**HSBC BANK CANADA**
**SECOND QUARTER 2008 REPORT TO SHAREHOLDERS**

- Net income attributable to common shares was C$142 million for the quarter ended 30 June 2008, an increase of 5.2 per cent over the quarter ended 30 June 2007.

- Net income attributable to common shares was C$297 million for the half-year ended 30 June 2008, an increase of 8.4 per cent over the same period in 2007.

- Return on average common equity was 18.9 per cent for the quarter ended 30 June 2008 and 19.9 per cent for the half-year ended 30 June 2008 compared with 20.7 per cent and 21.4 per cent respectively for the same periods in 2007.

- The cost efficiency ratio was 52.7 per cent for the quarter ended 30 June 2008 and 50.7 per cent for the half-year ended 30 June 2008 compared with 51.2 per cent and 51.7 per cent respectively for the same periods in 2007.

- Total assets were C$67.4 billion at 30 June 2008 compared with C$61.2 billion at 30 June 2007.

- Total funds under management were C$27.1 billion at 30 June 2008 compared with C$25.8 billion at 30 June 2007.

The world's local bank

HSBC

# Second Quarter 2008 Management's Discussion and Analysis

HSBC Bank Canada ("the bank") is an indirectly owned subsidiary of HSBC Holdings plc ("HSBC Holdings"). Throughout the Management's Discussion and Analysis ("MD&A"), the HSBC Holdings Group is defined as the "HSBC Group" or the "Group". The MD&A for the bank for the second quarter of 2008 is dated 24 July 2008. Unless otherwise indicated, all amounts are in Canadian dollars (tabular amounts are in C$ millions) and have been derived directly from our financial statements prepared in accordance with Canadian generally accepted accounting principles ("GAAP") or from the information used to prepare them. The sections included in the MD&A on risk management from pages 6 to 14 form an integral part of the unaudited consolidated financial statements and should be read in conjunction with the unaudited consolidated financial statements for the quarter ended 30 June 2008. Reference should be made to note 2 on page 24 regarding changes in accounting policies relating to presentation and disclosures of Capital and Financial Instruments, although the basis of measurement is unchanged from previous periods. Certain prior period amounts have been reclassified to conform to the presentation adopted in the current period.

**Financial Highlights**

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| **Earnings** | | | | | |
| Net income attributable to common shares | **142** | 155 | 135 | **297** | 274 |
| Basic earnings per share (C$) | **0.28** | 0.31 | 0.28 | **0.60** | 0.56 |
| **Performance ratios (%)**⌖ | | | | | |
| Return on average common equity | **18.9** | 21.2 | 20.7 | **19.9** | 21.4 |
| Return on average assets | **0.83** | 0.92 | 0.86 | **0.88** | 0.89 |
| Net interest margin | **2.03** | 2.08 | 2.29 | **2.06** | 2.29 |
| Cost efficiency ratio | **52.7** | 48.7 | 51.2 | **50.7** | 51.7 |
| Non-interest revenue: total revenue ratio | **39.7** | 42.4 | 36.6 | **41.1** | 37.6 |
| **Credit information** | | | | | |
| Gross impaired credit exposures | **290** | 314 | 195 | | |
| Allowance for credit losses | | | | | |
| – Balance at end of period | **365** | 370 | 323 | | |
| – As a percentage of gross impaired credit exposures | **126 %** | 118 % | 166 % | | |
| – As a percentage of gross loans and acceptances | **0.78 %** | 0.81 % | 0.74 % | | |
| **Average balances**⌖ | | | | | |
| Assets | **68,471** | 67,897 | 63,286 | **68,184** | 61,979 |
| Loans | **39,942** | 38,850 | 37,067 | **39,396** | 36,534 |
| Deposits | **51,830** | 50,972 | 46,691 | **51,401** | 46,275 |
| Common equity | **3,038** | 2,964 | 2,618 | **3,001** | 2,588 |
| **Capital ratios (%)**⌖⌖ | | | | | |
| Tier 1 | **9.3** | 9.1 | 8.8 | | |
| Total capital | **11.5** | 11.3 | 11.5 | | |
| **Total assets under administration** | | | | | |
| Funds under management | **27,118** | 26,283 | 25,795 | | |
| Custody accounts | **10,699** | 11,006 | 9,012 | | |
| Total assets under administration | **37,817** | 37,289 | 34,807 | | |

⌖ *These are non-GAAP amounts or non-GAAP measures. Please refer to the discussion outlining the use of non-GAAP measures in this document in the "GAAP and related non-GAAP measures used in the MD&A" section on page 17.*

⌖⌖ *Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada. Refer to page 32, note 14 in respect of new capital adequacy framework.*

# Analysis of Financial Results

## Overview

HSBC Bank Canada recorded net income attributable to common shares of C$142 million for the quarter ended 30 June 2008, an increase of C$7 million, or 5.2 per cent, from C$135 million for the second quarter of 2007. Net income attributable to common shares for the first half of 2008 was C$297 million compared with C$274 million for the same period in 2007, an increase of C$23 million or 8.4 per cent.

Commenting on the results, Lindsay Gordon, President and Chief Executive Officer, said: “HSBC Bank Canada's results for the second quarter were in line with expectations in a difficult environment for banks in Canada and worldwide. Falling market interest rates adversely impacted our net interest margin and although our ongoing credit position continues to be stable overall, further increases in specific credit provisions also impacted reported earnings.

“However, our underlying business in Canada remains strong and being part of the HSBC Group remains a significant advantage in times of uncertain market conditions. We will continue to pursue our strategy of growing our business by building on the international strengths of the HSBC Group with the aim of providing our customers with the financial products and services most suitable for their circumstances and we will strive to deliver a consistent level of excellent customer service throughout HSBC in Canada.”

## Net interest income

Net interest income of C$296 million for the quarter ended 30 June 2008 was C$11 million lower than C$307 million recorded in the same quarter of 2007. Average interest earning assets for the quarter were C$58.5 billion, 7.7 per cent higher than the same period in 2007. However, continuing competitive pressures and a challenging interest rate environment impacted the net interest margin, which decreased to 2.03 per cent for the quarter ended 30 June 2008 from 2.29 per cent for the same period in 2007. Since November 2007, a falling prime rate has resulted in reduced interest income on our floating rate loans without a corresponding reduction in interest expense as deposits re-priced less quickly. In addition, widening credit spreads experienced across the banking industry adversely impacted the cost of wholesale deposits.

Net interest income in the second quarter of 2008 was largely unchanged compared with the first quarter of 2008. Although average interest earning assets increased by C$0.8 billion compared to the first quarter of 2008, this was offset by a decrease in net interest margin from 2.08 per cent to 2.03 per cent.

On a year-to-date basis, net interest income was C$594 million which decreased marginally from C$601 million for the same period last year. Net interest income in 2008 benefited from continued growth in assets across all businesses, but a decrease in net interest margin to 2.06 per cent compared with 2.29 per cent in 2007 has more than offset the increase.

## Non-interest revenue

Non-interest revenue was C$195 million for the second quarter of 2008 compared with C$177 million in the same quarter of 2007, an increase of C$18 million, or 10.2 per cent. Securitization income was C$12 million higher due to increased activity as well as increased income resulting from larger spreads on loans securitized as a result of falling interest rates. Trading revenues increased C$3 million compared to the same period last year primarily due to volatile foreign exchange and credit markets experienced in the first half of 2008. Deposit and payment service charges and credit fees were each higher due to continued business growth. These increases were partially offset by lower capital market fees in 2008 and a C$7 million reduction in gains on available-for-sale securities due to a gain recorded in the same period last year from the sale of part of the bank’s shares in the Montreal Exchange.

Non-interest revenue decreased from the first quarter of 2008 by C$24 million, or 11.0 per cent. Trading income decreased by C$32 million from the prior quarter of which C$24 million was related to gains on certain debt obligations recorded at fair value as a result of widening credit spreads, while in the current quarter a small loss was recorded as credit spreads narrowed. In addition, trading revenues which had been very high in the first quarter due to

# Analysis of Financial Results *(continued)*

volatile market activity were C$6 million lower in the second quarter. Securitization income also decreased by C$6 million compared to the first quarter of 2008, mainly due to lower spreads on loans securitized. These decreases were partially offset by a C$5 million increase in capital market fees due to increased businesses activity experienced in the second quarter of 2008 and a C$2 million increase in investment administration fees as funds under management grew. During the second quarter of 2008, C$2 million in gains on disposals of certain available-for-sale securities was also recognized.

On a year-to-date basis, non-interest revenue was C$414 million, C$52 million, or 14.4 per cent, higher compared with C$362 million for the same period last year. Trading revenues increased C$40 million as a result of volatile foreign exchange and credit markets experienced in the first half of 2008. It included a positive impact of C$18 million arising from changes in the amount of certain debt obligations recorded at fair value. Securitization income was C$29 million higher due to increased activity as well as higher gains on securitizations of loans arising from the effect of falling interest rates. Deposit and payment service charges, credit fees and investment administration fees were also higher due to continued business growth. These increases were partially offset by a reduction in capital market fees of C$12 million due to lower capital market activity in the first half of 2008 compared to the same period in 2007. In addition, gains on available-for-sale securities were C$24 million lower than in the same period last year due to gains recorded in the first half of 2007 from the sale of the bank's shares in the Montreal Exchange. Gains on other securities were C$7 million lower due to lower income from the bank's investment in private equity funds compared to 2007.

**Non-interest expenses**

Non-interest expenses were C$259 million for the second quarter of 2008 compared with C$248 million for the same quarter of 2007, an increase of C$11 million, or 4.4 per cent. The cost efficiency ratio was 52.7 per cent for the second quarter of 2008 compared to 51.2 per cent for the same period in 2007. Salary expenses grew reflecting increased staff levels as we expanded the branch network, the direct bank and the payments and cash management businesses. This was partially offset by lower variable compensation as a result of reductions in capital market revenue and lower pension and post retirement benefit costs. Premises and equipment expenses increased as a result of additional investments in IT and higher occupancy costs.

Non-interest expenses increased by C$7 million compared to the first quarter of 2008. Salaries and benefits were marginally higher with increased variable compensation arising from increased capital market fees which were offset by lower pension and benefit expenses. Premises and equipment expenses increased by C$3 million arising from increased IT costs and higher occupancy expenses as the bank continued to open new branches.

On a year-to-date basis, non-interest expenses were C$511 million compared with C$498 million for the same period last year, an increase of C$13 million, or 2.6 per cent. Salaries and benefits expenses were C$3 million higher due to an increased employee base, and increased benefit costs as a result of opening new branches. These were offset by lower variable compensation arising from lower capital market fees and lower pension costs. Premises costs increased by C$10 million due to increased costs from new branches as well as increases in IT costs. Other non-interest expenses were higher due to continued investments in the business, as well as higher customer transaction costs. The cost efficiency ratio of 50.7 per cent compared favourably with 51.7 per cent for the same period in 2007.

**Credit quality and provision for credit losses**

The provision for credit losses was C$25 million for the second quarter of 2008, compared with C$12 million in the second quarter of 2007, and C$25 million for the first quarter of 2008. On a year-to-date basis, the provision for credit losses was C$50 million, compared with C$22 million for the same period of 2007.

The credit environment deteriorated somewhat in the latter part of 2007 and quarterly provisions for the first half of 2008 were at a similar level to that experienced in the second half of 2007. An increase in retail provisions primarily related to auto loans and a specific provision relating to the commercial construction sector in the first half of 2008 resulted in an increase of C$28 million compared with the same period in 2007.

# Analysis of Financial Results *(continued)*

The same factors impacted movements in impaired credit exposures. Gross impaired credit facilities were C$290 million, C$24 million lower compared with 31 March 2008 and C$95 million higher compared with C$195 million at 30 June 2007. Total impaired credit facilities, net of specific allowances for credit losses, were C$194 million at 30 June 2008 compared with C$188 million at 31 December 2007 and C$141 million at 30 June 2007. Overall credit quality remains sound, reflecting prudent lending standards.

The general allowance for credit losses remained unchanged at C$269 million compared with 31 December 2007 and at 30 June 2007. The total allowance for credit losses, as a percentage of loans and acceptances outstanding, was 0.78 per cent at 30 June 2008 compared with 0.79 per cent at 31 December 2007 and 0.74 per cent at 30 June 2007.

**Income taxes**

The effective tax rate in the second quarter of 2008 was 26.3 per cent compared with 35.5 per cent in the second quarter of 2007 and 32.1 per cent in the first quarter of 2008. The lower tax rate in the quarter ended 30 June 2008 compared to the first quarter of 2008 was largely due to resolution of certain tax deductions from prior years.

**Balance sheet**

Total assets at 30 June 2008 were C$67.4 billion, an increase of C$4.5 billion from 31 December 2007, and C$6.2 billion from 30 June 2007. Commercial loans and bankers' acceptances increased by C$621 million from the end of 2007, as commercial activity continued to grow. Although residential mortgage originations increased, this was offset by C$1.9 billion in securitizations in 2008 resulting in a net decrease of about C$470 million. Consumer loans grew by C$1.6 billion, of which C$900 million related to part of the industry restructuring of certain non-bank ABCP conduits where the bank re-purchased personal loans previously securitized. The securities portfolio and securities purchased under reverse repurchase arrangements increased by C$2.2 billion from 31 December 2007, improving the bank's liquidity position.

Total deposits increased by C$2.4 billion to C$51.3 billion at 30 June 2008 from C$48.9 billion at 31 December 2007 and were C$5.1 billion higher compared with C$46.2 billion at 30 June 2007. Personal deposits grew by C$1.2 billion over 31 December 2007 mainly driven by growth in High Rate and Direct Savings Accounts. In the same period commercial deposits also increased reflecting strong growth among our commercial clients, while wholesale deposits were relatively unchanged.

**Total assets under administration**

Funds under management were C$27.1 billion at 30 June 2008 compared with C$26.3 billion at 31 March 2008 and C$25.8 billion at 30 June 2007. Funds under management in the second quarter of 2008 benefited from strong investment sales, and increases in equity markets. Including custody and administration balances, total assets under administration were C$37.8 billion compared with C$37.3 billion at 31 March 2008 and C$34.8 billion at 30 June 2007.

**Sale of loan portfolio**

As part of a strategic review to focus operations on core customer facing businesses, on 29 July 2008 the bank completed the sale of a portfolio of approximately C$1.5 billion of certain consumer loans to The Bank of Nova Scotia, incurring an after tax loss of approximately C$20 million, which will be recorded in the third quarter of 2008.

**Potential acquisition**

As a result of an ongoing strategic review of HSBC's North American operations, HSBC Bank Canada intends to acquire HSBC Financial Corporation Limited, the holding company for the Group's Canadian consumer finance business, which had assets of C$5.2 billion at 31 March 2008. This transaction is subject to regulatory and Board approvals.

# Risk Management

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, market, operational and fiduciary 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.

*Risk governance and ownership*

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

- identification of 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 Board of Directors (“the Board”) for review, ratification and/or approval.

Our Board approves our risk management policies presented by the Risk Management Committee. Overall risk management limits are set, taking into account HSBC Group’s risk limits.

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

In addition to the risks that arise on a daily basis identified above, we are also exposed to strategic risk that arises if we fail to identify opportunities and/or threats arising from changes in the market, some of which may emerge over a number of years. These strategic opportunities or threats arise from a range of factors which might include 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 the HSBC Group.

**Credit risk management**

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business; but also from certain off-balance sheet products such as guarantees and credit derivatives, and from the bank’s holdings of assets in the form of debt securities.

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.

# Risk Management *(continued)*

*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 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; and adequacy of loan provisions. 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 branch managers' delegated lending limits and they review branch credit decisions to ensure these decisions reflect our portfolio management objectives. Our Credit Department may approve credits not meeting our lending guidelines on an exception basis with appropriate risk mitigation and reward considerations. 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 growth of this portfolio given the strong demand for credit from this sector and its cyclical nature. Where we are dependent upon third parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

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

In February 2008, regulatory approval was received to use the Advanced Internal Ratings Based approach for regulatory capital calculations. The obligation to meet all minimum requirements is ongoing and forms a key part of the approval conditions.

# Risk Management *(continued)*

The implementation and validation of a formal and strictly managed dual risk rating system assigned to all borrowing clients and facility structures is closely monitored and reviewed to ensure changes in risk profiles are appropriately reflected in the credit metrics. We use various credit scoring tools and related bureau-based management techniques, along with judgment, to assign risk metrics to individual obligors or pools of homogeneous credit exposures.

We have developed the credit risk management infrastructure and data management tools to capture and populate a number of databases with these key credit metrics and other obligor data. These data elements are key inputs for calculating minimum regulatory capital requirements under Basel II and producing granular credit management reporting including portfolio credit quality distributions, for example, probability of default and loss given default and rating transition matrices.

*Maximum exposure to credit risk*

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 financial assets recognised on the balance sheet, the exposure to credit risk equals their carrying amount. For financial guarantees granted, 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.

| | ***At 30 June 2008*** | *At 31 December 2007* |
|---|---|---|
| **On balance sheet exposure** | | |
| Cash held at Bank of Canada and other regulated financial institutions | **2,823** | 3,573 |
| Securities | | |
| As disclosed on balance sheet | **8,273** | 6,926 |
| Less: Equity securities not exposed to credit risk | **(187)** | (214) |
| Securities purchased under reverse repurchase agreements | **6,970** | 6,122 |
| Loans | **40,489** | 38,715 |
| Customers' liability under acceptances | **5,740** | 5,727 |
| Derivatives | **579** | 623 |
| Included within other assets | | |
| Accrued interest receivable | **143** | 156 |
| Due from clients, dealers and clearing corporations | **1,292** | 236 |
| Accounts receivable and other | **469** | 357 |
| | **66,591** | 62,221 |
| **Off balance sheet exposure** | | |
| Financial and performance standby letters of credit | **2,375** | 2,420 |
| Documentary and commercial standby letters of credit | **392** | 322 |
| Commitments to extend credit | **32,971** | 36,177 |
| Credit and yield enhancement | **52** | 50 |
| | **35,790** | 38,969 |
| **Maximum exposure** | **102,381** | 101,190 |

*Collateral and other credit enhancements*

It is our lending policy to assess the customer's capacity to repay, rather than rely excessively on the underlying collateral security. Depending on the customer's standing and the type of product, facilities may be unsecured. Nevertheless, collateral can be an important mitigant of credit risk.

# Risk Management *(continued)*

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.

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.

*Credit quality of financial assets neither past due nor impaired*

The credit quality of the portfolio of loans that were neither past due nor impaired can be assessed by reference to the Group's legacy credit risk grading system, on which the following information is based:

| | ***At 30 June 2008*** | *At 31 December 2007* |
|---|---|---|
| Grades: | | |
| 1 to 3 – satisfactory risk | **39,420** | 37,713 |
| 4 – watch list and special mention | **614** | 531 |
| 5 – sub-standard but not impaired | **227** | 218 |
| | **40,261** | 38,462 |

Grades 1 and 2 include corporate facilities demonstrating financial conditions, risk factors and the capacity to repay that is good to excellent, residential mortgages with low to moderate loan-to-value ratios and other retail accounts which are maintained within generally applicable product parameters.

Grade 3 represents satisfactory risk, and includes corporate facilities that require closer monitoring, mortgages with higher loan to value ratios, credit card exposures and other retail exposures which operate outside generally applicable product parameters without being impaired.

Grades 4 and 5 include facilities that require varying degrees of special attention.

Information in respect of geographic and industry concentrations is included on pages 27 to 28 of our 2007 Annual Report and Accounts.

*Loans past due but not impaired*

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.

# Risk Management *(continued)*

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

| | **At 30 June 2008** | At 31 December 2007 |
|---|---|---|
| Past due up to 29 days | **239** | 268 |
| Past due 30-59 days | **42** | 50 |
| Past due 60-89 days | **14** | 10 |
| Past due over 90 days | **8** | 9 |
| | **303** | 337 |

*Impaired financial assets*

When impairment losses occur, we reduce the carrying amount of loans and for other than temporary impairment losses on available-for-sale securities through the use of an allowance account with a charge to income.

Impairment allowances may be assessed and created either for individually significant accounts or on a collective basis, for groups of 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.

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 realisation; and
- a significant downgrading in credit rating by an external credit rating agency.

Loans and other credit facilities that were impaired amounted to C$290 million at 30 June 2008 (31 December 2007 – C$272 million).

Due to a lack of liquidity and the consequent lack of market prices of Canadian non-bank sponsored Asset Backed Commercial Paper (“non-bank ABCP”), we adjusted the carrying value, net of provisions, at 31 December 2007 to C$280 million. Although we have updated significant assumptions in our valuation model, there has been no change in management’s estimate of fair value subsequent to 31 December 2007. Detailed information on the valuation of our non-bank ABCP is included in our 2007 Annual Report and Accounts on page 51.

**Liquidity and funding management**

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.

# Risk Management *(continued)*

*Policies and procedures*

The management of liquidity and funding is carried out by our Treasury Department in accordance with practices and limits approved by the Board and HSBC Holdings. Compliance with policies is regularly monitored by the Asset and Liability Committee (“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*

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 provides 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.

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.

# Risk Management *(continued)*

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

| | *On demand and due within 3 months* | *Due between 3 and 12 months* | *Due between 1 and 5 years* | *Due after 5 years* |
|---|---|---|---|---|
| **At 30 June 2008** | | | | |
| Deposits | 37,370 | 9,139 | 4,065 | 716 |
| Acceptances | 5,740 | – | – | – |
| Securities sold under repurchase agreements | 372 | – | – | – |
| Securities sold short | 818 | – | – | – |
| Trading derivatives | 591 | – | – | – |
| Subordinated debentures | – | – | – | 829 |
| Other financial liabilities | 3,813 | – | – | – |
| | 48,704 | 9,139 | 4,065 | 1,545 |
| Loan commitments | 15,770 | 11,911 | 931 | 4,359 |
| | 64,474 | 21,050 | 4,996 | 5,904 |

Certain balances in the above table will not agree directly to the balances in the unaudited interim consolidated balance sheet as the table incorporates principal cash flows, on an undiscounted basis, except for derivatives. Furthermore, loan commitments are not recognized on the balance sheet. Trading 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 notice and commercial notice accounts of C$17.8 billion.

**Market risk management**

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 manage 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 held-for-trading. 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 available-for-sale and held-to-maturity.

*Policies and procedures*

Market risk is managed through strategies in accordance with policies and risk limits set out by ALCO and approved by the Board. 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.

# Risk Management *(continued)*

We use a range of tools to monitor and limit market risk exposures. These include: present value of a basis point ("PVBP"); value at risk ("VaR"); foreign exchange exposure limits; maximum loss limits; options premium paid limits; and product and issuance limits.

*Value at risk (VaR)*

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;
- 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 1 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.

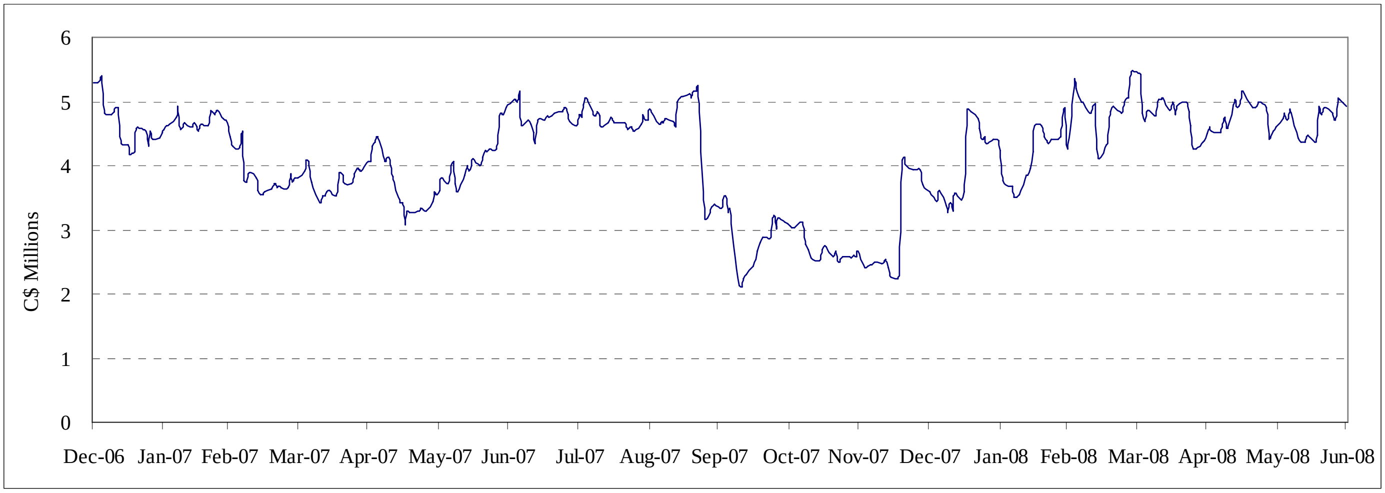
*Value at risk*

Value at risk disclosed in the table and graph below is the bank's total value at risk for both trading and non-trading financial instruments.

| | *Quarter ended* | | |
|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *31 December 2007* |
| End of quarter | **5** | 5 | 4 |
| Average | **5** | 4 | 3 |
| Minimum | **4** | 3 | 2 |
| Maximum | **5** | 5 | 4 |

# Risk Management *(continued)*

*Daily Value at risk*




# Other Information

### Related party transactions

Related party transaction policies and practices are unchanged from those outlined on page 75 of the 2007 Annual Report and Accounts. All transactions with related parties continue to be priced and accounted for as if they were provided in an open market on an arm's length basis or, where no market exists, at fair value.

### Financial instruments, including off-balance sheet arrangements

During the normal course of business, the bank makes extensive use of financial instruments including funding loans, purchasing securities and other investments, accepting deposits and entering into various derivative instrument contracts. The most significant off-balance sheet arrangements are guarantees and letters of credit, and derivatives, which were described on page 17 of the 2007 Annual Report and Accounts. Although the notional values of these financial instruments are not recorded on the balance sheet, derivatives, guarantees and letters of credit are recorded at fair value. In addition, in certain circumstances, the bank provides guarantees and letters of credit facilities to borrowers. There have been no changes in the basis of calculating the fair value of financial instruments from 31 December 2007, and no significant changes in the fair value of financial instruments that arose from factors other than normal economic, industry and market conditions.

### Accounting policies and critical accounting estimates

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The key assumptions and bases for estimates that are made under GAAP, and their impact on the amounts reported in the interim consolidated financial statements and notes, remain substantially unchanged from those described on pages 14 to 17 of the 2007 Annual Report and Accounts. Effective 1 January 2008, we adopted CICA Standards relating to the presentation and disclosure of Capital and Financial Instruments in accordance with CICA Handbook sections 1535, 3862 and 3863. There were no changes to the significant accounting policies and methods of computation from those used in the preparation of the bank's consolidated financial statements for the year ended 31 December 2007, which were outlined on pages 42 to 77 of the 2007 Annual Report and Accounts.

There was no change in management's best estimate of the fair value of the bank's non-bank ABCP from 31 December 2007. Information relating to estimates used in the valuation of non-bank ABCP is included on page 51 of the 2007 Annual Report and Accounts.

# Other Information *(continued)*

## Outstanding shares and securities

| | *At 24 July 2008* | |
|---|---|---|
| | ***Number*** | ***Amount*** |
| HSBC Canada Asset Trust Securities (HSBC HaTS™) (1) | | |
| – Series 2010 (2) | 200,000 | 200 |
| – Series 2015 (3) | 200,000 | 200 |
| | | 400 |
| Preferred Shares – Class 1 | | |
| – Series C (4) | 7,000,000 | 175 |
| – Series D (5) | 7,000,000 | 175 |
| | | 350 |
| Common shares | 498,668,000 | 1,225 |

Notes:

(1) Reported in non-controlling interest in trust and subsidiary in the Consolidated Balance Sheet.

(2) Cash distributions are non-cumulative and are payable semi-annually in an amount of C$38.90 per unit.

(3) Cash distributions are non-cumulative and are payable semi-annually in an amount of C$25.75 per unit.

(4) Cash dividends are non-cumulative and are payable quarterly in an amount of C$0.31875 per share.

(5) Cash dividends are non-cumulative and are payable quarterly in an amount of C$0.3125 per share.

During the second quarter of 2008, C$65 million in dividends were declared and paid on common shares.

Further details regarding features of the bank's securities and shares, including certain restrictions regarding distributions payable for HSBC HaTS, are disclosed in notes 9(a) and 11 of the 2007 Annual Report and Accounts.

Dividend record and payable dates for the bank's preferred shares for the remainder of 2008 and 2009, subject to approval by the Board, are:

| **2008** | |
|---|---|
| Record Date | Payable Date |
| September 15 | September 30 |
| December 15 | December 31 |

| **2009** | |
|---|---|
| Record Date | Payable Date |
| March 13 | March 31 |
| June 15 | June 30 |
| September 15 | September 30 |
| December 15 | December 31 |

The payable dates for HSBC HaTS distributions in 2008 and 2009 are 31 December 2008, 31 March 2009, 30 June 2009 and 31 December 2009.

# Other Information *(continued)*

### Management's responsibility for financial information

A rigorous and comprehensive financial governance framework is in place at the bank and its subsidiaries at both the management and board levels. Each year, the Annual Report and Accounts contains a statement signed by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) outlining management's responsibility for financial information contained in the report. Certifications, signed by the CEO and CFO, were filed with the Canadian Securities Administrators in March 2008 when the Annual Report and Accounts and other annual disclosure documents were filed. In those filings, the CEO and CFO certify, as required in Canada by Multilateral Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the appropriateness of the financial disclosures in the annual filings, the effectiveness of disclosure controls and procedures as well as the design of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting in accordance with GAAP. The CEO and CFO certify the appropriateness of the financial disclosures in interim filings with securities regulators, including this MD&A and the accompanying unaudited interim consolidated financial statements for the quarter ended 30 June 2008, and that they are responsible for the design and maintenance of disclosure controls, internal controls and procedures over financial information to provide reasonable assurance regarding the reliability of financial reporting in accordance with GAAP. There have been no changes in internal controls over financial reporting during the quarter ended 30 June 2008 that have materially affected or are reasonably likely to affect internal control over financial reporting.

As in prior quarters, the bank's Audit Committee reviewed this document, including the attached unaudited interim consolidated financial statements, and approved the document prior to its release.

A comprehensive discussion of the bank's businesses, strategies and objectives can be found in the Management's Discussion and Analysis in the 2007 Annual Report and Accounts, which can be accessed on the bank's web site at www.hsbc.ca. Readers are also encouraged to visit the site to view other quarterly financial information.

### Regulatory filings

The bank's continuous disclosure materials, including interim and annual filings, are available on the bank's web site at www.hsbc.ca, and on the Canadian Securities Administrators' web site at www.sedar.com.

### Caution regarding forward-looking financial statements

This document may contain forward-looking statements, including statements regarding the business and anticipated financial performance of the bank. 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 level and general economic conditions in geographic areas where the bank operates. Canada has an extremely competitive banking environment and pressures on interest rates and the bank's net interest margin may arise from actions taken by individual banks acting alone. Varying economic conditions may also affect equity and foreign exchange markets, which could also have an impact on the bank's revenues. In addition, there may be a number of factors relating to the valuation of non-bank ABCP. The factors disclosed above may not be complete and there could be other uncertainties and potential risk factors not considered here which may impact the bank's results and financial condition.

# Other Information *(continued)*

### GAAP and related non-GAAP measures used in the MD&A

The bank uses both GAAP and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP do not have standardized measures under GAAP and are unlikely to be comparable to similar measures used by other companies. The following outlines various GAAP and non-GAAP measures, which management regularly monitors to more clearly indicate the derivation of the measure.

Return on average common equity **–** Average common equity is calculated using month-end balances of common equity for the period.

Return on average assets **–** Average assets are calculated using average daily balances for the period.

Net interest margin **–** Calculated as net interest income divided by average interest earning assets. Average interest earning assets are calculated using average daily balances for the period.

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, loans, and deposits are calculated using daily average balances for the period. Average common equity is calculated using month-end balances of common equity for the period.

# Quarterly summary of condensed statements of income (unaudited)

| | *Quarter ended* | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *Figures in C$ millions (except per share amounts)* | ***30 June 2008*** | *31 March 2008* | *31 December 2007* | *30 September 2007* | *30 June 2007* | *31 March 2007* | *31 December 2006* | *30 September 2006* |
| Net interest income | **296** | 298 | 302 | 319 | 307 | 294 | 291 | 282 |
| Non-interest revenue | **195** | 219 | 162 | 184 | 177 | 185 | 168 | 160 |
| Total revenue | **491** | 517 | 464 | 503 | 484 | 479 | 459 | 442 |
| Non-interest expenses | **259** | 252 | 253 | 246 | 248 | 250 | 236 | 213 |
| Net operating income | **232** | 265 | 211 | 257 | 236 | 229 | 223 | 229 |
| Provision for credit losses | **25** | 25 | 24 | 21 | 12 | 10 | 17 | 5 |
| Income before the under noted | **207** | 240 | 187 | 236 | 224 | 219 | 206 | 224 |
| Provision for income taxes | **53** | 75 | 64 | 81 | 77 | 70 | 66 | 76 |
| Non-controlling interest in income of trust | **7** | 6 | 7 | 6 | 7 | 6 | 7 | 6 |
| Net income | **147** | 159 | 116 | 149 | 140 | 143 | 133 | 142 |
| Preferred share dividends | **5** | 4 | 5 | 4 | 5 | 4 | 5 | 4 |
| Net income attributable to common shares | **142** | 155 | 111 | 145 | 135 | 139 | 128 | 138 |
| Basic earnings per share (C$) | **0.28** | 0.31 | 0.22 | 0.30 | 0.28 | 0.28 | 0.26 | 0.28 |

The bank adopted new accounting standards relating to financial instruments for the first quarter of 2007. Prior periods have not been restated.

The quarterly trends in revenue and expenses were disclosed in detail on pages 12 to 14 of the 2007 Annual Report and Accounts.

# Review of Customer Group Results

## Personal Financial Services

Income before taxes and non-controlling interest in income of trust for the second quarter of 2008 was C$40 million compared with C$37 million for the same period in 2007. Net interest income was C$4 million higher due to continued growth in loans and deposits. However, net interest margins were adversely impacted by competitive pressures and higher funding costs resulting from the challenging interest rate environment. Non-interest revenue was C$12 million higher due to increased securitization income, service charges, foreign exchange revenues and fees from our Global Investor Immigration Services ("GIIS"). These were partially offset by lower retail brokerage commissions as uncertain equity markets resulted in lower client trading volumes. In addition, the same period in 2007 included a gain on sale of part of the bank's shares in the Montreal Exchange. Non-interest expenses were C$10 million higher due to an increase in staff costs and operating expenses from growth and ongoing investments, partially offset by lower variable employee compensation. Provision for credit losses were C$3 million higher due largely to losses in the auto loan portfolio.

Income before taxes and non-controlling interest in income of trust was C$10 million higher compared with the first quarter of 2008. Net interest income was C$14 million higher due to growth in loan and deposit volumes and higher net interest margins on floating rate loans. Non-interest revenue was C$3 million lower due to lower gains and recurring income from asset securitizations. This was partially offset by increased revenue from GIIS. Non-interest expenses were C$2 million higher due to an increase in premises expenses and brokerage fees related to GIIS.

On a year-to-date basis, income before taxes and non-controlling interest in income of trust was C$70 million compared with C$64 million for the same period last year. Net interest income was C$5 million higher as growth in the business was partially offset by lower net interest margins. Non-interest revenue was C$27 million higher compared to prior year. Securitization income was higher due to increased activity as well as higher gains on securitization of loans. GIIS revenue was higher due to increased volume, and service charges and foreign exchange revenues were also higher than the same period in 2007. These increases were partially offset by gains recorded on the sale of the bank's shares in the Montreal Exchange in the prior year. Non-interest expenses were C$19 million higher largely due to related growth and continued investments in the business. Provision for credit losses were C$7 million higher due largely to losses in the auto loan portfolio.

## Commercial Banking

Income before taxes and non-controlling interest in income of trust for the second quarter of 2008 was C$126 million, compared with C$130 million for the same period in 2007. Net interest income benefited from growth in loans and deposits; however, net interest margins declined compared to the prior year due to higher funding costs resulting from the challenging interest rate environment. Non-interest revenue was C$9 million higher and was driven by growth of fees on bankers' acceptances and other financial guarantees, and increased revenues from the Payments and Cash Management business. Non-interest expenses were C$1 million higher due to continued business growth. The provision for credit losses was C$10 million higher due to increased provisions in the manufacturing and export sectors.

Income before taxes and non-controlling interest in income of trust was C$3 million lower compared with the first quarter of 2008. Total revenues were unchanged compared to the prior quarter as higher non-interest revenue was offset by lower net interest income. Non-interest expenses increased C$2 million compared to prior quarter due to higher premises and equipment expenses arising from increased IT costs and higher occupancy expenses. Provisions for credit losses increased C$1 million from the first quarter of 2008.

On a year-to-date basis, income before taxes and non-controlling interest in income of trust was C$255 million compared with C$262 million in the same period last year. Net interest income was C$3 million higher as growth in volumes was largely offset by decreased net interest margins. Non-interest revenue was C$7 million higher from growth of credit fees, Payments and Cash Management revenue, and foreign exchange revenues. Non-interest expenses were lower due to a decrease in capital taxes and branch premise costs. Provisions for credit losses increased C$21 million as the credit environment deteriorated somewhat compared to the same period in 2007.

# Review of Customer Group Results *(continued)*

### Global Banking and Markets

Income before taxes and non-controlling interest in income of trust for the second quarter of 2008 was C$41 million, compared with C$57 million for the same period in 2007. Net interest income was C$13 million lower due to lower yields on securities and a compression of interest margins reflecting a challenging interest rate environment. Non-interest revenue was C$3 million lower as the prior year included a gain on the sale of part of the bank's shares in the Montreal Exchange. Non-interest revenue was impacted from a change in the fair value of certain debt obligations. However, these were partially offset by increased trading revenues as a result of volatile foreign exchange and credit markets. Non-interest expenses were unchanged compared to the same period in 2007.

Income before taxes and non-controlling interest in income of trust was C$40 million lower compared with the first quarter of 2008. Net interest income was C$13 million lower as reductions in the prime rate reduced interest income from assets without a corresponding reduction in interest expense as deposits re-priced less quickly. Non-interest revenue was C$24 million lower relating to gains in the first quarter of 2008 on certain debt obligations recorded at fair value resulting from widening credit spreads while in the current quarter a small loss was recorded as spreads narrowed. Non-interest expenses were C$3 million higher due to an increase in employee compensation.

On a year-to-date basis, income before taxes and non-controlling interest in income of trust was C$122 million compared with C$117 million in the same period last year. Net interest income was C$15 million lower resulting from a decrease in net interest margins and lower securities yields. Non-interest revenue was C$18 million higher as trading revenue benefited from volatile foreign exchange and credit markets. Non-interest expenses were C$2 million lower due to a decrease in variable employee compensation.

# Transition to International Financial Accounting Standards ("IFRS")

The Canadian Accounting Standards Board announced that for fiscal years commencing on or after 1 January 2011, all publicly accountable enterprises, including HSBC Bank Canada, are mandated to report their financial results using International Financial Accounting Standards. We have developed an implementation strategy and timetable, and during the third and fourth quarters of 2008 we plan to establish the appropriate governance structure to co-ordinate the transition to IFRS building on our current process of reporting our results to the HSBC Group based on IFRS. We expect to begin a detailed assessment of any additional impact on our local accounting policies, disclosures, financial systems and processes, and internal controls in transitioning to these new standards in the third quarter of 2008.

# Consolidated Statements of Income (Unaudited)

| *Figures in C$ millions (except per share amounts)* | *Quarter ended* ***30 June 2008*** | *31 March 2008* | *30 June 2007* | *Half-year ended* ***30 June 2008*** | *30 June 2007* |
|---|---|---|---|---|---|
| **Interest and dividend income** | | | | | |
| Loans | **602** | 642 | 616 | **1,244** | 1,213 |
| Securities | **65** | 73 | 71 | **138** | 129 |
| Deposits with regulated financial institutions | **21** | 36 | 62 | **57** | 121 |
| | **688** | 751 | 749 | **1,439** | 1,463 |
| **Interest expense** | | | | | |
| Deposits | **382** | 443 | 431 | **825** | 844 |
| Debentures | **10** | 10 | 11 | **20** | 18 |
| | **392** | 453 | 442 | **845** | 862 |
| **Net interest income** | **296** | 298 | 307 | **594** | 601 |
| **Non-interest revenue** | | | | | |
| Deposit and payment service charges | **28** | 27 | 25 | **55** | 48 |
| Credit fees | **30** | 31 | 28 | **61** | 55 |
| Capital market fees | **27** | 22 | 29 | **49** | 61 |
| Investment administration fees | **35** | 33 | 33 | **68** | 63 |
| Foreign exchange | **11** | 10 | 9 | **21** | 18 |
| Trade finance | **6** | 5 | 6 | **11** | 12 |
| Trading revenue | **19** | 51 | 16 | **70** | 30 |
| Gains on available-for-sale securities | **2** | – | 9 | **2** | 26 |
| Gains on other securities | **1** | 1 | 1 | **2** | 9 |
| Securitization income | **21** | 27 | 9 | **48** | 19 |
| Other | **15** | 12 | 12 | **27** | 21 |
| | **195** | 219 | 177 | **414** | 362 |
| **Total revenue** | **491** | 517 | 484 | **1,008** | 963 |
| **Non-interest expenses** | | | | | |
| Salaries and employee benefits | **143** | 142 | 139 | **285** | 282 |
| Premises and equipment | **38** | 35 | 32 | **73** | 63 |
| Other | **78** | 75 | 77 | **153** | 153 |
| | **259** | 252 | 248 | **511** | 498 |
| **Net operating income before provision for credit losses** | **232** | 265 | 236 | **497** | 465 |
| **Provision for credit losses** | **25** | 25 | 12 | **50** | 22 |
| **Income before taxes and non-controlling interest in income of trust** | **207** | 240 | 224 | **447** | 443 |
| Provision for income taxes | **53** | 75 | 77 | **128** | 147 |
| Non-controlling interest in income of trust | **7** | 6 | 7 | **13** | 13 |
| **Net income** | **147** | 159 | 140 | **306** | 283 |
| Preferred share dividends | **5** | 4 | 5 | **9** | 9 |
| **Net income attributable to common shares** | **142** | 155 | 135 | **297** | 274 |
| Average common shares outstanding (000) | **498,668** | 498,668 | 488,668 | **498,668** | 488,668 |
| Basic earnings per share (C$) | **0.28** | 0.31 | 0.28 | **0.59** | 0.56 |

*See notes to consolidated financial statements*

# Consolidated Balance Sheets (Unaudited)

| *Figures in C$ millions* | ***At 30 June 2008*** | *At 31 December 2007* | *At 30 June 2007* |
|---|---|---|---|
| **Assets** | | | |
| Cash and non-interest bearing deposits with banks | **527** | 510 | 448 |
| Interest bearing deposits with regulated financial institutions | **2,296** | 3,063 | 4,403 |
| | **2,823** | 3,573 | 4,851 |
| Available-for-sale securities | **6,817** | 5,639 | 6,024 |
| Trading securities | **1,408** | 1,227 | 1,891 |
| Other securities | **48** | 60 | 53 |
| | **8,273** | 6,926 | 7,968 |
| Securities purchased under reverse repurchase agreements | **6,970** | 6,122 | 2,794 |
| Loans | | | |
| – Businesses and government | **21,930** | 21,322 | 19,197 |
| – Residential mortgage | **12,454** | 12,920 | 14,367 |
| – Consumer | **6,470** | 4,826 | 4,236 |
| – Allowance for credit losses | **(365)** | (353) | (323) |
| | **40,489** | 38,715 | 37,477 |
| Customers' liability under acceptances | **5,740** | 5,727 | 5,644 |
| Derivatives | **579** | 623 | 535 |
| Land, buildings and equipment | **155** | 149 | 130 |
| Other assets | **2,357** | 1,096 | 1,766 |
| | **8,831** | 7,595 | 8,075 |
| Total assets | **67,386** | 62,931 | 61,165 |
| **Liabilities and shareholders' equity** | | | |
| Deposits | | | |
| – Regulated financial institutions | **1,439** | 1,535 | 2,087 |
| – Individuals | **19,464** | 18,291 | 17,010 |
| – Businesses and governments | **30,347** | 29,051 | 27,068 |
| | **51,250** | 48,877 | 46,165 |
| Acceptances | **5,740** | 5,727 | 5,644 |
| Assets sold under repurchase agreements | **372** | 320 | 95 |
| Derivatives | **591** | 649 | 675 |
| Securities sold short | **818** | 623 | 1,506 |
| Other liabilities | **3,967** | 2,256 | 2,811 |
| Non-controlling interest in trust and subsidiary | **430** | 430 | 430 |
| | **11,918** | 10,005 | 11,161 |
| Subordinated debentures | **802** | 801 | 836 |
| Shareholders' equity | | | |
| – Preferred shares | **350** | 350 | 350 |
| – Common shares | **1,225** | 1,225 | 1,125 |
| – Contributed surplus | **208** | 206 | 204 |
| – Retained earnings | **1,629** | 1,462 | 1,336 |
| – Accumulated other comprehensive income | **4** | 5 | (12) |
| | **3,416** | 3,248 | 3,003 |
| Total liabilities and shareholders' equity | **67,386** | 62,931 | 61,165 |

*See notes to consolidated financial statements*

# Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

| *Figures in C$ millions* | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| **Preferred shares** | | | | | |
| Balance at beginning and end of period | **350** | 350 | 350 | **350** | 350 |
| **Common shares** | | | | | |
| Balance at beginning and end of period | **1,225** | 1,225 | 1,125 | **1,225** | 1,125 |
| **Contributed surplus** | | | | | |
| Balance at beginning of period | **207** | 206 | 203 | **206** | 202 |
| Stock-based compensation | **1** | 1 | 1 | **2** | 2 |
| Balance at end of period | **208** | 207 | 204 | **208** | 204 |
| **Retained earnings** | | | | | |
| Balance at beginning of period | **1,552** | 1,462 | 1,266 | **1,462** | 1,192 |
| Net income for the period | **147** | 159 | 140 | **306** | 283 |
| Preferred share dividends | **(5)** | (4) | (5) | **(9)** | (9) |
| Common share dividends | **(65)** | (65) | (65) | **(130)** | (130) |
| Balance at end of period | **1,629** | 1,552 | 1,336 | **1,629** | 1,336 |
| **Accumulated other comprehensive income** | | | | | |
| Balance at beginning of period | **34** | 5 | 15 | **5** | 7 |
| Net change in unrealized gains on available-for-sale securities, net of income taxes | **(11)** | 8 | (12) | **(3)** | (5) |
| Net change in cash flow hedges | **(19)** | 21 | (15) | **2** | (14) |
| Balance at end of period | **4** | 34 | (12) | **4** | (12) |
| **Total shareholders' equity** | **3,416** | 3,368 | 3,003 | **3,416** | 3,003 |

# Consolidated Statements of Comprehensive Income (Unaudited)

| Figures in C$ millions | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| Net income | **147** | 159 | 140 | **306** | 283 |
| **Other comprehensive income (loss) on available-for-sale securities** | | | | | |
| Net unrealized gains (losses) from changes in fair value (net of taxes of $4, $(4), $2, $–, $–) | **(9)** | 8 | (5) | **(1)** | 2 |
| Reclassification of realized gains to earnings (net of taxes of $1, $–, $2, $1, $2) | **(2)** | – | (7) | **(2)** | (7) |
| | **(11)** | 8 | (12) | **(3)** | (5) |
| **Other comprehensive income (loss) on cash flow hedges** | | | | | |
| Unrealized gains (losses) from changes in fair value (net of taxes of $9, $(10), $9, $(1), $9) | **(19)** | 21 | (15) | **2** | (14) |
| Comprehensive income for the periods | **117** | 188 | 113 | **305** | 264 |

*See notes to consolidated financial statements.*

# Consolidated Statements of Cash Flows (Unaudited)

| *Figures in C$ millions* | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| **Cash flows provided by (used in) operating activities** | | | | | |
| Net income | **147** | 159 | 140 | **306** | 283 |
| Adjustments to net income to determine net cash provided by operating activities: | | | | | |
| Amortization expense | **10** | 8 | 9 | **18** | 18 |
| Provision for credit losses | **25** | 25 | 12 | **50** | 22 |
| Net accrued interest receivable and payable | **3** | 26 | (2) | **29** | 52 |
| Trading securities | **222** | (403) | 320 | **(181)** | (729) |
| Other, net | **155** | 449 | (90) | **604** | 1,209 |
| | **562** | 264 | 389 | **826** | 855 |
| **Cash flows provided by (used in) financing activities** | | | | | |
| Deposits received | **1,259** | 1,114 | 204 | **2,373** | 1,992 |
| Securities sold (purchased) under repurchase agreements | **(340)** | 392 | (372) | **52** | (67) |
| Proceeds from issue of subordinated debentures | **–** | – | 400 | **–** | 400 |
| Redemption of subordinated debentures | **–** | – | (100) | **–** | (100) |
| Dividends paid | **(69)** | (69) | (70) | **(138)** | (139) |
| | **850** | 1,437 | 62 | **2,287** | 2,086 |
| **Cash flows provided by (used in) investing activities** | | | | | |
| Loans funded, excluding securitizations | **(1,393)** | (1,467) | (1,203) | **(2,860)** | (3,025) |
| Proceeds from loans securitized | **1,000** | 934 | 482 | **1,934** | 755 |
| Loans purchased from securitization conduits | **(900)** | – | – | **(900)** | – |
| Available-for-sale securities, net | **(468)** | (710) | (467) | **(1,178)** | (2,473) |
| Non-trading securities (purchased) sold | **(6)** | 18 | (28) | **12** | (3) |
| Securities (sold) purchased under reverse repurchase agreements | **(270)** | (578) | 798 | **(848)** | 1,966 |
| Net change in interest bearing deposits with regulated financial institutions | **648** | 119 | (25) | **767** | (65) |
| Acquisition of land, buildings and equipment | **(17)** | (7) | (19) | **(24)** | (24) |
| | **(1,406)** | (1,691) | (462) | **(3,097)** | (2,869) |
| **Increase (decrease) in cash and cash equivalents** | **6** | 10 | (11) | **16** | 72 |
| **Cash and cash equivalents, beginning of period** | **494** | 484 | 430 | **484** | 347 |
| **Cash and cash equivalents, end of period** | **500** | 494 | 419 | **500** | 419 |
| Represented by: | | | | | |
| Cash and non-interest bearing deposits with banks | **527** | 520 | 448 | | |
| Less: non-operating deposits with banks ⌖ | **(27)** | (26) | (29) | | |
| Cash and cash equivalents, end of period | **500** | 494 | 419 | | |

⌖ *Non-operating deposits comprise primarily of cash restricted for recourse on securitization transactions.*

*See notes to consolidated financial statements.*

# Notes to Consolidated Financial Statements (Unaudited)

## 1. Basis of presentation

These consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements of the bank for the year ended 31 December 2007 as set out on pages 42 to 77 of the 2007 Annual Report and Accounts. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) using the same accounting policies and methods of computation as were used for the bank's consolidated financial statements for the year ended 31 December 2007. Certain prior period amounts have been reclassified to conform to the presentation adopted in the current period. Unless otherwise stated, all tabular amounts are in C$ millions.

## 2. Changes in accounting policies

There have been no changes in accounting policies relating to measurement or computation of amounts included in the financial statements. Changes in policies relating to presentation and disclosure have been adopted as follows:

*i) Capital Disclosures*

Effective 1 January 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 are included in note 14.

*ii) Financial Instruments – Presentation and Disclosure*

Effective 1 January 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 Section 3862, we have included certain of the disclosure requirements of these sections in the MD&A – "Risk Management" on pages 6 to 14, which form an integral part of these financial statements.

## 3. Net operating income

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

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *31 December 2007* | ***30 June 2008*** | *30 June 2007* |
| **Income** | | | | | |
| Interest earned on financial instruments not held- for-trading | **668** | 729 | 775 | **1,397** | 1,401 |
| Fees earned on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments | **36** | 36 | 34 | **72** | 67 |
| Fees earned on trust and other fiduciary activities where we hold or invest assets on behalf of our customers | **36** | 34 | 36 | **70** | 64 |

# Notes to Consolidated Financial Statements (Unaudited) *(continued)*

## 3. Net operating income (continued)

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *31 December 2007* | ***30 June 2008*** | *30 June 2007* |
| **Expense** | | | | | |
| Interest expense on financial instruments not held-for-trading | **372** | 428 | 471 | **800** | 792 |
| Fee expense on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments | **7** | 4 | 5 | **11** | 8 |
| Fee expense relating to trust and other fiduciary activities where we hold or invest assets on behalf of our customer | **3** | 3 | 4 | **6** | 6 |
| **Gains/(losses) recognized** | | | | | |
| Securitized loans sold to third parties | **19** | 17 | 11 | **36** | 4 |
| Financial instruments held-for-trading ⌖ | **25** | 29 | 22 | **54** | 36 |
| Financial liabilities designated as held-for-trading | **(5)** | 19 | 6 | **14** | – |
| Hedging items ⌖ | | | | | |
| Ineffectiveness: | | | | | |
| Cash flow hedges | **(3)** | 7 | 5 | **4** | (7) |
| Fair value hedges | **(1)** | – | (1) | **(1)** | (1) |
| Economic hedges ⌖⌖ | **3** | (4) | (1) | **(1)** | 2 |

⌖ Included in trading income.

⌖⌖ Gains/losses on hedging derivatives that do not qualify for hedge accounting under GAAP.

## 4. Stock-based compensation

The expense for stock-based compensation was as follows:

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| Group share options and savings-related option plans | **1** | 1 | 1 | **2** | 2 |
| Restricted share plan | **6** | 5 | 6 | **11** | 10 |
| | **7** | 6 | 7 | **13** | 12 |

## 5. Employee future benefits

The expense for employee future benefits was as follows:

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| Pension plans – defined benefit | **2** | 3 | 6 | **5** | 12 |
| Pension plans – defined contribution | **4** | 5 | 3 | **9** | 7 |
| Other benefits | **3** | 2 | 2 | **5** | 4 |
| | **9** | 10 | 11 | **19** | 23 |

# Notes to Consolidated Financial Statements (Unaudited) *(continued)*

## 6. Classification of financial instruments

a) The carrying value of financial instruments by classification is as follows:

| | *Trading* | *Designated as trading* | *Available-for-sale* | *Hedging items* | *Loans and receivables* | *Financial liabilities* (1) | *Other* (2) | *Total* |
|---|---|---|---|---|---|---|---|---|
| **At 30 June 2008** | | | | | | | | |
| **Financial Assets:** | | | | | | | | |
| Cash or deposits with Bank of Canada | **–** | **–** | **–** | **–** | **138** | **–** | **–** | **138** |
| Deposits with regulated financial institutions | **676** | **–** | **348** | **–** | **1,661** | **–** | **–** | **2,685** |
| Securities | **1,408** | **–** | **6,817** | **–** | **–** | **–** | **48** | **8,273** |
| Securities purchased under reverse repurchase agreements | **–** | **–** | **–** | **–** | **6,970** | **–** | **–** | **6,970** |
| Loans | **–** | **–** | **–** | **–** | **40,489** | **–** | **–** | **40,489** |
| Customers' liability under acceptances | **–** | **–** | **–** | **–** | **5,740** | **–** | **–** | **5,740** |
| Derivatives | **511** | **–** | **–** | **68** | **–** | **–** | **–** | **579** |
| Land, building, equipment and other assets | **–** | **–** | **–** | **–** | **2,192** | **–** | **320** | **2,512** |
| **Total** | **2,595** | **–** | **7,165** | **68** | **57,190** | **–** | **368** | **67,386** |
| **Financial Liabilities:** | | | | | | | | |
| Deposits | **277** | **779** | **–** | **–** | **–** | **50,194** | **–** | **51,250** |
| Acceptances | **–** | **–** | **–** | **–** | **–** | **5,740** | **–** | **5,740** |
| Securities sold under repurchase agreements | **–** | **–** | **–** | **–** | **–** | **372** | **–** | **372** |
| Derivatives | **508** | **–** | **–** | **83** | **–** | **–** | **–** | **591** |
| Securities sold short | **818** | **–** | **–** | **–** | **–** | **–** | **–** | **818** |
| Equity and other liabilities | **–** | **–** | **–** | **–** | **–** | **3,813** | **3,570** | **7,383** |
| Non-controlling interest in trust and subsidiary | **–** | **–** | **–** | **–** | **–** | **–** | **430** | **430** |
| Subordinated Debentures | **–** | **373** | **–** | **–** | **–** | **338** | **91** | **802** |
| **Total** | **1,603** | **1,152** | **–** | **83** | **–** | **60,457** | **4,091** | **67,386** |
| At 31 December 2007 | | | | | | | | |
| Financial Assets: | | | | | | | | |
| Cash or deposits with Bank of Canada | – | – | – | – | 202 | – | – | 202 |
| Deposits with regulated financial institutions | 878 | – | 175 | – | 2,318 | – | – | 3,371 |
| Securities | 1,227 | – | 5,639 | – | – | – | 60 | 6,926 |
| Securities purchased under reverse repurchase agreements | – | – | – | – | 6,122 | – | – | 6,122 |
| Loans | – | – | – | – | 38,715 | – | – | 38,715 |
| Customers' liability under acceptances | – | – | – | – | 5,727 | – | – | 5,727 |
| Derivatives | 584 | – | – | 39 | – | – | – | 623 |
| Land, building, equipment and other assets | – | – | – | – | 927 | – | 318 | 1,245 |
| Total | 2,689 | – | 5,814 | 39 | 54,011 | – | 378 | 62,931 |
| Financial Liabilities: | | | | | | | | |
| Deposits | 456 | 982 | – | – | – | 47,439 | – | 48,877 |
| Acceptances | – | – | – | – | – | 5,727 | – | 5,727 |
| Securities sold under repurchase agreements | – | – | – | – | – | 320 | – | 320 |
| Derivatives | 617 | – | – | 32 | – | – | – | 649 |
| Securities sold short | 623 | – | – | – | – | – | – | 623 |
| Equity and other liabilities | – | – | – | – | – | 2,104 | 3,400 | 5,504 |
| Non-controlling interest in trust and subsidiary | – | – | – | – | – | – | 430 | 430 |
| Subordinated Debentures | – | 374 | – | – | – | 339 | 88 | 801 |
| Total | 1,696 | 1,356 | – | 32 | – | 55,929 | 3,918 | 62,931 |

## 6. Classification of financial instruments (continued)

Notes:
(1) Measured at amortized cost.
(2) Included in other is a subordinated debenture in a fair value hedging relationship which is adjusted for the fair value of the hedged risk, 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 held to maturity securities of C$9 million (31 December 2007 – C$8 million).

b) Additional information relating to financial liabilities designated as trading is as follows:

| | *Contractual amount payable at maturity* | *Fair value* | *Cumulative fair value (loss)/gain* | *Cumulative fair value gain attributable to credit risk* |
|---|---|---|---|---|
| **At 30 June 2008** | | | | |
| Deposits | **819** | **779** | **40** | **4** |
| Subordinated debentures | **400** | **373** | **27** | **35** |
| | **1,219** | **1,152** | **67** | **39** |
| At 31 December 2007 | | | | |
| Deposits | 966 | 982 | (16) | |
| Subordinated debentures | 400 | 374 | 26 | |
| | 1,366 | 1,356 | 10 | |

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.

## 7. Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

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 not observable. For these instruments, the fair value derived is more judgmental. ‘Not observable’ in this context means that there is little or no current market data available

**7. Fair value of financial instruments (continued)**

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 (historical data may, for example, 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 unobservable 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 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 position in government bonds are valued using a quoted market price. Non-bank sponsored Asset Backed Commercial Paper ("non-bank ABCP") are valued using a valuation technique with significant non-observable inputs. All other financial instruments are valued using a valuation technique with observable inputs.

There was no change in management's best estimate of the fair value of the bank's non-bank ABCP from 31 December 2007 as set out on page 51 of our 2007 Annual Report and Accounts.

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 relating to the valuation of non-bank ABCP is set out on page 51 of the 2007 Annual Report and Accounts. The effect of a 10 per cent adverse change in key assumptions would result in a further provision of C$15 million.

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 balance sheet. 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.

| | *Carrying amount* | *Fair value* | *Fair value over/(under) carrying amount* |
|---|---|---|---|
| **At 30 June 2008** | | | |
| Loans | **40,489** | **40,435** | **(54)** |
| Deposits | **51,250** | **51,376** | **126** |
| At 31 December 2007 | | | |
| Loans | 38,715 | 38,516 | (199) |
| Deposits | 48,877 | 48,890 | 13 |

## 8. Allowance for credit losses

A continuity of the bank's allowance for credit losses is as follows:

| | *Quarter end* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *31 December 2007* | ***30 June 2008*** | *30 June 2007* |
| Balance at beginning of period | **370** | 353 | 336 | **353** | 327 |
| Charge to income statement | **25** | 25 | 24 | **50** | 22 |
| Amount written-off | **(30)** | (8) | (7) | **(38)** | (26) |
| Balance at end of period | **365** | 370 | 353 | **365** | 323 |

## 9. Securitization

Securitization activity during the second quarter of 2008 was as follows:

| | ***Residential mortgages*** |
|---|---|
| Sold to third parties | 1,002 |
| Net cash proceeds received | 1,000 |
| Retained rights to future excess interest | 30 |
| Retained servicing liability | 6 |
| Pre-tax gain on sale | 19 |

The key assumptions made at time of sale were (%):

| | |
|---|---|
| Prepayment rate | 18.00% |
| Excess spread | 1.19% |
| Expected credit losses on insured mortgages securitized and sold | 00.0% |
| Discount rate | 4.26% |

As part of the industry restructuring of certain non-bank ABCP conduits involved in the Montreal Accord, during the quarter, the bank purchased approximately C$900 million of personal loans previously securitized and sold to certain of these conduits. There was no material gain or loss recognized as a result of this transaction. The assets purchased were recognized and accounted for as loans and receivables.

## 10. Issued and outstanding shares

| | ***At 30 June 2008*** | | *At 31 December 2007* | | *At 30 June 2007* | |
|---|---|---|---|---|---|---|
| | ***Number*** | ***Amount*** | *Number* | *Amount* | *Number* | *Amount* |
| Preferred Shares – Class 1 | | | | | | |
| – Series C | **7,000,000** | **175** | 7,000,000 | 175 | 7,000,000 | 175 |
| – Series D | **7,000,000** | **175** | 7,000,000 | 175 | 7,000,000 | 175 |
| | | **350** | | 350 | | 350 |
| Common shares | **498,688,000** | **1,225** | 498,668,000 | 1,225 | 488,668,000 | 1,125 |

# Notes to Consolidated Financial Statements (Unaudited) *(continued)*

## 11. Customer group segmentation

The bank reports and manages its operations according to the customer group definitions of the HSBC Group.

Effective 1 January 2008, the reporting of some of the bank's businesses was realigned to different customer groups. In addition, there have been a number of changes in cost allocation methodologies.

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| **Personal Financial Services** | | | | | |
| Net interest income | **110** | 96 | 106 | **206** | 201 |
| Non-interest revenue | **83** | 86 | 71 | **169** | 142 |
| Total revenue | **193** | 182 | 177 | **375** | 343 |
| Non-interest expenses | **144** | 142 | 134 | **286** | 267 |
| Net operating income | **49** | 40 | 43 | **89** | 76 |
| Provision for credit losses | **9** | 10 | 6 | **19** | 12 |
| Income before taxes and non-controlling interest in income of trust | **40** | 30 | 37 | **70** | 64 |
| Provision for income taxes | **11** | 9 | 12 | **20** | 20 |
| Non-controlling interest in income of trust | **2** | 1 | 1 | **3** | 3 |
| Net income | **27** | 20 | 24 | **47** | 41 |
| Average assets | **20,148** | 19,196 | 19,965 | **19,672** | 19,411 |
| **Commercial Banking** | | | | | |
| Net interest income | **170** | 173 | 172 | **343** | 340 |
| Non-interest revenue | **53** | 50 | 44 | **103** | 96 |
| Total revenue | **223** | 223 | 216 | **446** | 436 |
| Non-interest expenses | **81** | 79 | 80 | **160** | 164 |
| Net operating income | **142** | 144 | 136 | **286** | 272 |
| Provision for credit losses | **16** | 15 | 6 | **31** | 10 |
| Income before taxes and non-controlling interest in income of trust | **126** | 129 | 130 | **255** | 262 |
| Provision for income taxes | **32** | 41 | 46 | **73** | 89 |
| Non-controlling interest in income of trust | **4** | 4 | 5 | **8** | 8 |
| Net income | **90** | 84 | 79 | **174** | 165 |
| Average assets | **26,594** | 26,481 | 24,103 | **26,538** | 23,460 |

# Notes to Consolidated Financial Statements (Unaudited) *(continued)*

## 11. Customer group segmentation (continued)

| | *Quarter ended* | | | *Half-year ended* | |
|---|---|---|---|---|---|
| | ***30 June 2008*** | *31 March 2008* | *30 June 2007* | ***30 June 2008*** | *30 June 2007* |
| **Global Banking and Markets** | | | | | |
| Net interest income | **16** | 29 | 29 | **45** | 60 |
| Non-interest revenue | **59** | 83 | 62 | **142** | 124 |
| Total revenue | **75** | 112 | 91 | **187** | 184 |
| Non-interest expenses | **34** | 31 | 34 | **65** | 67 |
| Net operating income | **41** | 81 | 57 | **122** | 117 |
| Provision for credit losses | **–** | – | – | **–** | – |
| Income before taxes and non-controlling interest in income of trust | **41** | 81 | 57 | **122** | 117 |
| Provision for income taxes | **10** | 25 | 19 | **35** | 38 |
| Non-controlling interest in income of trust | **1** | 1 | 1 | **2** | 2 |
| Net income | **30** | 55 | 37 | **85** | 77 |
| Average assets | **21,729** | 22,220 | 19,218 | **21,974** | 19,108 |

## 12. Financial assets pledged and collateral accepted

a) Financial assets pledged to secure liabilities are as follows:

| | ***At 30 June 2008*** | *At 31 December 2007* |
|---|---|---|
| Securities | **2,795** | 3,419 |
| Loans | **2,125** | 3,457 |
| Other | **–** | 3 |
| | **4,920** | 6,879 |

In the ordinary course of business, we pledge assets recorded on our balance sheet 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 C$7,705 million (31 December 2007 – C$6,700 million). The fair value of any such collateral that has been sold or repledged is C$797 million (31 December 2007 – C$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.

## 13. Financial assets not qualifying for derecognition

a) Mortgages sold with recourse

We have agreed to repurchase any mortgage purchased from us by the HSBC Mortgage Mutual Fund if any principal and interest payments due are more than 90 days in arrears. Total mortgages sold with recourse as at 30 June 2008 were C$562 million (31 December 2007 – C$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 as at 30 June 2008 were C$185 million (31 December 2007 - C$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 we have agreed to repurchase at a specified future date as at 30 June 2008 were C$372 million (31 December 2007 - C$320 million) and are separately disclosed on the balance sheet.

## 14. 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.

To ensure our processes are appropriately governed and to meet our objectives, we enforce policies approved by the Board of Directors ("the Board") and HSBC Holdings approved policies. An annual capital plan is prepared and approved by the Board and HSBC Holdings with the objective of maintaining both the optimal amount of capital and the mix between the different components of capital. Our policy is to hold capital in a range of different forms and from diverse sources.

Our Finance and Treasury Departments manage compliance with our policies daily, with bi-weekly monitoring by our Asset and Liability Committee ("ALCO"). ALCO is chaired by our Chief Financial Officer (CFO) and includes the Chief Executive Officer (CEO,) Chief Operating Officer (COO), and our senior executives responsible for credit, risk management, marketing and sales, and treasury. Positions and limits are monitored by its sub committee, Tactical ALCO ("TALCO") committee, in intervening weeks. TALCO is also chaired by our CFO and includes members responsible for finance, treasury and marketing.

b) Capital managed

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 and retained earnings. Tier 2 capital includes subordinated debentures together with certain other adjustments.

**14. Capital management (continued)**

c) Capital ratio regulations

The Office of the Superintendent of Financial Institutions Canada ("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 continues to recommend financial institutions 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. We adhered to these capital ratios during the half-year ended 30 June 2008 and during 2007.

d) 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 Advanced Internal Ratings Based approach ("AIRB") 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, loss given default, exposure at default and effective maturity for calculating risk weights 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. Until the conditions are met, a capital floor is in effect at 100 per cent of the Basel I based minimum capital requirement.

e) Regulatory capital and ratios

OSFI's maximum permitted assets to capital multiple is 20 times and we target to be prudently below this threshold at 17 times. We maintained a capital multiple ratio below the required maximum threshold during the half-year ended 30 June 2008 and during 2007.

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 1 January 2008 that changes how capital ratios are calculated. Due to the adoption of the revised Basel II framework, the quarters presented below are not comparable.

# Notes to Consolidated Financial Statements (Unaudited) *(continued)*

## 14. Capital management (continued)

| | ***At 30 June 2008 (Basel II)*** | *At 31 December 2007 (Basel I)* |
|---|---|---|
| **Tier 1 capital** | | |
| Common shares | **1,225** | 1,225 |
| Contributed surplus | **208** | 206 |
| Retained earnings | **1,630** | 1,462 |
| Non-cumulative preferred shares [1] | **350** | 350 |
| Non-controlling interests in trust and subsidiary [2] | **430** | 430 |
| Securitization-related deductions and other | **(68)** | – |
| Goodwill | **(15)** | (15) |
| Total Tier 1 capital | **3,760** | 3,658 |
| **Tier 2 capital** | | |
| Subordinated debentures | **802** | 801 |
| Other | **88** | 269 |
| Total Tier 2 capital | **890** | 1,070 |
| **Total Tier 1 and Tier 2 capital** | **4,650** | 4,728 |
| Securitization-related deductions | **–** | (50) |
| **Total capital available for regulatory purposes** | **4,650** | 4,678 |
| **Total risk-weighted assets [3]** | **40,379** | 41,372 |
| | | |
| **Actual Regulatory capital ratios** | | |
| Tier 1 capital | **9.3 %** | 8.8 % |
| Total capital | **11.5 %** | 11.3 % |
| **Actual Assets to capital multiple** | **14.6 x** | 14.1 x |
| | | |
| **Minimum regulatory capital ratios required** | | |
| Tier 1 capital | **7 %** | 7 % |
| Total capital | **10 %** | 10 % |
| | | |
| **Maximum assets to capital multiple allowed** | **20.0 x** | 20.0 x |

Notes:
(1) Represents C$175 million in each of Series C and Series D preferred shares.
(2) Includes C$400 million of HSBC HaTS™.
(3) 2008 Basel II risk weighted assets include an adjustment according to the Transitional Arrangements outlined in Section 1.7 of the Capital Adequacy Requirements guidelines.

## 15. Subsequent event

On 29 July 2008, the Bank completed the sale of approximately C$1.5 billion of certain consumer loans incurring an after tax loss of approximately C$20 million, which will be recorded in the third quarter of 2008.

# Shareholder Information

**PRINCIPAL ADDRESSES**

**Vancouver (head office):**
HSBC Bank Canada
885 West Georgia Street
Vancouver, British Columbia
Canada V6C 3E9
Tel: (604) 685-1000
Fax: (604) 641-1849

**Toronto:**
HSBC Bank Canada
70 York Street
Toronto, Ontario
Canada M5J 1S9
Tel: (416) 868-8000
Fax: (416) 868-3800

**WEB SITE**
hsbc.ca

**MEDIA ENQUIRIES**

| | |
|---|---|
| Ernest Yee | (604) 641-2973 |
| Sharon Wilks | (416) 868-3878 |

**For dividend information, change in shareholder address or to advise of duplicate mailings, please contact:**

Computershare Trust Company of Canada
Shareholder Service Department
100 University Avenue
Toronto, Ontario
Canada M5J 2Y1

Tel: 1 (800) 564-6253
Fax: 1 (800) 453-0330

**For other shareholder enquiries please contact:**

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

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

**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)

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 180 offices. With around 11,000 properties in 85 countries and territories and assets of US$2,547 billion at 30 June 2008, the HSBC Group is one of the world's largest banking and financial services organizations.



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**HSBC Bank Canada**
885 West Georgia Street
Vancouver, B.C.
Canada V6C 3E9
Telephone: (604) 685-1000
Web: hsbc.ca