured at fair value and subsequently measured at amortized cost using the effective interest rate method, net of any unearned income and an allowance for credit losses.

Interest income is recorded on an accrual basis unless the loan is classified as an impaired loan. For credit card loans that are classified as impaired, interest income continues to be recorded on an accrual basis and is provided for in the allowance for credit losses. Loans are considered to be impaired when, in management's opinion, there is no longer reasonable assurance as to the ultimate collectibility of the full amount of principal or interest. Where a payment (principal or interest) is contractually 90 days in arrears, the loan will be classified as impaired, unless the loan is secured and the collection efforts are expected to result in repayment of the loan or in restoring it to a current status within 180 days from the date it became contractually in arrears. A loan that is contractually 180 days in arrears is classified as impaired in all situations, except when it is guaranteed or insured by Federal or Provincial governments; such loans are classified as impaired if the loan is contractually 365 days in arrears.

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, except for credit card loans. Interest income is recognized only when all allowances for credit losses have been reversed.

g *Allowance for credit losses*

An allowance is maintained for credit losses which, in management's opinion, is considered adequate to absorb all incurred 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 that may be susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

The allowance for credit losses consists of specific and general allowances, each of which is reviewed on a regular basis. The allowance for credit losses reduces the gross value of an asset to its net carrying value.

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. The estimated realizable amount is determined by discounting the expected future cash flows at the effective interest rate inherent in the loan at the date of impairment. The fair value of any collateral securing the loan, net of any expected realization costs or the observable market price for the loan may be used to measure the estimated realizable amount.

The general allowance is our best estimate of incurred losses in the portfolio for those assets that are not individually identified as being impaired. For business and government loans, the underlying credit metrics including probability of default, loss given default and exposure at default, for each customer are derived from the bank's internal rating systems as a basis for determining the general allowance. Management is able to amend these metrics for some or all borrowers where they consider that the rating system metrics do not fully reflect incurred losses. This judgemental adjustment employs an established framework and references both internal and external indicators of credit quality.

For consumer loans, residential mortgages and credit cards, expected losses are estimated through analysis of historical loss migration and write-off trends.

The level of the general allowance is re-assessed each quarter and may fluctuate as a result of changes in portfolio volumes, concentrations and risk; analysis of developing trends in probability of loss, severity of loss and exposure at default factors; and management's current assessment of indicators that may have affected the condition of the portfolio. The balance of the general allowance is also analyzed as a function of risk-weighted assets and is also referenced to applicable industry data.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

g *Allowance for credit losses (continued)*

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 consolidated balance sheets as guaranteed loans and borrowings and a liability is recorded in respect of the consideration received. Conversely, securities purchased under reverse repurchase agreements are not recognized on the consolidated balance sheets and an asset is recorded representing the consideration paid. Interest income on securities purchased under reverse repurchase agreements, and interest expense on securities sold under repurchase agreements are recorded using the effective interest rate method.

i *Obligations related to securities sold short*

The bank's obligation to deliver securities sold that were not owned at the time of sale is recorded at fair value. Adjustments to fair value and gains and losses on sale are recorded in trading revenue in the consolidated statements of income.

j *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 – 3 to 5 years and leasehold improvements – lesser of lease term or estimated useful life. Gains and losses on disposal are recorded in other non-interest revenue in the year of disposal.

k *Goodwill and other intangible assets*

Goodwill, which represents the excess of the price paid for subsidiaries over the fair value of the net assets acquired, is not amortized and is recognized in other assets.

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

Goodwill and other intangible assets are reviewed at least annually, or more frequently if events or changes in circumstances indicate that the assets might be impaired, 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.

l *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 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.

m *Income taxes*

Income taxes are accounted for under the asset and liability method. Under this method, future income tax assets and liabilities are determined based on temporary differences (differences between the tax basis and accounting basis of assets and liabilities as well as any applicable operating losses and tax credit carry forwards) and are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment. 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, adjusted for any amounts included in other comprehensive income ("OCI").

The net future income tax asset is included in other assets in the consolidated balance sheets.

n *Employee future benefits*

The bank accrues its obligations under employee benefit plans (including pension plans and post-retirement plans other than pensions) and the related costs, net of plan assets. The pension plans include both defined benefit and defined contribution plans. The post-retirement plans 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 the bank or our employees, while the supplemental pension arrangements are not funded.

The costs of employee benefit plans are actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected investment performance, salary escalation, retirement ages of employees and expected health care costs.

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

The excess of the net actuarial gains or losses over 10 per cent of the greater of the accrued benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees covered under the plan in question.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of active employees at the date of amendment.

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 period of the active employees.

o *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. Realized and unrealized gains and losses from foreign currency translation are included in non-interest revenue, and presented in the consolidated statements of income, with the exception of unrealized foreign exchange gains and losses on AFS securities, which are included in AOCI, and presented in the statements of comprehensive income, until such time that they are realized and included in non-interest revenue.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

p *Derivative instruments and hedges*

Derivative instruments are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. 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.

Non-hedging derivative instruments are marked to market and the resulting net gains or losses are recognized in non-interest revenue in the current period, with a corresponding asset or liability recorded on the consolidated balance sheets.

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3865, *Hedges* specifies the circumstances under which hedge accounting is permissible and how hedge accounting should be applied in the financial statements.

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 identified assets and liabilities or identified firm commitments or forecasted transactions. We also formally assess, at the hedge's inception, retrospectively and prospectively on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows attributed to the hedged risks.

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 exposures 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 exposures.

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

Hedges are designated as either fair value hedges or cash flow hedges. Fair value hedges are used to manage the impact on income from changes in the fair value of fixed rate assets and liabilities caused by changes in interest rates. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk, which amounts are recorded in trading income. Changes in fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging instrument, normally a derivative, on which fair value changes are also recorded in trading income.

Cash flow hedges are used to manage the impact on income from the effects of changes in the interest rates on variable rate assets and liabilities. In a cash flow hedging relationship, the effective portion of the change in fair value of the hedging derivative will be recognized in OCI, while the ineffective portion is recognized in trading income. The amounts recognized in OCI 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.

q *Trust assets under administration*

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

1 Accounting policies *(continued)*

r *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 consolidated balance sheets 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. A gain or loss on sale is recognized when the securitized assets are transferred.

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 AFS, are included in other assets and recorded at fair value. Retained interests are tested regularly for other-than-temporary impairment, and carrying values reduced to reflect any such impairment in non-interest income. 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.

s *Stock-based compensation*

We provide compensation to certain key employees in the form of share-based awards of shares of our Parent. In addition, eligible employees are invited to participate in a savings-related share option program. The bank accounts for stock-based compensation plans using the fair value based method whereby compensation cost is measured at fair value at the date of grant and recognized over the awards' vesting period in compensation expense and, where appropriate, contributed surplus.

t *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.

u *Variable interest entities*

Variable interest entities ("VIEs") are consolidated where the bank is the primary beneficiary. An entity is a VIE when, by design, one or both of the following conditions exist: total equity investment at risk is insufficient to permit the bank to finance its activities without additional subordinated support from others and/or as a group, the holders of the equity investment at risk lack certain essential characteristics of a controlling financial interest. The primary beneficiary is the enterprise that absorbs or receives the majority of the VIE's expected losses, expected residual returns, or both.

v *Changes in accounting policies*

i) Capital disclosures

Effective January 1, 2008, the bank adopted CICA Handbook Section 1535, *Capital Disclosures*, which establishes disclosure requirements relating to entities' objectives, policies and processes for managing capital, quantitative disclosures about what the entity regards as capital, whether the entity has complied with any capital requirements and the consequences of non-compliance with such capital requirements. These disclosures are included in note 27.

ii) Financial instruments – disclosure and presentation

Effective January 1, 2008, the bank adopted CICA Handbook Section 3862, *Financial Instruments – Disclosures*, and Section 3863, *Financial Instruments – Presentation*. These sections establish comprehensive disclosure and presentation requirements related to financial instruments. The standards revise the current disclosure requirements of CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and place an increased emphasis on disclosures regarding the risks associated with financial instruments and how these risks are managed.

As permitted by CICA Handbook section 3862, we have included certain of the required disclosures as part of the MD&A, in the sections indicated on pages 24 to 37, which form an integral part of these financial statements.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

v *Changes in accounting policies (continued)*

iii) Financial instruments – recognition and measurement

Effective July 1, 2008, CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement* and CICA Handbook Section 3862, *Financial Instruments – Disclosures* were amended to include the ability to reclassify financial instruments out of the HFT category under rare circumstances. The bank did not reclassify any of its financial instruments as a result of these amendments.

w *Future accounting and reporting changes*

i) Goodwill and intangible assets

Effective January 1, 2009, CICA Handbook Section 3064, *Goodwill and Intangible Assets*, replaces CICA Handbook Sections 3062, *Goodwill and Other Intangible Assets*, and 3450, *Research and Development Costs*. Section 3064 provides guidance on the definition of an intangible asset and the recognition of internally generated intangible assets.

Although the bank will adopt this standard in 2009, it is not expected to have a material impact on the bank's financial position and results of operations.

ii) Credit risk and the fair value of financial assets and financial liabilities

On January 20, 2009, the CICA issued an abstract, EIC-173, *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, which requires entities to take into account their own credit risk and the credit risk of counterparties when determining the fair value of derivative instruments. EIC-173 will be required to be applied retrospectively without restatement. The bank is in the process of considering the impact of this abstract.

2 Business combination

Effective November 30, 2008, the bank acquired from a US affiliate, HSBC Finance Corporation, 100 per cent of the voting share capital of HSBC Financial, the Canadian holding company for its Canadian consumer finance activities. The aggregate purchase price was $346 million, satisfied by the issue of Class 2, Series B preferred shares at a fair value of $346 million (note 13).

The acquisition represents a transfer of equity interests between entities under common control and, accordingly, the transfer was accounted for using the continuity of interests method at the net book value of the net assets transferred as recorded in the accounts of HSBC Financial.

As a result of the acquisition, the consolidated financial statements and related notes presented for all prior periods, have been restated, except where otherwise noted, to include the financial position and results of operations of HSBC Financial. The financial position and the results of operations of HSBC Financial have been adjusted to conform with the accounting policies of the bank.

The following table summarizes the carrying value of the assets acquired and liabilities assumed at the date of acquisition:

Total assets acquired	$ 4,383
Total liabilities assumed	4,037
Net assets acquired	$ 346

Although preferred shares were issued in exchange for common shares issued by HSBC Financial previously held by another HSBC Group company, no new equity was contributed. Accordingly, new preferred shares issued with a fair value of $346 million have been recorded as a recapitalization of the combined shareholders equity of HSBC Bank Canada and HSBC Financial as follows:

Common shares of HSBC Financial cancelled	$ 68
Charge to contributed surplus	239
Charge to retained earnings	39
	$ 346

2 Business combination *(continued)*

The impact of the acquisition on previously reported opening balances of shareholders' equity is as follows:

	2008	2007
Common shares		
As previously reported	**$ 1,225**	$ 1,125
HSBC Financial common shares	**68**	68
As restated	**$ 1,293**	$ 1,193
Contributed surplus		
As previously reported	**$ 206**	$ 202
HSBC Financial contributed surplus	**26**	22
As restated	**$ 232**	$ 224
Retained earnings		
As previously reported	**$ 1,462**	$ 1,192
HSBC Financial retained earnings	**274**	256
As restated	**$ 1,736**	$ 1,448
Accumulated other comprehensive income		
As previously reported	**$ 5**	$ 7
HSBC Financial accumulated other comprehensive income	**(4)**	(3)
As restated	**$ 1**	$ 4

The effect of the acquisition on the consolidated balance sheets and consolidated statements of income of the bank is as follows:

Consolidated Balance Sheets

	2008		
	Pro-forma excluding HSBC Financial[(1)]	*Impact of HSBC Financial*	*Total*
Assets			
Cash resources	**$ 1,815**	**$ 40**	**$ 1,855**
Securities	**10,772**	**46**	**10,818**
Securities purchased under reverse repurchase agreements	**6,682**	**–**	**6,682**
Loans	**39,812**	**3,834**	**43,646**
Other assets	**8,909**	**139**	**9,048**
	$ 67,990	**$ 4,059**	**$ 72,049**
Liabilities and Shareholders' Equity			
Deposits	**51,961**	**1**	**51,962**
Other liabilities	**11,435**	**3,711**	**15,146**
Subordinated debentures	**788**	**–**	**788**
Shareholders' equity	**3,806**	**347**	**4,153**
	$ 67,990	**$ 4,059**	**$ 72,049**

(1) *Represents the following customer groups: Personal Financial Services, Commercial Banking, and Global Banking and Markets; excluding Consumer Finance.*

Notes to Consolidated Financial Statements (continued)

2 Business combination *(continued)*

Consolidated Statements of Income

	2008		
	Pro-forma excluding HSBC Financial [1]	*Impact of HSBC Financial*	*Total*
Net interest income	**$ 1,168**	**$ 476**	**$ 1,644**
Non-interest revenue	**778**	**59**	**837**
Total revenue	**1,946**	**535**	**2,481**
Non-interest expense	**1,008**	**222**	**1,230**
Net operating income before provision for credit losses	**938**	**313**	**1,251**
Provision for credit losses	**151**	**228**	**379**
Income before provision for income taxes and non-controlling interest in income of trust	**787**	**85**	**872**
Provision for income taxes	**219**	**34**	**253**
Non-controlling interest in income of trust	**26**	**–**	**26**
Net income	**$ 542**	**$ 51**	**$ 593**

(1) *Represents the following customer groups: Personal Financial Services, Commercial Banking, and Global Banking and Markets; excluding Consumer Finance.*

Consolidated Balance Sheets

	2007		
	Previously reported	*Impact of HSBC Financial*	*As restated*
Assets			
Cash resources	$ 3,573	$ 101	$ 3,674
Securities	6,926	65	6,991
Securities purchased under reverse repurchase agreements	6,122	–	6,122
Loans	38,715	4,880	43,595
Other assets	7,595	153	7,748
	$ 62,931	$ 5,199	$ 68,130
Liabilities and Shareholders' Equity			
Deposits	48,877	1	48,878
Other liabilities	10,005	4,834	14,839
Subordinated debentures	801	–	801
Shareholders' equity	3,248	364	3,612
	$ 62,931	$ 5,199	$ 68,130

2 Business combination *(continued)*

Consolidated Statements of Income

	2007		
	Previously reported	*Impact of HSBC Financial*	*As restated*
Net interest income	$ 1,222	$ 496	$ 1,718
Non-interest revenue	708	73	781
Total revenue	1,930	569	2,499
Non-interest expense	997	274	1,271
Net operating income before provision for credit losses	933	295	1,228
Provision for credit losses	67	172	239
Income before provision for income taxes and non-controlling interest in income of trust	866	123	989
Provision for income taxes	292	55	347
Non-controlling interest in income of trust	26	–	26
Net income	$ 548	$ 68	$ 616

3 Securities

a *Analysis of securities*

	2008				
	Term to maturity				
	Within 1 year	*1–5 years*	*5–10 years*	*No specific maturity*	*Total fair value*
Available-for-sale securities (at fair value):					
Securities issued or guaranteed by:					
Canada	**$ 4,999**	**$ 4,154**	**$ –**	**$ –**	**$ 9,153**
Provinces	**124**	**46**	**–**	**–**	**170**
	5,123	**4,200**	**–**	**–**	**9,323**
Others	**–**	**45**	**–**	**181**	**226**
Investment funds	**–**	**–**	**–**	**4**	**4**
Equity securities	**49**	**81**	**–**	**–**	**130**
Total available-for-sale securities	**$ 5,172**	**$ 4,326**	**$ –**	**$ 185**	**$ 9,683**
Held-for-trading securities (at fair value):					
Securities issued or guaranteed by:					
Canada	**$ 371**	**$ 182**	**$ 42**	**$ –**	**$ 595**
Provinces	**47**	**13**	**114**	**–**	**174**
	418	**195**	**156**	**–**	**769**
Others	**236**	**12**	**9**	**34**	**291**
Equity securities	**–**	**–**	**–**	**19**	**19**
Total held-for-trading securities	**$ 654**	**$ 207**	**$ 165**	**$ 53**	**$ 1,079**

Notes to Consolidated Financial Statements (continued)

3 Securities *(continued)*

a *Analysis of securities (continued)*

	2007				
	Term to maturity				
	Within 1 year	*1–5 years*	*5–10 years*	*No specific maturity*	*Total fair value*
Available-for-sale securities (at fair value):					
Securities issued or guaranteed by:					
Canada	$ 3,426	$ 1,509	$ –	$ –	$ 4,935
Provinces	298	25	–	–	323
	3,724	1,534	–	–	5,258
Others	5	62	–	233	300
Investment funds	–	–	–	2	2
Equity securities	18	105	18	3	144
Total available-for-sale securities	$ 3,747	$ 1,701	$ 18	$ 238	$ 5,704
Held-for-trading securities (at fair value):					
Securities issued or guaranteed by:					
Canada	$ 364	$ 137	$ 43	$ –	$ 544
Provinces	7	16	55	–	78
	371	153	98	–	622
Others	485	35	19	50	589
Equity securities	–	–	–	16	16
Total held-for-trading securities	$ 856	$ 188	$ 117	$ 66	$ 1,227

Other securities (not included in the above table) not designated as AFS or HFT include a foreign currency denominated provincial government bond designated as HTM of $12 million (2007 – $8 million), merchant banking investments recognized at fair value of $42 million (2007 – $49 million) and investments in equities with significant influence recognized using the equity method of $2 million (2007 – $3 million).

The total carrying value of securities includes amounts denominated in currency other than Canadian dollars of $103 million (Canadian equivalent) (2007 – $90 million).

Included in AFS securities issued or guaranteed by Canada are mortgage-backed securities retained by the bank in connection with mortgage securitizations of $874 million (2007 – $1,391 million) (note 5).

b *Canadian non-bank sponsored asset backed commercial paper*

At December 31, 2008, we held $330 million (2007 – $328 million) in par value holdings of Canadian non-bank sponsored asset backed commercial paper ("non-bank ABCP") that was subject to the standstill and court approved restructuring plan proposed by signatories to the Montreal Accord ("the Plan"). These non-bank ABCP are backed by traditional securitization assets, and leveraged and unleveraged collateralized debt obligations ("CDOs"), some of which have indirect US sub-prime exposures.

Restructuring plan

The Plan was filed with the Ontario Court of Justice under the Companies' Creditors Arrangement Act by the Pan-Canadian Investors Committee on March 17, 2008 and proposed exchanging the notes representing the non-bank ABCP for longer-term floating rate notes designed to more closely match the maturity of the underlying pool of assets.

Noteholders approved the Plan on April 25, 2008 and, on June 5, 2008, the Ontario Superior Court of Justice sanctioned the Plan. After various unsuccessful appeals, a final agreement was reached on December 24, 2008. Subsequent to December 31, 2008, the Plan Implementation Order was granted by the Superior Court of Ontario and, on January 21, 2009, the Plan was implemented.

3 Securities *(continued)*

b *Canadian non-bank sponsored asset backed commercial paper (continued)*

Under the terms of the Plan, non-bank ABCP was replaced with longer-term floating rate notes with maturities more closely matching the maturities of the underlying assets, which were allocated into one of three Master Asset Vehicles ("MAV1", "MAV2" or "MAV3"). MAV1 and MAV2 contain those series of non-bank ABCP supported in whole or in part by synthetic assets (largely CDOs). The majority of these series were pooled and supported by margin funding facilities (self-funded in the case of MAV1 noteholders) provided by certain financial institutions and noteholders as well as a senior funding facility provided by the governments of Canada and certain of the Provinces. The margin funding facilities and senior funding facility will fund margin calls in the event insufficient collateral exists within the pooled series to support the leveraged CDOs. Those assets that have exposure to US sub-prime mortgages or that did not have their collateral triggers adjusted were considered ineligible for pooling ("ineligible assets") and will not benefit from the funding facilities. MAV3 contains those series of non-bank ABCP backed solely by traditional securitization assets or ineligible assets.

At December 31, 2008, we expected to receive $164 million in Class A-1 notes, $102 million in Class A-2 notes, $18 million in Class B notes and $9 million in Class C notes backed by the pooled assets in MAV2, $31 million in various tracking notes backed by ineligible assets in MAV2, and $4 million in traditional asset tracking notes issued by MAV3. Subsequent to December 31, 2008, our existing non-bank ABCP was exchanged for these new notes upon implementation of the Plan. The Class A-1, Class A-2, Class B and Class C notes are issued under a senior-subordinated structure in respect of the pooled assets. The Class A-1 notes rank in priority to Class A-2 notes that in turn are senior to the Class B and C notes. The Class A-1 and A-2 notes pay a quarterly coupon of 50 basis points below the Bankers Acceptance rate. The Class B and C subordinated notes are zero coupon in nature, paying interest and principal only after the Class A-1 and A-2 notes are settled in full. The tracking notes pass through the cash flows of the underlying assets. All of the restructured notes are expected to be substantially repaid or mature on or before January 2017.

Fair value

The bank has determined the fair value of non-bank ABCP using a discounted cash flow model that estimates the fair value of the notes.

In the current year, as a result of updating the model's assumptions based on the anticipated terms of the Plan, an additional impairment charge of $73 million was recognized, of which $11 million was recorded as a reduction of trading income and $62 million recorded as losses on AFS securities. The carrying value of the bank's non-bank ABCP, net of provisions, at December 31, 2008 is $212 million, of which $31 million is classified as HFT and $181 million is classified as AFS. The recorded net carrying value of the non-bank ABCP represents management's best estimate of the fair value of the non-bank ABCP at December 31, 2008. At December 31, 2007, the carrying amount of non-bank ABCP was $283 million.

In prior periods, management's significant assumptions in the valuation of non-bank ABCP included the probability of success of the Plan. In updating the model's assumptions in the current year, management used expected coupon rates, credit ratings and maturity dates of the underlying categories of assets based on the anticipated terms outlined under the Plan and revised assumptions regarding discount rates. Determination of the discount rate was derived based on interest rates on a number of asset backed securities with similar, but not identical duration and risk characteristics. At December 31, 2008, the effect of a 100 basis point adverse change in the discount rate, the valuation model's significant non-observable input, would result in a further provision of approximately $14 million.

Our valuation was based on our assessment, at December 31, 2008, of estimates and circumstances that may change in subsequent periods. Items that may have a material impact on the fair value of the non-bank ABCP or subsequent notes under the Plan include any further changes in economic conditions including market liquidity and interest rates.

c *Net gains (losses) on available-for-sale securities*

	2008	2007
Realized gains	**$ 1**	$ 26
Realized losses and other than temporary impairment	**(69)**	(39)
Net losses on available-for-sale securities	**$ (68)**	$ (13)

In addition to $62 million of losses relating to non-bank ABCP discussed in note 3(b) above, at December 31, 2008, certain of our AFS securities, including preferred shares and mutual fund investments, were identified as being other-than-temporarily impaired. As a result, an impairment charge of $8 million was recognized in non-interest revenue in 2008 (2007 – $nil).

Notes to Consolidated Financial Statements (continued)

4 Loans

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

	2008				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	**$ 23,067**	**$ 11,869**	**$ 4,029**	**$ 5,296**	**$ 44,261**
Specific allowance at beginning of year	**68**	**1**	**–**	**15**	**84**
Provision for credit losses[1]	**130**	**–**	**–**	**–**	**130**
Recoveries	**2**	**–**	**–**	**–**	**2**
Write-offs	**(39)**	**–**	**–**	**–**	**(39)**
Transfers out	**–**	**–**	**–**	**(15)**	**(15)**
Specific allowance at end of year	**161**	**1**	**–**	**–**	**162**
General allowance at beginning of year[2]	**234**	**1**	**161**	**34**	**430**
Provision for credit losses[1]	**–**	**–**	**228**	**21**	**249**
Write-offs, net of recoveries	**–**	**–**	**(195)**	**(46)**	**(241)**
Transfers in	**–**	**–**	**–**	**15**	**15**
General allowance at end of year[2]	**234**	**1**	**194**	**24**	**453**
Total allowance[2]	**395**	**2**	**194**	**24**	**615**
Net amount at end of year	**$ 22,672**	**$ 11,867**	**$ 3,835**	**$ 5,272**	**$ 43,646**

	2007				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	$ 21,322	$ 12,920	$ 5,041	$ 4,826	$ 44,109
Specific allowance at beginning of year	47	1	–	10	58
Provision for credit losses[1]	42	–	–	25	67
Recoveries	3	–	–	2	5
Write-offs	(24)	–	–	(22)	(46)
Specific allowance at end of year	68	1	–	15	84
General allowance at beginning of year[2]	234	1	146	34	415
Provision for credit losses[1]	–	–	172	–	172
Write-offs, net of recoveries	–	–	(157)	–	(157)
General allowance at end of year[2]	234	1	161	34	430
Total allowance[2]	302	2	161	49	514
Net amount at end of year	$ 21,020	$ 12,918	$ 4,880	$ 4,777	$ 43,595

(1) *Total provision for credit losses for 2008 was $379 million (2007 – $239 million).*
(2) *Includes general allowance for customers who can utilize facilities through either direct borrowings or acceptances.*

Total net loans includes amounts denominated in US dollars of $2,540 million (Canadian equivalent) (2007 – $1,160 million) and other foreign currencies of $29 million (Canadian equivalent) (2007 – $68 million). Included in residential mortgages are $924 million of National Housing Act insured mortgages (2007 – $897 million), and $577 million of mortgages insured by a third party private insurer with an “AA” rating (2007 – $747 million).

4 Loans *(continued)*

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

	Gross impaired amount		*Specific allowance*		*Net of specific allowance*	
	2008	2007	**2008**	2007	**2008**	2007
Business and government	**$ 688**	$ 226	**$ 161**	$ 68	**$ 527**	$ 158
Residential mortgages	**37**	22	**1**	1	**36**	21
Consumer finance loans	**181**	148	**–**	–	**181**	148
Other consumer loans	**26**	24	**–**	15	**26**	9
Total	**$ 932**	$ 420	**$ 162**	$ 84	**$ 770**	$ 336

5 Loan securitization

a *Securitization activity during the year is as follows:*

	2008			2007		
	Residential mortgages	*Consumer term loans*	*Total*	*Residential mortgages*	*Consumer term loans*	*Total*
Net securitization activity						
Securitized and sold	**$ 4,304**	**$ –**	**$ 4,304**	$ 2,304	$ 107	$ 2,411
Net cash proceeds received	**4,286**	**–**	**4,286**	2,289	105	2,394
Retained rights to future excess interest	**120**	**–**	**120**	48	5	53
Retained servicing liability	**25**	**–**	**25**	13	–	13
Pre-tax gain on sale	**76**	**–**	**76**	20	1	21
Key assumptions at time of sale						
Prepayment rate	**18.98%**	**–**		25.02%	26.82%	
Excess spread	**1.27%**	**–**		1.11%	4.06%	
Expected credit losses	**0.00%**	**–**		0.01%	0.63%	
Discount rate	**4.32%**	**–**		5.41%	8.36%	

Servicing and other income from securitized assets was $14 million (2007 – $13 million). Credit losses of $2 million were realized on securitized consumer loans (2007 – $2 million).

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

	2008	2007
Residential mortgages		
Conventional	**$ 1,417**	$ 2,005
Mortgage-backed securities[1]	**4,827**	1,794
	6,244	3,799
Consumer loans		
Personal lines of credit	**–**	1,200
Term loans	**–**	226
	–	1,426
	$ 6,244	$ 5,225

(1) *Excludes insured mortgages which were securitized and retained by the bank of $874 million (2007 – $1,391 million). These assets are classified as AFS securities (note 3).*

Notes to Consolidated Financial Statements (continued)

5 Loan securitization *(continued)*

During 2008, as part of the industry restructuring of certain non-bank ABCP conduits involved in the Montreal Accord, the bank purchased approximately $900 million of personal loans previously securitized and sold to certain securitization conduits. In addition, the bank exercised an option to purchase approximately $162 million of personal loans previously securitized and sold. There were no material gains or losses recognized as a result of these transactions. The assets purchased were recorded as loans and receivables.

c *Sensitivity of assumptions*

The following table outlines key economic assumptions used in measuring fair value of retained interests at December 31. These assumptions are the weighted average for all assets at year end. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another. The impact of a 10 per cent and 20 per cent increase to these assumptions is not significant.

	Residential mortgages		*Personal lines of credit*		*Consumer term loans*	
	2008	2007	**2008**	2007	**2008**	2007
Fair value of retained interests	**$ 137**	$ 48	**$ –**	$ 8	**$ –**	$ 8
Discount rate	**4.02%**	5.24%	**–**	6.30%	**–**	8.29%
Prepayment rate	**18.92%**	22.47%	**–**	100.00%	**–**	29.00%
Expected credit losses	**0.01%**	0.01%	**–**	0.19%	**–**	0.63%

6 Land, buildings and equipment

	2008			2007
	Cost	*Accumulated amortization*	*Net book value*	*Net book value*
Land	**$ 2**	**$ –**	**$ 2**	$ 2
Buildings	**20**	**6**	**14**	15
Furniture and equipment	**112**	**71**	**41**	43
Computer equipment and software	**89**	**35**	**54**	46
Leasehold improvements	**138**	**69**	**69**	66
Total	**$ 361**	**$ 181**	**$ 180**	$ 172

Amortization for 2008 was $44 million (2007 – $41 million).

7 Other assets

	2008	2007
Accrued interest receivable	**$ 177**	$ 215
Interest earning other assets	**175**	224
Due from clients, dealers and clearing corporations	**306**	236
Future income taxes, net (note 26)	**32**	86
Goodwill and other intangible assets, net	**16**	24
Pension asset (note 25)	**78**	66
Accounts receivable and other	**427**	375
Total	**$ 1,211**	$ 1,226

Amortization of intangible assets for 2008 was $2 million (2007 – $5 million). No impairment was recorded for 2008. A reduction in goodwill and other intangible assets of $10 million was incurred in 2007 due to the anticipated sale of a business by HSBC Financial.

8 Deposits

	2008			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	**$ 649**	**$ –**	**$ 2,659**	**$ 3,308**
Notice	**–**	**7,173**	**9,921**	**17,094**
Fixed date	**615**	**13,891**	**17,054**	**31,560**
Total	**$ 1,264**	**$ 21,064**	**$ 29,634**	**$ 51,962**

	2007			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	$ 368	$ –	$ 2,552	$ 2,920
Notice	–	5,055	9,081	14,136
Fixed date	1,167	13,237	17,418	31,822
Total	$ 1,535	$ 18,292	$ 29,051	$ 48,878

Deposits denominated in US dollars amount to $9,954 million (Canadian equivalent) (2007 – $8,461 million) and in other foreign currencies amount to $1,396 million (Canadian equivalent) (2007 – $2,079 million). Certain deposits have been designated as trading (note 17).

9 Interest bearing liabilities of subsidiaries, other than deposits

	2008	2007
Broker client accounts	**$ 671**	$ 527
Commercial paper	**–**	661
Medium term notes	**3,493**	3,994
	$ 4,164	$ 5,182

Interest expense on medium term notes was $177 million for 2008 (2007 – $176 million). The weighted average interest rate was 4.14 per cent during 2008 (2007 – 4.41 per cent). Medium term notes are guaranteed by HSBC Finance Corporation, HSBC Financials' former parent company.

10 Other liabilities

	2008	2007
Accrued interest payable	**$ 387**	$ 412
Mortgages sold with recourse (note 22)	**591**	436
Payable to clients, dealers and clearing corporations	**288**	301
Pension liability (note 25)	**25**	22
Other employee future benefits liability (note 25)	**88**	79
Accounts payable and other	**595**	647
Total	**$ 1,974**	$ 1,897

11 Non-controlling interest in trust and subsidiary

	2008	2007
HSBC Canada Asset Trust	**$ 400**	$ 400
HSBC Mortgage Corporation (Canada)	**30**	30
	$ 430	$ 430

Notes to Consolidated Financial Statements (continued)

11 Non-controlling interest in trust and subsidiary *(continued)*

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 and Genworth Financial Mortgage Insurance Company Canada insured first mortgages originated by the bank, and Trust deposits with the bank.

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 13).

	2008		2007	
	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 per cent to December 31, 2010 and the six month bankers' acceptance rate plus 2.37 per cent 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 per cent to June 30, 2015 and the six month bankers' acceptance rate plus 1.50 per cent 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 payment of a premium in certain circumstances and regulatory approval.*

b *HSBC Mortgage Corporation (Canada)*

The HSBC Group holds $30 million, a 100 per cent 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 2008 and 2007. Dividends may be declared at the discretion of the directors of HMC.

12 Subordinated debentures

Subordinated 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*	**2008**	2007
Issued to HSBC Group companies				
4.822[1]	2094	US$85	**$ 110**	$ 87
Issued to third parties				
4.39[2]	2015		**100**	100
4.94[3]	2021		**200**	200
4.80[4]	2022		**338**	374
30 day bankers' acceptance rate plus 0.50%	2083		**40**	40
			$ 678	$ 714
Total			**$ 788**	$ 801

(1) *The interest rate is fixed at 4.822 per cent until July 2010. Interest expense for the year amounted to $4 million (2007 – $4 million). These debentures are in a fair value hedging relationship which is adjusted for the fair value of the hedged risk.*

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

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

(4) *Issued in April 2007 for $400 million. Interest rate is fixed at 4.80 per cent until April 2017 and thereafter interest is payable at an annual rate equal to the 90 day bankers' acceptance rate plus 1.00 per cent. These debentures are designated as HFT under the fair value option.*

13 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 shares.

Issued and fully paid:

	2008		2007	
	Number of shares	*Amount*	*Number of shares*	*Amount*
Preferred Shares Class 1				
Series C[1]	**7,000,000**	**$ 175**	7,000,000	$ 175
Series D[2]	**7,000,000**	**175**	7,000,000	175
Preferred shares Class 2				
Series B[3]	**86,450,000**	**346**	–	–
		696		350
Common Shares				
HSBC Bank Canada[4]	**498,668,000**	**1,225**	498,668,000	1,225
HSBC Financial Corporation Limited[5]	–	–	27,681,210	68
		$ 1,225		$ 1,293

(1) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.10 per cent, payable quarterly, as and when declared. During 2008 and 2007, $9 million in dividends were declared and paid. The shares will not be redeemable by the bank 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 per cent, payable quarterly, as and when declared. During 2008 and 2007 $9 million in dividends were declared and paid.*

The shares will not be redeemable by the bank 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) *The shares are voting and non-cumulative. During 2008, the bank issued 86,450,000 shares with a fair value of $346 million in consideration for the common shares of HSBC Financial, to HSBC Finance Corporation, a US affiliate (note 2). During 2008, dividends were declared of $2 million and were paid on January 15, 2009. Each share yields 7.75 per cent, payable quarterly, as and when declared. Holders are entitled to one vote for each share held.*

(4) *During 2008, $270 million (2007 – $260 million) in dividends were declared and paid. During 2007, 10 million common shares were issued for cash of $10 per share.*

(5) *During 2008, $50 million in dividends were declared and paid. In 2007, $50 million in dividends were declared and subsequently paid in 2008. HSBC Financial's common shares were cancelled on recapitalization (note 2). The number of common shares of HSBC Financial has been restated to reflect the weighted-average outstanding shares of the constituents of the business combination (note 2).*

Dividend restrictions:

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).

Notes to Consolidated Financial Statements (continued)

14 Variable interest entities

a *The following table provides information regarding the bank's VIEs, in which we have a significant variable interest and including one that we consolidate under Accounting Guideline 15 ("AcG-15"):*

	2008		2007	
	Total assets	*Maximum exposure to loss*	*Total assets*	*Maximum exposure to loss*
Unconsolidated VIEs:				
Securitization vehicles managed by the bank[1]	**$ 475**	**$ 322**	$ 877	$ 798
Securitization vehicles managed by others[2]	**4,676**	**24**	12,066	66
Investment funds[3]	**42**	**2**	13	1
Consolidated VIEs:				
Specialized Financing Entity[4]	**700**	**–**	700	–

(1) *The maximum exposure to loss resulting from our significant variable interests in these VIEs consists mainly of the bank's ownership interests in the asset backed commercial paper issued by these VIEs, the fair value of derivatives and the provision of credit enhancement and liquidity facilities. Included in our consolidated balance sheets is $150 million (2007 – $356 million) of asset backed commercial paper issued by this VIE. In 2007, an additional $300 million of this commercial paper is included in the balance sheet of one of our unconsolidated affiliates.*

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

(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 11). This trust is a VIE, but we are considered its primary beneficiary and, therefore, consolidate this structure in our consolidated balance sheets.*

b *Securitization vehicles managed by the bank*

Multi-seller conduit

We act as financial services agent for a multi-seller asset backed commercial paper conduit program ("multi-seller conduit") and also provide a program wide credit enhancement facility, swap facilities, liquidity facilities and securities distribution services as the lead dealer to the multi-seller conduit. From time to time, the bank in its capacity as lead dealer may hold asset backed commercial paper issued by the conduit, which is classified as HFT. Also, the bank earns fees which are recognized in income when received.

This multi-seller conduit provides the bank's clients with alternate sources of financing through the securitization of their assets. Clients sell financial assets to the conduit and the conduit funds its purchase of such financial assets through the issuance of short term asset backed commercial paper to investors. Each client continues to service the financial assets they have sold to the multi-seller conduit and absorbs the first losses associated with such assets. The bank has no rights to the assets as they are owned by the multi-seller conduit.

During 2007, the bank converted its liquidity facilities provided to the multi-seller conduit from general market disruption liquidity facilities to liquidity facilities which can be drawn by the multi-seller conduit as long as, at the time of draw, the multi-seller conduit meets certain tests designed to ensure that such liquidity facilities do not provide credit enhancement. For more detail on the liquidity facilities and program wide credit enhancement facility outlined above, refer to the disclosure on guarantees, commitments and contingent liabilities (note 30).

During 2008, a new Subordinated Program Wide Committed Purchase Agreement ("SPWE") was established by HSBC Bank plc, a United Kingdom affiliate, to replace the first loss capital notes issued to a single unrelated third party. The capital notes were fully paid off and no longer remain outstanding and were replaced entirely by the SPWE in 2008. The SPWE is sized to cover the majority of the expected losses of the conduit. At December 31, 2008, the authorized limit of the SPWE exceeded the conduits expected losses; as a result, the bank is not the primary beneficiary and is not required to consolidate the multi-seller conduit under AcG-15.

c *Securitization vehicles managed by others*

We hold variable interests in third-party asset backed commercial paper conduits, primarily through providing liquidity facilities to such conduits. However, as we are not the primary beneficiary, we do not consolidate these conduits under AcG-15.

15 Principal subsidiaries

Principal subsidiaries	*Principal office address*	*Shareholders' equity*
HSBC Securities (Canada) Inc.	Toronto, Ontario	$ 378
HSBC Bridgetown Investments (Barbados), LLC	St. Michael, Barbados	354
HSBC Financial Corporation Limited	Toronto, Ontario	348
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia	121
HSBC Capital (Canada) Inc.	Vancouver, British Columbia	70
HSBC Trust Company (Canada)	Vancouver, British Columbia	55
Household Trust Company	Toronto, Ontario	38
HSBC Global Asset Management (Canada) Limited (formerly HSBC Investments (Canada) Limited)	Vancouver, British Columbia	12
HSBC Loan Corporation (Canada)	Vancouver, British Columbia	11
HSBC Investment Funds (Canada) Inc.	Vancouver, British Columbia	5

16 Risk management

The risk management policies and procedures of the bank are included in the MD&A. The sections of the Risk Management section, included on pages 24 to 37 of the MD&A where indicated, relating to financial instruments including credit, market and liquidity risks form an integral part of these consolidated financial statements.

17 Classification of financial instruments

a *The carrying value of financial assets by classification is as follows:*

	2008					
	Held-for-trading	*Available-for-sale*	*Loans and receivables*	*Hedging items*	*Other*[1]	*Total*
Cash resources	**$ 64**	**$ –**	**$ 1,791**	**$ –**	**$ –**	**$ 1,855**
Securities	**1,079**	**9,683**	**–**	**–**	**56**	**10,818**
Securities purchased under reverse repurchase agreements	**–**	**–**	**6,682**	**–**	**–**	**6,682**
Loans[2]	**–**	**–**	**43,646**	**–**	**–**	**43,646**
Customers' liability under acceptances	**–**	**–**	**5,209**	**–**	**–**	**5,209**
Derivatives	**1,996**	**–**	**–**	**452**	**–**	**2,448**
Land, buildings, equipment and other assets	**–**	**–**	**1,042**	**–**	**349**	**1,391**
Total	**$ 3,139**	**$ 9,683**	**$ 58,370**	**$ 452**	**$ 405**	**$ 72,049**

Notes to Consolidated Financial Statements (continued)

17 Classification of financial instruments *(continued)*

a *The carrying value of financial assets by classification is as follows: (continued)*

	2007					
	Held-for-trading	*Available-for-sale*	*Loans and receivables*	*Hedging items*	*Other*(1)	*Total*
Cash resoures	$ 878	$ 175	$ 2,621	$ –	$ –	$ 3,674
Securities	1,227	5,704	–	–	60	6,991
Securities purchased under reverse repurchase agreements	–	–	6,122	–	–	6,122
Loans(2)	–	–	43,595	–	–	43,595
Customers' liability under acceptances	–	–	5,727	–	–	5,727
Derivatives	584	–	–	39	–	623
Land, buildings, equipment and other assets	–	–	997	–	401	1,398
Total	$ 2,689	$ 5,879	$ 59,062	$ 39	$ 461	$ 68,130

(1) *Included in other are items that do not meet the definition of a financial instrument, financial instruments that have been excluded from the scope of CICA Handbook Section 3855 and HTM securities of $12 million (2007 – $8 million.)*

(2) *Net of allowance for credit losses.*

b *The carrying value of financial liabilities by classification is as follows:*

	2008					
	Held-for-trading	*Designated as held-for-trading*(1)	*Financial liabilities at amortized cost*	*Hedging items*	*Other*(2)	*Total*
Deposits	**$ 23**	**$ 557**	**$ 51,382**	**$ –**	**$ –**	**$ 51,962**
Acceptances	–	–	**5,209**	–	–	**5,209**
Interest bearing liabilities of subsidiaries, other than deposits	–	**672**	**3,361**	–	**131**	**4,164**
Derivatives	**1,859**	–	–	**164**	–	**2,023**
Securities sold under repurchase agreements	–	–	**715**	–	–	**715**
Securities sold short	**631**	–	–	–	–	**631**
Equity and other liabilities	–	–	**1,718**	–	**4,409**	**6,127**
Non-controlling interest in trust and subsidiary	–	–	–	–	**430**	**430**
Subordinated debentures	–	**338**	**340**	–	**110**	**788**
Total	**$ 2,513**	**$ 1,567**	**$ 62,725**	**$ 164**	**$ 5,080**	**$ 72,049**

17 Classification of financial instruments *(continued)*

b *The carrying value of financial liabilities by classification is as follows: (continued)*

	2007					
	Held-for-trading	*Designated as held-for-trading* [1]	*Financial liabilities at amortized cost*	*Hedging items*	*Other* [2]	*Total*
Deposits	$ 456	$ 982	$ 47,440	$ –	$ –	$ 48,878
Acceptances	–	–	5,727	–	–	5,727
Interest bearing liabilities of subsidiaries, other than deposits	–	863	4,193	–	126	5,182
Derivatives	617	–	–	43	–	660
Securities sold under repurchase agreements	–	–	320	–	–	320
Securities sold short	623	–	–	–	–	623
Equity and other liabilities	–	–	1,750	–	3,759	5,509
Non-controlling interest in trust and subsidiary	–	–	–	–	430	430
Subordinated debentures	–	374	340	–	87	801
Total	$ 1,696	$ 2,219	$ 59,770	$ 43	$ 4,402	$ 68,130

(1) *Financial instruments designated as held-for-trading under the fair value option.*

(2) *Included in other are subordinated debentures and interest bearing liabilities of subsidiaries other than deposits, in a fair value hedging relationship, which are adjusted for the fair value of the hedged risk, items that do not meet the definition of a financial instrument, and financial instruments that have been excluded from the scope of CICA Handbook Section 3855.*

c *Additional information relating to financial liabilities designated as held-for-trading under the fair value option is as follows:*

	2008			
	Contractual amount payable at maturity	*Fair value*	*Cumulative fair value gain*	*Cumulative fair value gain attributable to credit risk*
Deposits	**$ 692**	**$ 557**	**$ 135**	**$ 6**
Interest bearing liabilities of subsidiaries, other than deposits	**675**	**672**	**3**	**24**
Subordinated debentures	**400**	**338**	**62**	**126**
	$ 1,767	**$ 1,567**	**$ 200**	**$ 156**

	2007			
	Contractual amount payable at maturity	*Fair value*	*Cumulative fair value gain (loss)*	*Cumulative fair value gain attributable to credit risk*
Deposits	$ 966	$ 982	$ (16)	$ –
Interest bearing liabilities of subsidiaries, other than deposits	875	863	12	6
Subordinated debentures	400	374	26	20
	$ 2,241	$ 2,219	$ 22	$ 26

The cumulative fair value adjustment attributable to credit risk was computed by calculating the total cumulative fair value adjustment and eliminating fair value attributable to market risk.

18 Fair value of financial instruments

Fair value is the estimated amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction under no compulsion to act.

a *Methods employed in the determination of fair value*

Fair values are determined according to the following hierarchy:

i) Quoted market price – Financial instruments with quoted prices for identical instruments in active markets.

ii) Valuation technique using observable inputs – Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets or financial instruments valued using models where all significant inputs are observable.

iii) Valuation technique with significant non-observable inputs – Financial instruments valued using models where one or more significant inputs are not observable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are non-observable. For these instruments, the fair value derived is more judgemental. "Non-observable" in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (for example, historical data may be used). Furthermore, the assessment of a hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the non-observable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

The valuation models used where quoted market prices are not available incorporate certain assumptions that we anticipate would be used by a market participant to establish fair value. Where we believe that there are additional considerations not included within the valuation model, appropriate adjustments may be made.

Transaction costs are not included in the calculation of fair value. Trade origination costs such as brokerage fees are included in operating expenses. The future costs of administering the bank's over-the-counter derivative portfolio are also not included in fair value, but are expensed as incurred.

b *Analysis of fair value determination*

T-Bills, equities, government bonds, preferred shares and financial liability short positions in government bonds are valued using quoted market prices. Non-bank ABCP, certain mortgage backed securities, certain retail structured notes and their corresponding offsetting interest rate swaps, are valued using a valuation technique with significant non-observable inputs. All other financial instruments are valued using a valuation technique with observable inputs.

c *Effect of changes in significant non-observable assumptions to reasonably possible alternatives*

The fair value of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. A summary of the significant assumptions used in the valuation of non-bank ABCP, and their effect on fair value applying reasonably possible alternatives, is set out in note 3(b).

18 Fair value of financial instruments *(continued)*

d *Analysis of financial instruments not carried at fair value*

The table below provides an analysis of the fair value of financial instruments not carried at fair value on the consolidated balance sheets. Other financial instruments that are not included below are either carried at fair value or their carrying value is a reasonable approximation of their fair value due to their short-term nature or other reasons. Therefore, certain amounts will not directly agree to the balances in the consolidated balance sheets.

	2008		
	Carrying amount	*Fair value*	*Fair value over (under) carrying amount*
Loans	**$ 43,646**	**$ 43,802**	**$ 156**
Deposits	**51,382**	**51,842**	**460**
Interest bearing liabilities of subsidiaries, other than deposits	**3,361**	**3,333**	**(28)**
Subordinated debentures	**340**	**312**	**(28)**

	2007		
	Carrying amount	*Fair value*	*Fair value over (under) carrying amount*
Loans	$ 43,595	$ 43,485	$ (110)
Deposits	47,440	47,453	13
Interest bearing liabilities of subsidiaries, other than deposits	4,193	4,164	(29)
Subordinated debentures	340	321	(19)

e *Methods and assumptions used in estimating fair value of financial instruments not carried at fair value*

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

- 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.
- Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, fair values are determined using quoted market prices of similar securities or the use of valuation models.
- For floating rate loans, potential adjustments for credit spread changes are not considered when estimating fair values. Therefore, fair values are assumed to be equal to carrying value.
- 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. Certain deposits are either classified as HFT or are designated as HFT using the fair value option.
- The fair value of debentures is determined by reference to current market prices for debt with similar terms and risks. The carrying value of certain deposits is adjusted due to being designated as HFT under the fair value option or are subject to a fair value hedging relationship.

Notes to Consolidated Financial Statements (continued)

19 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 sheets. Derivative instruments 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 for our customers ("Trading"). Asset/liability management ("ALM") derivatives are used by the bank to manage exposures to interest rate and foreign currency fluctuations, and may include certain hedging positions that ALM may not qualify for formal hedge accounting. 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, and 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. Accounting policies relating to derivatives are set out in note 1(p). 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(p).

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 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.

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

	2008			
	Notional amount[1]	*Fair value*	*Credit equivalent amount*[2]	*Risk-weighted balance*[3]
Interest rate contracts				
Futures	**$ 990**	**$ –**	**$ 3**	**$ –**
Swaps	**26,501**	**805**	**813**	**350**
Caps	**20**	**–**	**–**	**–**
	27,511	**805**	**816**	**350**
Foreign exchange contracts				
Spot contracts	**776**	**2**	**9**	**1**
Forward contracts	**32,176**	**1,163**	**1,476**	**339**
Currency futures	**1**	**–**	**–**	**–**
Currency swaps and options	**8,144**	**478**	**539**	**186**
	41,097	**1,643**	**2,024**	**526**
Other derivative contracts				
Credit	**249**	**–**	**–**	**–**
Equity	**79**	**–**	**–**	**–**
	328	**–**	**–**	**–**
Total	**$ 68,936**	**$ 2,448**	**$ 2,840**	**$ 876**

19 Derivative instruments *(continued)*

a *An analysis of the derivative portfolio and related credit exposure is as follows: (continued)*

	2007			
	Notional amount[1]	*Fair value*	*Credit equivalent amount*[2]	*Risk-weighted balance*[3]
Interest rate contracts				
Futures	$ 609	$ –	$ –	$ –
Swaps	21,479	67	165	48
Caps	20	–	–	–
	22,108	67	165	48
Foreign exchange contracts				
Spot contracts	529	1	1	–
Forward contracts	35,175	355	762	233
Currency futures	1	–	–	–
Currency swaps and options	6,702	199	410	154
	42,407	555	1,173	387
Other derivative contracts				
Credit	290	–	35	7
Equity	56	1	2	1
	346	1	37	8
Total	$ 64,861	$ 623	$ 1,375	$ 443

(1) *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.*

(2) *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.*

(3) *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 credit worthiness of the counterparties 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.

Notes to Consolidated Financial Statements (continued)

19 Derivative instruments *(continued)*

b *The following table summarizes the notional amounts by remaining term to maturity of the derivative portfolio:*

	2008								
	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	**$ 990**	**$ –**	**$ –**	**$ 990**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 990**
Swaps	**2,911**	**4,150**	**2,662**	**9,723**	**3,740**	**12,438**	**600**	**16,778**	**26,501**
Caps	**20**	**–**	**–**	**20**	**–**	**–**	**–**	**–**	**20**
	3,921	**4,150**	**2,662**	**10,733**	**3,740**	**12,438**	**600**	**16,778**	**27,511**
Foreign exchange contracts									
Spot contracts	**376**	**–**	**–**	**376**	**400**	**–**	**–**	**400**	**776**
Forward contracts	**22,173**	**927**	**–**	**23,100**	**8,506**	**570**	**–**	**9,076**	**32,176**
Currency futures	**1**	**–**	**–**	**1**	**–**	**–**	**–**	**–**	**1**
Currency swaps and options	**3,703**	**2,531**	**1,446**	**7,680**	**9**	**455**	**–**	**464**	**8,144**
	26,253	**3,458**	**1,446**	**31,157**	**8,915**	**1,025**	**–**	**9,940**	**41,097**
Other derivative contracts									
Credit	**249**	**–**	**–**	**249**	**–**	**–**	**–**	**–**	**249**
Equity	**79**	**–**	**–**	**79**	**–**	**–**	**–**	**–**	**79**
	328	**–**	**–**	**328**	**–**	**–**	**–**	**–**	**328**
Total	**$ 30,502**	**$ 7,608**	**$ 4,108**	**$ 42,218**	**$ 12,655**	**$ 13,463**	**$ 600**	**$ 26,718**	**$ 68,936**

19 Derivative instruments *(continued)*

b *The following table summarizes the notional amounts by remaining term to maturity of the derivative portfolio: (continued)*

	2007								
	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	$ 609	$ –	$ –	$ 609	$ –	$ –	$ –	$ –	$ 609
Swaps	3,190	7,383	1,358	11,931	5,500	3,448	600	9,548	21,479
Caps	–	20	–	20	–	–	–	–	20
	3,799	7,403	1,358	12,560	5,500	3,448	600	9,548	22,108
Foreign exchange contracts									
Spot contracts	354	–	–	354	175	–	–	175	529
Forward contracts	25,235	1,258	–	26,493	8,547	135	–	8,682	35,175
Currency futures	1	–	–	1	–	–	–	–	1
Currency swaps and options	3,566	1,218	1,911	6,695	–	7	–	7	6,702
	29,156	2,476	1,911	33,543	8,722	142	–	8,864	42,407
Other derivative contracts									
Credit	–	290	–	290	–	–	–	–	290
Equity	56	–	–	56	–	–	–	–	56
	56	290	–	346	–	–	–	–	346
Total	$ 33,011	$ 10,169	$ 3,269	$ 46,449	$ 14,222	$ 3,590	$ 600	$ 18,412	$ 64,861

Derivative transactions with HSBC Group companies

Included in the above tables are a number of derivative transactions with HSBC Group companies incurred in the normal course of business at market terms and conditions. At December 31, 2008 the tables included notional amounts of $6,334 million (2007 – $4,532 million) relating to interest rate derivatives, $13,154 million (2007 – $11,137 million) relating to foreign currency derivatives and $288 million (2007 – $318 million) relating to other derivatives.

Notes to Consolidated Financial Statements (continued)

19 Derivative instruments *(continued)*

c *The following tables summarize the fair values of the bank's derivative portfolio segregated between derivatives that are in a favorable or receivable position and those in an unfavorable or payable position. Fair values of derivative instruments are determined using quoted market prices, if one exists.*

2008

	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	**$ 229**	**$ (242)**	**$ (13)**	**$ 576**	**$ (251)**	**$ 325**	**$ 312**
Foreign exchange contracts							
Spot contracts	**2**	**(2)**	**–**	**–**	**–**	**–**	**–**
Forward contracts	**857**	**(834)**	**23**	**306**	**(100)**	**206**	**229**
Currency swaps and options	**452**	**(446)**	**6**	**26**	**(26)**	**–**	**6**
	1,311	**(1,282)**	**29**	**332**	**(126)**	**206**	**235**
Other derivative contracts							
Credit	**–**	**(122)**	**(122)**	**–**	**–**	**–**	**(122)**
Total	**$ 1,540**	**$ (1,646)**	**$ (106)**	**$ 908**	**$ (377)**	**$ 531**	**$ 425**

2007

	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	$ 60	$ (45)	$ 15	$ 7	$ (19)	$ (12)	$ 3
Foreign exchange contracts							
Spot contracts	–	(3)	(3)	1	–	1	(2)
Forward contracts	308	(281)	27	47	(107)	(60)	(33)
Currency swaps and options	199	(194)	5	–	–	–	5
	507	(478)	29	48	(107)	(59)	(30)
Other derivative contracts							
Credit	–	(10)	(10)	–	–	–	(10)
Equity	1	(1)	–	–	–	–	–
	1	(11)	(10)	–	–	–	(10)
Total	$ 568	$ (534)	$ 34	$ 55	$ (126)	$ (71)	$ (37)

20 Interest rate sensitivity position

The following tables provide an analysis of the interest rate sensitivity position based on contractual repricing dates of assets and liabilities:

	2008									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	**$ 52**	**$ 1,041**	**$ –**	**2.2**	**$ 273**	**3.3**	**$ –**	**–**	**$ 489**	**$ 1,855**
Securities	**1,029**	**3,747**	**2,806**	**2.0**	**3,236**	**3.4**	**–**	**–**	**–**	**10,818**
Securities purchased under reverse repurchase agreements	**–**	**6,682**	**–**	**1.5**	**–**	**–**	**–**	**–**	**–**	**6,682**
Loans	**29,461**	**1,918**	**3,150**	**4.3**	**8,734**	**8.0**	**136**	**4.4**	**247**	**43,646**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**5,209**	**5,209**
Other assets	**175**	**–**	**–**	**2.4**	**–**	**–**	**–**	**–**	**3,664**	**3,839**
Total assets	**30,717**	**13,388**	**5,956**		**12,243**		**136**		**9,609**	**72,049**
Deposits	**14,095**	**15,458**	**10,548**	**2.0**	**5,554**	**4.2**	**–**	**–**	**6,307**	**51,962**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**5,209**	**5,209**
Interest bearing liabilities of subsidiaries, other than deposits	**669**	**845**	**650**	**2.7**	**2,000**	**4.4**	**–**	**–**	**–**	**4,164**
Securities sold under repurchase agreements	**–**	**715**	**–**	**1.5**	**–**	**–**	**–**	**–**	**–**	**715**
Other liabilities	**633**	**–**	**–**	**1.5**	**–**	**–**	**–**	**–**	**3,995**	**4,628**
Non-controlling interest in subsidiaries	**–**	**–**	**–**	**–**	**200**	**7.8**	**200**	**5.1**	**30**	**430**
Subordinated debt	**–**	**40**	**–**	**2.0**	**210**	**4.4**	**538**	**5.4**	**–**	**788**
Shareholders' equity	**–**	**–**	**–**	**–**	**350**	**5.1**	**–**		**3,803**	**4,153**
Total liabilities and shareholders' equity	**15,397**	**17,058**	**11,198**		**8,314**		**738**		**19,344**	**72,049**
On balance sheet gap	**15,320**	**(3,670)**	**(5,242)**		**3,929**		**(602)**		**(9,735)**	**–**
Off balance sheet positions	**–**	**(5,455)**	**1,147**		**3,708**		**600**		**–**	**–**
Total interest rate gap	**$ 15,320**	**$ (9,125)**	**$ (4,095)**		**$ 7,637**		**$ (2)**		**$ (9,735)**	**$ –**

Notes to Consolidated Financial Statements (continued)

20 Interest rate sensitivity position *(continued)*

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

	2007[1]									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	$ 878	$ 2,135	$ 50	4.9	$ –	–	$ –	–	$ 510	$ 3,573
Securities	1,245	3,971	1,469	4.0	186	3.7	19	4.0	36	6,926
Securities purchased under reverse repurchase agreements	–	6,122	–	4.3	–	–	–	–	–	6,122
Loans	25,335	1,245	3,284	6.0	8,794	5.6	141	6.7	(84)	38,715
Acceptances	–	–	–	–	–	–	–	–	5,727	5,727
Other assets	224	–	–	5.6	–	–	–	–	1,644	1,868
Total assets	27,682	13,473	4,803		8,980		160		7,833	62,931
Deposits	11,497	18,758	9,828	3.6	3,234	4.5	–	–	5,560	48,877
Acceptances	–	–	–	–	–	–	–	–	5,727	5,727
Securities sold under repurchase agreements	–	320	–	4.3	–	–	–	–	–	320
Other liabilities	1,151	–	–	3.3	–	–	–	–	2,377	3,528
Non-controlling interest in subsidiaries	–	–	–	–	200	7.8	200	5.1	30	430
Subordinated debt	–	40	–	5.1	187	4.5	574	5.1	–	801
Shareholders' equity	–	–	–	–	350	5.1	–	–	2,898	3,248
Total liabilities and shareholders' equity	12,648	19,118	9,828		3,971		774		16,592	62,931
On balance sheet gap	15,034	(5,645)	(5,025)		5,009		(614)		(8,759)	–
Off balance sheet positions	–	(3,580)	1,664		1,316		600		–	–
Total interest rate gap	$ 15,034	$ (9,225)	$ (3,361)		$ 6,325		$ (14)		$ (8,759)	$ –

(1) *The 2007 interest rate sensitivity has not been restated to reflect the acquisition of HSBC Financial as it is not meaningful to do so (note 2).*

21 Financial assets pledged and collateral accepted

a *Financial assets pledged to secure liabilities*

		2008		2007
Securities	**$**	**226**	$	3,419
Loans		**4,630**		3,457
Other		–		3
	$	**4,856**	$	6,879

In the ordinary course of business, we pledge assets recorded on our consolidated balance sheets to secure our liabilities held with the Bank of Canada, clearing and payment systems and depositories. In addition, we also pledge assets in relation to borrowing, securities lending and securities sold under repurchase agreements.

These transactions are conducted under terms that are usual and customary to financial institutions asset pledging to the above mentioned parties and to standard securities lending and repurchase agreements.

b *Collateral accepted as security*

The fair value of assets accepted as collateral that we are permitted to sell or repledge in the absence of default is $7,334 million (2007 – $6,700 million). The fair value of any such collateral that has been sold or repledged is $570 million (2007 – $516 million). We are obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to financial institutions asset pledging to the above mentioned parties and to standard securities borrowing and reverse repurchase agreements.

22 Financial assets not qualifying for derecognition

a *Mortgages sold with recourse*

We have agreed to repurchase any mortgage purchased from the bank 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 at December 31, 2008 were $591 million (2007 – $436 million) and are included in other liabilities.

b *Securities lending*

We have lent securities which we have agreed to repurchase at notice of the customer. The customer has agreed to return lent securities at our request under terms and conditions that are usual and customary to standard securities lending agreements. The total securities lent at December 31, 2008 were $82 million (2007 – $119 million) and are included in other liabilities.

c *Repurchase agreements*

We have lent securities which we have agreed to repurchase at a specified future date under terms and conditions that are usual and customary to standard repurchase agreements. Total securities at December 31, 2008 which we have agreed to repurchase at a specified future date were $715 million (2007 – $320 million) and are separately disclosed in the consolidated balance sheets.

Notes to Consolidated Financial Statements (continued)

23 Net operating income

Net operating income is stated after the following items of income, expense, gains and losses:

	2008	2007
Income		
Interest earned on financial instruments not held-for-trading	**$ 3,326**	$ 3,636
Fees earned on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments	**147**	136
Fees earned on trust and other fiduciary activities where we hold or invest assets on behalf of our customers	**133**	135
Expense		
Interest expense on financial instruments not held-for-trading	**$ 1,642**	$ 1,911
Fee expense on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments	**24**	18
Fee expense relating to trust and other fiduciary activities where we hold or invest assets on behalf of our customers	**11**	12
Gains (losses) recognized		
Securitized loans sold to third parties	**$ 76**	$ 21
Financial instruments held-for-trading[1]	**177**	83
Financial liabilities designated as held-for-trading[1]	**100**	36
Hedging items[1]		
Ineffectiveness:		
Cash flow hedges	**20**	(1)
Fair value hedges	**(2)**	(4)
Economic hedges[1], [2]	**(86)**	(2)

(1) *Included in trading income.*

(2) *Gains (losses) on hedging derivatives that do not qualify for hedge accounting under GAAP.*

24 Stock-based compensation

Options were previously granted to certain of our employees under the HSBC Holdings Group Share Option Plan ("Group Share Option Plan") until it was terminated in 2005 and the HSBC Savings-Related Share Option Scheme ("Savings-Related Share Option Scheme"). 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 ("Achievement 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.

a *The following table presents information for each plan:*

	2008	2007
Savings-Related Share Option Scheme (1, 3 or 5 year vesting period)		
Total options granted	**1,304,122**	1,193,276
Fair value per option granted ($ per share)	**$3.67 – 4.43**	$4.54 – 4.95
Total compensation expense recognized	**$ 4**	$ 3
Significant assumptions used to calculate fair value:		
Risk free interest rate	**4.50%**	5.50%
Expected life (years)	**1 – 5**	1 – 5
Expected volatility	**25.00%**	17.00%
Achievement Awards		
Total compensation expense recognized	**$ 28**	$ 25

24 Stock-based compensation *(continued)*

b *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 fifth anniversary of the commencement of the savings contract depending on conditions set at the date of grant. The exercise price is at a 20 per cent discount to the market value at the date of grant.

c *Achievement 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 31 month 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.

25 Employee future benefits

We sponsor a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to eligible employees.

The bank measures its accrued benefit obligations and the fair value of plan assets for accounting purposes at September 30, except for HSBC Financial's employee benefit plans for which a measurement date of December 31 is used.

The following table presents information related to our defined benefit plans:

	Pension benefits		*Non-pension benefits*	
	2008	2007	**2008**	2007
Accrued benefit obligations				
Balance at beginning of year	**$ 423**	$ 418	**$ 121**	$ 115
Transfer to defined contribution plan	**–**	(3)	**–**	–
Current service cost	**14**	16	**5**	5
Interest cost	**23**	22	**6**	6
Benefits paid	**(21)**	(19)	**(3)**	(3)
Actuarial gain	**(75)**	(12)	**(24)**	(2)
Employee contributions	**1**	1	**–**	–
Balance at end of year	**$ 365**	$ 423	**$ 105**	$ 121
Plan assets				
Fair value at beginning of year	**$ 378**	$ 354	**$ –**	$ –
Transfer to defined contribution plan	**–**	(3)	**–**	–
Actual return on plan assets	**(57)**	31	**–**	–
Bank contributions	**12**	14	**3**	3
Employee contributions	**1**	1	**–**	–
Benefits paid	**(20)**	(19)	**(3)**	(3)
Fair value at end of year	**$ 314**	$ 378	**$ –**	$ –
Funded status				
Funded status – deficit	**$ (51)**	$ (45)	**$ (105)**	$ (121)
Bank contributions after measurement date	**1**	1	**–**	–
Unamortized net actuarial loss	**124**	123	**31**	57
Unamortized past service costs	**9**	11	**(18)**	(19)
Unamortized transitional (asset) obligation	**(26)**	(31)	**4**	4
Accrued benefit asset (liability)	**57**	59	**(88)**	(79)
Valuation allowance	**(4)**	(15)	**–**	–
Accrued benefit asset (liability), net of valuation allowance	**$ 53**	$ 44	**$ (88)**	$ (79)

Notes to Consolidated Financial Statements (continued)

25 Employee future benefits *(continued)*

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

	Pension benefits		*Non-pension benefits*	
	2008	2007	**2008**	2007
Other assets (note 7)	**$ 78**	$ 66	**$ –**	$ –
Other liabilities (note 10)	**(25)**	(22)	**(88)**	(79)
Total	**$ 53**	$ 44	**$ (88)**	$ (79)

Effective December 1, 2004, we amended our post-retirement, non-pension arrangements. Employees who retired between January 1, 2005 and December 31, 2007 had the option of participating in the existing plan or in a newer flexible benefits plan. Commencing January 1, 2008, retiring employees will participate only in the new flexible benefits plan.

Included in the accrued benefit obligations and fair value of pension plan assets at year-end are the following amounts in respect of plans with accrued benefit obligations in excess of fair value of assets:

	2008	2007
Accrued benefit obligations	**$ 261**	$ 302
Fair value of plan assets	**191**	227
Funded status – deficit at measurement date	**70**	75
Bank contributions after measurement date	**1**	1
Funded status – deficit at end of year	**$ 69**	$ 74

The distribution of the pension plan assets is shown below:

	Percentage of pension plan assets (%)	
	2008	2007
Equity securities	**63**	69
Debt securities	**36**	30
Other	**1**	1
Total	**100**	100

The expense for employee future benefits is as follows:

	Pension benefits		*Non-pension benefits*	
	2008	2007	**2008**	2007
Service cost	**$ 14**	$ 16	**$ 5**	$ 5
Interest cost	**23**	22	**6**	6
Actual return on plan assets	**57**	(32)	**–**	–
Actuarial gain on accrued benefit obligation	**(75)**	(12)	**(24)**	(2)
Costs arising in the year	**19**	(6)	**(13)**	9
Differences between costs arising in the year and costs recognized in the year in respect of:				
– Actual and expected return on plan assets	**(84)**	8	**–**	–
– Actuarial gain	**80**	20	**26**	4
– Amendments	**1**	(1)	**(2)**	(2)
– Amortization of transitional (asset) obligation	**(3)**	(3)	**1**	1
Net benefit plan expense recognized before change in valuation allowance	**13**	18	**12**	12
(Decrease) increase in valuation allowance	**(11)**	11	**–**	–
Net benefit plan expense	**2**	29	**12**	12
Defined contribution plan expense	**17**	16	**–**	–
Total expense	**$ 19**	$ 45	**$ 12**	$ 12

The total cash payments for employee future benefits for 2008, consisting of cash contributed by the bank 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 $32 million (2007 – $32 million).

25 Employee future benefits *(continued)*

Actuarial valuations for the bank's pension plans are prepared at least every three years. The most recent valuation of the bank's main pension plans was conducted at December 31, 2006, and the date of the next required valuation is December 31, 2009. The most recent valuations of the bank's other benefit plans were conducted at December 31, 2005, and January 1, 2006, and the dates of the next required valuations are December 31, 2008, and January 1, 2009, respectively.

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*	
	2008	2007	**2008**	2007
Accrued benefit obligations				
Discount rate (%)	**6.50 – 7.00**	5.25 – 5.50	**6.50 – 7.00**	5.25 – 5.50
Rate of compensation increase (%)	**3.80 – 4.00**	3.80 – 4.00	**3.80 – 4.00**	3.80 – 4.00
Net benefit plan expense				
Discount rate (%)	**5.25 – 5.50**	5.25	**5.25 – 5.50**	5.25
Expected long-term rate of return on plan assets (%)	**7.00 – 7.50**	7.00 – 7.50	**–**	–
Rate of compensation increase (%)	**3.80 – 4.00**	3.30 – 4.00	**3.80 – 4.00**	3.30 – 4.00

For measurement purposes for 2008, an 8.20 – 9.00 per cent health care cost trend rate was assumed grading down to 4.90 – 5.00 per cent by 2012 and assumed to remain level thereafter (2007 – 9.00 – 9.50 per cent grading down to 4.90 – 5.00 per cent by 2012 and assumed to remain level thereafter).

The 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 2008, as well as the net benefits expense for 2008, 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 (%)	–	6.75 – 7.00	–	–
Impact of 1% increase	$ –	$ (4)	$ –	$ –
Impact of 1% decrease	$ –	$ 4	$ –	$ –
Discount rate (%)	6.50 – 7.00	5.25 – 5.50	6.50 – 7.00	5.25 – 5.50
Impact of 1% increase	$ (53)	$ (3)	$ (16)	$ (1)
Impact of 1% decrease	$ 64	$ 4	$ 20	$ 2
Rate of compensation increase (%)	3.80 – 4.00	3.80 – 4.00	3.80 – 4.00	3.80 – 4.00
Impact of 0.25% increase	$ 6	$ 1	–	–
Impact of 0.25% decrease	$ (6)	$ (1)	–	–
Assumed overall health care cost trend (%)	–	–	8.20 – 9.00	9.00 – 9.50[1]
Impact of 1% increase	$ –	$ –	$ 10	$ 2
Impact of 1% decrease	$ –	$ –	$ (8)	$ (1)

(1) *For measurement purposes an 8.20 – 9.00 per cent health care cost trend rate in 2008 was assumed grading down to 4.90 – 5.00 per cent in 2012 and thereafter.*

Notes to Consolidated Financial Statements (continued)

26 Income taxes

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

	2008	2007
Current income taxes:		
Federal	**$ 118**	$ 213
Provincial	**81**	113
	199	326
Future income taxes:		
Federal	**33**	13
Provincial	**21**	8
	54	21
Total provision for income taxes	**$ 253**	$ 347

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:*

	2008 (%)	2007 (%)
Combined federal and provincial income tax rate	**32.7**	34.8
Adjustments resulting from:		
Adjustment for tax exempt income	**(0.3)**	(1.2)
Substantively enacted tax rate changes	**0.1**	1.4
Other, net	**(2.6)**	1.0
Effective tax rate	**29.9**	36.0

c *The components of the net future income tax asset reported in other assets (note 7) are as follows:*

	2008	2007
Future income tax assets:		
Allowance for credit losses	**$ 87**	$ 86
Other available deductions	**64**	87
Buildings and equipment	**–**	2
Other	**27**	13
	178	188
Future income tax liabilities:		
Leases	**69**	34
Deferred charges	**45**	42
Securitization related	**29**	15
Other	**3**	11
	146	102
Net future income tax asset	**$ 32**	$ 86

27 Capital management

a *Objectives, policies and processes*

Our objectives in managing our financial capital resources include: generating shareholder value while supporting business activities including the asset base and risk positions; providing prudent depositor security; and exceeding applicable regulatory requirements and long-term internal targets.

The bank's capital management principals and related policies define the Internal Capital Adequacy Assessment Process by which management examines the bank's risk profile from both regulatory and economic capital viewpoints and ensures that the level of capital:

– Supports our risk profile and outstanding commitments;
– Exceeds our formal, minimum regulatory capital requirements by an agreed margin;
– Withstands a severe economic downturn stress scenario; and
– Remains consistent with our strategic and operational goals, and shareholder and rating agency expectations.

Our approach includes using appropriate risk and financial metrics and targets in assessing capital adequacy in the context of its current position and various possible scenarios. In addition, in order to maintain the most cost effective capital structure, we redeem or issue capital instruments as deemed necessary.

b *Capital managed and capital ratio regulations*

Total capital comprises both Tier 1 and Tier 2 capital. Tier 1 capital is the permanent capital of the bank, comprising common shareholder's equity, qualifying non-cumulative preferred shares, qualifying innovative capital instruments, contributed surplus, retained earnings and certain other adjustments. Tier 2 capital includes subordinated debentures together with certain other adjustments. There are restrictions on the amount of Tier 2 capital as a percentage of total capital that qualifies in the calculation of capital adequacy.

OSFI considers financial institutions to be well-capitalized if they maintain a Tier 1 capital ratio (as a percentage of risk-weighted assets) of 7 per cent and a total regulatory capital ratio of 10 per cent. The bank maintained ratios that exceeded these requirements in both 2008 and 2007.

In addition to regulatory capital ratios, banks are expected to meet an assets-to-capital multiple test. The assets-to-capital multiple is calculated by dividing a bank's total assets, including specified off-balance sheet items, by its total capital. The bank met the assets-to-capital multiple test in both 2008 and 2007.

c *Revision of regulatory capital management framework*

Effective January 1, 2008, the bank adopted and implemented a new regulatory capital management framework. The new framework, Basel II, replaced Basel I, the framework in place for the past 20 years. Basel II is an improvement over Basel I in that it aligns regulatory capital requirements more closely with the risk profile of the business.

Notes to Consolidated Financial Statements (continued)

27 Capital management *(continued)*

d *Regulatory capital*

	2008 (Basel II)	2007[1] (Basel I)
Tier 1 capital		
Common shares	**$ 1,225**	$ 1,225
Contributed surplus	**–**	206
Retained earnings	**1,950**	1,462
Non-cumulative preferred shares	**696**	350
Non-controlling interests in trust and subsidiary[2]	**430**	430
Securitization-related deductions and other	**(89)**	–
Goodwill	**(15)**	(15)
Total Tier 1 capital	**$ 4,197**	$ 3,658
Tier 2 capital		
Subordinated debentures	**$ 788**	$ 801
Other	**245**	269
Securitization-related deductions	**(29)**	–
Total Tier 2 capital	**$ 1,004**	$ 1,070
Total Tier 1 and Tier 2 capital	**$ 5,201**	$ 4,728
Securitization-related deductions	**–**	(50)
Total capital available for regulatory purposes	**$ 5,201**	$ 4,678

(1) *2007 Basel I Tier 1 and Tier 2 capital have not been restated to reflect the acquisition of HSBC Financial as it is not meaningful to do so (note 2).*

(2) *Includes $400 million of HSBC HaTS™ (2007 – $400 million).*

28 Segmented information

a *Customer groups*

We manage and report our operations according to our main customer groups. 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 appropriate allocation formulas. 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 Global Banking and Markets.

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.

Global 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.

Consumer Finance provides Canadian consumers a wide range of consumer finance products including real estate secured loans, unsecured personal loans, specialty insurance products and private label credit cards to retail merchants.

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.

28 Segmented information *(continued)*

a *Customer groups (continued)*

In the current year, the bank acquired HSBC Financial from HSBC Finance Corporation (note 2). The results of operations of HSBC Financial have been reported as the Consumer Finance customer group.

	2008				
	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Consumer Finance*	*Total*
Net interest income	**$ 395**	**$ 694**	**$ 78**	**$ 477**	**$ 1,644**
Non-interest revenue	**265**	**181**	**333**	**58**	**837**
Total revenue	**660**	**875**	**411**	**535**	**2,481**
Non-interest expenses	**569**	**317**	**122**	**222**	**1,230**
Net operating income	**91**	**558**	**289**	**313**	**1,251**
Provision for credit losses	**21**	**130**	**–**	**228**	**379**
Income before undernoted	**70**	**428**	**289**	**85**	**872**
Provision for income taxes	**19**	**118**	**82**	**34**	**253**
Non-controlling interest in income of trust	**6**	**16**	**4**	**–**	**26**
Net income	**$ 45**	**$ 294**	**$ 203**	**$ 51**	**$ 593**
Preferred share dividends	**4**	**11**	**3**	**2**	**20**
Net income attributable to common shares	**$ 41**	**$ 283**	**$ 200**	**$ 49**	**$ 573**
Average assets	**$ 19,401**	**$ 26,912**	**$ 22,759**	**$ 4,880**	**$ 73,952**

	2007				
	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Consumer Finance*	*Total*
Net interest income	$ 402	$ 704	$ 116	$ 496	$ 1,718
Non-interest revenue	269	179	260	73	781
Total revenue	671	883	376	569	2,499
Non-interest expenses	536	329	132	274	1,271
Net operating income	135	554	244	295	1,228
Provision for credit losses	24	43	–	172	239
Income before undernoted	111	511	244	123	989
Provision for income taxes	36	173	83	55	347
Non-controlling interest in income of trust	7	15	4	–	26
Net income	$ 68	$ 323	$ 157	$ 68	$ 616
Preferred share dividends	4	11	3	–	18
Net income attributable to common shares	$ 64	$ 312	$ 154	$ 68	$ 598
Average assets	$ 19,528	$ 24,232	$ 19,513	$ 4,921	$ 68,194

Notes to Consolidated Financial Statements (continued)

28 Segmented information *(continued)*

b *Geographic*

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

	2008			
	Assets		*Liabilities*	
	Amount	*Percent*	*Amount*	*Percent*
Canada	**$ 70,247**	**97.5**	**$ 63,011**	**92.8**
United States	**1,029**	**1.4**	**1,200**	**1.8**
Other countries	**773**	**1.1**	**3,685**	**5.4**
Total	**$ 72,049**	**100.0**	**$ 67,896**	**100.0**

	2007			
	Assets		*Liabilities*	
	Amount	*Percent*	*Amount*	*Percent*
Canada	$ 65,483	96.1	$ 59,814	92.7
United States	1,266	1.9	1,204	1.9
Other countries	1,381	2.0	3,500	5.4
Total	$ 68,130	100.0	$ 64,518	100.0

29 Related party transactions

Fees are charged by HSBC Group companies with respect to guarantees of deposits and medium term notes, and administrative and technical services provided to the bank. The total fees for the year amounted to $120 million (2007 – $98 million) and were recorded in non-interest expenses.

Included in non-interest revenue were fees of $16 million (2007 – $19 million) received from a HSBC group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

HSBC Group companies hold certain debentures and preferred shares (notes 12 and 13). See also note 19(b) relating to derivative instruments.

A certain company within the HSBC Group has agreed to provide a standby borrowing facility of up to US $500 million to the bank 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 the HSBC Group, none of which are material to these financial statements.

30 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 the bank 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.

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

a *Credit-related (continued)*

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

	2008	2007
Financial and performance standby letters of credit	**$ 2,570**	$ 2,420
Documentary and commercial letters of credit	**397**	322
Commitments to extend credit	**37,426**	41,329
Credit and yield enhancement	**14**	50
	$ 40,407	$ 44,121

b *Long-term lease commitments*

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

2009	$ 49
2010	41
2011	36
2012	27
2013	23
2014 (and thereafter)	55
	$ 231

The total rental expense charged in respect of premises for 2008 was $63 million (2007 – $63 million).

c *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.

d *Contingent liabilities*

During 2004, the Canada Revenue Agency issued Notices of Reassessments with respect to a specific material issue relating to the 1996-2001 taxation years. We have filed Notices of Objections. The ultimate resolution of these issues is indeterminate at this stage. However, we believe that adequate provisions to cover these matters are reflected in the consolidated balance sheets at December 31, 2008 and 2007.

As part of the sale of an automobile loan portfolio, the bank has agreed, for a period of two years ending in July 2010, to indemnify the acquirer for 80 per cent of any cumulative losses on the portfolio in excess of a certain limit, with a maximum potential payment of $20 million. The bank does not anticipate any payment pursuant to this indemnity, as its current estimate of losses is less than that limit.

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

e *Backstop liquidity facilities*

Backstop liquidity facilities are provided to asset-backed commercial paper conduit programs ("programs") administered by the bank and third parties, as an alternative source of financing in the event that such programs are unable to access commercial paper markets, or in limited circumstances, when predetermined performance measures of the financial assets owned by these programs are not met. Generally, these facilities have a term of up to one year. The terms of the backstop liquidity facilities do not require the bank to advance money to these programs in the event of bankruptcy or to purchase non-performing or defaulted assets. None of the backstop liquidity facilities provided to programs administered by the bank have been drawn upon. No amounts were drawn on backstop liquidity facilities provided to programs administered by third parties at December 31, 2008 or 2007. Undrawn commitments in respect of backstop liquidity facilities are included in the amounts in note 30(a) above.

f *Credit enhancements*

The bank provides partial program-wide credit enhancement to the multi-seller conduit program administered by it to protect commercial paper investors in the event that the collections on the underlying assets and any draws on the transaction specific credit enhancement and liquidity backstop facilities are insufficient to repay the maturing asset backed commercial paper issued by such multi-seller conduit program. Each of the asset pools funded by this multi-seller conduit program is structured to achieve a high investment grade credit profile through the provision of transaction specific credit enhancement provided by the seller of each asset pool to this multi-seller conduit program. The term of this program-wide credit enhancement is 16 months.

HSBC Group International Network*

Services are provided by around 9,500 offices in 86 countries and territories:

Europe	Offices
Armenia	13
Austria	1
Belgium	2
Channel Islands	38
Cyprus	1
Czech Republic	7
France	454
Georgia	1
Germany	13
Greece	27
Hungary	11
Ireland	7
Isle of Man	8
Italy	3
Luxembourg	4
Malta	54
Monaco	2
Netherlands	1
Poland	24
Russia	12
Slovakia	4
Spain	4
Sweden	3
Switzerland	17
Turkey	229
Ukraine	1
United Kingdom	1,618

Asia-Pacific	Offices
Australia	34
Bangladesh	10
Brunei Darussalam	12
China	136
Cook Islands	1
Hong Kong Special Administrative Region	325
India	155
Indonesia	114
Japan	14
Kazakhstan	3
Korea, Republic of	15
Macau Special Administrative Region	7
Malaysia	49
Maldives	1
New Zealand	11
Pakistan	9
Philippines	27
Singapore	27
Sri Lanka	15
Taiwan	43
Thailand	1
Vietnam	4

Americas	Offices
Argentina	226
Bahamas	8
Bermuda	15
Brazil	1,889
British Virgin Islands	3
Canada	292
Cayman Islands	13
Chile	2
Colombia	32
Costa Rica	46
El Salvador	90
Honduras	87
Mexico	1,265
Nicaragua	3
Panama	83
Paraguay	6
Peru	17
United States of America	1,584
Uruguay	11
Venezuela	1

Middle East and Africa	Offices
Algeria	2
Bahrain	9
Egypt	76
Iran	1
Iraq	15
Israel	3
Jordan	5
Kuwait	1
Lebanon	7
Libya	2
Mauritius	12
Oman	9
Palestinian Autonomous Area	1
Qatar	6
Saudi Arabia	88
South Africa	5
United Arab Emirates	33

Associated companies are included in the network of offices.

HSBC Bank Canada Bank Branches and Subsidiaries**

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

Alberta:
Calgary (8)
Edmonton (6)
Lethbridge
Medicine Hat
Red Deer
St. Albert

Saskatchewan:
Regina
Saskatoon

Manitoba:
Winnipeg (2)

Ontario:
Aurora
Barrie
Brampton (2)
Burlington
Etobicoke
Hamilton
Kanata
Kingston
Kitchener
London
Markham (4)
Milton
Mississauga (4)
Oakville
Oshawa
Ottawa
Richmond Hill (2)
St. Catharines
Sault Ste. Marie
Scarborough (3)
Thunder Bay
Timmins
Toronto (12)
Unionville
Vaughan (2)
Whitby
Willowdale
Windsor
Woodbridge

Quebec:
Boucherville
Brossard
Chicoutimi
Laval
Montreal (4)
Pointe-Claire
Quebec City
Saint Leonard
Sherbrooke
Trois-Rivières

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* *At March 2, 2009*
** *At December 31, 2008*

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Vancouver

Matthew Bosrock
Deputy Chief Executive Officer
Vancouver

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Regional President,
Central and Eastern Canada and
Executive Vice President,
Commercial Banking
Toronto

Brad Meredith
Executive Vice President,
Global Banking and Markets
Toronto

Tracy Redies
Executive Vice President,
Personal Financial Services and
Wealth Management
Vancouver

Bob Anthony
Chief Risk Officer
Vancouver

Graham McIsaac
Chief Financial Officer
Vancouver

Todd Skinner
President and Chief Executive
Officer
HSBC Financial Corporation
Limited
Toronto

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Retail Branch Network – West
Vancouver

Blake Hellam
Senior Vice President and Head of
Branch Network – East
Toronto

Miguel Barrieras
Senior Vice President, National
Head of Business Banking and
Head of Quebec
Montreal

Mike Cepin
Senior Vice President and
Head of Commercial Banking –
BC Region
Vancouver

Robin Penfold
Senior Vice President and
Head of Commercial Banking –
Western Region
Calgary

Dino Medves
Senior Vice President and
Head of Commercial Banking –
Central and Eastern Canada
Toronto

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HSBC Global Asset Management
(Canada) Limited
Toronto

Lorne Harper
President and Chief Executive
Officer
HSBC Securities (Canada) Inc.
Toronto

David Mullen
Chief Executive Officer
HSBC Capital (Canada) Inc.
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Todd Skinner
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Officer
HSBC Financial Corporation
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HSBC Trust Company (Canada)
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Toronto

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Chairman
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Group Chief Executive
HSBC Holdings plc

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Burrard International Holdings Inc

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HSBC Bank Canada

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Chief Executive Officer
Holt Renfrew & Co. Limited

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HSBC North America
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Corporate Director

** At March 2, 2009*